



Data

Price (22/03/2012)	HK\$2.33
Issued shares	2,000mn
Market cap	HK\$4,660mn
Free float ratio	25%
52week high/low	HK\$2.44/1.54

Major shareholders:

- Chen Yixi-Chairman (36.59%)
- Li Wei-CEO (20.01%)
- Miao Bingwen(18.4%)

Stock performance

	1M	3M	YTD
1028 HK Equity	-2.5%	33.1%	19.5%
HSI Index	-3.0%	13.7%	13.4%
HSCICG Index	2.4%	11.3%	12.7%



Source: Bloomberg

Disclosure:

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Analyst:

Judy Hu (judyhu@abci.com.hk)
Tel: (852) 21478310

Hongguo International (1028) – BUY

(12 mth target HK\$2.85)

Solid growth ahead

Sales and net profit in line

Hongguo(1028) released its FY 2011 annual results. Its sales grew by 29.8% yoy to Rmb 2,044 mn. Its net profit grew by 70.8%yoy to Rmb 290 mn (FD EPS Rmb 0.145, up 45.2%YoY), in line with our expectation. The gross profit margin and net profit margin were 63.5%(+1.8ppt) and 14.2% (+3.3%ppt) respectively due to efficient cost control. Hongguo proposed a final DPS of Rmb 0.032, representing a 2.21% dividend yield.

Inventory turnover days went up

Its inventory turnover days surged to 238 days in 2011 from 200 days in 2010 due to mismatch of winter seasonal sales and management expectation. By the end of 2011, its inventory reach Rmb 561.84 mn. Slow-moving goods will tie up financial resources and obsolete risk of inventory is high.

Valuation:

We rise 12M target price at HK\$ 2.85, based on 12.6x FY 2012PE and 10.0x FY 2013PE, representing 61% discount with Belle(1880) of 20.3 FY 2012 PE and 21% discount with Daphne(210) of 15.3FY 2012 PE. As its profitability is in line with peers Belle(1880) and Daphne(210) , we expect the valuation is reasonable due to its small business scale.

Risk: 1)High execution risk on new brand;2)Lack of stock liquidity.

Financial highlights

Yr ended Dec31(Rmb mn)	2011	2012 F	2013 F	2014 F
Revenue	2,044	2,733	3,468	4,279
Chg (yoy)	29.76%	33.71%	26.89%	23.41%
Gross profit	1,298	1,694	2,150	2,653
Chg (yoy)	33.53%	30.50%	26.89%	23.41%
Net Income	290	369	469	578
Chg (yoy)	70.84%	27.33%	26.89%	23.41%
Diluted EPS(Rmb)	0.145	0.185	0.234	0.289
Chg (yoy)	45.21%	27.33%	26.89%	23.41%
P/E(x)	13.16	10.34	8.15	6.61
DPS(Rmb)	0.032	0.037	0.047	0.058
Dividend yield	2.21%	2.53%	3.21%	3.96%

Source: Hongguo, ABCI Securities;@Forex:HK\$1.22/Rmb

Hongguo International Holdings Limited

We participated in Hongguo FY 2011 annual results conference.

Key takeaways:

1) Management expect that same store sales growth (SSSG) in 1Q 2012 may be less than 10% due to weak sales growth in the first 2 months. The sales gradually recover in Mar 2012. Management guided a 10% SSSG for this year as ASP growth may slow down to 5% in 2012 compared with 14% in 2011. In other words, the management expects low single digit volume growth in same store basis.

2) The group plans to control inventory risk by fasten sales and enhance operating efficiency. Management target to low inventory turnover day to 200-220 days in 2012. If this is the case, we expect to see the group to cut prices to dump its slow moving goods in foreseeable future.

3) The group will further expand its retail outlets by opening approx. 200-300 proprietary outlets and 100 third-party outlets in 2012. Hence, major growth driver is the expansion of outlets. However, working capital required to keep inventory in the outlets will increase. The group will exhaust financial resources rapidly if the inventory turnover days stay at high level.

4) The new brand "Sundance" lauched on August of 2011 expanded rapidly than expectation. At the end of 2011, the group has opened 100 stores on "Sundance". Management guided it will open 100 more stores on "Sundance". Sales from "Sundance", which was launched in August, recorded a sales of Rmb 17.1 mn in Aug - Dec and account for 1.1% of total retail sales for FY2011. We expect "Sundance" will contribute more revenue in this year due to rapid expansion.

5) The company will launch two new brand this year to divercify its brand portfolio and strength its muti-brand strategy to increase market share in mid-high-end women's footwear market in China. We believe new brands will balance the proportion of each brand in sales as we see "C.banner" account for 69.9% of total retail sales in 2011.

FY 2011 Financial results

(Rmb mn)	FY 2011	Our forecasts	Difference
Revenues	2,044	2,044	0.0%
Pretax profit	405	382	6.1%
Net profit	290	286	1.5%
EPS(Rmb)	0.145	0.143	1.4%

Source: Hongguo, ABCI Securities

Earnings revision and assumptions change

We revised our SSSG to 9.5% and 9% in 2012 and 2013 to factor in the weak sales growth in 1Q 2012 and slower down of ASP growth. We expect the group to open 350 and 395 new stores in 2012 and 2013, representing a 20.0%yoy and 18.8%yoy respectively.



Earnings revisions-FY 2012/2013

(Rmb mn)	FY 2012			FY 2013		
	New	Old	Difference	New	Old	Difference
Revenues	2,733	2,600	5.1%	3,468	3,293	5.3%
Pretax profit	493	509	-3.2%	625	645	-3.1%
Net profit	369	382	-3.3%	469	483	-3.0%
EPS(Rmb)	0.18	0.191	-3.3%	0.234	0.242	-3.2%

Source: Hongguo, ABCI Securities

Key operating assumptions

	2010	2011	2012F	2013F	2014F
SSSG(%)	17.7%	14.60%	9.50%	9.00%	8.00%
Total stores No.	1,045	1,748	2,098	2,493	2,853
New stores added	117	459	350	395	360

Business segment breakdown as % of total sales

	2010	2011	2012F	2013F	2014F
Retail	75.7%	76.10%	78%	80%	81%
Wholesale	9.6%	12.54%	12.61%	12.73%	11.60%
OEM	14.7%	11.54%	9.06%	7.50%	6.38%

Source: Hongguo, ABCI Securities

Peers comparison-FY 2011

	Belle(Footwear)	Daphne	*Hongguo
Code	1880 HK	210 HK	1028 HK
Market positioning	Mid-to-high end	Mid end/Low end	Mid-to-high end
Operation statistics			
No.of stores	10,270	6,165	1,748
New store growth	23.6%	18.6%	35.6%
Same store sales growth	15%	21%(core brands)	14.6%
Financial data			
Inventory turnover days	202	172	238
AR turnover days	31	10	38
AP turnover days	35	68	81
2011 Revenue (Rmb mn)	28,945	8,577	2,044
yoy growth	22.1%	29.5%	29.8%
2011 Net profit (Rmb mn)	4,255	933	290
yoy growth	24.2%	56.7%	70.8%
Gross profit margin	57.2%	61.1%	63.5%
Net profit margin	14.7%	10.9%	14.2%
ROAE	23.1%	24.7%	28.4%
ROAA	18.3%	16.2%	21.3%

Source: Belle, Daphne, Hongguo, ABCI Securities



Valuation

Code	Name	Market cap(HK\$ mn)	Price(HK\$)	2012 PE	2013 PE
1880	Belle	123,477	14.64	20.3	17.0
210	Daphne	16,980	10.34	15.3	12.6
1836	Stella	14,346	18.06	10.7	9.0
1028	Hongguo	4,660	2.33	10.3	8.2

Source: Bloomberg, ABCI Securities



Hongguo Income statement

Yr ended Dec31 (Rmb mn)	2010	2011	2012 F	2013 F	2014 F
Continuing operations:					
Sales	1,575	2,044	2,733	3,468	4,279
Cost of sales	(603)	(745)	(1,038)	(1,318)	(1,626)
Gross profit	972	1,298	1,694	2,150	2,653
Selling and distribution expense	(653)	(818)	(1,093)	(1,387)	(1,712)
Administrative expense	(85)	(74)	(109)	(139)	(171)
Other income	9	3	4	4	4
EBIT	235	406	492	624	770
Finance cost	(1)	(2)	(2)	(2)	(2)
Share of loss of a joint venture	(3)	(2)	(2)	(2)	(2)
PBT	240	405	493	625	771
Taxation	(68)	(115)	(123)	(156)	(193)
Net Income from continuing operations	172	290	369	469	578
Discontinued operations	(2)	0	0	0	0
Net profit attributable to equity holders of the co.	170	290	369	469	578
Non-controlling interests	0	0	0	0	0
Diluted EPS(Rmb)	0.100	0.145	0.185	0.234	0.289
Dividend	192	64	74	94	116
DPS(Rmb)	0.113	0.032	0.037	0.047	0.058
Shares outstanding(mn)	1,700	1,700	2,000	2,000	2,000
Dividend payout ratio(%)	113%	22%	20%	20%	20%
Growth&Margin					
	2010	2011	2012 F	2013 F	2014 F
Sales growth(yoy)	22.57%	29.76%	33.71%	26.89%	23.41%
Gross profit growth(yoy)	49.31%	33.53%	30.50%	26.89%	23.41%
Net profit growth(yoy)	113.30%	70.84%	27.33%	26.89%	23.41%
EPS growth(yoy)	113.30%	45.21%	27.33%	26.89%	23.41%
Gross profit margin	61.73%	63.53%	62.00%	62.00%	62.00%
EBIT margin	14.89%	19.87%	18.00%	18.00%	18.00%
Net profit margin	10.78%	14.20%	13.52%	13.52%	13.51%

Source: Hongguo, ABCI Securities estimates



Disclosures

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**Office address: ABCI Securities Company Limited, 13/F Fairmont House, 8 Cotton Tree Drive, Central, Hong Kong.
Tel: (852) 2868 2183**