Belle International (1880 HK) - BUY

Price (14 Feb 2014)	HK$ 8.37
Target Price	HK$ 10.05
Upside %	20%
Rating	BUY
ADTV	HK$ 201,048,069
Outstanding Shares	8434.2 mil
Market Cap	HK$ 70,848 mil
52 Week Range	HK$8.00 – HK$18.58

➢ Business Profile

Belle International Holdings Limited is engaged in the manufacturing, distribution and retail sales of shoes and footwear products.

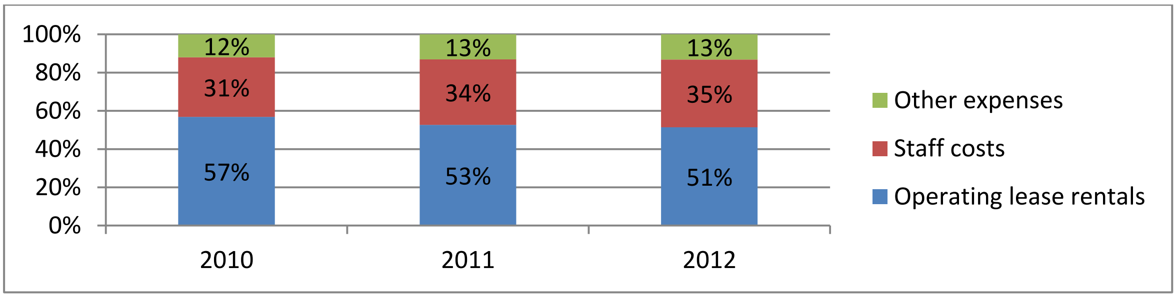
Belle owns 10 footwear brands such as Belle, Teenmix, Tata and Staccato, and is the agent for 8 well-known international brands like Bata, Clarks and BCBG. It directly manages and controls an extensive nationwide retail distribution network. Currently, there are 19,077 retail outlets (13,183 footwear outlets and 5,894 sportswear outlets) across China and 155 outlets in Hong Kong and Macau.

Revenue Segments

Business Segments	Business Model
Footwear (64% of total revenue in 2012)	- Vertically integrated business model for company-owned brands; covers product design and development, procurement, production, marketing and promotion, distribution and retail capabilities. - Retail distribution of international brands
Sportswear (36% of total revenue in 2012)	- Retail distribution - First-tier sportswear brands - Nike and Adidas, Second-tier sportswear brands - PUMA, Mizuno, Converse.

Cost Breakdown

Cost Breakdown (as % of total expense) from 2010 - 2012



Source: Company

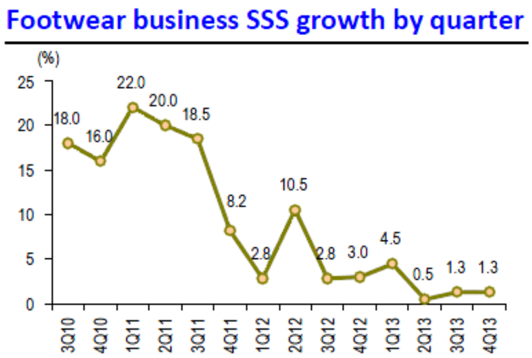
➢ Upside/Downside Risks

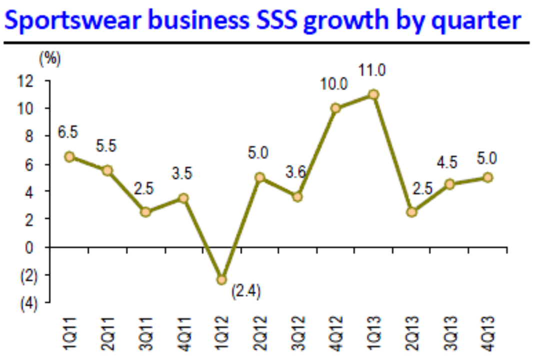
<u>**Company-specific Risks**</u>

Strong presence in Chinese footwear market: Leading footwear and sportswear retailer in China with an extensive reach of supply chain network and logistics (more than 100 distribution centres and 19,000 retail outlets across China). Targeted both mid-range and premium brands with a variety of portfolio.

Rising operational expenses: Margins can be compressed going forward as operational expenses continue to rise from inflationary pressures. Staff costs can be expected to continue to rise in China (staff costs risen from 31% in 2010 to 35% in 2012), and increasing rental rates in Hong Kong.

Improvements in SSSG growth trend: Retail business in China temporarily under pressure which resulted 2013 SSSG growth to weaken and management may be more conservative on future store plans. However, Belle's SSSG growth and stores expansion can sustain if there is positive market sentiment in Chinese retail market.





Source: Company, broker reports

Industry-specific Risks

Weak macroeconomic environment: Weak macroeconomic outlook and negative market sentiment can drive growth down and makes the Chinese footwear industry a challenging environment to operate in. Cyclical industry that is highly dependent on consumer demand and revenues can continue to suffer if economy outlook does not pick up.

Competition with e-commerce brands: Industry is facing increase competition from e-commerce channels since consumers can now easily switch to e-commerce channels to save time and for convenience. Moreover, they can be cost efficient since they need not have to spend much on rental expense. However, e-commerce may not footwear retailers that much as footwear products generally require consumers to have a direct experience of trying the products before purchasing it.

Geographical Risks

Focus on China's second and third-tier cities: In the short term, Belle's store expansion in China's second and third-tier cities may affect Belle's revenue growth as average income and purchasing power are lower than China's major cities. In the long term, view store expansion in these cities to be positive as the growth in middle income class can drive SSSG.

➢ **Key Themes**

Well-positioned to take advantage of potential growth and opportunities: Expand portfolio of brands and integrate acquired brands as part of growth strategy to create synergies. Recent acquired brands in 2012/2013 complement the group's portfolio.

- Acquired Long Hao, which is engaged in the sales and distribution of footwear products, leather bags and suitcases in China and also owns and operates certain self-owned brands including SKAP, a well-known footwear and leather goods brand in China. Acquisition enables Belle to own and operate a self-owned brand in the high-end casual footwear sector.
- Bought Baroque Japan (31.96% stake for cost of ¥9 billion). Provides Belle the scope to expand beyond footwear products into apparel and accessories, and to expand into the Japanese market for its Chinese footwear shoe brands.
- Acquired Big Step a retailer of Nike and Adidas sportswear in China to drive growth in Belle's sportswear segment.

China's economic growth and rising incomes: China's slowdown in economy is inevitable and future growth rate will moderate in Chinese consumer retail market, however there is income growth and rising consumer base as Chinese policymakers embrace sustainable and higher-quality development.

According to National Bureau of Statistics, rising disposable personal income in China increased to RMB 24,565 in 2012 from RMB 21,810 in 2011. China's disposable income per capital for urban residents increased by 12.6% on nominal basis and real income increased by 9.6%. Therefore, rising disposable income and continued sophistication of Chinese consumers can provide long-term growth potential and increased demand for Belle's footwear and sportswear products for its unique brands positioning, leading R&D initiatives and broad product lines.

Still a highly efficient business

- Established e-commerce channels by creating own online shopping platform (yougou.com) which compliments its flagship store on Alibaba-owned tmall.com, China's largest business-to-customer site.
- Belle's vertically integrated business model for footwear allows it to compete efficiently on product research and design, manufacturing and distribution efficiency and brand positioning. Belle's market leadership in footwear allows it to spread R&D, network expansion and logistics costs over a larger sales base. This strategy helps Belle to shorten manufacturing cycle to 2 months as opposed to its peers which took 6 months. Execution of half-scale production run in early stage of cycle allows it to manage consumer tastes and preferences and make it cost efficient by limiting or expanding investments in new or current products.
- Healthy levels of gross profit margins and net cash flow make Belle's operating ability more cost efficient than peers

➢ **Valuation Assessment**

Market-Based Valuation

Peer Comparison With China's Footwear Retailers

BBERG TICKER	NAME	Local Price HKD	MARKET CAP HKD MIL	P/E (x) 2014 E	P/B (x) 2014 E	ROE (%) 2014 E	EV/EBITDA (x) 2014 E	Divid Yield (%) 2014 E
1880 HK	Belle	8.37	70,848	12.7	2.2	18.17%	7.4	1.18%
210 HK	Daphne	3.79	6,135	16.1	1.3	8.54%	6.6	1.69%
1836 HK	Stella	18.1	14,807	15.9	2.0	12.75%	10.5	4.99%
738 HK	Le Saunda	3.73	2,353	7.8	1.6	17.80%	6.6	4.83%
Average				13.14	1.77	14.00%	7.8	3.17%

Source: Bloomberg

Belle is trading at 12.7x 2014 PER based on Bloomberg consensus. Valuation of Chinese footwear retailers are under pressure based on concerns regarding low earnings visibility and increased competition from e-commerce brands. Belle has higher ROE and is more resilient than peers.

Discounted Cash Flow Valuation (DCF)

Based on DCF model, derive at target price of **HK$ 10.05** assuming WACC of 13.7% and terminal growth rate of 3%. This is an upside of 20% from current price of HK$ 8.37.

Valuation	**RMB mil**
NPV of FCF	11,364
NPV of Terminal Value	38,051
Target Enterprise Value	**49,414**
Less Total Debt	(2,176)
Less Minority Interest	(143)
Add Cash	2,287
Add S/T investment	7,162
Add Associate / JV Investment	604
Add Non Op Asset	8,987
Target Equity Valuation	**66,134**
Weighted no of diluted shares	8,434.2
Target Price	**HK$10.05**

By: L.H.
February 2014