Company Report: Lifestyle International (01212 HK)

公司报告：利福国际 (01212 HK)

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Passed the Trough, Initiate with "Buy"

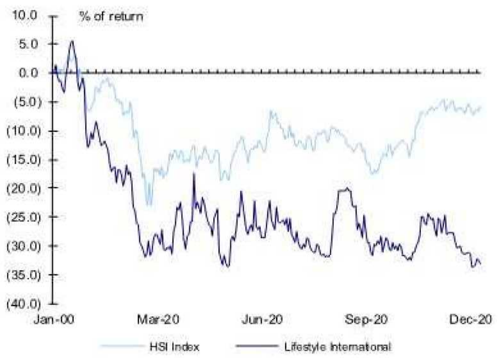
穿过低谷，首次覆盖给予“买入”评级

- **Lifestyle International is the largest department store operator in Hong Kong.** The Hong Kong retail market has been facing tough challenges resulting from the impact from the COVID-19 pandemic in 2020. The Company's operations has been negatively affected. However, the Company's business is relatively resilient, largely attributed to local consumption. Despite the Company's revenue falling 55.2% YoY in 1H20, its core business was still profit making.
- We do not expect a strong retail sales turnaround in 2021 in Hong Kong considering the still fast spreading COVID-19 pandemic. However, several coronavirus vaccines have been approved for widespread use, which is good news for the Company. **We expect the Company's revenue to recover by 30.2% YoY and 25.2%YoY in 2021 and 2022, respectively.** In addition, we believe that the Company's self-owned properties and stable gross margin could strongly support the bottom line.
- We believe that negative factors have been largely priced in and the market values the Company with a large discount compared with its historical average. We argue that the downside risks may be limited and **initiate with "Buy" rating and a TP of HK$7.07.** Our TP represents 10.6x and 7.4x 2021 and 2022 PER, respectively. Main risks include: 1) ongoing COVID-19 pandemic; 2) slower-than-expected SSSG recovery; and 3) delays in the completion of the Kai Tak project.

- **利福国际是香港最大的百货店运营商。**2020 年香港零售市场在新冠疫情冲击下面临艰难的挑战。公司的经营受到不利影响。然而，公司的业务相对具有韧性并且很大程度上来自本地消费。尽管 2020 年上半年公司收入同比下降 55.2%，其核心业务仍然维持盈利。
- 考虑到仍在快速蔓延的新冠疫情，我们不认为香港零售销售在 2021 年会有强劲反弹。然而，一些新冠病毒疫苗被批准大规模使用，利好公司。**我们预期公司收入在 2021 年和 2022 年分别同比回升 30.2%和 25.2%。**此外，我们认为公司的自有物业和稳定的毛利率对其盈利是强有力的支撑。
- 我们认为负面因素已经基本反映在股价中，并且市场对公司的估值相对于其历史平均有很大折让。我们认为下行风险有限，**首次给予“买入”评级，目标价 7.07 港元。**目标价分别相当于 10.6 倍和 7.4 倍 2021 年及 2022 年市盈率。主要风险包括：1）新冠疫情持续；2）慢于预期的同店复苏；3）启德项目完工推迟。

Rating:	**Buy** Initial
评级：	**买入** (首次覆盖)
6-18m TP 目标价:	**HK$7.07**
Revised from 原目标价:	
Share price 股价:	HK$5.990

Stock performance
股价表现



Change in Share Price 股价变动	1 M 1 个月	3 M 3 个月	1 Y 1 年
Abs. % 绝对变动 %	(11.0)	(5.2)	(34.1)
Rel. % to HS Index 相对恒指变动 %	(11.9)	(18.5)	(27.9)
Avg. Share price(HK$) 平均股价（港元）	6.2	6.3	6.8

Source: Bloomberg, Guotai Junan International.

Year End 年结 12/31	Turnover 收入 (HK$ m)	Net Profit 股东净利 (HK$ m)	EPS 每股净利 (HK$)	EPS 每股净利变动 (△ %)	PER 市盈率 (x)	BPS 每股净资产 (HK$)	PBR 市净率 (x)	DPS 每股股息 (HK$)	Yield 股息率 (%)	ROE 净资产收益率 (%)
2018A	4,358	1,690	1.078	(47.7)	5.6	1.870	3.2	0.640	10.7	49.6
2019A	3,542	1,891	1.259	16.8	4.8	2.558	2.3	0.370	6.2	55.8
2020F	1,987	158	0.105	(91.7)	57.0	2.663	2.2	0.000	0.0	4.0
2021F	2,587	1,006	0.670	538.1	8.9	3.333	1.8	0.100	1.7	22.3
2022F	3,238	1,433	0.954	42.4	6.3	4.043	1.5	0.290	4.8	25.9

Shares in issue (m) 总股数 (m)	1,501.9	Major shareholder 大股东	Lau Luen Hung 74.97%
Market cap. (HK$ m) 市值 (HK$ m)	8,996.4	Free float (%) 自由流通比率 (%)	25.0
3 month average vol. 3 个月平均成交股数 ('000)	540.1	FY20 Net gearing (%) FY20 净负债/股东资金 (%)	367.0
52 Weeks high/low (HK$) 52 周高/低 (HK$)	9.500 / 5.800	FY20 Est. NAV (HK$) FY20 每股估值（港元）	8.0

Source: the Company, Guotai Junan International.

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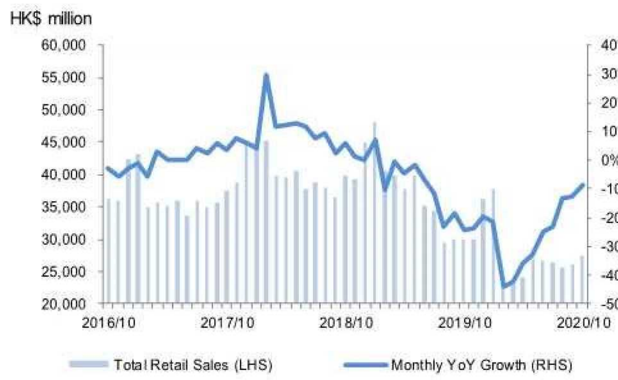
INDUSTRY ANALYSIS

The Hong Kong Retail Market

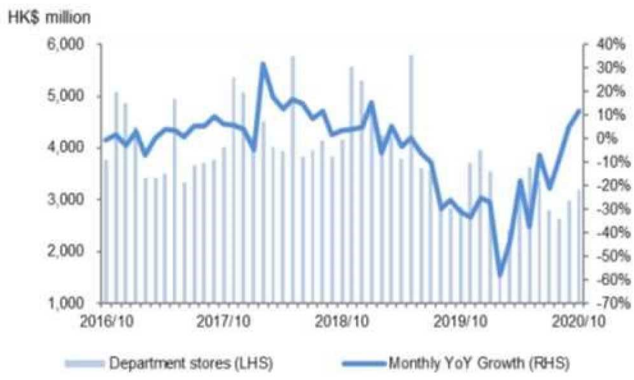
Hong Kong retail market dropped significantly but has begun to rebound. Suffering from China-US trade disputes and social unrest, total retail sales in Hong Kong dropped by 11.1% YoY to HK$431 billion in 2019. Just after the easing of social unrest, the outbreak of COVID-19 hit the retail market badly in 2020. In January to October, value of total retail sales slumped by 27.0% YoY to HK$266 billion, according to the Census and Statistics Department of Hong Kong. In the context of a weak macro economy and no contribution from tourists, retail sales recorded its largest decline since the SARS epidemic. Within all the categories, those that rely less on tourists showed better performance. Sales growth of department stores turned positive in Sep. and Oct. on a low base, despite its low absolute value. Considering the fourth wave outbreak of COVID-19 recently, we do not expect the retail market to recover in 4Q20 and 1Q21. We expect total retail sales to decline by 24% YoY to HK$327 million in 2020.

Figure-1: Total Retail Sales in Hong Kong



Source: Census and Statistics Department of Hong Kong.

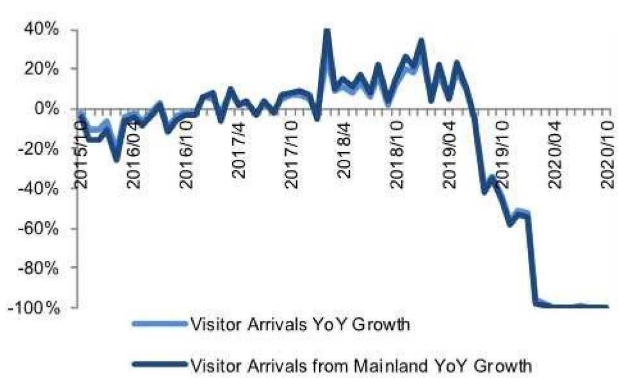
Figure-2: Retail Sales of Department Stores in Hong Kong



Source: Census and Statistics Department of Hong Kong.

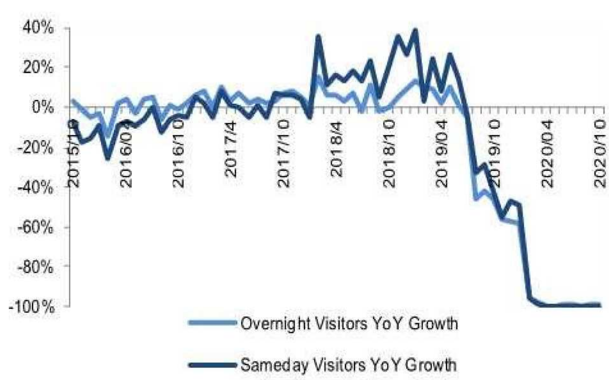
Strict travel restrictions cut retail sales from tourists. The Hong Kong government closed most of its crossing borders in February and prohibited tourists arriving in Hong Kong to reduce the risk of the virus spreading. Visitor arrivals then fell by 96%-99% in March to October. Only several thousands of visitors arrived in Hong Kong per month during the period. In comparison, visitor arrivals reached 5-6 million per month in 1H19. Therefore, categories which are highly dependent on tourists, such as jewellery, watches and clocks and valuable gifts, and medicines and cosmetics, experienced the largest decline. We do not expect borders reopening until thorough control of the COVID-19 pandemic is achieved.

Figure-3: Visitor Arrivals in Hong Kong



Source: Hong Kong Tousism Board.

Figure-4: Same-day/ Overnight Visitor Arrivals in Hong Kong



Source: Hong Kong Tousism Board.

Weak local consumption sentiment. Private consumption expenditure in Hong Kong declined by 11.1% YoY in 1-3Q20 and 8.2% YoY in 3Q20, under the context of a sluggish economy. Unemployment rate rose to 6.3% in Sep.-Nov., 2020, with the number of unemployed persons reaching 244,000. As for tourism-related industries like retail, accommodation and food services sectors, unemployment even reached 10.1%. The underemployment rate stayed at a high level of 3.4%. In the context of a lack of tourists and social distancing policies, economic activities were partly halted.

The Hong Kong government has been taking measures to support enterprises and residents. The government launched three rounds of anti-epidemic fund, amounting HK$30 billion, HK$137.5 billion and HK$24 billion. On Dec. 21, the Legislative Council approved the fourth round of HK$6.4 billion anti-epidemic fund to further support the sectors most affected by the latest social distancing measures, such as restaurants, gyms and cinemas. Besides, the government launched the Cash Payout Scheme to send HK$10,000 to each permanent residents and launched Employment Support Scheme to subsidy enterprises not firing employees. We believe that these burden-relieving measures can partly support enterprises and residents during the challenging environment.

The darkest times have come, stay cautiously positive in 2021. The COVID-19 pandemic has been fast spreading over the world when the Northern Hemisphere entered into winter and the fourth wave of COVID-19 pandemic has arrived in Hong Kong. It is still a challenging task to contain the virus and provide a normal and healthy operating environment. The good news is that several coronavirus vaccines have passed phase 3 efficacy trials and have been approved by many countries for widespread use. We may expect life to return to pre-pandemic times with the success of vaccines. However, it will still take time to prove the effectiveness of the vaccine and reach sufficient production capacity to bring the whole society back to normal. Before this happens, we assume that the retail market will still face challenges and the rebound may be slow. Many Hong Kong retailers have taken measures to focus more on local residents and develop online sales to overcome the challenges.

COMPANY ANALYSIS

Corporate Profile

Lifestyle International ("Lifestyle" or the "Company") is the largest department store operator in Hong Kong. The Company is mainly engaged in operating mid-end to upper-end department stores under the SOGO brand in Hong Kong. Lifestyle currently operates two SOGO stores, including one in Causeway Bay (CWB), the largest department in Hong Kong, and one in Tsim Sha Tsui (TST). In 2019, the Company recorded gross sales proceeds (GSP) of HK$9,445 million, accounting for around 20.4% of total department store sales in Hong Kong. The Company adopts the concept of "one-stop shopping" in its operations, offering a wide variety of goods ranging from daily necessities to luxury products. The CWB store consists of a large gross floor space and offers more comprehensive product mix, while the TST store focuses more on personal care and cosmetics, mainly targeting mainland Chinese tourists. The Company also operates the Wa San Mai Japanese restaurant as a complementary facility in its CWB store.

Figure-5: SOGO TST

Source: the Company.

Figure-6: SOGO CWB

Source: the Company.

Table-1: SOGO Stores' Profile

	SOGO CWB		SOGO TST	
Floor Space	40,000 sq.m.		12,000 sq.m.	
Ownership	Self-owned		Rented	
	2019	1H20	2019	1H20
GSP (HK$ mn)	7,802	n.a.	1,643	n.a.
SSSG	-19.4%	-49.3%	-18.8%	-71.1%
Concessionaire rate	24.6%	23.3%	26.0%	25.0%
Avg. daily traffic	69,882	42,400	14,300	5,200
Avg. ticket size (non-food) (HK$)	1,489	1,403	1,301	1,642
Stay and buy ratio	33.8%	40.1%	27.6%	24.9%

Source: the Company, Guotai Junan International.

Lifestyle has been constructing the Kai Tak project as an expansion plan in Hong Kong. To capture growth opportunities in the East Kowloon area, the Company purchased a piece of land in the Kai Tak area and plans to build two blocks of commercial buildings. The construction started around the end of 2017 and is expected to be completed in 2023, delayed due to the outbreak of COVID-19. The project will provide around 101,000 sq.m for retail and office use upon its completion, of which approximately 49% is expected to be for own use. The Company will host its third department store in the building with complementary retailing, entertainment, dining and lifestyle facilities, while most of the office section will be leased out for rental income. The land purchase cost was around HK$7.4 billion and total construction cost is expected to reach over HK$14 billion, according to the Company. We are concerned that the operation of the Kai Tak project may not reach the management's previous expectations considering the uncertainties in Hong Kong and we have not put the project into our valuation calculation. However, it may be a catalyst alongside the recovering retailing and property markets in Hong Kong.

Lifestyle's outstanding shares are concentrated within Mr. Lau's family. Mr. Lau Luen Hung, the Chairman of the Company, and his relatives, hold 75% of total outstanding shares. Both the chairman's son and daughter are the key management members of Lifestyle. Mr. Lau Kam Sen is responsible for project management and Ms. Lau Kam Shim responsible for international boutiques and the sales promotion division of the Company.

Business Model

Concessionaire sales model is Lifestyle's main business model. The Company runs the business mainly through direct sales, concessionaire sales and consignment. In 2019, concessionaire sales and direct sales accounted for around 72% and 13% of the Company's GSP, respectively. Most of the high-end brands, including in cosmetics, jewellery, apparel and other categories, have their own counters in SOGO stores and operate through the concessionaire model. SOGO stores have charged relatively stable concessionaire rates in recent years, ranging from 24% to 25%, leveraging on its solid customer traffic and bargaining power. However, due to the impact from the COVID-19 pandemic, the Company actively lowered concessionaire rate in 1H20 to get through the trough with its tenants.

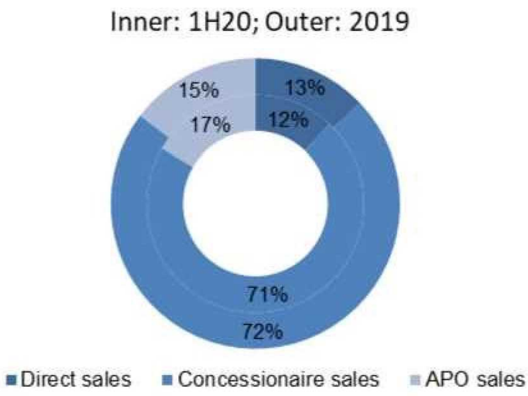
Thankful Week is SOGO's signature promotion event. Thankful Week runs semi-annually, in which many of SOGO's brands hold special promotions, often offering steep discounts to their products. Thanks to the attractive discounts, the event is highly anticipated and considered a cultural phenomenon among local shoppers and tourists. In 2020, the Company held its 35th anniversary sale with the enhanced SOGO Rewards app and SOGO eStore services, responding to the spread of COVID-19.

FINANCIAL ANALYSIS

GSP and Revenue

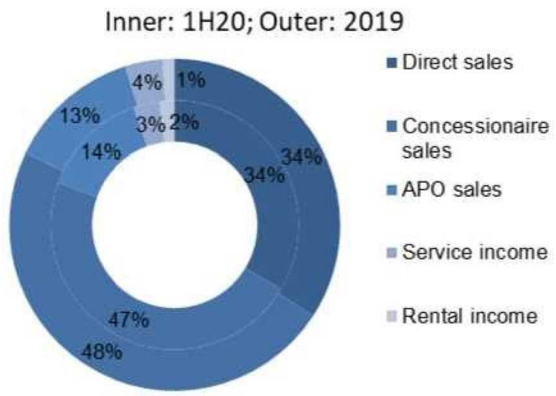
GSP grew stably during 2016-2018 but recorded decline in 2019. Lifestyle's sales are highly related to the Hong Kong macro economy and tourist arrivals, in line with overall Hong Kong retail market growth. In 2015-2018, the Company's GSP growth continuously outperformed overall retail growth in Hong Kong, reporting a CAGR of 4.9%. However, the Company's operations were heavily impacted by the social unrest in 2H19. On one hand, stores were forced to close or shorten operating hours over safety concerns and a total of approximately 60 business days were affected. On the other hand, the ongoing and intensified unrest hindered tourists, especially tourists from mainland China, from shopping in Hong Kong. As a result, GSP recorded a sharp drop of 36.0% in 2H19 and 19.3% in 2019.

Figure-7: GSP Breakdown by Operation Model



Source: the Company, Guotai Junan International.

Figure-8: Revenue Breakdown by Operation Model



Source: the Company, Guotai Junan International.

The ongoing COVID-19 pandemic weighed on 2020 sales. On one hand, border control measures and quarantine policy prevented tourists from arriving and spending in Hong Kong. On the other hand, the Hong Kong economy was heavily hit without the income related to tourism and therefore domestic consumption and retail spending fell as well. In 1H20, the Company's GSP slumped by 53.5% YoY to HK$2,631.5 million and revenue dropped by 55.2% YoY to HK$942.0 million. By store, over 60% of SOGO CWB's customers were local residents in previous years, being relatively more resilient compared with SOGO TST in the context of the sharp decline in the number of tourists. SSSG of SOGO CWB was down 49.3% YoY. Average daily traffic shrank by 46.1% YoY to 42,400 and average ticket size of non-foods products was down by 5.9% YoY. In comparison, around 70% of SOGO TST's sales were contributed from tourists in previous years resulting in these stores suffering more. SSSG plunged by 71.1% YoY and average daily traffic significantly dropped by 71.6% YoY. In addition, stores adjusted their operating hours and operational procedures in response to the pandemic situation.

Acquisition a property in London. On Nov.20, 2020, the Company announced that it had entered into an agreement with BP (BP PLC) to acquire BP's headquarters office. The total consideration was GBP250.1 million (approximately HK$2,571 million) and has been fully settled in cash funded by the Company's own resources and existing bank facilities upon completion. Immediately following the deal, the Company and BP entered a lease agreement that the Company agreed to lease the property to BP for a term of 24 months at the principle rent of GBP11.2 million (approximately HK$115 million) per annum. The Company expects the annual net rental income from the property after taxation will be around HK$72 million. According to the Company, the property is located in St. James's Square, London, one of the city's most prestigious locations. The Company believes that the acquisition is a good opportunity for the Company to diversify and enhance its asset portfolio and create long-term rental income.

Lifestyle has been actively investing in notes and shares. The Company keeps a portfolio of financial assets which include debt equities, as part of its cash management and investment strategy. Within its portfolio, the Company has been trading a large amount of notes issued by China Evergrande (03333 HK) and its subsidiaries. In April 2020, the Company acquired notes from the secondary market at a total consideration of US$128.7 million. Then during April 2020 and October 2020, the Company, on the open market, disposed of the notes for an aggregate consideration of approximately US$138.3 million, with consideration to the extreme market volatility amid mounting uncertainty. The aggregate interest income accrued to the

Company in respect of the notes under the disposals in 2020 amounted to approximately HK$109.5 million. Besides, the Company acquired a total of 59,704 shares of a wholly-owned subsidiary of China Evergrande, at a consideration of HK$500 million, in August 2020.

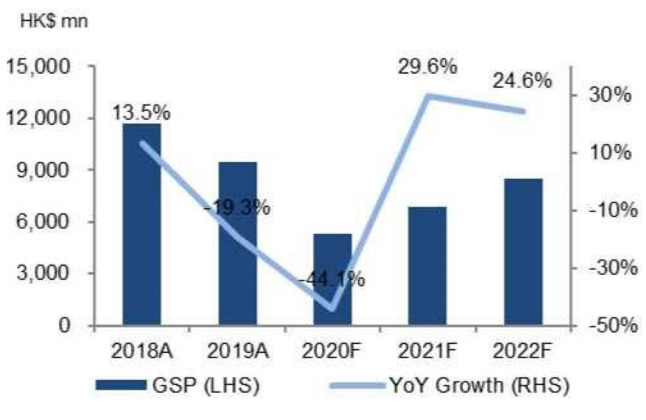
Table-2: Lifestyle's Notes Trading Details related to China Evergrande in 2020

Date	Note	Principle	Consideration	Buy/ Sell
2020.4.7	11.5% note 2022	US$60.0 mn	US$45.2 mn	Buy
	12.0% note 2023	US$60.0 mn	US$45.9 mn	Buy
	10.5% note 2024	US$50.0 mn	US$37.6 mn	Buy
2020.4.23- 6.23	12.0% note 2023	US$36.0 mn	US$35.4 mn	Sell
	10.5% note 2024	US$50.0 mn	US$40.5 mn	Sell
2020.7.2- 10.14	12.0% note 2023	US$24.0 mn	US$62.4 mn	Sell
	11.5% note 2022	US$35.0 mn		Sell
	8.90% note 2021	US$2.0 mn		Sell
	6.25% note 2021	US$2.0 mn		Sell

Source: the Company, Guotai Junan International.

We expect the Company's sales to gradually recover in the coming years. Impacted by the ongoing COVID-19 pandemic and closed borders, tourists still cannot contribute in 2H20 and we think that the Company's GSP will not significantly rebound during the period. Despite the Hong Kong government's HK$10,000 cash handout, tighter social distancing measures and high unemployment rate is also hindering local consumption. However, the decline rate is estimated to narrow on a lower base. In 2021, we are of the view that travel restrictions will be gradually lifted when the pandemic is well controlled and the vaccines are proved to be effective, and travelers will start to return to Hong Kong. Nevertheless, we do not deem that tourists consumption demand will return all of a sudden and it will still take time to rebound. As for domestic consumption, we believe that consumption confidence and purchasing power will recover along with the macro economy when the COVID-19 pandemic can be effectively contained. We estimate GSP to decline by 30.0% YoY in 2H20 and 44.1% YoY in 2020, respectively, but to recover by 29.6% YoY and 24.6% YoY in 2021 and 2022, respectively. In terms of revenue, we forecast it to be HK$1,987 million, HK$2,587 million and HK$3,238 million in 2020-2022, down 43.9% YoY%, up 30.2% YoY and up 25.2% YoY, respectively.

Figure-9: Lifestyle's GSP and YoY Growth



Source: the Company, Guotai Junan International.

Figure-10: Lifestyle's Revenue and YoY Growth

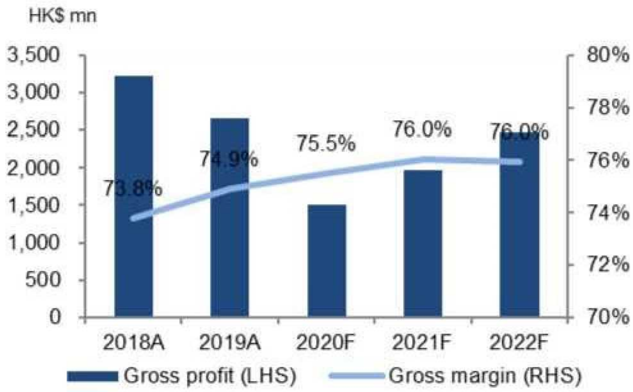
Source: the Company, Guotai Junan International.

Gross Profit and Gross Margin

The Company recorded stable gross margin in recent years. Gross margin was 75.4%, 73.8% and 74.9% in 2017-2019, respectively. Concessionaire commission was 100% recorded as gross profit, and therefore gross margin was relatively high compared with other retailers. The Company's overall concessionaire rate slighted improved from 24.2% in 2015 to 24.8% in 2019, representing the Company's strong bargaining power. By store, SOGO TST recorded higher concessionaire rate of 26.0%, higher than SOGO CWB's 24.6% in 2019. In 1H20, overall concessionaire rate declined to 23.5%, of which SOGO TST and SOGO CWB was down to 25.0% and 23.3%, respectively, affected by the outbreak of COVID-19 and retail sales decline. However, concessionaire sales declined less than direct sales during the period, gross margin increased to 74.7%, up 0.7 ppts YoY.

We forecast concessionaire rate to decrease while overall gross margin to rise in 2020. The Company guided that it intends to maintain business with its tenants amid a challenging environment and will negotiate concessionaire and rental rates to help the tenants get through the tough situation. Thus we expect that overall concessionaire rate will be around 23.5% in 2020 and 2021. Besides, categories such as cosmetics and luxury goods which have higher margin were hit badly and may drag the overall margin. However, since the Company's direct sales recorded larger decline, we expect overall gross margin to slightly improve in 2020 and 2021, reaching 75.5% and 76.0%, respectively. We expect gross profit to shrink by 43.5% YoY to HK$1,500 million in 2020 with the sharp decline in sales revenue but forecast it to increase by 31.1% YoY in 2021.

Figure-11: Lifestyle's Gross Profit and Gross Margin



Source: the Company, Guotai Junan International.

Figure-12: Lifestyle's Concessionaire Rate

Source: the Company, Guotai Junan International.

Operating Profit

The Company's selling and distribution costs decreased by 24.8% YoY to HK$282 million in 1H20. The decrease was mainly attributable to a significant drop in rental expenses for SOGO TST, which was due to a large drop in sales revenue that only the fixed base rent was required to be paid during the period. During the period, the Company maintained a full-time work force of 664 employees, up 5 compared with the number as at the end of 2019. Staff costs (excluding directors' emoluments) declined by 10.1% YoY to HK$103 million, due to less sales commission on sales reduction. In addition, the Company tightened unnecessary expenses to get through the unfavorable environment. However, SD&A to revenue ratio still increased by 15.0 ppts YoY due to operating deleverage.

We forecast lower operating margin in 2020 and 2021 due to operating deleverage, considering that the Company's major operating expenses are labor costs and rental expenses, which have limited room for further reduction in 2H20 compared with 1H20. We estimate selling and distributing expenses and administrative expenses to reduce by 20.2% YoY and 13.5% YoY in 2020, respectively. In 2021, we estimate that SD&A expenses will increase by 14.9% YoY due to rising variable costs along with recovering sales revenue. Due to operating deleverage, we do not expect operating margin to improve quickly and expect it to stay at 50.3% and 51.2% in 2020 and 2021, respectively.

Shareholders' Profit

The Company reported a net loss of HK$227 million in 1H20. The loss was mainly due to 1) a 53.5% drop in total gross sales proceeds as a result of the outbreak of COVID-19. 2) The Company recorded a mark-to-market fair value loss of HK$461 million on its financial investment. 3) A fair value loss of HK$180 million on the Company's investment property under development in Kai Tak. Excluding the fair value change of the Company's assets, core shareholders' profit dropped by 63.0% YoY to HK$367 million, still making profit. Besides, before the impact from the social unrest and the COVID-19 outbreak, the Company kept a good record in profit making, recording shareholders' profit of HK$1,690 million and HK$1,891 million in 2018 and 2019, respectively.

We forecast shareholders' profit to turn positive in 2020 and gradually recover in 2021 and 2022. The Company has diversified investment in variable financial assets and properties, which recorded fair value loss in 1H20 in a downturn market. However, we assume that the loss will narrow in 2H20 with capital market turnaround. We expect shareholders' profit to be HK$158 million in 2020, and rise to HK$1,006 million and HK$1,433 million in 2021 and 2022, respectively. The Company suspended dividend payout in 2H19 and 1H20 to retain its cash in an uncertain environment. However, we estimate that the Company will assume its 30% payout ratio when the market rebounds.

Figure-13: Lifestyle's Operating Profit & YoY Growth

Source: the Company, Guotai Junan International.

Figure-14: Lifestyle's Shareholders' Profit & Net Margin

Source: the Company, Guotai Junan International.

Table-3: Key Financial Forecasts

HK$ mn	Forecasts			YoY Change		
	2020F	2021F	2022F	2020F	2021F	2022F
GSP	5,280	6,843	8,527	(44.1%)	29.6%	24.6%
Total revenue	1,987	2,587	3,238	(43.9%)	30.2%	25.2%
Gross profit	1,500	1,967	2,460	(43.5%)	31.1%	25.0%
SD&A expenses	-676	-776	-832	(19.1%)	14.9%	7.2%
Operating profit	1,000	1,323	1,765	(49.1%)	32.4%	33.4%
PBT	208	1,156	1,647	(90.4%)	454.9%	42.5%
Taxation	-50	-150	-214	(81.9%)	200.6%	42.5%
Shareholders' profit	158	1,006	1,433	(91.6%)	535.2%	42.5%
EPS (HK$)	0.105	0.670	0.954	(91.6%)	535.2%	42.5%
Gross margin	75.5%	76.0%	76.0%	0.6 ppts	0.5 ppts	-0.1 ppts
Operating margin	50.3%	51.2%	54.5%	-5.2 ppts	0.8 ppts	3.4 ppts
Net margin	8.0%	38.9%	44.3%	-45.4 ppts	30.9 ppts	5.4 ppts

Source: the Company, Guotai Junan International.

VALUATION

Investment highlights for the Company include: 1) Lifestyle is a leading and solid department store operator in Hong Kong. Despite that the Company has been experiencing headwinds amid a challenging operating environment in 2019 and 2020, Lifestyle is one of the most resilient retailing operators in Hong Kong and the Company's core business is still able to make profit. 2) The Company's self-owned properties make it more defensive amid the market downturn. The Company owns the SOGO CWB property and the twin towers in Kai Tak are under construction. The Company can achieve higher profit margin compared with its peers with less operating expenses. In addition, the Company could enjoy fair value gain and rising rental income from these properties when the market recovers. 3) We believe that the market has priced in a bearish scenario and the Company's share price reached a historical low, implying limited downside risk. Future price catalyst could be faster-than-expected retail market rebound if the pandemic can be well contained with strict measures or effective vaccines can be widely used. Besides, the Company has started to adjust its strategy to focus more on local residents, in order to partly offset the negative impact from lost tourist traffic.

Initiate with "Buy" investment rating and TP is set at HK$7.07. The Company's share price shrank by around 52% since June 2019, suffered from social unrest and the outbreak of COVID-19. The recent fourth wave of COVID-19 outbreak further hit the share price. However, we are of the view that the market is overly pessimistic on the Company and has underestimated the fundamentals. Our TP is derived from 10.6x 2021 PER, lower than the Company's historic average of 12.0x, taking account into the market's low risk preference. TP is also equivalent to 7.4x 2022 PER.

Major downside risk factors include: 1) Ongoing COVID-19 pandemic, 2) Slower-than-expected SSSG recovery, 3) Delays in the completion of the Kai Tak project.

Table-4: Peers Comparison Table

Company				PE(x)				PB(x)				ROE(%)	D/Y(%)	Market Cap
	Stock Code	Currency	Last price	19A	20F	21F	22F	19A	20F	21F	22F	20F	20F	HKD mn
HK - Listed Department Stores														
Golden Eagle Retail	3308 HK	HKD	7.050	8.8	10.7	8.0	n.a.	1.5	1.3	1.1	n.a.	13.2	n.a.	11,704
Lifestyle Intl	1212 HK	HKD	5.990	4.8	17.2	8.8	7.4	2.3	2.2	1.9	1.7	18.1	0.1	8,996
Wing On Co International	289 HK	HKD	16.800	6.4	n.a.	n.a.	n.a.	0.3	n.a.	n.a.	n.a.	n.a.	n.a.	4,905
New World Dept Store China	825 HK	HKD	1.180	59.0	n.a.	n.a.	n.a.	0.3	0.5	n.a.	n.a.	(9.6)	0.0	1,990
Maoye International	848 HK	HKD	0.330	8.0	n.a.	n.a.	n.a.	0.1	n.a.	n.a.	n.a.	n.a.	n.a.	1,696
Parkson Retail	3368 HK	HKD	0.260	n.a.	n.a.	n.a.	n.a.	0.1	n.a.	n.a.	n.a.	n.a.	n.a.	685
Simple Average				17.4	14.0	8.4	7.4	0.8	1.3	1.5	1.7	7.2	0.1	
Weighted Average				10.5	13.5	8.3	7.4	1.4	1.6	1.5	1.7	13.1	0.1	
HK Based Retailers														
Chow Tai Fook Jewellery	1929 HK	HKD	9.700	33.4	20.6	17.5	15.2	3.7	3.5	3.4	3.2	17.2	3.7	97,000
Luk Fook Holdings	590 HK	HKD	18.240	12.3	12.7	9.5	7.9	1.0	1.0	0.9	0.9	8.3	5.3	10,709
Chow Sang Sang	116 HK	HKD	8.650	9.1	9.2	6.2	5.5	0.6	0.5	0.5	0.5	5.9	4.4	5,860
Sa Sa International	178 HK	HKD	1.200	n.a.	n.a.	75.0	17.1	2.2	2.5	2.4	2.3	(13.1)	0.0	3,724
Oriental Watch Holdings	398 HK	HKD	2.640	15.0	n.a.	n.a.	n.a.	0.7	n.a.	n.a.	n.a.	n.a.	n.a.	1,287
Bonjour Holdings	653 HK	HKD	0.150	n.a.	n.a.	n.a.	n.a.	1.2	n.a.	n.a.	n.a.	n.a.	n.a.	512
King Fook Holdings	280 HK	HKD	0.280	45.2	n.a.	n.a.	n.a.	0.4	n.a.	n.a.	n.a.	n.a.	n.a.	256
Tse Sui Luen	417 HK	HKD	0.840	n.a.	n.a.	n.a.	n.a.	0.2	n.a.	n.a.	n.a.	n.a.	n.a.	209
Simple Average				23.0	14.1	27.0	11.4	1.3	1.9	1.8	1.7	4.6	3.4	
Weighted Average				30.1	19.2	18.1	14.1	3.2	3.1	3.0	2.8	14.8	3.8	
PRC - Listed Department Stores														
Chongqing Department Store	600729 CH	CNY	27.910	11.5	11.0	9.1	7.9	1.8	1.6	1.4	1.3	15.0	2.8	13,471
Wangfujing Group	600859 CH	CNY	31.190	25.2	51.8	24.1	18.9	2.1	2.1	2.0	1.8	3.8	0.4	28,746
Rainbow Digital Commercial	002419 CH	CNY	7.710	10.8	27.1	12.0	9.5	1.3	1.3	1.3	1.2	4.9	2.9	10,987
Wuhan Department Store	000501 CH	CNY	11.630	7.3	7.3	6.9	n.a.	0.9	n.a.	n.a.	n.a.	n.a.	n.a.	10,618
Hunan Friendship & Apollo	002277 CH	CNY	3.630	16.0	21.4	14.5	11.3	0.7	0.7	0.7	n.a.	3.0	0.8	6,009
Hefei Department Store	000417 CH	CNY	4.830	23.6	28.4	24.2	n.a.	0.9	0.9	0.9	n.a.	3.4	1.0	4,472
Simple Average				15.7	24.5	15.1	11.9	1.3	1.3	1.3	1.4	6.0	1.6	
Weighted Average				17.2	30.5	16.4	13.9	1.6	1.7	1.5	1.5	6.2	1.4	

Source: Bloomberg, Guotai Junan International.

Financial Statements and Ratios

Income Statement

Year end 31 Dec (HK$ m)	2018A	2019A	2020F	2021F	2022F
Total Revenue	4,358	3,542	1,987	2,587	3,238
Cost of sales	(1,143)	(889)	(487)	(620)	(779)
Gross profit	3,215	2,653	1,500	1,967	2,460
Other income & gains	109	147	175	132	138
Selling & distribution expenses	(722)	(697)	(556)	(647)	(696)
Administrative expenses	(137)	(138)	(119)	(129)	(136)
Operating Profit	2,464	1,965	1,000	1,323	1,765
Interest and investment gains	(271)	740	(250)	193	223
Fair value changes	251	(174)	(180)	50	67
Finance income, net	(31)	(539)	(541)	(360)	(341)
Profit Before Tax	2,162	2,166	208	1,156	1,647
Income Tax	(472)	(276)	(50)	(150)	(214)
Profit After Tax	1,690	1,891	158	1,006	1,433
Non-controlling Interest	0	0	0	0	0
Shareholders' Profit / Loss	1,690	1,891	158	1,006	1,433
Basic EPS	1.078	1.259	0.105	0.670	0.954

Cash Flow Statement

Year end 31 Dec (HK$ m)	2018A	2019A	2020F	2021F	2022F
PBT	2,162	2,166	208	1,156	1,647
Finance costs, net	123	164	152	226	227
Depreciation & amortisation	185	271	223	246	270
Fair value changes of FA	516	(404)	360	150	120
Change in WC	(14)	(290)	(47)	124	64
Income tax paid	(345)	(103)	(50)	(150)	(214)
Others	(184)	224	292	(145)	(85)
Cash from Operating Activities	2,443	2,029	1,139	1,607	2,030
Additions to PPE	266	239	500	500	500
Additions to investment properties	155	218	3,732	1,000	1,000
Others	(5,780)	2,034	(8,312)	(2,843)	(2,842)
Cash from Investing Activities	(5,360)	2,492	(4,080)	(1,343)	(1,342)
Net bank loans	(2)	468	2,888	0	0
Dividend paid	(1,006)	(1,006)	0	0	(366)
Others	(2,086)	1,731	(361)	(410)	(408)
Cash from Financing Activities	(3,094)	1,192	2,526	(410)	(774)
Net Changes in Cash	(6,010)	5,713	(415)	(146)	(86)
Cash at Beg of Year	7,423	1,413	7,113	6,697	6,551
Foreign exchange effect	0	(14)	0	0	0
Cash at End of Year	1,413	7,113	6,697	6,551	6,466

Balance Sheet

Year end 31 Dec (HK$ m)	2018A	2019A	2020F	2021F	2022F
Investment properties	5,132	5,420	8,962	9,962	10,962
PPE	5,876	6,292	6,568	6,822	7,052
Financial assets	19	649	966	979	986
Others	64	72	72	72	72
Total Non-current Assets	11,091	12,433	16,568	17,836	19,072
Cash & Cash Equivalents	1,413	7,113	6,697	6,551	6,466
Inventories	45	39	31	37	44
Trade and other receivables	155	103	82	102	122
Financial assets	3,081	3,306	3,820	3,859	3,871
Time deposits	4,783	1,509	186	186	186
Total Current Assets	9,477	12,069	10,817	10,736	10,689
Total Assets	20,568	24,502	27,385	28,571	29,761
Trade and other payables	1,046	826	744	892	982
Tax payables	290	491	250	263	276
Short term bank borrowings	3,100	4,071	3,800	3,800	3,800
Others	157	214	385	391	396
Total Current Liabilities	4,594	5,603	5,179	5,345	5,454
Long term bank borrowings	8,114	7,641	10,800	10,800	10,800
Long term bonds	4,656	6,962	6,962	6,962	6,962
Deferred tax liabilities	271	243	231	243	255
Others	0	211	213	215	217
Total Non-current Liabilities	13,042	15,058	18,206	18,220	18,234
Total Liabilities	17,636	20,660	23,385	23,566	23,688
Total Shareholders' Equity	2,931	3,841	4,000	5,006	6,073
Minority Interest	0	0	0	0	0
Total Equity	2,931	3,841	4,000	5,006	6,073

Financial Ratios

	2018A	2019A	2020F	2021F	2022F
Profitability:					
Gross margin (%)	73.8	74.9	75.5	76.0	76.0
Operating margin (%)	56.5	55.5	50.3	51.2	54.5
Net profit margin (%)	38.8	53.4	8.0	38.9	44.3
ROE (%)	49.6	55.8	4.0	22.3	25.9
ROA (%)	8.1	8.4	0.6	3.6	4.9
Operating (days):					
Inventory days	13.3	17.1	26.1	20.0	19.1
A/C receivable days	13.9	13.3	17.0	13.0	12.6
Liquidity & Solvency:					
Current ratio (x)	2.1	2.2	2.1	2.0	2.0
Interest cover (x)	7.7	5.9	0.6	2.8	4.0
Net gearing (%)	330.0	261.7	367.0	296.2	248.6
Payout ratio (%)	32.5	0.0	0.0	15.0	30.0

Source: the Company, Guotai Junan International.

Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index

Time Horizon: 6 to 18 months

Rating		Definition
Buy	买入	Relative Performance>15%; or the fundamental outlook of the company or sector is favorable.
Accumulate	收集	Relative Performance is 5% to 15%; or the fundamental outlook of the company or sector is favorable.
Neutral	中性	Relative Performance is -5% to 5%; or the fundamental outlook of the company or sector is neutral.
Reduce	减持	Relative Performance is -5% to -15%; or the fundamental outlook of the company or sector is unfavorable.
Sell	卖出	Relative Performance <-15%; or the fundamental outlook of the company or sector is unfavorable.

Sector Rating Definition

The Benchmark: Hong Kong Hang Seng Index

Time Horizon: 6 to 18 months

Rating		Definition
Outperform	跑赢大市	Relative Performance>5%; or the fundamental outlook of the sector is favorable.
Neutral	中性	Relative Performance is -5% to 5%; or the fundamental outlook of the sector is neutral.
Underperform	跑输大市	Relative Performance<-5%; Or the fundamental outlook of the sector is unfavorable.

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