

Lifestyle International(1212.HK)

Benefiting from the recovering retail market, higher sales growth bringing operation leverage

Hong Kong | Consumer | Company report

25 July 2018

Investment Summary

- Benefiting from strong local consumption and a 15% increase in Mainland tourists visiting HK, HK's overall retail market continued to recover since last second half year. In last May, the value of total retail sales rose 12.9% y.o.y., accelerating from 12.2% in April. Among different categories, department store sales increased by 16.7%. In the first four months of this year, the value of total retail sales and department store sales increased by 13.7% and 13.9% respectively.

- Lifestyle has completed the disposal of its entire 59.56% stake in Lifestyle Properties and thus now focus in its retail business i.e. operating the two Sogo Department Stores in Causeway Bay and Tsim Sha Tsui. According to the management team, the overall revenue growth for the year to date has been able to maintain double digit growth. Average daily traffic, sales per ticket, stay and buy ratio all has been increased during the period. During the last Thankful Week event in May, record-breaking sales has also been able to achieved as previous years.

We consider that the two Sogo department stores' sales performance is highly related to the overall retail market performance in HK, and fast-growing cosmetics category shares around 25% of the total sales of Lifestyle, whereas jewelry and other luxury items accounted for around 10 to 20%. We thus expect Lifestyle's overall revenue to record a double-digit growth this whole financial year and perform better than the overall HK retail market performance.

- In terms of Lifestyle's profit margins, the management team indicated that the larger labor costs are expected to increase with low single digits which will be same as the market. Other expenses are expected to keep flat or follow a certain percentage of the rise in sales. We believe that the growth in sales can offset the impact of the increase in wage costs to a certain extent, and releasing some of the pressure from fixed costs. Profit margin indicators such as gross profit and operating profit margins, are expected to expand slightly from last year.

- In terms of medium to long-term development, Lifestyle is developing new project in Kai Tak. It plans to open a third Sogo Department Store in Hong Kong with other commercial, entertainment and catering facilities. The project is expected to help to capture the untapped customer base in the East Kowloon area. It commenced ground breaking works in December 2017, marking the start of construction for the two commercial blocks that at completion by end of 2021 or early 2022, which is expected to bring new growth driver to Lifestyle.

The management also stated that they will continue to pay attention to merger and acquisition (M&A) opportunities related to department stores business. They will focus in Hong Kong market and apart from M&A, they will also consider joint venture or other form of business expansion.

- We expect the company's overall revenue this year to reach double-digit growth, and its gross profit margin and operating profit margin are expected to see slight expansion. We give Accumulate rating, forecast price-earnings ratio 14.6 times, i.e. target price HKD17.2.(Closing price at 23July 2018)

Accumulate (Initially)

CMP HKD15.26

(Closing price at 23 July 2018)

TARGET HKD17.2 (+12.71%)

COMPANY DATA

O/S SHARES (MN) :	1602
MARKET CAP (HKDMN) :	25449
52 - WK LO/HI (HKD):	9.93/28.05

SHARE HOLDING PATTERN , %

Director Thomas Lau & Family	69.23
FMR LLC	4.99

PRICE PERFORMANCE , %

	1M	6M	1Y
Lifestyle	-4.51	30.87	43.69
HSI	-2.44	14.20	5.25

RETURN VS. HSI



Source: Aastocks, Phillip Securities

KEY FINANCIALS

RMB mn	FY16	FY17	FY18E	FY19E
Net Sales	4,672	4,899	5,486	5,761
Net Profit	1,601	2,875	1,887	2,009
EPS, HKD	1.00	1.79	1.18	1.25
PER, x	15.28	8.51	12.96	12.18
BVPS, HKD	1.53	2.52	3.07	3.69
P/BV, x	9.99	6.05	4.97	4.13
ROE, %	65.40	71.08	38.36	33.96

Source: Company, Phillip Securities Est.

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Business Overview

Company profile and ongoing projects

The company completed disposal of its entire 59.56% stake in Lifestyle Properties on 13th April 2017. It becomes a retail operator that specializes in the operation of mid to upper-end department stores in Hong Kong. Its two SOGO stores in Hong Kong including the flagship store in Causeway Bay (SOGO CWB), one of the largest and leading department stores in Hong Kong, as well as the Tsim Sha Tsui store (SOGO TST). The former is its own property. The latter is a leased property.

To further cement SOGO CWB's position as one of the iconic landmarks in HK, The company has launched in October 2017 the CVISION, an imposing outdoor full-HD LED advertising screen at the building façade of the SOGO CWB store, which is expected to greatly enhance the effectiveness of the company's advertising activities.

In addition to the two existing SOGO department stores, there is Kai Tak project which is under construction currently. The company through government tender on 23 November 2016 acquired a plot of land in Kai Tak, at a price of HK\$7388 million.

With a site area of approximately 14159 square meters, its Kai Tak Land will be developed into two blocks of commercial buildings to provide space for both retailing and office use, with a total gross floor area of approximately 101,000 square meters. The retailing area is planned to house a full-fledged department store and other facilities complementary to the operations of a department store as well as to use for the operation of a shopping mall and other entertaining and dining facilities, and the office space will be divided partly for self-use and partly for leasing out for rental income.

The proposed development is expected to be completed by end of 2021 or early 2022, and it is believed that this Kai Tak Project will be able to create a landmark position in the new Kai Tak development and East Kowloon area and will further broaden and solidify the company's presence in HK retailing market. The project commenced ground breaking works in December 2017, marking the start of construction for the two commercial blocks. The company aims to complete the foundation construction work in 2019, before the first phase of the Shatin-Central Link commences operations.

One-off items included in net profit of FY2017

The net profit attributable to continuing operation was HK\$2874.6million, an increase of 79.6% y.o.y. The significant jump apart from owing to the rise in sales and concessionaire commission income brought by an improving retail environment during the year, was mainly attributable to one-off items including the increase of fair value gain compared to FY2016 from financial assets, on the back of robust performance of the global stock markets; a fair value revaluation gain on the investment properties of HK\$844.2million, which did not occur in FY2016.

Year-to-date SSS performance better than last year

The sales revenue of SOGO CWB, which accounted for 84.8% of total revenue, recorded an increase of 4.3% last year, thanked to the recovery in tourism in Hong Kong and improvement in local consumption, in the past year, despite the fact that the supermarket completely closed stores in March and April. The stay and buy ratio remained at approximately 34.1% during the year, and average sales per

ticket grew from HKD794 to 864, partly due to the temporary shutdown of the supermarket.

SOGO TST recorded an increase of 22.3% in sales revenue last year and continued to benefit from the strong sales momentum of cosmetics and skin care products. This category accounted for approximately 60% of the total sales of the store. The average daily traffic, sales per ticket, stay and buy ratio during the year all recorded a growth.

According to the management team, the SSS performance during the first five months of this year, is better than last year and can maintain a double-digit growth in overall top line. The average daily traffic, sales per ticket, stay and buy ratio all recorded a growth.

Among different product categories, cosmetics category has grown the fastest. Take SOGO TST as an example, cosmetic sales revenue grew 30% y.o.y, and the trend has continued for this year.

To know more, among different product categories, HK's value of sales of medicines and cosmetics recorded a growth of 18.7% y.o.y, which is higher than the overall growth of the value of total retail sales in May, and also higher than the growth of 16.8% and 17.4% in April and the first five months respectively. The value of sales of jewellery, watches and clocks, and valuable gifts increased by 23.8%, which is the highest growth among all the other categories, the growth of in April and the first 5 months are 24.5% and 22.8% respectively.

In regards to the proportion shares of customers from mainland China and local customers, we can use UnionPay cards to roughly calculate. Sales from China customers accounted for 40% of the total sales last year, with the rest being local customers. As for this year, with the rapid growth of spending of China consumer, the proportion has increased slightly to about 43%.

Both Sogo held its semi-annual "Thankful Week ", record-breaking sales has been able to achieve as previous years. The revenues of the two Thankful Weeks last year for SOGO CWB, accounted for about 27.8% of the store's gross sales proceeds of the year. The sales growth of SOGO TST even surpassing its counterpart SOGO CWB. The revenue of the November event rose 32.8% y.o.y.

We expect the above trends will continue in short-term. Due to the recent trade disputes between China and USA, the stock market and RMB rate is fluctuating. This coupled with US Federal Reserve is expected to raise interest rates further , implies that the stock market and property market in HK facing uncertainties which may bring risks to retail market in 2H. Plusing the high-base effect, we expect Lifestyle will experience a slower growth in 2H than 1H.

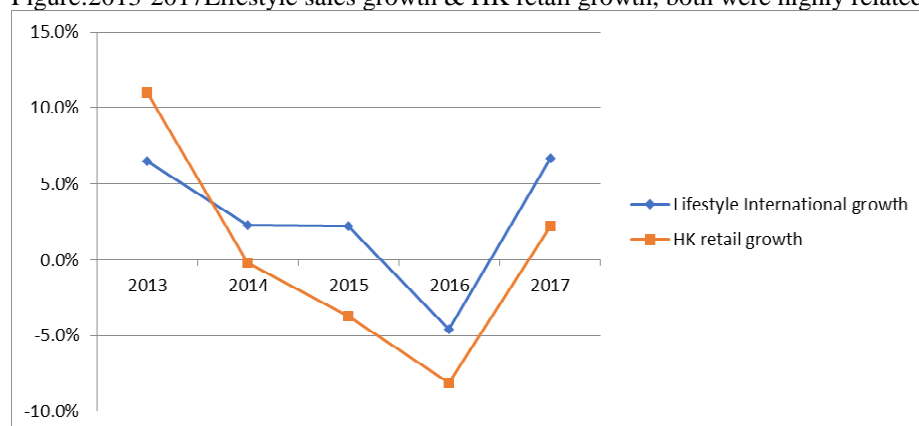
We expected that it may be negatively affected by factors such as higher base last year and thus showing slower growth than 1H. However, infrastructure projects like HK-Zhuhai-Macao Bridge and Express Rail Link will be put into service from the second half of the year. We expect these will help to bring more Chinese tourists and visitors to HK which will be able to offset some of the negative impacts.

Figure: financial reports highlights 2016 & 2017

SOGO CWB			SOGO TST	
2017	2016		2017	2016
+4.3%	-6.7%	SSS growth	+22.3%	+12.4%
79,000	81,700	Ave.daily traffic(persons)	14,900	13,900
864	794	Ave.sales per ticket(HK\$)	1034	983
34.1%	34.3%	Stay and buy ratio	27.7%	25.4%
40,000sq.m.		Floor space(GFA)	~12,000sq.m.	

Source: Company, Phillip Securities

Figure:2013-2017Lifestyle sales growth & HK retail growth, both were highly related



Source: Company, Phillip Securities

Revenue growth helps expand profit margins

Lifestyle has launched the Sogo Rewards program over the past two years. The program aims at attracting consumers to become members, rewarding members with coupons with the rule of more spending more rewards. According to the management team, the program has successfully attracted up to around 400,000 members since 2016, and their consumption accounts for 45% of total revenue. Currently, each purchase of HKD10,000 can redeem HKD50 souvenir vouchers. With the expecting increase in overall sales this year, we expect the related expenses will also increase..

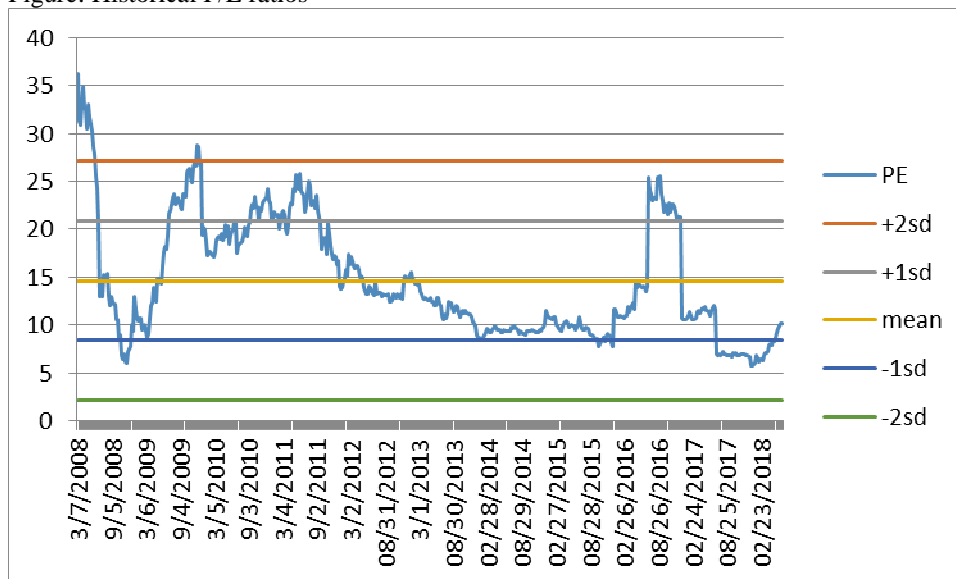
In terms of other expenses, the management team stated that the larger labor cost is expected to increase with the low single digit in the market. Other expenses are expected to keep flat or follow a certain percentage of the rise in sales. We believe that the growth in sales can offset the impact of the increase in wage costs to a certain extent, and releasing some of the pressure from fixed costs. Profit margin indicators such as gross profit margin and operating profit margin, are expected to expand from last year.

Valuation and Risk

We expect the company's overall revenue this year to reach double-digit growth, and its gross profit margin and operating profit margin are expected to see slight expansion. As our model assumes non-current income such as change in fair value of financial instruments and fair value changes on investment properties which do happened in 2017, will all be zero for the coming years, the net profit margins will be a bit lower, same as the absolute value.

We give Neutral rating, forecast price-earnings ratio 14.6 times, i.e. target price HKD17.2. Potential risks include huge market or currency rate fluctuations, huge drop of the number Chinese tourists and visitors, and local consumption not as strong as expected. (Closing price at 23July 2018)

Figure: Historical P/E ratios



Source: Bloomberg, Phillip Securities

Financials

FYE	FY2016	FY2017	FY2018E	FY2019E	FY2020E
Valuation Ratios					
Price to Earnings (P/E)	15.28	8.51	12.96	12.18	11.58
Price to Book (P/B)	9.99	6.05	4.97	4.13	3.49
Per Share Data (HKD)					
EPS	1.00	1.79	1.18	1.25	1.32
Book Value Per Share	1.53	2.52	3.07	3.69	4.38
Dividend Per Share	0.632	0.632	0.632	0.632	0.632
Growth (%)					
Revenue	NA	4.85%	12.00%	5.00%	4.00%
Operating Income	NA	0.96%	14.96%	5.49%	4.48%
Net Profit	NA	79.56%	-34.36%	6.45%	5.10%
Margins (%)					
Gross Profit Margin	56.57%	56.88%	57.00%	57.10%	57.20%
Operating Profit Margin	43.70%	42.08%	43.19%	43.39%	43.59%
Net Profit Margin	34.27%	58.68%	34.39%	34.87%	35.24%
Key Ratios					
ROE (%)	65.40%	71.08%	38.36%	33.96%	30.10%
ROA (%)	7.58%	13.29%	7.17%	6.35%	5.63%
Income Statement (HKD, M)					
Revenue	4,672	4,899	5,486	5,761	5,991
-Cost of Goods Sold	-2,029	-2,112	-2,359	-2,471	-2,564
Gross Income	2,643	2,786	3,127	3,289	3,427
-Operation Expenses	-601	-725	-758	-790	-815
Operating Income	2,042	2,061	2,370	2,500	2,612
Pretax Income	1,939	3,411	2,260	2,406	2,528
Net Profit	1,601	2,875	1,887	2,009	2,111
-Non-recurring items	-178	-1,464	0	0	0
Net Profit (adjusted)	1,423	1,411	1,887	2,009	2,111

Source: Company, Phillip Securities (HK) Research Estimates
(Financial figures as at July 23 2018)

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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