

CHAIRMAN'S STATEMENT

"We continue our commitment to the expansion of our business, to providing outstanding customer services, to offering a premium shopping experience for our customers, and to upholding our position as a leading cosmetics retailer in the Asian region."

Dr Simon Kwok, SBS², JP
Chairman and Chief Executive Officer

I hereby report that Sa Sa International Holdings delivered a weaker performance for the year ended 31 March 2017 (the "financial year") in an environment of slower economic growth, a less strong Renminbi and changing consumer preferences.

Against the backdrop of keener online and offline competition and a continued slowdown in growth of Mainland Chinese tourist spending, turnover reached HK\$7,746.2 million, a slight decrease of 0.6%, while profit decreased by 14.8% to HK\$326.7 million. Our retail outlets decreased from 291 to 288 across the region due to network rationalisation. Although the market environment remains challenging, with our overseas and online operations underperforming, we saw encouraging signs of stabilisation in the second half of the financial year.

The Group is committed to generating sustained and consistent returns to our shareholders. The Board of Directors proposes a final dividend of 8.0 HK cents per share, making a total annual dividend for the financial year of 17.0 HK cents per share after taking into account the interim dividend of 5.0 HK cents per share paid together with a special dividend of 4.0 HK cents per share. Subject to shareholders' approval, the final dividend will be payable in cash with a scrip dividend alternative.

◊ Since 30 June 2017





Market Environment – Still Challenging

In our core market of Hong Kong and Macau, retail sales have been a major beneficiary of the Individual Traveller Scheme first launched in 2003. However, this reliance has made us vulnerable to uncertainties in the market.

The one-trip-per-week restriction imposed in 2015 on Shenzhen residents for Hong Kong travel saw same-day visitor numbers fall on a year-to-year basis and these numbers have continued to decline. In addition to a general slowdown in Mainland Chinese tourist arrivals, there has also been a structural adjustment in the mix of first and second tier city versus lower tier city tourists, of overnight and same-day tourists, and of their spending habits. Hong Kong's strong currency has made it difficult to attract tourists for shopping while at the same time stimulating local outbound travel.

However, the decrease in the number of Mainland tourists visiting Hong Kong slowed and numbers began to rise in the last quarter of the financial year. This suggests that the effect of the one-trip-per-week policy on same-day visitation has now been almost fully absorbed.

During the financial year, medicines and cosmetics sales in Hong Kong grew 2.2% while the overall retail market declined by 5.2%. During the same period, cosmetics and sanitary articles sales in Macau grew by a robust 8.6%, while the overall retail market declined slightly by 0.5%, indicating that the cosmetics industry continues to perform reasonably well.

The Central Government has listed Macau tourism as a key focus for economic stimulus. Macau's attractions are expanding rapidly to attract and accommodate tourists. We are optimistic that the retail sector in Macau will show increasingly positive growth.

Overall our sales and profitability in Hong Kong and Macau weakened but began to show signs of stabilising. Our combined sales in Hong Kong and Macau remained broadly flat as we strategically adapted our business operations to respond more closely to customer and market needs. However, leveraging our market awareness, we changed the product mix to adapt more quickly to evolving consumer preferences.

We also implemented a more cautious store network strategy and consolidated our network of stores to be more sales and cost effective. Further strategies have included centralising and streamlining work processes to improve operational and cost effectiveness, and enhancing store productivity. We are also remapping our product strategy with an emphasis on agility, effectiveness and efficiency, in order to respond to growing demand and to recapture our brisk sales and solid growth.

To enhance the competitiveness of our product portfolio, we have been eliminating underperforming SKUs to make way for new and productive SKUs. We are also focusing on the launch time of new products, as well as on their display, variety and pricing.

Beyond Hong Kong and Macau

In addition to addressing the challenging Hong Kong retail environment, the Group has adjusted our strategy in our non-Hong Kong markets. We have intensified our focus on e-commerce and we have taken decisive steps to integrate our online and offline operations ("O2O") in Hong Kong and China to provide an enhanced O2O shopping experience to customers, as well as to serve Mainland tourists after they have left Hong Kong to return home.

We have also sharpened our critical analysis of the profitability and efficiency of our non-Hong Kong markets' operations. We have improved our product offerings to align them more closely with the latest market trends and consolidated our store network in Singapore and Taiwan to improve store level contribution. We have also continued with our network expansion in Malaysia to exploit our market leading position.

In Mainland China, we have continued to build our management team and adjust our strategies to adapt to this important and evolving market. We have taken steps to integrate our online offerings into physical stores and facilitated online purchases in these stores to strengthen our product range and to provide an improved shopping experience.

Our new boutique store format has proven to be successful and will continue to be our main format of choice in the China market. This is a strategically important choice given the popularity of online purchases, which makes retail space increasingly available at reasonable cost but which still requires enhanced returns on the space utilised.

The issue of the Terminal High Altitude Area Defense ("THAAD") anti-missile system has had a negative effect on the Group's sales of South Korean products. We have adjusted our product mix and promotional focus in the China market, including the promotion of non-Korean products such as those from Taiwan and Japan.

In Malaysia, we have broadened our customer base to target the ethnic Malay population, and expanded our store network. We have also improved our product offerings to align with the latest market trends and made some very initial investments in digital marketing to enhance the shopping experience, build brand presence and gain market share.

In Singapore, we have continued to restructure our management team and operations, and to consolidate our store network. We have begun to reap the benefits of integrating our Singapore with our Malaysia team with the decline in sales slowing, and both shop and office expenses decreasing. We have enhanced our product offerings to align with the latest market demand, and strengthened our digital presence due to changes in the product mix. However, store level contribution has weakened due to a significantly lower gross profit percentage as a result of these product mix changes.

In Taiwan, we changed the management in November, and the new team began to improve product offerings and bring operations under control. Although there is still plenty of scope for improvement, operations have shown signs of stabilising.

In our e-commerce business, we recorded a significantly weaker performance due to our determination to improve our logistics function in Hong Kong and to establish a new Free Trade Zone warehouse in China. Although both initiatives are strategically vital to improve our fulfillment standards and costs, they were initially poorly executed, which resulted in further elevated costs and damage to customer service. The promotions to drive the e-commerce business were also too price focused, giving rise to unacceptable margins. These two factors significantly impacted our profitability for the year.





Our logistics function is now under better management and we are just beginning to see the first signs of improvement in both Hong Kong and in the Free Trade Zone warehouse in China. However, there is still a long way to go to sharpen our competitiveness, decrease our costs and enhance levels of customer service. When fully realised, the new enhancements will strengthen our operational and cost effectiveness as well as driving up our fulfillment standards, which in turn will improve the customer shopping experience. Losses have been narrowing since the improvements to the logistics function and pricing strategy were implemented in March 2017. We believe that the most difficult times are now behind us.

Overall, we are developing expertise and capabilities that will gradually give more breadth and depth to our customer acquisition and retention efforts. This will enable us to improve the customer experience in vital areas such as shipping lead times where we significantly lag the market, and to drive sales with better recognition of consumers' behaviour, needs and habits. We are committed to increasing resources to improve the shopping experience, as well as our product offerings and marketing effectiveness.

Pathway to the Future

We believe that although there will still be challenges in the Hong Kong and Macau markets in FY 2017/18, both the market environment and the Group's prospects are gradually stabilising and showing clear signs of improvement. We are confident that Hong Kong will continue to enjoy the advantages of being adjacent to economically robust southern China, and looking forward, we aim to further strengthen the Group's competitiveness and performance.

In terms of product strategy, we will streamline our product portfolio by removing unproductive SKUs. This will allow us to better manage our inventory, reduce carrying costs and make way for new and more productive products and shelf displays. The sourcing process will be enhanced to bring in popular new products, and we will target fast moving trendy products to achieve faster turnover.

In view of the popularity of Asian cosmetic products, and to cater for rapidly changing customer preferences, we are enriching our Korean product portfolio across all product sources, including house brands and non-house brands. We will forge close partnerships with suppliers and with Asian beauty brands while continuing to enhance branding and marketing initiatives for our own brands, thereby contributing to the profit margin of the Group. In this context, we officially launched our new own brand "Eleanor" in May 2017 and we will continue to enrich our product mix.

Overall, we will focus on retail network rationalisation, increasing store productivity and reducing operating costs, including rental costs. The streamlining of SKUs will allow us to enhance store productivity by removing unproductive SKUs. This will allow us to run smaller stores, which are more profitable in the current operating environment. The centralisation of operations will further enable us to reduce costs at the store level. We are placing greater emphasis on locations that will deliver continuous growth for targeted store expansion, such as the New Territories districts near the Mainland border. At the same time, we are rationalising our stores in those tourist districts in which "Sasa" stores are concentrated as a result of rapid growth over the past decade, such as Causeway Bay, Tsim Sha Tsui and Mongkok. These efforts will allow us to streamline our cost structure and improve store productivity.

We also aim to generate sales through market differentiation. New store formats such as Sa Sa Boutique will target different customer segments while also increasing market share, particularly for the local segment. In terms of O2O and cross border e-commerce, greater efforts in digital marketing and in the integration of our online and offline CRM will ensure an improved shopping experience. Such initiatives will help us to maintain closer contact with our customers and to serve them even if they do not return regularly to Hong Kong. Customer acquisition and retention will both enhance and drive sales growth, and we will further strengthen sales channels through new and closer partnerships.

Service excellence has always been Sa Sa's premier core value. Our service has helped us to build relationships and trust with local and overseas customers while also strengthening Sa Sa as a top-of-the-mind brand in the market. To respond to rapid changes in the market environment, our services, training and incentives are all developing to cater for innovative product offerings and more digital interactivity that align with evolving consumer preferences – both in terms of product affinity and the shopping experience.

We recognise that the provision of an excellent shopping experience that consumers truly enjoy is essential and involves both online and offline efforts, as well as excellent after sales service such as post-order fulfillment. We are therefore making sustained efforts to integrate our online and offline customer database, and to enhance our logistics support. Online efforts include more sophisticated digital marketing, social media interactivity and offline initiatives such as enhancing the in store shopping experience with attractive product placements and store displays.

Delivering Our Vision

We aim to respond to forthcoming market challenges with flexibility and decisiveness. We are committed to expansion according to a strategy that is both disciplined and forward thinking. Although we are somewhat cautious about the short-term outlook, we are confident of the long-term sustainability of our business, not only in our Hong Kong stores, but also in the offline and online environments and throughout the region. We base this optimism on the fast-growing Mainland Chinese middle class whose levels of affluence will steadily rise, and who will continue to increase their spending. Hong Kong will also become further integrated with China through enhanced transportation infrastructure such as the high-speed rail link and the Hong Kong-Zhuhai-Macau bridge.

As mentioned above, we will strenuously improve our store operations and cost structure and improve our product strategy as well as operations to adapt to intense competition and general weakness in the retail market. As part of our investments towards a more effective and scalable operation in Hong Kong and Macau, we are moving into new warehouse facilities in the new financial year. The new facilities will consolidate our current multiple warehouse workflows into one and allow automation to increase efficiencies. This will include an estimated CAPEX of approximately HK\$77 million and a one-off estimated relocation expense of approximately HK\$40 million.

The new warehouse will allow us to consolidate four dispersed warehouses into one, further enabling automation, and resulting in space and manpower savings of over 10%. Handling efficiency will also be increased, allowing faster execution of goods in and goods out and cutting short lead times for deliveries to our stores in Hong Kong and Macau.





A new mobile app will be launched in the second half of FY 2017/18, followed by a variety of new supporting services, in order to enhance interaction with customers and the overall shopping experience. We are confident that the increasing integration of our O2O operations will better serve our customers and provide a shopping experience that will grow our customer base, reinforce customer loyalty, and drive sales.

Leveraging on the solid foundation and experience of our Hong Kong core market, the Group is committed to improving the operations of our overseas markets, while working on strategies to adapt and cater to the local market conditions of each respective market, and to increase their proportionate contribution.

Finally, we take considerable pride in our commitments as a socially responsible corporate citizen. As the Group continues to expand and grow, we are proud to accelerate our programmes in this area as we celebrate our commitment to “from the community, for the community”, which we strongly believe is the key to sustainable business success.

Conclusion

I would like to take this opportunity to express my deepest appreciation to everyone who has contributed to the Group’s performance and long-term sustainable growth. No matter what challenges the future may bring, I firmly believe that the Group’s financial robustness, our adaptability and resilience, and our strong governance and development strategies will ensure that we are able to rise to meet the future. The Group has a long track record of durability and success in all economic circumstances. We continue our commitment to the expansion of our business, to providing outstanding customer services, to offering a premium shopping experience for our customers, and to upholding our position as a leading cosmetics retailer in the Asian region.

Simon Kwok
Chairman and Chief Executive Officer
Hong Kong, 15 June 2017

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