

16 September 2014

Sa Sa International (178.HK)

Still Struggle in the nearest future

HONG KONG | RETAIL | COMPANY RESULTS

- Revenue grew 14.2% YoY to HK\$ 8,756.1 million with GPM of 46.5% while profit was up 13.3% YoY to HK\$ 935.2 million. Final and special dividends per share proposed were 14.5 HK cents.
- The changing travel pattern and shopping behaviour of Mainland China tourists pose structural threat to the revenue generation
- The weak performance in Mainland China market showed Sa Sa Int'l was still struggling in strategy formulation.
- We changed the investment rating from "Accumulate" to "Reduce"

Financial Highlights

Sa Sa Int'l reported FY14 revenue grew 14.2% YoY to HK\$ 8,756.1 million with a stable gross profit margin of 46.5% (2013: 46.4%). The revenue from Hong Kong and Macau market of HK\$7,122.1 million grew 16.7% YoY and contributed 81.3% of the total revenue while the Mainland China's and worldwide sales inched up 2.67% YoY and 4.62% YoY respectively, lowering their contributions to 4.2% and 14.5% of the total revenue in FY14 (2013: 4.6%; 15.8%). The overall profit was up 13.3% YoY to HK\$935.2 million with the net profit margin of 10.7% (2013: 10.8%). The profit growth in Hong Kong & Macau market has been slightly offset by the loss in Mainland China market and the sluggish growth in other segments. Final and special dividends per share proposed were 14.5 HK cents.

How we view this

The extended weak performance on the international sales showed Sa Sa Int'l still struggled in establishing a right business strategy. The situation was even worse in the Mainland China market due to high tax rate on imported cosmetic products. We forecast FY15 revenue grows 8.2% with a stable gross profit margin. We are cautious with the sustainability of the revenue growth afterwards based on (1) the lack of the effective strategy on Mainland China market; and (2) changing travel pattern and shopping behaviour of Mainland China tourists.

Investment Action

We expect Sa Sa Int'l managed to achieve a 2-year revenue CAGR of 9.12% and 9.22% EPS CAGR in 2015-16, factoring in the tough business environment in the nearest future. Our TP of HK\$ 5.07 is based on 13x FY16 P/E, implying potential 12.7% capital downside to last close. Thus, we changed the investment rating from "Accumulate" to "Reduce". Upside risk is higher-than-expected sales growth and unexpected stimulus program. Downside risk is lower-than-expected sales revenue and worse-than-expected business environment.

Key Financial Summary

	FY11	FY12	FY13	FY14E	FY15E	FY16E
Revenue (HKD mn)	4,901.4	6,405.1	7,669.8	8,756.1	9,469.7	10,426.2
NPAT (HKD mn)	509.0	690.0	826.0	935.2	1,003.8	1,115.6
EPS (HKD cents)	0.2	0.2	0.3	0.3	0.4	0.4
P/E (X)	31.9	23.6	19.8	17.6	16.4	14.8
BVPS (HKD)	0.5	0.6	0.7	0.8	0.9	0.9
P/B (X)	12.1	10.0	8.3	7.1	6.5	6.1
DPS (HKD)	0.04	0.06	0.08	0.14	0.12	0.14

Source: Bloomberg; PSR Estimates

Rating:

Reduce

From "Accumulate" to "Reduce"

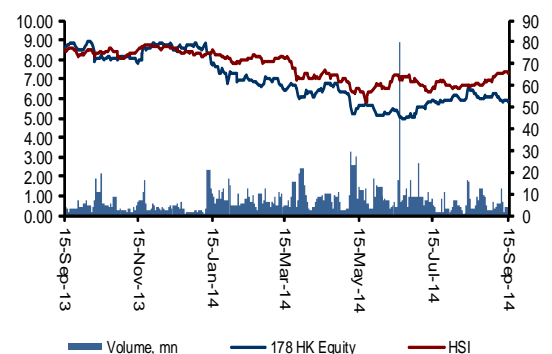
Target Price (HKD)	5.07
Forecast Dividend (HKD)	0.14
Closing Price (HKD)	5.81
Potential Upside	-8.7%

Company Description

Sa Sa International Holdings Limited is a leading cosmetics retailing group in Asia. The group caters to the market by offering a large variety of quality products from over 600 beauty brands around the globe, covering from skin care, fragrance, make-up, body care and hair care to health food.

Company Data

Raw Beta (Past 2yrs weekly data)	0.79
Market Cap. (HKD mn)	16,526
Enterprise Value (HKD mn)	15,617
52 week range (HKD)	4.98 - 9.18
Closing Price in 52 week range	



Major Shareholders

1. Sunrise Height Incorporation	48.99%
2. Green Ravine Ltd	14.18%
3. Columbia Wanger Asset Management	2.34%

Valuation Method

PE

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Weak performance in Mainland China market – The extended profit loss in Mainland China market and the 3.7% drop of SSG in FY14 revealed Sa Sa Int'l was still in trouble with the market penetration. The management attributed the weak performance to the relative inexperienced new staff, weaker execution abilities and sudden changes in management, with the belief that the strategy of more focus on House brand products was on the right track. Although Sa Sa Int'l has operated in Mainland China for almost a decade, we believe Sa Sa Int'l still suffers in the nearest future since the structural problems still exist. The Chinese government has imposed on top of 17% VAT, 30% consumption tax and 10% import duty on foreign cosmetic products in China. The high tax rates hamper Sa Sa Int'l pricing strategy and makes the imported cosmetic products relatively unattractive in China.

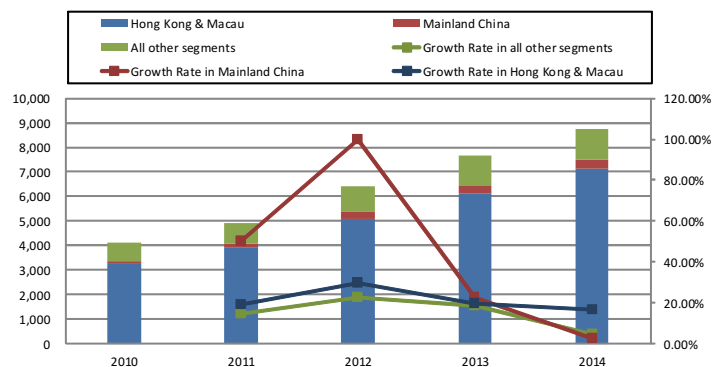


Fig: Turnover (million) & growth rate of turnover breakdown by segment

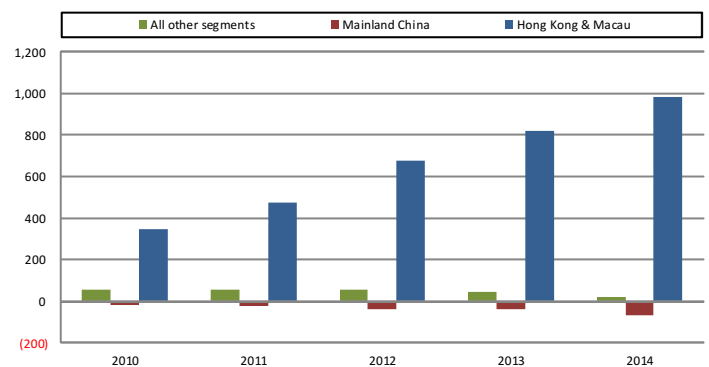


Fig: Net Income (million) breakdown by segment

The changing travel pattern and shopping behavior of Mainland China tourists – Sa Sa Int'l plays a leading role in Hong Kong and Macau cosmetic markets, which contributed 81.3% of total revenue to the Group. The Mainland tourists are still the primary customer group for the revenue generation in the market. The FY14 annual report showed the number of transactions of Mainland China tourists increased by 26.9% while the average sales value per ticket decreased by 2.8%, suggesting the travel pattern and shopping behavior of the Mainland China tourists has been changing given that the total sales increased. We believe the numbers of Mainland China tourist arrivals directly affect the number of transactions of Mainland China tourists. According to statistics from Hong Kong Tourism Board, Mainland tourist arrivals rose by 15.5% for the first seven months of 2014. Still, when we analyzed the 5-year growth rates and the numbers of Mainland China tourists of each month, there was a slowdown of outbound Chinese tourist growth and we believe the trend continues in the nearest future.

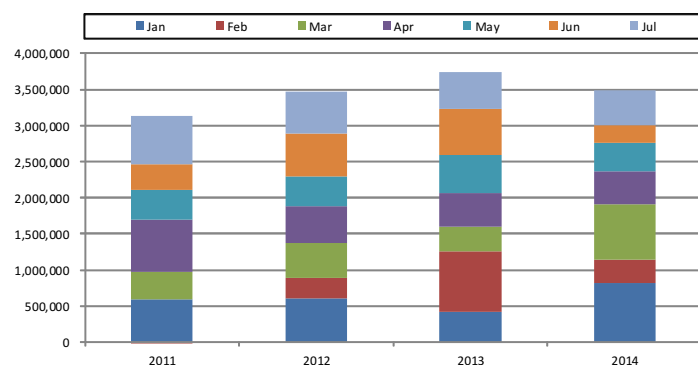


Fig: Numbers of Mainland China tourist arrivals YoY growth (Jan - Jul of each year)

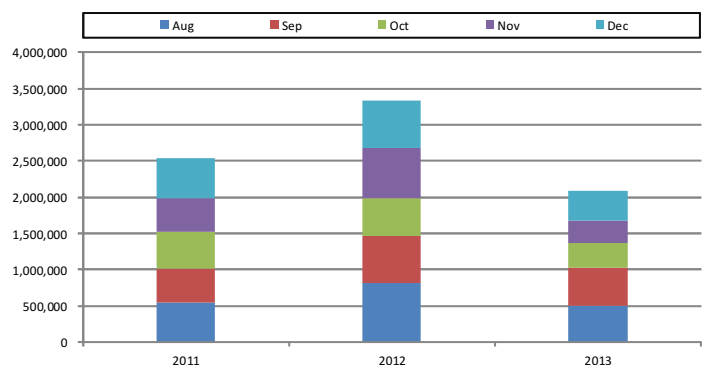


Fig: Numbers of Mainland China tourist arrivals YoY growth (Aug - Dec of each year)

Sa Sa International (178.HK)

16 September 2014

178.HK:

Income Statement (HKD mn)	FY2011	FY2012	FY2013	FY2014	FY2015E	FY2016E
Sales Revenue	4,901	6,405	7,670	8,756	9,470	10,426
Cost of sales	(2,690)	(3,508)	(4,112)	(4,683)	(5,142)	(5,609)
Gross Profit	2,212	2,897	3,558	4,073	4,328	4,817
Operating Revenue (Expense)	(1,750)	(2,298)	(2,568)	(2,952)	(3,134)	(3,472)
Operating Income	599	830	990	1,121	1,193	1,345
Interest Income (Expense) / FX gain (loss)	15	5	4	5	5	5
EBT	614	835	995	1,126	1,198	1,350
Taxation	(104)	(145)	(169)	(191)	(194)	(235)
Profit After Tax	509	690	826	935	1,004	1,116
Net Income, reported	509	690	826	935	1,004	1,116

Per share data (HKD)	FY2011	FY2012	FY2013	FY2014	FY2015E	FY2016E
EPS, reported	0.18	0.25	0.29	0.33	0.35	0.39
DPS (HKD)	0.04	0.06	0.08	0.14	0.12	0.14
BVPS	0.48	0.58	0.70	0.82	0.90	0.95

Cashflow Statements (RMB mn)	FY2011	FY2012	FY2013	FY2014	FY2015E	FY2016E
CFO						
Net Income	509	690	826	935	1,004	1,116
Depreciation & Amortization	79	117	173	188	193	200
Other Non-Cash Adjustment	14	27	24	52	45	49
Change in Non-Cash Capital	(156)	(190)	(171)	(147)	(59)	(52)
Cash From Operations	447	644	851	1,028	1,183	1,313

CFI						
Disposal of Fixed Assets	14	2	3	4	4	4
Capital Expenditures	(137)	(247)	(192)	(268)	(345)	(384)
Other Investing Activities	155	59	(174)	(362)	(412)	(432)
Cash From Investing Activities	32	(187)	(362)	(625)	(753)	(812)

CFF						
Dividends Paid	(391)	(436)	(522)	(652)	(596)	(634)
Change in Short-term borrowing	0	0	0	80	80	80
Increase in Capital Stocks	28	14	13	47	26	24
Other Financing Activities	17	3	0	(2)	0	0
Cash from Financing Activities	(347)	(419)	(509)	(527)	(490)	(530)
Net Change in Cash	132	39	(20)	(124)	(60)	(29)

Source: Bloomberg, PSR est

Price: HK\$ 5.81 (15/09/2014); TP: HK\$5.07; Recommendation: Reduce

Balance Sheet (HKD mn)	FY2011	FY2012	FY2013	FY2014	FY2015E	FY2016E
Assets						
Cash & Short-term Investment	618	599	752	989	1,081	1,125
Accounts & Notes Receivable	48	71	93	52	62	78
Inventories	802	1,191	1,235	1,373	1,485	1,561
Other Current Assets	91	136	154	198	213	241
Total Current Assets	1,560	1,996	2,234	2,613	2,841	3,005
Total Non-current Assets	316	471	563	625	634	651
Total Assets	1,877	2,467	2,797	3,237	3,475	3,656

Liabilities & Shareholders' Equity						
Accounts Payable	254	451	411	392	387	364
Short-term liabilities	251	357	381	466	475	486
Total Current Liabilities	506	808	792	857	871	905
Total Long-term liabilities	18	28	30	55	57	60
Total liabilities	524	836	822	912	928	965
Shareholder Equity	1,353	1,631	1,975	2,325	2,547	2,691

Valuation Ratios	FY2011	FY2012	FY2013	FY2014	FY2015E	FY2016E
P/E (X)	31.9	23.6	19.8	17.6	16.4	14.8
P/B (X)	12.1	10.0	8.3	7.1	6.5	6.1
P/S (X)	3.32	2.54	2.14	1.88	1.74	1.58
Dividend Yield (%)	22.0%	24.4%	27.3%	42.4%	35.0%	35.0%

Growth & Margins (%)						
Growth						
Revenue	19.2%	30.7%	19.7%	14.2%	8.2%	10.1%
Operating income	29.7%	38.6%	19.3%	13.2%	6.4%	12.7%
EBT	31.7%	36.1%	19.2%	13.2%	6.4%	12.7%
Net Income	33.4%	35.4%	19.7%	13.3%	7.3%	11.1%
Margins						
Gross Profit margin	45.1%	45.2%	46.4%	46.5%	45.7%	46.2%
Operating margin	12.2%	13.0%	12.9%	12.8%	12.6%	12.9%
EBT margin	12.5%	13.0%	13.0%	12.9%	12.7%	13.0%
Net Profit Margin	10.4%	10.8%	10.8%	10.7%	10.6%	10.7%

Key Ratios						
ROE (%)	40.1%	46.2%	45.8%	43.5%	41.2%	42.6%
ROA (%)	29.6%	31.8%	31.4%	31.0%	27.9%	28.2%

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within $\pm 5\%$ from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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