

Le Saunda (738 HK)

Buy

Target price: HK\$5.00



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Strong push on e-commerce, better earnings outlook; upgrade to Buy

Upgrade to Buy We upgrade LS from Hold to Buy given its better earnings outlook and re-rating potential due to its strong push on e-commerce business development. The company aims to have a mid-teen contribution from e-commerce revenue in FY16 (vs 10% in FY15). This is much higher than peers' low to mid single-digit revenue contribution in the last financial year. After our upward earnings revision, we forecast LS will post an 11% CAGR in core profit in FY16-17 (vs 4% previously). We raise our TP from HK\$3.10 to HK\$5.00, based on 13x FY16E P/E (9.5x FY16E P/E previously), which is still a 10% discount to peers. Potential catalyst: In-depth co-operation with third party e-commerce platforms.

Strong FY15 results Core profit jumped 21% YoY to HK\$225m, 9% above our estimate. The earnings surprise was mainly due to a lower-than-expected SG&A expense ratio (54.5% vs our estimate of 55.6%). Revenue increased 3% YoY driven by 7.5% SSSG but partly offset by a 3% store decline. GM was stable at 67.2% (vs 67.1% in FY14). OP margin widened by 1.7pp YoY to 14.4%, primarily led by 286% growth in government incentives and a 0.9pp decrease in rental expenses ratio. The company announced the issuance of one bonus share for every ten existing shares.

E-commerce the key growth driver E-commerce revenue surged ~190% YoY to reach 10% of revenue in FY15 (vs 3% of revenue in FY14). The e-commerce business has two divisions: the transformation of the CNE brand into an O2O brand, and online business for the Le Saunda brand. In FY15, the company closed 57 CNE offline stores and opened eight new CNE O2O stores. The business was profitable with OP margin estimated at mid-teens. In FY16, the company plans to add open 30 CNE O2O stores and speed up the development of Le Saunda MEN's online business. The company is also looking for more in-depth co-operation with e-commerce platforms. Management targets an e-commerce revenue proportion as a percentage of total revenue to reach mid-teens in FY16.

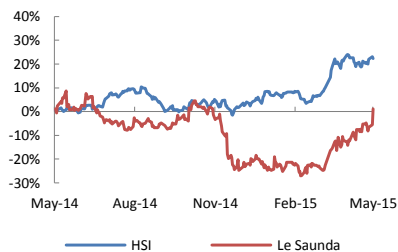
Accelerating store expansion Linea Rosa brand was established in FY12. The brand was profitable with its sales per store the highest among the company's brand portfolio in FY15. The company plans to accelerate Linea Rosa's network expansion in FY16 by adding another 50 stores (52 stores in FY15). For the Le Saunda brand, the company also aims to open 30 new stores mainly in second-tier cities. The company's store expansion has been more prudent than peers over the last four financial years. It also has less stores for its core brands compared to its peers' major brands of similar positioning. We do not expect the accelerated expansion to increase the risk of cannibalization.

1Q16 trading update SSS has been recovering in Apr and May from a very weak Mar (~10% decline) due to the late CNY in Feb. We estimate SSS could be flat to slightly negative in 1Q16. Management expects better SSS in 2H16 through the launching of new products.

Earnings upgrade We raise our FY16/17 core profit estimates by 18%/23% mainly to reflect a lower SG&A expenses ratio and higher revenue assumptions. In FY16, we expect the company to deliver 11% core profit growth driven by 60% growth in e-commerce revenue and 8% revenue growth (at 3% SSSG) from physical stores.

Downside risks The company fails to meet its e-commerce growth target; new store performance below expectation.

Stock performance



Source: Bloomberg

Key data

May 27 close (HK\$)	3.84
Shares in issue (m)	641.9
Major shareholder	Lee Tsz Bun (43.3%)
Market cap (HK\$ bn)	2.5
3M avg. vol. (m)	0.5
52W high/low (HK\$)	4.05/2.75

Source: Bloomberg

Valuation

	Turnover (HK\$ m)	Core profit (HK\$ m)	Core EPS (HK\$)	Core EPS YoY (%)	Core P/E	Ex-net cash core P/E	Yield (%)	BPS (HK\$)	P/B	ROE (%)
2013	1,762	153	0.24	-8	16.1	13.2	3.7	2.0	1.9	12.4
2014	2,039	185	0.29	21	13.3	9.5	7.0	2.4	1.6	13.3
2015	2,108	225	0.35	21	11.0	8.1	5.7	2.4	1.6	14.7
2016E	2,377	249	0.39	11	9.9	6.9	6.2	2.6	1.5	15.4
2017E	2,653	275	0.43	10	9.0	5.9	6.8	2.8	1.4	15.9

Sources: Company data, GF Securities (HK)

Figure 1: Results review

Y/E Feb (HK\$m)	FY15	FY14	% change	2H15	2H14	% change	1H15	1H14	% change
Revenue	2,108	2,039	3%	1,167	1,165	0%	941	874	8%
Cost of sales	(691)	(671)	3%	(380)	(374)	1%	(312)	(297)	5%
Gross profit	1,417	1,368	4%	787	791	0%	629	577	9%
Other income	34	12	187%	17	10	66%	18	2	774%
Selling and distribution expenses	(893)	(883)	1%	(489)	(501)	-2%	(404)	(382)	6%
Administrative expenses	(256)	(238)	7%	(139)	(138)	1%	(117)	(101)	17%
Operating profit	303	259	17%	176	163	9%	126	97	30%
Finance income, net	11	8	26%	5	5	5%	6	4	53%
Other gains, net	(6)	5	-205%	(2)	1	-289%	(3)	4	-179%
One-off gains, net	6	87	-94%	0	87	-100%	6	0	na
Fair value gains on investment properties	3	6	-47%	3	6	-47%	0	0	na
Share of profit/(loss) of JV	7	1	1175%	7	0	1332%	0	0	54%
Profit before tax	324	367	-12%	189	262	-28%	135	105	28%
Tax expense	(84)	(78)	8%	(48)	(50)	-5%	(37)	(28)	30%
Profit after tax	239	289	-17%	141	212	-33%	98	77	28%
Non-controlling interests	(2)	(1)	55%	(1)	(1)	1%	(1)	(0)	345%
Net profit	237	287	-17%	140	211	-33%	97	76	27%
Core profit	225	185	21%	132	115	15%	93	70	32%
EPS (HK\$)	0.37	0.45	-18%	0.22	0.33	-34%	0.15	0.12	27%
DPS (HK\$)	0.22	0.27	-19%				0.08	0.07	14%
Margin & Ratio (%)									
Gross profit margin	67.2	67.1	0.1	67.5	67.9	(0.4)	66.9	66.1	0.8
Operating profit margin	14.4	12.7	1.6	15.1	14.0	1.2	13.4	11.1	2.3
Staff expenses ratio	22.5	22.3	0.3	20.7	20.4	0.3	24.8	24.8	0.0
Rental expenses ratio	25.2	26.3	(1.1)	25.8	27.4	(1.6)	24.4	24.8	(0.3)
S&D expenses ratio	54.5	55.0	(0.5)	53.8	54.8	(1.0)	42.9	43.7	(0.8)
Admin expenses ratio	12.1	11.7	0.5	11.9	11.8	0.1	12.5	11.5	1.0
Core profit margin	10.6	9.1	1.6	11.3	9.9	1.4	9.8	8.0	1.8
Effective tax rate	26.1	21.3	4.7	25.2	19.1	6.1	27.2	26.8	0.4
Payout ratio	59.5	60.1	(0.6)				52.8	58.5	(5.7)
	FY15	FY14	change	1H15	1H14	change			
Store number	904	928	(24)	863	997	-13%			
Inventory days	231	220	11	241	234	7			
A/C receivables days	37	26	11	39	39	0			
A/C payable days	126	131	(5)	156	132	24			
Net cash (HK\$m)	637	696	-9%				583	476	23%

Sources: Company data, GF Securities (HK)

Figure 2: SSS and retail business revenue growth



Sources: Company data, GF Securities (HK)

* Self-owned retail business includes e-commerce sales starting from 2Q15

Figure 3: Key assumptions

(HK\$ m)	FY12	FY13	FY14	FY15	FY16E	FY17E
Total revenue	1,545	1,762	2,039	2,108	2,377	2,653
growth %	17.1%	14.1%	15.7%	3.4%	12.7%	11.6%
Retail	1,509	1,726	2,028	2,105	2,373	2,649
growth %	25.3%	14.4%	17.5%	3.8%	12.8%	11.6%
- offline *			1,959	1,904	2,052	2,211
growth %				-2.8%	7.8%	7.8%
- online *			69	201	322	438
growth %				190.4%	59.7%	36.2%
OEM	36	36	11	3	3	3
growth %	-68.6%	0.6%	-68.8%	-70.4%	0.0%	0.0%
SSS growth (%)	8.2%	6.1%	13.8%	7.5%	3.0%	3.0%
Store growth (%)	20.2%	6.8%	-5.7%	-2.6%	9.3%	6.2%
Gross margin	64.4%	64.7%	67.1%	67.2%	66.7%	66.3%
Retail - offline				68.7%	68.9%	69.2%
Retail - online				53.2%	52.6%	51.6%
OEM				56.0%	56.0%	56.0%
Selling & distribution expenses ratio	39.4%	42.5%	43.3%	42.3%	42.2%	42.1%
Administrative expenses ratio	11.4%	10.8%	11.7%	12.1%	11.9%	11.7%
Operating profit margin	13.8%	11.9%	12.7%	14.4%	14.0%	13.8%
Effective tax rate	21.6%	25.7%	21.3%	26.1%	26.0%	26.0%
Core profit margin	10.7%	8.7%	9.1%	10.6%	10.5%	10.4%

Sources: Company data, GF Securities (HK)

Note: FY14 and FY15 offline and online sales and GM are our estimates

Figure 4: P/E band



Sources: Company data, GF Securities (HK), Bloomberg

Figure 5: Valuation comparison for footwear companies

Footwear	Ticker	Rating	Price (May 27 2015)	TP (HK\$)	Mkt Cap (HK\$ m)	FY14E	FY15E	FY16E	FY14E	FY15E	FY16E	FY14E	FY15E	FY16E	P/B (x)	ROE (%)
Le Saunda *	738 HK	Buy	3.84	5.00	2,465	11.0	9.9	9.0	21	11	10	5.7	6.2	6.8	1.5	15.4
Belle *	1880 HK	Buy	10.82	12.40	91,258	14.9	14.2	13.3	10	5	6	6.9	4.1	4.4	2.7	19.3
Daphne	210 HK	Underperform	2.46	2.00	4,057	23.5	80.3	93.6	(52)	(71)	(14)	1.4	0.4	0.3	0.8	1.0
Fuguiniao	1819 HK	NR	15.66	na	8,377	na	na	na	na	na	na	na	na	na	na	na
C. Banner	1028 HK	NR	2.97	na	5,940	19.5	14.9	11.9	4	31	25	na	2.9	3.8	2.2	17.7
Average						17.2	29.8	32.0	(4)	(6)	6	4.7	3.4	3.8	1.8	13.3

Sources: Source: Bloomberg, GF Securities (HK)

* Company year ended in Feb. Its financial figures of financial year 2015/2016/2017 are shown as FY14/15E/16E to facilitate data comparison.

Figure 6: Financial statements

Income Statement						Balance Sheet					
Year end Feb 28 (HK\$ m)	FY13	FY14	FY15	FY16E	FY17E	Year end Feb 28 (HK\$ m)	FY13	FY14	FY15	FY16E	FY17E
Revenue	1,762	2,039	2,108	2,377	2,653	Fixed assets					
Cost of sales	(621)	(671)	(691)	(792)	(894)	PPE	238	219	202	191	175
Gross profit	1,141	1,368	1,417	1,585	1,758	Investment properties	90	92	95	95	95
Other income	8	12	34	34	34	Investment in a JV	35	36	42	43	43
Selling & distribution expenses	(749)	(883)	(893)	(1,003)	(1,117)	Others	51	42	42	42	41
Administration expenses	(190)	(238)	(256)	(283)	(310)	Deferred tax assets	52	57	70	70	70
Operating profit	210	259	303	333	366		465	445	452	440	424
Net finance cost	6	8	11	11	13	Current assets					
Other gains, net	8	92	(0)	0	0	Inventories	469	484	511	574	635
FV change of investment properties	16	6	3	0	0	A/C receivables	199	199	231	247	276
Share of profit/(loss) of JV	1	1	7	1	1	Deposits and prepayments	42	46	53	54	61
Profit before tax	241	367	324	345	379	Others	0	7	0	0	0
Income tax expense	(62)	(78)	(84)	(90)	(99)	Cash and bank balances	436	696	637	746	837
Non-controlling interests	0	(1)	(2)	(2)	(1)		1,146	1,432	1,432	1,621	1,808
Net profit	179	287	237	254	280	Total assets	1,610	1,877	1,884	2,062	2,232
Core profit	153	185	225	249	275	Current liabilities					
Core EPS (HK\$)	0.24	0.29	0.35	0.39	0.43	A/C payables	218	262	215	271	306
Growth rates (%)						Amount due to a JV	37	34	36	36	36
Revenue	14	16	3	13	12	Tax liabilities	21	29	30	33	36
Core profit	(8)	21	21	11	10		277	325	280	340	378
Core EPS	(8)	21	21	11	10	Non-current liabilities					
Margin & ratios (%)						Deferred tax liabilities	32	38	44	44	44
Gross profit margin	64.7	67.1	67.2	66.7	66.3		32	38	44	44	44
OP margin	11.9	12.7	14.4	14.0	13.8	Equity					
Core profit margin	8.7	9.1	10.6	10.5	10.4	Shareholders' equity	1,290	1,500	1,545	1,662	1,794
Effective tax rate	25.7	21.3	26.1	26.0	26.0	Non-controlling interests	12	13	15	16	17
Payout ratio	50.7	60.1	59.5	60.0	60.0		1,302	1,514	1,559	1,678	1,810
						Total liabilities & equity	1,610	1,877	1,884	2,062	2,232
Cash Flow Statement						Financial Ratios					
Year end Feb 28 (HK\$ m)	FY13	FY14	FY15	FY16E	FY17E	Year end Feb 28	FY13	FY14	FY15	FY16E	FY17E
Profit before tax	241	367		345	379	Current ratio	4.1	4.4	5.1	4.8	4.8
Share of (profit)/loss of JV	(1)	(1)		(1)	(1)	Quick ratio	2.4	2.9	3.3	3.1	3.1
FV gain on investment properties	(16)	(6)		0	0	A/C receivable turnover days	35	36	37	37	36
Gain on disposal of investment properties	0	(87)		0	0	A/C payable turnover days	123	131	126	112	118
Depreciation and amortization	52	57		62	67	Inventory turnover days	265	259	263	250	247
Net finance cost	(6)	(8)		(11)	(13)	Asset turnover	1.1	1.1	1.1	1.2	1.2
Share option expenses	13	15		11	11	Total assets/total equity	1.2	1.2	1.2	1.2	1.2
Others	3	1		0	0	Net cash	436	696	637	746	837
Change in amount due to a JV	7	(3)		0	0	Core ROE (%)	12.4	13.3	14.7	15.4	15.9
Change of working capital	(81)	32		(24)	(61)	Core ROA (%)	9.9	10.6	11.9	12.4	12.8
Tax paid	(61)	(69)		(87)	(94)						
Operating cash flow	149	298		295	288						
Capex	(49)	(49)		(50)	(50)						
Disposals	0	102		0	0						
Interest received	6	8		11	13						
Change in term deposits	(4)	(66)		0	0						
Change in pledged deposits	(1)	(0)		0	0						
Others	0	0		0	0						
Investing cash flow	(48)	(4)		(39)	(37)						
Change of borrowings	0	0		0	0						
Dividend paid	(91)	(100)		(147)	(160)						
Others	(0)	0		0	0						
Financing cash flow	(91)	(100)		(147)	(160)						

Sources: Company data, GF Securities (HK)

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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