



# Company Report

## Daphne (210 HK) – Sell

Footwear Industry

Cut 12-mth target price to HK\$6.55 (previous HK\$8.94)

**Key data**

Share price (HK\$)	8.22
Target price (HK\$)	6.55
Downside potential (%)	20.3
52Wk H/L(HK\$)	11.84 / 5.89
Issued shares (mn)	1641
Market cap (HK\$mn)	13,541
30-day avg vol (HK\$mn)	42.8
Major shareholders (%):	
Chang Chih-Kai's family	24.47
TPG Asia	18.23

Source: Company, Bloomberg, ABCI Securities

**Revenue composition in 1H FY12 (%)**

Core brands(Daphne,Shoebox)	90.0
Other brands	7.0
OEM	3.0

Source: Company

**Share performance (%)**

	Absolute	Relative*
1-mth	7.7	2.7
3-mth	(15.7)	(19.2)
6-mth	(19.4)	(14.2)

Source: Bloomberg

\*Relative to Hang Seng Index

**1 year price performance**

Source: Bloomberg

**Analyst****Report date:** 16 Aug, 2012

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Previous report

Date: 5 Jul, 2012

Rating: Buy

**We downgrade Daphne to “SELL” and cut its 12-mth target price to HK\$6.55 as we do not expect a turn-around for its 2H sales and margins. We expect its ASP and gross profit margin to further decline in 3Q FY12 due to heavy discount offered to clear spring-summer inventory in Aug and Sep. The effects of new initiatives to improve operating efficiency are unlikely to surface till 4Q FY12.**

**Margin dropped and inventory surged in 1H FY12:** Its 1H net profit grew by 9.6%YoY to HK\$482.6mn. The operating profit margin was down 2.2ppt to 13.8% in 1H FY12 due to 3.9% decline of ASP on keen market competition and fast growing of staff and rental costs. Its inventory turnover days surged to 202 days in 1H FY12 (vs 149 days in 1H FY11).

**2H FY12 outlook is challenging:** We do not expect a turn-around for its 2H sale and margin. We expect its ASP and gross profit margin to further decline in 3Q FY12 due to heavy discount offered to clear spring-winter inventory in Aug and Sep. Its SSSG will drop to 8%-10% in 2H FY12 and we maintain its full year SSSG at 12%. We expect its net profit to grow by 11.0%YoY in 2H FY12. As the group will continue to expand its retail network by open directly- managed stores, we expect that rental cost to sales will increase. The effects of new initiatives to improve operating efficiency are unlikely to surface till 4Q FY12.

**Downgrade to Sell:** The stock is trading at 15.1x PER for FY12. As FD EPS growth will slow down, we downgrade the counter to “SELL” from “BUY” and cut 12M target price to HK\$6.55 from HK\$8.94, representing 12.0x PER of FY12 or 10.4x PER of FY13.

**Risk factors:** Slow-than-expect sales recovery in 2H FY12; increasing inventory risk; heavy promotion to erode margin.

**Forecast and valuation**

FY ended Dec 31	FY10A	FY11A	FY12E	FY13E	FY14E
Sales(HK\$ mn)	6,623.9	8,576.8	10,637.7	12,538.1	14,929.3
Chg (YoY)	13.6%	29.5%	24.0%	17.9%	19.1%
Net Income(HK\$ mn)	595.6	933.1	1,029.6	1,191.7	1,469.7
Chg (YoY)	51.2%	56.7%	10.4%	15.7%	23.3%
FD EPS (HK\$)	0.319	0.498	0.546	0.631	0.779
Chg (YoY)	40.8%	56.0%	9.6%	15.7%	23.3%
PER (x)	-	16.51	15.07	13.02	10.56
DPS(HK\$)	0.120	0.170	0.188	0.217	0.268
Dividend yield	-	2.1%	2.3%	2.6%	3.3%
ROAE	21.5%	24.8%	22.3%	21.8%	22.7%
ROAA	13.3%	16.2%	15.0%	15.1%	15.9%

Source: Company data, ABCI Securities estimates



Exhibit 1: 1H FY2012 results review

(HK\$ mn)	Actual	ABCI est.	Difference	YoY growth
Turnover	5,079.5	4,787.0	6.1%	28.9%
Gross profit	3,083.3	2,848.2	8.3%	27.8%
Operating profit	699.6	660.6	5.9%	11.0%
Net profit	482.6	481.1	0.3%	9.6%
Gross profit margin	60.7%	59.5%		–
Operating profit margin	13.8%	13.8%		–
Net profit margin	9.5%	10.1%		–

Source: Company data, , ABCI Securities estimates

Exhibit 2: 1H FY2012 business segment review

	Core brands business	Other brands business	OEM
Sales	4,602.1	332.0	145.4
YoY growth	33.4%	39.1%	(38.2%)
Gross profit	2,821.8	192.4	74.6
Gross profit margin	60.8%	57.8%	11.4%
	(-1.7ppt)	(-4.3ppt)	(-3.5ppt)
Operating profit(loss)	778.1	(40.2)	25.0
Operating profit margin	16.8%	(12.1%)	3.8%
	(-2.8ppt)	-	(-2.8ppt)

Source: Company data, , ABCI Securities estimates

**Strong sale growth with margin squeezing 1H FY12:** Its 1H sales grew by 28.9%YoY to HK\$5079.5mn, 6.1% higher than our previous forecast. We believe the better-than-expected sales growth was driven by intensified promotion (discount up to 50% compared with 36% in FY11) and strong SSSG (17% for core brands) in 1H FY12. Its 1H net profit grew by 9.6% to HK\$482.6mn, which is in line with our forecast. The GPM and OPM dragged down 0.5ppt and 2.2ppt to 60.7% and 13.8% in 1H FY12 due to ASP decline(core brands ASP dropped 3.9%YoY) and fast growing of staff and rental cost. Its 1H GMP and OPM for the core brands dropped to 60.8% (vs 62.5% in 1H FY11) and 16.8% (vs 19.6% in 1H FY11). Its inventory turnover days further extended to 202 days compared with 149 days in 1H FY11.



**2H FY12 outlook is challenging:** We do not expect a turn-around for its 2H sale and margin due to the weak consumer market, heavy discount environment of women's footwear industry and high base effect of last year. The management has confirmed that the whole women's footwear industry is undergoing a heavy discount to clear inventory. The group will provide attractive discount to clear up spring-summer items in Aug and Sep. We expect its ASP and gross profit margin to further decline in 3Q FY12. We expect its sale and net profit to grow by 19.9%YoY and 11.0%YoY in 2H FY12. Its SSSG will drop to 8%-10% in 2H FY12 and we maintain its full year SSSG at 12%. The group has implemented a series of new initiatives to optimize supply-chain, sales channel and staff productivity. We believe the operating efficiency will improve from 4Q FY12. As the group will continue to expend its retail network by open directly- managed stores (% of directly-managed stores increased to 83% in1H FY12 from 81% at the end of FY11), we expect rental cost to sales will increase due to slow sales ramp-up.

**Exhibit 3:2H and FY12 forecast**

	2H FY2012 forecast	FY2012 forecast	Previous forecast	Difference
Turnover	5,558.2	10,637.7	10637.7	0.0%
<b>YoY growth</b>	19.9%	24.0%	24.0%	-
Gross profit	3,278.1	6,361.3	6393.3	-0.5%
<b>YoY growth</b>	15.8%	21.3%	21.9%	-
Operating profit	811.2	1,510.8	1,489.6	1.4%
<b>YoY growth</b>	9.9%	10.4%	8.8%	-
Net profit	547.0	1,029.6	1,041.4	-1.1%
<b>YoY growth</b>	11.0%	10.4%	11.6%	-
Gross profit margin	59.0%	59.8%	60.1%	
Operating profit margin	14.6%	14.2%	14.0%	
Net profit margin	9.8%	9.7%	9.8%	

Source: Company data, , ABCI Securities estimates



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ABCI SECURITIES COMPANY LIMITED

Daphne International Holdings Limited

### Daphne financial summary

#### Consolidated Income Statement

FY ended at 31 Dec (HK\$ mn)	2010A	2011A	2012F	2013F	2014F
Turnover	6,623.9	8,576.8	10,637.7	12,538.1	14,929.3
Cost of sales	(2,823.0)	(3,333.0)	(4,276.4)	(5,077.9)	(5,971.7)
Gross profit	3,800.9	5,243.8	6,361.3	7,460.2	8,957.6
Selling & Distribution Expenses	(2,485.4)	(3,366.3)	(4,233.8)	(5,015.2)	(5,971.7)
Administrative expenses	(444.4)	(556.0)	(691.5)	(812.8)	(970.4)
Other income	88.9	121.4	74.7	74.7	74.7
Other (losses)/gains	11.7	(74.2)	0.0	0.0	0.0
EBITDA	1,114.0	1,554.4	1,739.2	1,994.1	2,436.4
D & A	142.2	185.9	228.4	287.3	346.2
EBIT	971.8	1,368.6	1,510.8	1,706.8	2,090.2
Finance income	0.0	0.0	0.0	0.0	0.0
Finance costs	(44.8)	(46.9)	(50.0)	(46.5)	(46.5)
Fair value loss on derivative financial instrument-warrants	(77.3)	0.0	0.0	0.0	0.0
Share of profit of an associated company	0.6	0.4	(30.0)	0.0	0.0
Profit before taxation	850.3	1,322.1	1,430.8	1,660.3	2,043.7
Income tax	(238.6)	(377.4)	(389.2)	(456.6)	(562.0)
Profit for the year	611.7	944.7	1,041.6	1,203.7	1,481.7
Minority interests	16.1	11.7	12.0	12.0	12.0
Profit Attributable to Equity Holders of the Company	595.6	933.1	1,029.6	1,191.7	1,469.7
EPS (HK\$)	0.364	0.570	0.625	0.723	0.892
Diluted EPS (HK\$)	0.319	0.498	0.546	0.631	0.779
Dividend	196.5	278.8	308.9	357.5	440.9
DPS (HK\$)	0.120	0.170	0.188	0.217	0.268

Source: Daphne, ABCI Securities estimates



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**Consolidated Balance Sheet**

<b>As of 31 Dec (HK\$ mn)</b>	<b>2010A</b>	<b>2011A</b>	<b>2012F</b>	<b>2013F</b>	<b>2014F</b>
Non-current assets	1,123.3	1,446.7	1,706.4	1,955.7	2,180.9
Intangible assets	129.9	129.9	135.4	140.2	144.5
Land use rights	50.3	51.2	62.1	72.7	83.1
Fixed assets	710.9	899.7	1,155.0	1,352.2	1,491.3
Others	232.2	366.0	353.9	390.6	461.9
Current assets	3,925.8	5,054.7	5,562.4	6,529.4	7,708.4
Inventories	1,084.3	2,058.5	2,442.9	2,635.0	3,052.3
Trade receivables	210.4	274.3	326.9	381.7	462.1
Other receivables, deposits and prepayments	571.4	926.1	846.9	1,242.8	1,245.4
Pledged bank deposit	0.0	0.0	0.0	0.0	0.0
Bank deposit with maturity over three months	35.4	0.0	0.0	0.0	0.0
Cash and cash equivalents	2,024.3	1,795.7	1,945.7	2,269.8	2,948.6
Current liabilities	1,160.5	1,640.2	1,617.1	1,950.6	2,242.6
Trade payables	577.9	819.1	973.4	1,155.1	1,348.0
Other payables and accrued charges	372.0	563.5	636.7	788.5	887.6
Income tax payable	199.3	250.6	0.0	0.0	0.0
Bank loans	11.3	7.0	7.0	7.0	7.0
Derivative financial instrument – warrants	0.0	0.0	0.0	0.0	0.0
Non-current liabilities	581.0	629.6	629.6	629.6	629.6
Convertible bonds	556.6	605.9	605.9	605.9	605.9
Others	24.3	23.7	23.7	23.7	23.7
Total equity	3,307.6	4,231.6	5,022.1	5,904.9	7,017.1
Equity attributable to equity holders of the Company	3,124.3	4,035.9	4,826.3	5,709.2	6,821.3
Minority interests	183.3	195.8	195.8	195.8	195.8
Book value per share (HK\$)	1.675	2.154	2.557	3.025	3.614

Source: Daphne, ABCI Securities estimates



**Consolidated Cash Flow Statement**

<b>Yr end 31 Dec (HK\$ mn)</b>	<b>2010F</b>	<b>2011A</b>	<b>2012F</b>	<b>2013F</b>	<b>2014F</b>
Profit before taxation	850.3	1,322.1	1,430.8	1,660.3	2,043.7
Depreciation & Amortization	142.2	185.9	228.4	287.3	346.2
Interest expense	44.8	46.9	46.5	46.5	46.5
(Interest income)	(37.2)	(63.1)	(63.1)	(63.1)	(63.1)
Others	138.2	121.1	30.0	0.0	0.0
Working capital change	18.4	(1,002.8)	(130.3)	(309.4)	(208.2)
Income tax paid	(264.4)	(367.3)	(639.8)	(456.6)	(562.0)
Net cash generated from operating activities	892.4	242.6	902.5	1,165.0	1,603.1
Capex	(281.3)	(393.7)	(500.0)	(500.0)	(500.0)
Others	52.1	70.9	63.1	63.1	63.1
Net cash used in investing activities	(229.2)	(322.7)	(436.9)	(436.9)	(436.9)
Dividend paid	(184.4)	(234.8)	(308.9)	(357.5)	(440.9)
Other investing activities	(51.7)	(7.2)	(6.9)	(46.5)	(46.5)
Net cash generated from/(used in) financing activities	(236.1)	(242.0)	(315.8)	(404.0)	(487.4)
Net increase in cash	427.1	(322.1)	149.9	324.1	678.8
Cash at beginning of year	1,544.9	2,024.4	1,795.8	1,945.7	2,269.8
Effect on foreign exchange	52.4	93.5	0.0	0.0	0.0
Cash at end of year	2,024.4	1,795.8	1,945.7	2,269.8	2,948.6

**Key Financial Ratios**

<b>Yr end 31 Dec</b>	<b>2010A</b>	<b>2011A</b>	<b>2012F</b>	<b>2013F</b>	<b>2014F</b>
Revenue growth	13.6%	29.5%	24.0%	17.9%	19.1%
Net profit growth	51.2%	56.7%	10.4%	15.7%	23.3%
Gross margin	57.4%	61.1%	59.8%	59.5%	60.0%
Operating margin	14.7%	16.0%	14.2%	13.6%	14.0%
Net profit margin	9.0%	10.9%	9.7%	9.5%	9.8%
ROAE	21.5%	24.8%	22.3%	21.8%	22.7%
ROAA	13.3%	16.2%	15.0%	15.1%	16.0%
Inventory turnover days	128	172	192	183	174
Account receivable days	11	10	10	10	10
Account payable days	62	76	76	76	76
Net cash/ equity	60.9%	42.3%	38.6%	38.3%	41.9%
Dividend payout ratio	33.0%	29.9%	30.0%	30.0%	30.0%
Dividend yield	-	2.1%	2.3%	2.6%	3.3%

Source: Daphne, ABCI Securities estimates



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