

## BUY

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## Nation-wide player powering its twin engines

Patrick Wong  
 (852)-2532-1915  
[patrickwong@firstshanghai.com.hk](mailto:patrickwong@firstshanghai.com.hk)

➤ **Portfolio diversification:** NWDS currently has 32 stores in 18 major cities in PRC; including 19 self-owned stores and 13 managed stores with a total gross floor area (GFA) of approximately 962,570 sqm. Stores are either named as "New World" or "Ba Li Chun Tian". The widespread of these stores allows the company to reduce the risk of significant earnings fluctuation.

➤ **Twin engines delivering strong growth:** We prefer NWDS because of its benefits from the strong growth of PRC economy and the dramatic surge in retail sales. Combining with the company's strong organic and strategic growths, NWDS can continue to maintain its status as one of the leading department store players in PRC.

➤ **Strong bargaining power:** NWDS has a strong bargaining power over its concessionaires; therefore, it is able to charge a relatively higher commission rate comparing with its peers. During the period of 2005-2007, the commission rates charged by NWDS were 22.15%, 21.52% and 20.21%, which were on the top range in the industry.

➤ **Revenue grows at a CAGR of 14.31% from 2007- 2010:** Based on our financial model, we forecast that the revenue of NWDS grows at a CAGR of 14.31% from 2007- 2010 and its profit attributable to equity holders grows at a CAGR of 18.71% during the same period.

➤ **Investment conclusion:** We initiate coverage on NWDS with a Buy rating and a 12 month target price of HK\$8.79 that implies 50% upside from the current level. We use DCF methodology to value NSWD, with an assumed WACC of 12.89%. Our 12 month target price implies a P/E of 19.59x June 2009E earnings.

➤ **Key risks:** 1) Inability to execute growth strategy and 2) significant slow down in PRC economy and Chinese retails market are key risks to our target price.

|                            |                                   |
|----------------------------|-----------------------------------|
| Industry                   | Department Store                  |
| Price                      | HK\$ 5.85                         |
| Target price               | HK\$ 8.79<br>(+ 50%)              |
| Bloomberg/<br>Reuters code | 825.HK                            |
| Market cap.                | HK\$ 9.77 bn                      |
| O/S shares                 | 1.67 bn                           |
| 52wk high/low              | HK\$ 11.56 / 4.13                 |
| NAV per share              | HK\$ 0.51                         |
| Major shareholder          | New World<br>Development (72.29%) |

### Earning Summary

| Year end 30 June    | 2006 | 2007  | 2008E | 2009E | 2010E |
|---------------------|------|-------|-------|-------|-------|
| Revenue (HKD mn)    | 807  | 1,047 | 1,322 | 1,575 | 1,788 |
| Growth (%)          | 25%  | 30%   | 26%   | 19%   | 13%   |
| Net profit (HKD mn) | 158  | 303   | 393   | 499   | 601   |
| Growth (%)          | 57%  | 92%   | 30%   | 27%   | 21%   |
| EPS (HKD)           | 0.09 | 0.18  | 0.24  | 0.30  | 0.36  |
| P/E (x)             | 61.9 | 32.3  | 24.9  | 19.6  | 16.3  |
| DPS (HKD)           | 0.00 | 0.00  | 0.07  | 0.09  | 0.11  |
| Dividend yield(%)   | -    | -     | 1.2%  | 1.5%  | 1.9%  |

### Price Performance



Source: Company information, FSSL

Source: Bloomberg

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## Background of New World Department Store

NWDS is a mid to high end nation wide department stores owner and operator, with 19 self-owned stores and 13 managed stores.

New World Department Store (NWDS) was established in 1993 and was listed on the Hong Kong Stock Exchange in July 2007. It is one of the largest department stores owner and operator with extensive national network in PRC.

NWDS currently operates 32 stores with a total gross floor area of approximately 962,570 sqm in 18 major cities in PRC, including Beijing, Shanghai, Shenyang and Wuhan. Of these 32 stores, 19 are self-owned stores (stores owned and managed by NWDS) and 13 are managed stores (stores owned by third parties, but managed by NWDS). In addition, stores are either named as "New World" or "Ba Li Chun Tian". "Ba Li Chun Tian" brand is only used in Shanghai; this is to avoid the confusion with "Xin Shi Jie" department store, which carries the same Chinese characters as NWDS but is operated by independent third party.

NWDS offers a wide variety of merchandise including fashion, accessories, jewellery and cosmetics, and targets at the consumers with high purchasing power in the mid to high end retails market in PRC.

Figures 1 and 2 show the products and the brands (both international and domestic) offered by NWDS.

Figure 1: NWDS merchandise mix

| Category   | Main products  |
|--|--|
| Ladieswear and accessories                             | Ladieswear, underwear, fur, leather, ladies' accessories, shoes, handbags, gold, fine and custom jewellery, beauty and skincare products.  |
| Menswear and accessories                               | Menswear, casual wear, underwear, handbags, shoes and accessories.   |
| Kidswear and kids' goods, sportswear and sport's goods | Kid's wear and accessories, baby wear and goods, sportswear and goods.   |
| Watches, gifts and stationery                          | Watches, clocks, optical goods, stationery, Chinese art and craft, gifts and toys.   |
| Household items and electrical goods                   | Household items, bedding, home accessories, furniture, home and personal electrical appliances, electronic goods, healthcare equipment, photographic equipment, sports equipment, audio and video systems. |
| Groceries and perishables                              | Food, liquor, wine and tobacco.  |

Source: Company data

Figure 2: International and domestic brands

| <b>Fashion</b>                                |                     |                   |
|---|---------------------|-------------------|
| Burberry                                      | Aquascutum          | Ermenegildo Zegna |
| Daks  | Alfred Dunhill      | Cerruti 1881      |
| Hugo Boss                                     | Nike                | Vicutu            |
| Autason                                       | Carlo Castello      | Leo               |
| Espirit                                       | Ports International | Only              |
| Etam  | Exception           | E. Land           |
| <b>Accessory</b>                              |                     |                   |
| Chow Tai Fook                                 | Time City           | Belle             |
| Le Saunda                                     | Walker Shop         | Fed               |
| <b>Cosmetics</b>                              |                     |                   |
| Lancome                                       | Olay                | Christian Dior    |
| Shiseido                                      | Aupres              | L'oreal           |
| <b>Household, electrical goods and others</b> |                     |                   |
| Osim  | Aussino             | Toyohya           |
| A-Fontane                                     | Sheridan            |                   |

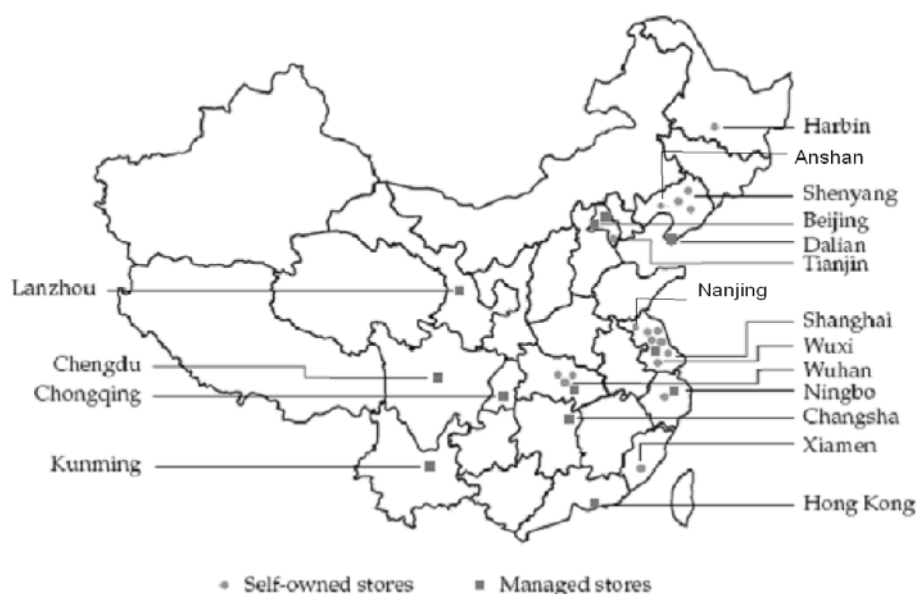
Source: Company data

## NWDS stores analysis

NWDS is one of the two department stores players which operates and manages stores on a national basis (the other player is Parkson Retail). It currently operates and manages 32 stores in 18 major cities in PRC.; including Anshan, Beijing, Changsha, Chengdu, Chongqing, Dalian, Harbin, Hong Kong, Kunming, Lanzhou, Nanjing, Ningbo, Shanghai, Shenyang, Tianjin, Wuhan, Wuxi and Xiamen.

Its stores are mainly located in 6 regions, which are Northeastern China, Northern China, Eastern China, Central China, Southern China and Southwestern China.

Figure 3: NWDS stores location



Source: Company data, FSSL

Cities such as Beijing, Shanghai, Ningbo, Nanjing, Wuxi and Tianjin, where NWDS has presence, have relatively high disposal income per capita. For instance, the disposal income per capita in the first quarter of 2008 for Beijing, Shanghai, Zhejiang province, Jiangsu province and Tianjin were RMB 6,490, RMB 7,650, RMB 7,459, RMB 5,554, and RMB 4,749.4; which were higher than the national's average urban disposal income per capita of RMB 4,386. High disposable income implies greater consumption power on luxury goods, which should benefit NWDS.

Also, most of the NWDS stores are located in cities or provinces where GRP per capita and disposal income growth were high (please refer to figure 4).

Figure 4: PRC GRP per capita and disposal income

| <u>City/<br/>Province</u> | <u>GRP<br/>per capita<br/>rank</u> | <u>Disposable<br/>income per<br/>capita rank</u> | <u>Disposal<br/>income<br/>03-05<br/>CAGR</u> | <u>No of<br/>NWDS<br/>stores</u> |
|---------------------------|------------------------------------|--|---|----------------------------------|
| Shanghai                  | 1                                  | 1  | 12.0%   | 7                                |
| Beijing                   | 2                                  | 2  | 12.8%   | 3                                |
| Tianjin                   | 3                                  | 5  | 10.7%   | 1                                |
| Zhejiang                  | 4                                  | 3  | 11.2%   | 3                                |
| Jiangsu                   | 5                                  | 7  | 15.3%   | 1                                |
| Liaoning                  | 8                                  | 15   | 12.2%   | 5                                |
| Fujian                    | 9                                  | 6  | 11.0%   | 1                                |
| Heilongjiang              | 12                                 | 24   | 11.3%   | 1                                |
| Hubei                     | 16                                 | 18   | 9.5%  | 5                                |
| Chongqing                 | 18                                 | 9  | 12.5%   | 1                                |
| Hunan                     | 20                                 | 10   | 11.4%   | 1                                |
| Sichuan                   | 26                                 | 23   | 9.1%  | 1                                |
| Yunan                     | 29                                 | 13   | 10.1%   | 1                                |
| Gansu                     | 30                                 | 29   | 10.2%   | 1                                |

Source: Company data, China Statistics Yearbook 2006

Among the 32 stores, 19 are self-owned stores (stores owned and managed by NWDS) and 13 are managed stores (stores owned by third parties but managed by NWDS). In addition, stores are either named as "New World" or "Ba Li Chun Tian". "Ba Li Chun Tian" brand is only used in Shanghai; this is to avoid the confusion with "Xin Shi Jie" department store, which carries the same Chinese characters as NWDS but is operated by independent third party.

### Store age

The average store age for all stores is 5.3 years. Whereas, self-owned stores and managed stores have an average age of 6.5 and 3.6 years respectively. As the average store age is young, high organic growth potential can be seen from NWDS. In general, stores take 1-3 years to achieve break-even and will enjoy a high growth period from the 4<sup>th</sup> to 7<sup>th</sup> years.

### Size of stores

The total GFA of all stores is 962,570 sqm; self-owned stores account for 506,270 sqm and

managed stores account for 456,300 sqm. The average sizes for self-owned stores and managed stores are 26,646 sqm and 35,100 sqm respectively.

### Concessionaire sales per sqm

Moreover, the concessionaire sales per sqm for self owned stores in 2007 were HK\$ 8,514 per sqm, which represented a growth of 12.3% over the same period last year. We expect this growth rate can be maintained at 7-8% until 2010.

Figure 5: NWDS stores analysis

| Region                   | Province     | Stores                         | Commencement Date | Management Date | Yrs of Ops         | GFA (sq.m) | OFA (sq.m) |         |
|--------------------------|--------------|--------------------------------|-------------------|-----------------|--------------------|------------|------------|---------|
| <b>Self-owned stores</b> |              |                                |                   |                 |                    |            |            |         |
| Northeast                | Tianjin      | Tianjin                        | Oct-1997          |                 | 10.9               | 56,000     | 31,600     |         |
| Northeast                | Liaoning     | Anshan                         | Oct-2007          |                 | 0.9                | 35,000     |            |         |
| Northeast                | Heilongjiang | Harbin                         | Nov-1996          |                 | 11.8               | 32,000     | 19,000     |         |
| Northeast                | Liaoning     | Shenyang Nanjing Street Branch | Nov-1995          |                 | 12.8               | 13,890     | 10,800     |         |
| Northeast                | Liaoning     | Shenyang Taiyuan Street Branch | Aug-2000          |                 | 8.0                | 10,800     | 7,200      |         |
| Northeast                | Liaoning     | Shenyang Zhonghua Road Branch  | Dec-2005          |                 | 2.7                | 44,000     | 31,100     |         |
| Northeast                | Liaoning     | Shenyang Zhong Street Branch   | 2010              |                 |                    | 32,500     |            |         |
| East                     | Jiangsu      | Nanjing                        | Nov-2007          |                 | 0.8                | 30,000     |            |         |
| East                     | Zhejiang     | Ningbo                         | Apr-1998          |                 | 10.4               | 10,000     | 7,800      |         |
| East                     | Shanghai     | Shanghai Changning Branch      | Sep-2004          |                 | 4.0                | 6,680      | 5,600      |         |
| East                     | Shanghai     | Shanghai Hongkou Branch        | Oct-2003          |                 | 4.9                | 19,600     |            |         |
| East                     | Shanghai     | Shanghai Huaihai Branch        | Dec-2001          |                 | 6.7                | 22,500     | 17,300     |         |
| East                     | Shanghai     | Shanghai Xinning Branch        | Jan-2002          |                 | 6.6                | 21,000     | 15,500     |         |
| East                     | Shanghai     | Shanghai Qibao Branch          | Dec-2005          |                 | 2.7                | 36,550     | 24,400     |         |
| East                     | Jiangsu      | Wuxi                           | Jan-1996          |                 | 12.6               | 18,600     | 9,800      |         |
| Central                  | Hubei        | Wuhan                          | Nov-1994          |                 | 13.8               | 42,000     | 30,000     |         |
| Central                  | Hubei        | Wuhan Trendy Plaza             | Dec-2001          |                 | 6.7                | 23,000     | 18,500     |         |
| Central                  | Hubei        | Wuhan Wuchang Branch           | Oct-2005          |                 | 2.9                | 22,650     | 16,700     |         |
| Central                  | Hubei        | Wuahn Qiaokou Branch           | Sep-2006          |                 | 2.0                | 42,000     | 30,000     |         |
| Central                  | Hubei        | Wuahn HangYang Branch          | End of 2008       |                 |                    | 53,000     |            |         |
| Central                  | Fujian       | Xiamen                         | Sep-2006          |                 | 2.0                | 20,000     | 14,800     |         |
|                          |              |                                |                   |                 | <b>Avg</b>         | 6.5        | 28,180     | 18,131  |
|                          |              |                                |                   |                 | <b>Total</b>       |            | 591,770    | 290,100 |
| <b>Managed stores</b>    |              |                                |                   |                 |                    |            |            |         |
| North                    | Beijing      | Beijing Shopping Mall          | Jul-1998          | Jul-1998        | 10.1               | 93,000     | 53,300     |         |
| North                    | Beijing      | Beijing Trendy Store           | Mar-2007          | Mar-2007        | 1.5                | 39,400     | 19,000     |         |
| North                    | Beijing      | Beijing Liying Store           | End 2008 (Est)    |                 | -                  | 52,000     |            |         |
| North                    | Gansu        | Lanzhou                        | Sep-2005          | Sep-2005        | 3.0                | 27,200     | 22,000     |         |
| Northeast                | Liaoning     | Dalian                         | Nov-2002          | Jul-2006        | 5.8                | 32,000     | 24,400     |         |
| East                     | Zhejiang     | Ningbo Trendy                  | Nov-2004          | Jan-2007        | 3.8                | 10,600     | 9,800      |         |
| East                     | Shanghai     | Shanghai Pujian                | Sep-2007          | Sep-2007        | 1.0                | 46,000     |            |         |
| East                     | Shanghai     | Shanghai Wujiaochang Branch    | Dec-2006          | Dec-2006        | 1.7                | 44,000     | 35,200     |         |
| Central                  | Hunan        | Changsha Trendy Plaza          | Sep-2006          | Sep-2006        | 2.0                | 35,000     | 23,500     |         |
| Central                  | Hubei        | Wuhan Xudong                   | Jan-2008          | Jan-2008        | 0.6                | 30,000     |            |         |
| South                    | Hongkong     | Hong Kong                      | Apr-1999          | Jul-2006        | 9.4                | 15,000     | 10,500     |         |
| Southwest                | Sichuan      | Chengdu                        | Dec-2006          | Dec-2006        | 1.7                | 29,500     | 21,000     |         |
| Southwest                | Chongqing    | Chongqing                      | Sep-2006          | Sep-2006        | 2.0                | 42,000     | 34,400     |         |
| Southwest                | Yunnan       | Kunming                        | Jan-2004          | Jan-2007        | 4.2                | 12,600     | 8,300      |         |
|                          |              |                                |                   |                 | <b>Avg</b>         | 3.6        | 36,307     | 23,764  |
|                          |              |                                |                   |                 | <b>Total</b>       |            | 508,300    | 261,400 |
|                          |              |                                |                   |                 | <b>Grand avg</b>   | 5.3        | 31,431     | 20,426  |
|                          |              |                                |                   |                 | <b>Grand total</b> |            | 1,100,070  | 551,500 |

Source: Company data, FSSL.

## Business model

Similar to other PRC department stores operators, NWDS generates most of its revenue from the following areas: 1) concessionaire income, 2) direct sales, 3) leasing of properties and 4) management of third parties stores.

Figure 6: Sources of revenue



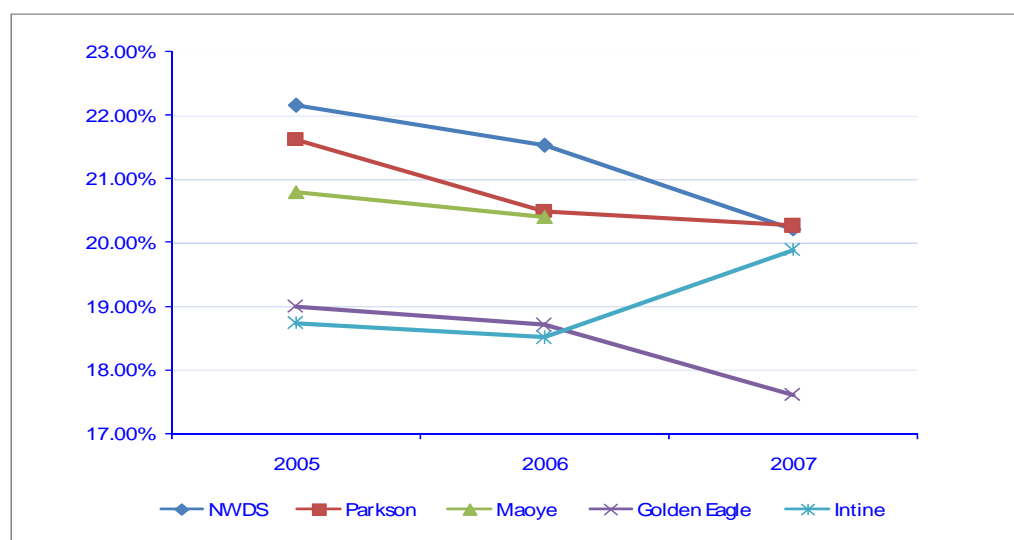
Source: Company data, FSSL

### Concessionaire income

Under this arrangement, NWDS allows suppliers of various brands, known as concessionaires, to occupy designated areas and sell their products within the stores of NWDS. In return, NWDS charges these concessionaires a commission rate, which is based on an agreed percentage of gross sales proceeds subject to an agreed minimum commission amount depending on 1) the brand recognition of concessionaires, 2) the products provided by concessionaires and 3) the operation and age of relevant stores.

The commission rates charged by NWDS were on the top range among its peers, which were 22.15%, 21.52% and 20.21% for years 2005, 2006 and 2007 respectively. The ability to charge such higher commission rates is due to NWDS's strong bargaining power over and its long term favourable relationship with its concessionaires.

Figure 7: PRC department stores commission rates



Source: Company data, FSSL

The pros of concessionaire model include: 1) minimum inventory risk and 2) lower operating expenses. Concessionaires have sole control over their inventories and NWDS does not bear any inventory risk of concessionaires' goods. Also, concessionaires are responsible for the setup and maintenance costs of counters and their employee expenses. Hence, NWDS incurs a lesser amount of operating expenses.

As this business model is favourable to department stores players, NWDS generates most of its revenue from concessionaire sales. Concessionaire sales accounted for 73%, 77% and 73% of the company's total revenue in 2005, 2006 and 2007 respectively, which represented HK\$ 474.3mn, HK\$ 618.7mn and HK\$ 759.1mn.

We expect the concessionaire sales are still going to be strong in 2008 and 2009. NWDS should be able to achieve a high ten's to mid twenty's double digit growth, which is driven by a significant increase in per square meter sales resulting from the operation of high growth and mature stores. More than half of the self-owned stores are high growth and mature stores (whose ages are greater than 4 years old).

Figure 8: NWDS revenue breakdown

|                           | 2005<br>Ended 30 Jun 05<br>(HK\$ million) | 2006<br>Ended 30 Jun 06<br>(HK\$ million) | 2007<br>Ended 30 Jun 07<br>(HK\$ million) |
|---------------------------|---|---|---|
| <b>Revenue</b>            | 646.86                                    | 806.74                                    | 1,046.88                                  |
| Concessionaire income     | 474.33                                    | 618.72                                    | 759.12                                    |
| Direct sales              | 85.82                                     | 86.70                                     | 116.59                                    |
| Management fees           | 34.03                                     | 44.44                                     | 106.45                                    |
| Rental income             | 52.68                                     | 56.88                                     | 64.72                                     |
| <b>% of total revenue</b> | 100%                                      | 100%                                      | 100%                                      |
| Concessionaire income     | 73%                                       | 77%                                       | 73%                                       |
| Direct sales              | 13%                                       | 11%                                       | 11%                                       |
| Management fees           | 5%  | 6%  | 10%                                       |
| Rental income             | 8%  | 7%  | 6%  |

Source: Company data, FSSL.

### Direct sales

The second largest revenue generator of NWDS is from direct sales. In relation to direct sales, the company sells merchandises, which are purchased directly from their suppliers, to end consumers. Merchandises sold under this business model generally offer higher profit margin, and they include cosmetic products, accessories, handbags and Beijing Olympics products.

Direct sales contributed approximately 11%-13% of total revenue during the period of 2005-2007. The revenue growth of direct sales in 2007 was recorded at an increase of 34.5% over the previous year, which represented HK\$ 116.6mn.

### Management fees

NWDS also generates income from managed stores. The management fees it charges are based on a fixed management fee and/or an agreed percentage of the store's revenue; for examples, 1.5%-5% of gross sales proceeds or 5%-10% of profit before tax.

This business model allows NWDS to enjoy the upside potential of managed stores with a minimum guaranteed amount of management fees, but without the need to bear any downside risk of these stores. In additions, NWDS can save the costly start up costs of

new department stores.

Some of the managed stores are owned by connected parties, and it is believed that NWDS will acquire these stores once they can reach certain profit level. According to the company, NWDS will acquire the Kunming Store and the Ningbo Trendy Store within 3 years time. The acquisition of these stores should further boost the revenue of NWDS.

### **Strong revenue growth resulting from favourable PRC economy**

We expect the growth of revenue to be around low to mid 20% for years 2008 and 2009 because of the strong growth in PRC economy (GDP growth was 11.4% for 2007 and was 10.6% for the first quarter of 2008) and the continuous improvement in retails sales market (the growth rate of 2007 was 16.75% and the growth rates of the last 4 years were at least 12.9%).

The strong PRC economy growth that raises disposable income of consumers, together with the strong demand of luxury goods by the affluent PRC consumers should have a major positive impact on the sales of NWDS. In addition, we believe that department store is one of the most preferred avenues for consumer spending in PRC.

## Investment opportunities

### Strong growth driven by twin engines

The majority of stores owned and operated by NWDS, have only been in operation for approximately 5 years. Therefore, we see a huge growth potential from these stores. Generally, new stores usually take 2-3 years to breakeven and will start making profit from the 4<sup>th</sup> year onwards. We expect a low to mid 20% of revenue growth for years 2008 and 2009.

In addition to organic growth, the opening and acquisition of department stores will also boost the revenue of NWDS. Up to date, NWDS has already opened and operated an additional 4 stores since its listing on HKEX. According to the company, NWDS expects to open at least 2 extra stores by the end of 2008 in Wuhan and Beijing. These actions demonstrate the ability of NWDS to fulfill its commitments. Furthermore, the newly opened stores will be the main future growth drivers.

### Portfolio diversification

NWDS's extensive network allows it to reduce the risk of significant earnings fluctuation. Unlike other players such as Maoye (848.HK), Intime (1833.HK) and Golden Eagle (3308.HK), which have focuses on Guangdong & Sichuan provinces, Zhejiang province and Jiangsu province respectively; the 32 stores of NWDS are widely spread across 18 major cities in PRC. Sales slowdown in any particular city/ region will not significantly affect the overall revenue of the company.

For instance, if a company earned a majority of revenue from its Sichuan stores; its overall earnings could have dropped substantially during and after the Sichuan earthquake this year.

Figure 9: Location of department stores

| Province     | NWDS      | Parkson   | Maoye     | Golden Eagle | Intime   |
|--------------|-----------|-----------|-----------|--------------|----------|
| Anhui        |           | 1         |           |              |          |
| Beijing      | 2         | 3         |           |              | 1        |
| Chongqing    | 1         | 3         | 2         |              |          |
| Fujian       | 1         |           |           |              |          |
| Gansu        | 1         |           |           |              |          |
| Guangdong    |           | 1         | 4         |              |          |
| Guangxi      |           | 1         |           |              |          |
| Guizhou      |           | 2         |           |              |          |
| Heilongjiang | 1         | 1         |           |              |          |
| Henan        |           | 1         |           |              |          |
| Hong Kong    | 1         |           |           |              |          |
| Hubei        | 5         |           |           |              | 1        |
| Hunan        | 1         | 2         |           |              |          |
| Jiangsu      | 2         | 1         | 1         | 7            |          |
| Jilin        |           | 1         |           |              |          |
| Liaoning     | 5         | 6         |           |              |          |
| Shaanxi      |           | 5         |           | 2            |          |
| Shandong     |           | 3         |           |              |          |
| Shanghai     | 7         | 3         |           |              |          |
| Sichuan      | 1         | 3         | 7         |              |          |
| Tianjin      | 1         | 1         |           |              |          |
| Xinjiang     |           | 1         |           |              |          |
| Yunnan       | 1         | 2         |           | 1            |          |
| Zhejiang     | 2         | 1         |           |              | 7        |
| <b>Total</b> | <b>32</b> | <b>42</b> | <b>14</b> | <b>10</b>    | <b>9</b> |

Source: Company data, FSSL.

## Strong bargaining power

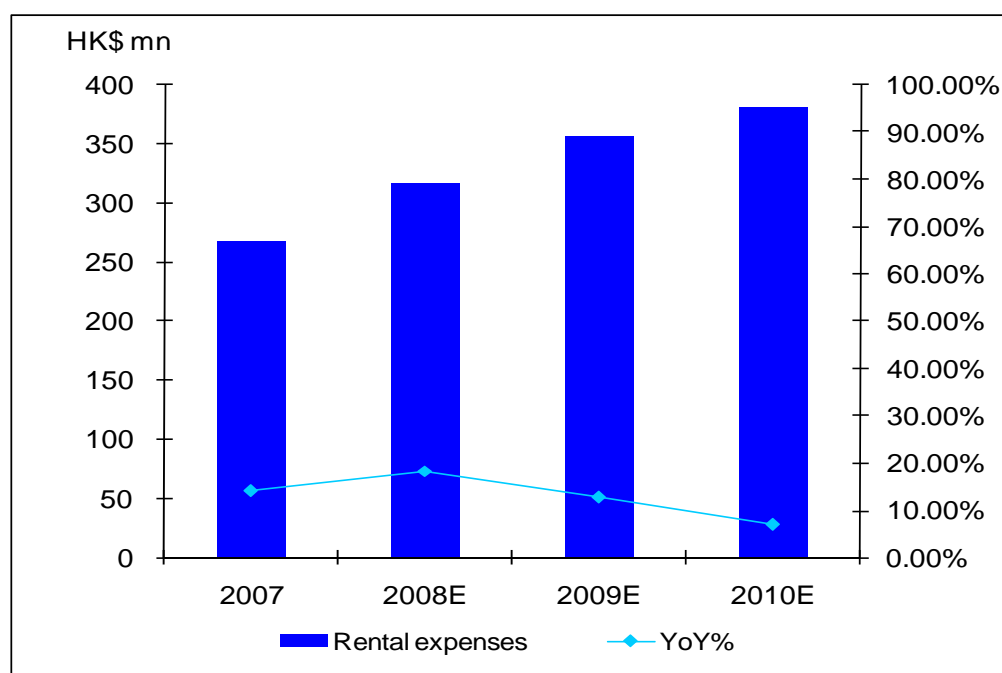
Also, such large scale operation together with its multiple presences in a city/region enhance the bargaining power of NWDS over its concessionaires and supplies in negotiating commissions and cost of goods. As a result, NWDS is able to charge a relatively higher commission rate comparing with its peers. During the period of 2005-2007, the commission rates charged by NWDS were 22.15%, 21.52% and 20.21%, which were on the top range in the industry as shown in figure 7.

## Operating leverage

NWDS applies a straight line depreciation methodology for its rental expenses; hence, its rental expenses are fixed throughout the lease term. As shown in figure 10, NWDS rental expenses are relatively stable throughout the years under reviewed. The rise in rental expense represents the rent paid for the additional stores. Therefore, any growth in revenue will contribute to the net profit. For illustration, in figure 11 we assume that the company does not open any new stores in the coming years and the rental expense remains at HK\$ 267 million throughout the period. Any rise in revenue from 2008 to 2010 will generate extra net profits for the company (i.e the additional difference between the revenue and rental expense); other factors remain constant.

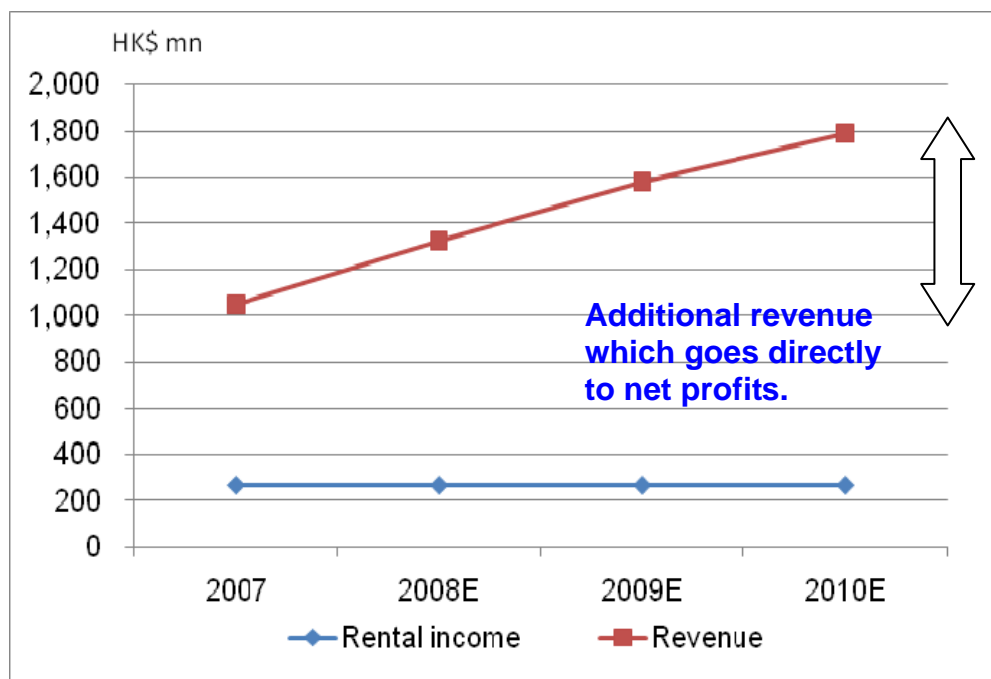
Most of the lease will not expire until in more than 10 years, NWDS will benefit greatly from this operating leverage; in particular, under its high growth period.

Figure 10: NWDS Rental expenses



Source: Company data, FSSL.

Figure 11: Illustration of operating leverage



Source: Company data, FSSL.

**Future strategy**

The company will continue to broaden its national network through organic growth and acquisition strategies. NWDS plans to open new stores in cities where it already has a presence (this strategy is to further increase its bargaining power over its concessionaires and suppliers) and in new cities such as Xi’an, Zhengzhou and Taiyuan. In additions, NWDS has the options or right of first refusal to acquire its managed stores. According to the company, NWDS will acquire the Kunming Store and the Ningbo Trendy Store within 3 years time.

## Financial Analysis

1. Concessionaire income and direct sales growth rate: we assume average concessionaire sales per sqm and direct sales per sqm grow at 8.84% and 15% respectively for 2008. We further assume the commission rate to be approximately 20.3% for 2008.
2. Rental expense: we assume an average of HK\$ 800 per sqm for all self-owned stores, which is based on the rent per sqm of previous 4 years.
3. Effective tax rate: 25%.
4. Dividend payout ratio: 30%.

### Strong double digit growth from concessionaire income and direct sales

#### Concessionaire income

Based on our financial model, we assume the concessionaire sales per sqm grow at 8.84% and 7% respectively for year 2008 and 2009. By multiplying average concessionaire sales per sqm and total GFA of self-owned stores, we forecast the concessionaire sales to be around HK\$ 4,691 million and HK\$ 5,545 million for year 2008 and 2009.

Further, we assume the commission rate to stay at approximately 20.3%. We forecast the concessionaire income for 2008 and 2009 to be HK\$ 952 million and HK 1,125 million, which grow at a rate of 25.45% and 18.2% respectively.

#### Direct sales

We also assume the average direct sales per sqm grow at a rate of 15% in 2008 and 2009, and the average direct sales per sqm would be approximately HK\$ 304 and HK\$ 349 respectively. By multiplying average direct sales per sqm and total GFA of self-owned stores, we forecast that the direct sales to be approximately HK\$153 million and HK\$195 million and grow at a rate of 31.94% and 27.04% for year 2008 and 2009.

Figure 12: Concessionaire income and direct sales growth rate

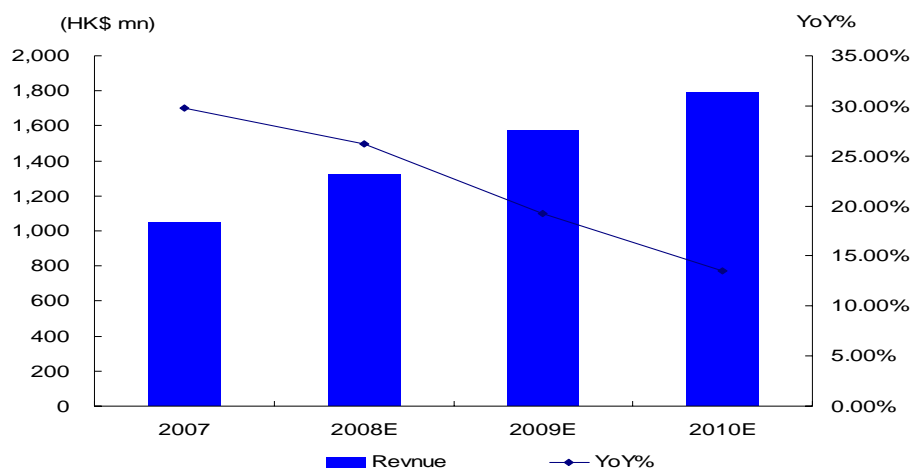
|                                | 2006<br>Ended 30 Jun 06<br>(HK\$ million) | 2007<br>Ended 30 Jun 07<br>(HK\$ million) | 2008E<br>Ended 30 Jun 08<br>(HK\$ million) | 2009E<br>Ended 30 Jun 09<br>(HK\$ million) |
|--------------------------------|---|---|--|--|
| <b>Concessionaire income</b>   | <b>618.72</b>                             | <b>759.12</b>                             | <b>952.34</b>                              | <b>1,125.68</b>                            |
| YoY%                           | 30.44%                                    | 22.69%                                    | 25.45%                                     | 18.20%                                     |
| Gross concessionaire sales     | 2,875.48                                  | 3,756.92                                  | 4,691.35                                   | 5,545.25                                   |
| YoY%                           | 34.30%                                    | 30.65%                                    | 24.87%                                     | 18.20%                                     |
| Total stores                   | 15  | 17  | 19   | 20   |
| Addition store                 | 3   | 2   | 2  | 1  |
| Total GFA (sqm)                | 379,270                                   | 441,270                                   | 506,270                                    | 559,270                                    |
| Net Additions GFA (sqm)        | 103,200                                   | 62,000                                    | 65,000                                     | 53,000                                     |
| YoY%                           | 37.38%                                    | 16.35%                                    | 14.73%                                     | 10.47%                                     |
| Concessionaire sale/Sqm (HK\$) | 7,582                                     | 8,514                                     | 9,266                                      | 9,915                                      |
| YoY%                           | -2.24%                                    | 12.30%                                    | 8.84%                                      | 7.00%                                      |
| Commission rate                | 21.52%                                    | 20.21%                                    | 20.30%                                     | 20.30%                                     |
| YoY%                           | -2.88%                                    | -6.09%                                    | 0.46%                                      | 0.00%                                      |
| <b>Direct sales</b>            | <b>86.70</b>                              | <b>116.59</b>                             | <b>153.83</b>                              | <b>195.42</b>                              |
| YoY%                           | 1.02%                                     | 34.48%                                    | 31.94%                                     | 27.04%                                     |
| Total GFA (sqm)                | 379,270                                   | 441,270                                   | 506,270                                    | 559,270                                    |
| Direct sales/sqm (HK\$)        | 229                                       | 264                                       | 304  | 349  |
| YoY%                           | -26.47%                                   | 15.58%                                    | 15.00%                                     | 15.00%                                     |

Source: Company data, FSSL.

### Revenue grows at a CAGR of 14.31% from 2007- 2010

Based on our financial model, we forecast the revenue for years 2008, 2009 and 2010 to be HK\$ 1,322 mn, HK\$ 1,575 mn and HK\$1,788 mn; which represent a CAGR of 14.31% throughout the period of 2007-2010.

Figure 13: Summary of NWDS revenue and revenue growth rate



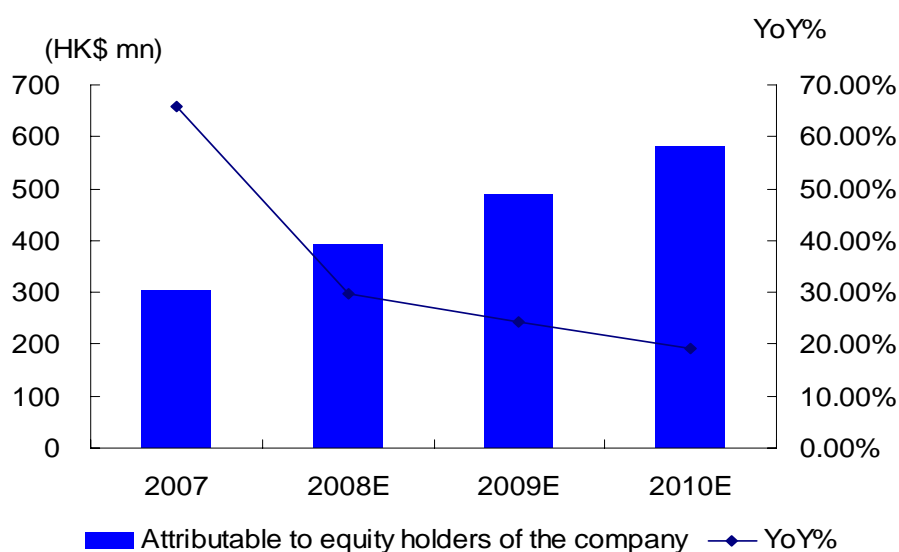
Source: Company data, FSSL

### Profit attributable to equity holders grows at a 18.71% of CAGR from 2007-2010

Our forecast of a 18.71% of CAGR from 2007-2010 is based on the following reasons:

1. Strong revenue growth during this period driven by organic and expansion growths.
2. Stable rental expenses and depreciation & amortization.

Figure 14: NWDS net profit attributable to equity holders and its growth rate



Source: Company data, FSSL.

## Valuation

We use DCF methodology to value NSWD, with an assumed WACC of 12.89%. Our 12 month target price of HK\$ 8.79 implies a P/E of 19.59x June 2009E earnings and provides 50% of upside potential from current level.

Figure 15: DCF model

| Cash flow forecast     |          |         |         |          |          |          |          |          |
|------------------------|----------|---------|---------|----------|----------|----------|----------|----------|
|                        | 2007     | 2008E   | 2009E   | 2010E    | 2011E    | 2012E    | 2013E    | 2014E    |
| EBIT                   | 353.91   | 512.70  | 665.08  | 801.64   | 930.27   | 1,069.01 | 1,222.49 | 1,392.86 |
| Tax                    | (48.56)  | (71.38) | (90.69) | (109.31) | (126.85) | (145.77) | (166.70) | (189.93) |
| Dep. & amort.          | 97.46    | 111.81  | 123.52  | 130.69   | 137.87   | 145.05   | 152.23   | 159.41   |
| Chg in working capital | 301.64   | 98.68   | (12.89) | 122.84   | 161.21   | 153.81   | 172.24   | 192.98   |
| CAPEX                  | (153.14) | (56.37) | (62.01) | (68.21)  | (75.03)  | (82.53)  | (90.79)  | (99.87)  |
| Free cash flow         | 551.32   | 595.44  | 623.01  | 877.66   | 1,027.48 | 1,139.57 | 1,289.47 | 1,455.44 |

|                        | High growth period |        |        | Stable growth period |          |          |          |               |
|------------------------|--------------------|--------|--------|----------------------|----------|----------|----------|---------------|
|                        | 2008E              | 2009E  | 2010E  | 2011E                | 2012E    | 2013E    | 2014E    | 2015E onwards |
| Free cash flow         | 595.44             | 623.01 | 877.66 | 1,027.48             | 1,139.57 | 1,289.47 | 1,455.44 |               |
| Present value          | 595.44             | 551.88 | 688.67 | 714.18               | 701.65   | 703.29   | 703.17   | 6,487.06      |
| Terminal value         |                    |        |        |                      |          |          |          | 15,157.80     |
| Company intrinsic val. | 10,549.90          |        |        |                      |          |          |          |               |
| Debt                   |                    |        |        |                      |          |          |          |               |
| Equity                 | 10,549.90          |        |        |                      |          |          |          |               |
| Net cash               | 4,267.97           |        |        |                      |          |          |          |               |
| Share outstanding      | 1,686,145,000      |        |        |                      |          |          |          |               |
| Target price           | 8.79               |        |        |                      |          |          |          |               |

### Assumption

|                      |       |
|----------------------|-------|
| Terminal growth rate | 3.00% |
|----------------------|-------|

Source: Company data, FSSL.

Figure 16: WACC model

| WACC model       |               |
|------------------|---------------|
| % Debt           | 0.00%         |
| Return on debt   | N/A           |
| Tax rate         | 25.00%        |
| % Equity         | 100.00%       |
| Risk free rate   | 3.35%         |
| Beta             | 0.87          |
| Return on market | 14.32%        |
| Return on equity | 12.89%        |
| <b>WACC</b>      | <b>12.89%</b> |

Source: Company data, FSSL.

Figure 17: Sensitivity analysis

|                      |       | WACC   |        |             |        |        |        |
|----------------------|-------|--------|--------|-------------|--------|--------|--------|
|                      |       | 11.89% | 12.39% | 12.89%      | 13.39% | 13.89% | 14.39% |
| Terminal growth rate | 4.50% | 10.58  | 10.03  | 9.54        | 9.11   | 8.73   | 8.39   |
|                      | 4.00% | 10.20  | 9.70   | 9.26        | 8.87   | 8.52   | 8.20   |
|                      | 3.50% | 9.87   | 9.42   | 9.01        | 8.65   | 8.33   | 8.03   |
|                      | 3.00% | 9.57   | 9.16   | <b>8.79</b> | 8.45   | 8.15   | 7.88   |
|                      | 2.50% | 9.31   | 8.93   | 8.59        | 8.27   | 7.99   | 7.73   |
|                      | 2.00% | 9.07   | 8.72   | 8.40        | 8.11   | 7.85   | 7.60   |
|                      | 1.50% | 8.86   | 8.53   | 8.23        | 7.96   | 7.71   | 7.48   |

Source: Company data, FSSL.

## Investment risks

### Inability to execute growth strategy

NWDS relies on existing stores and newly opened & acquired stores for revenue growth. Fail to properly manage the existing stores and to open & acquire new stores may reduce the growth of NWDS. However, the management has demonstrated its ability to deliver excellent organic growth; for example, the overall SSS growth rate was 27% for the first quarter of 2008. Also, the management has fulfilled its commitment of opening and acquiring 2-3 stores per year. These provide us confidence in the management to execute its growth strategy.

### Economy and consumer spending slowdown

High inflation in PRC may dampen the economic growth of the country and may also negatively affect the purchasing power of the consumers. Recent data suggests that GDP growth of PRC is still strong, which was 10.6% in the first quarter of 2008. In addition, the target consumers of NWDS are affluent consumers who are less likely to be affected by inflation.

# Financial Summary

## Income statement

| Year end 30 June      | 2006<br>HKD mn | 2007<br>HKD mn | 2008E<br>HKD mn | 2009E<br>HKD mn | 2010E<br>HKD mn |
|-----------------------|----------------|----------------|-----------------|-----------------|-----------------|
| Revenue               | 806.74         | 1,046.89       | 1,321.66        | 1,575.28        | 1,787.56        |
| Gross profit          | 741.72         | 961.61         | 1,204.29        | 1,424.80        | 1,604.45        |
| Other income          | 24.94          | 32.33          | 126.73          | 143.77          | 157.95          |
| EBITDA                | 253.34         | 451.37         | 624.51          | 788.60          | 932.34          |
| EBIT                  | 171.95         | 353.91         | 512.70          | 665.08          | 801.64          |
| Profit before tax     | 182.62         | 356.10         | 523.49          | 665.08          | 801.64          |
| Tax                   | (24.69)        | (53.33)        | (130.87)        | (166.27)        | (200.41)        |
| Net profit            | 157.94         | 302.77         | 392.62          | 498.81          | 601.23          |
| EPS (HKD)             | 0.09           | 0.18           | 0.24            | 0.30            | 0.36            |
| DPS(HKD)              | 0.00           | 0.00           | 0.07            | 0.09            | 0.11            |
| Growth                |                |                |                 |                 |                 |
| Revenue growth (%)    | 24.72%         | 29.77%         | 26.25%          | 19.19%          | 13.48%          |
| EBITDA growth (%)     | 33.88%         | 105.83%        | 44.87%          | 29.72%          | 20.53%          |
| Net profit growth (%) | 56.76%         | 91.70%         | 29.68%          | 27.05%          | 20.53%          |

## Ratio analysis

| Year end 30 June              | 2006    | 2007    | 2008E   | 2009E   | 2010E   |
|-------------------------------|---------|---------|---------|---------|---------|
| Earnings analysis             |         |         |         |         |         |
| Gross margin                  | 25.00%  | 26.86%  | 23.70%  | 23.00%  | 23.00%  |
| EBITDA margin                 | 31.40%  | 43.12%  | 47.25%  | 50.06%  | 52.16%  |
| Net profit margin             | 19.58%  | 28.92%  | 42.57%  | 31.66%  | 33.63%  |
| Operating analysis            |         |         |         |         |         |
| SG&A/ revenue                 | -34.54% | -31.80% | -29.50% | -26.89% | -25.13% |
| Effective tax rate            | 13.52%  | 14.98%  | 25.00%  | 25.00%  | 25.00%  |
| Dividend payout ratio         | 0.00%   | 0.00%   | 30.00%  | 30.00%  | 30.00%  |
| Inventory t/o (days)          | 87      | 97      | 109     | 111     | 114     |
| Account payable t/o (days)    | 74      | 73      | 77      | 78      | 74      |
| Account receivable t/o (days) | 4       | 6       | 6       | 6       | 6       |
| Financial analysis            |         |         |         |         |         |
| Net debt to equity            | 0       | 0       | 0       | 0       | 0       |
| Sales/ assets (x)             | 0.50    | 0.51    | 0.25    | 0.27    | 0.28    |
| Assets/ equity (x)            | 8.61    | 2.40    | 1.44    | 1.43    | 1.44    |
| ROE                           | 83.81%  | 35.32%  | 10.52%  | 12.22%  | 13.36%  |

## Balance Sheet

| Year end 30 June          | 2006<br>HKD mn | 2007<br>HKD mn | 2008E<br>HKD mn | 2009E<br>HKD mn | 2010E<br>HKD mn |
|---------------------------|----------------|----------------|-----------------|-----------------|-----------------|
| Cash and cash equivalents | 488.73         | 967.53         | 3,948.87        | 4,267.97        | 4,778.71        |
| Account receivable        | 299.64         | 163.17         | 379.78          | 457.97          | 521.47          |
| Inventories               | 15.71          | 29.71          | 40.14           | 51.46           | 62.62           |
| Others                    | 10.10          | 96.75          | 83.30           | 83.30           | 83.30           |
| Total current assets      | 814.17         | 1,257.16       | 4,452.09        | 4,860.71        | 5,446.09        |
| Fixed assets              | 568.12         | 563.72         | 620.10          | 682.10          | 750.32          |
| Intangible assets         | 170.57         | 168.45         | 168.10          | 167.75          | 167.40          |
| Others                    | 70.43          | 68.65          | 122.09          | 120.63          | 119.21          |
| Total assets              | 1,623.29       | 2,057.98       | 5,362.38        | 5,831.19        | 6,483.02        |
| Short term loans          | 0.00           | 0.00           | 0.00            | 0.00            | 0.00            |
| Accounts payable          | 569.60         | 663.86         | 961.53          | 982.56          | 1,115.17        |
| Others                    | 727.21         | 363.09         | 455.72          | 524.08          | 604.80          |
| Total current liabilities | 1,296.80       | 1,026.94       | 1,417.25        | 1,506.64        | 1,719.98        |
| Long term debt            | 0.00           | 0.00           | 0.00            | 0.00            | 0.00            |
| Total liabilities         | 1,434.84       | 1,200.75       | 1,630.80        | 1,750.83        | 1,983.35        |
| Shareholder equity        | 188.45         | 857.23         | 3,731.46        | 4,080.62        | 4,501.49        |
| Minority                  | 0.00           | 0.00           | 0.00            | 0.00            | 0.00            |
| BVPS (HKD)                | 0.11           | 0.51           | 2.24            | 2.45            | 2.70            |

## Cash flow statement

| Year end 30 June            | 2006<br>HKD mn | 2007<br>HKD mn | 2008E<br>HKD mn | 2009E<br>HKD mn | 2010E<br>HKD mn |
|-----------------------------|----------------|----------------|-----------------|-----------------|-----------------|
| EBITDA                      | 253.34         | 451.37         | 624.51          | 788.60          | 932.34          |
| Depreciation & amortisation | 81.39          | 97.46          | 111.81          | 123.52          | 130.69          |
| Change in working capital   | 342.76         | 215.90         | 334.17          | 64.08           | 180.25          |
| Tax                         | (24.69)        | (53.33)        | (130.87)        | (166.27)        | (200.41)        |
| Cash flow from operations   | 378.03         | 636.92         | 556.75          | 566.56          | 817.83          |
| Capex                       | (206.56)       | (99.83)        | (56.37)         | (62.01)         | (68.21)         |
| Others                      | 7.27           | (41.45)        | 105.85          | 118.47          | 128.04          |
| Cash flow from investing    | (199.29)       | (141.28)       | 49.48           | 56.46           | 59.83           |
| Equity raised/(repaid)      | 0.00           | 0.00           | 2,560.77        | 0.00            | 0.00            |
| Debt raised/(repaid)        | 0.00           | 0.00           | 0.00            | 0.00            | 0.00            |
| Dividend paid               | 0.00           | 0.00           | (117.79)        | (149.64)        | (180.37)        |
| Others                      | 0.01           | (13.29)        | (67.88)         | (154.27)        | (186.55)        |
| Cash flow from financing    | 0.01           | (13.29)        | 2,375.10        | (303.91)        | (366.92)        |
| Net change in cash          | 161.70         | 478.80         | 2,981.33        | 319.10          | 510.74          |

Source: Company information, FSSL

**First Shanghai Securities Limited**

19/F Wing On House  
71 Des Voeux Road Central  
Hong Kong  
Tel: (852) 2522-2101  
Fax (852) 2810-6789

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