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Business review on Sa Sa International Holdings Limited
financial performances and corporate governance

Executive Summary

This review focuses on evaluating the financial performance of Sa Sa International Holdings Limited (“Sasa”) in the past 3 fiscal years and compare the business performance with its competitors. The market position of Sasa is still robust despite it is suffering from net loss position in two consecutive fiscal years due to the adverse condition in the retail environment. However, through the evaluation of financial ratios, it is important for the management to respond quickly to the identified weak areas like earning ability and operating efficiency. It is suggested that the company should enhance these areas by financing the expansion of online business in debt and implement more control on inventory to keep up with the industry benchmark. Meanwhile, the management can achieve improvement in corporate governance by modifying the board structure, reviewing directors’ remuneration package and implement more comprehensive reporting procedures into the operation.

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1. Introduction

A brief overview of the background of Sa Sa International Holdings Limited (“Sasa”) is performed in this section to understand the history and development of the company to help analysis and make recommendation on its performance within the market.

1.1 Company background

Dr. Kwok Siu Ming Simon and Dr. Kwok Law Kwai Chun Eleanor started their cosmetics retail business in 1978 and have developed Sasa’s business from a small street counter to a famous beauty retailer with over 200 stores located in Hong Kong & Macau, Mainland China and Malaysia in around 40 years. The company currently provides wide range of beauty products from skincare to body care, make-up, fragrance and different supplements with more than 600 brands available for sales (Sasa, 2021(a)). The founders are still the substantial shareholders of the company and collectively holds approximately 62.69% of the shares as of 31 March 2021, and both of them are also actively participating in the operation who acts as the chairman, CEO and vice-chairman of the company (Sasa, 2021(b)).

1.2 Market value of Sasa

Sasa got listed in Hong Kong in 1997 (stock code: 0178.HK) at HKD 2.38 per share with an oversubscription rate of more than 200 times upon initial public listing (Sasa, 2021(c)). The attractiveness of Sasa stock varies greatly after listing and its market value has been experiencing fluctuations over 20 years of listing.

Figure 1 Historical stock price of Sasa

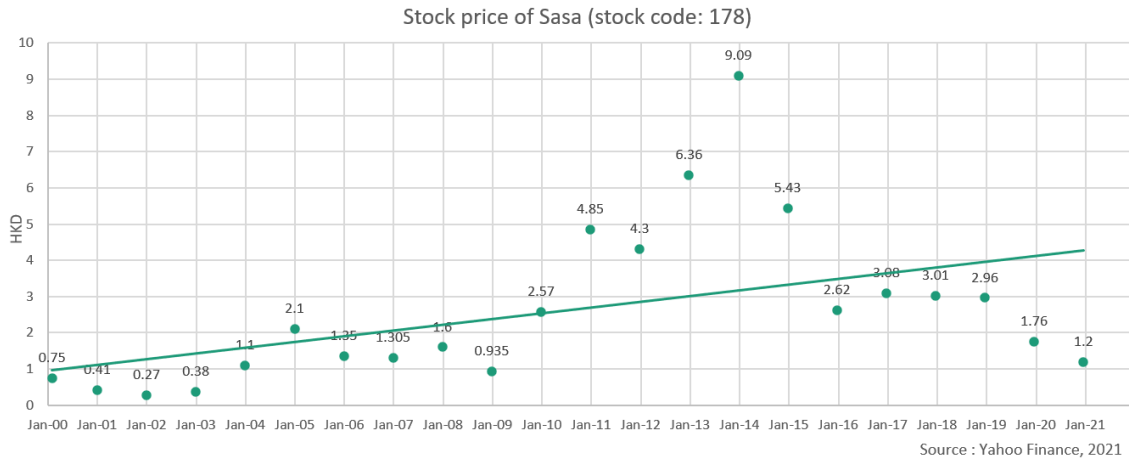
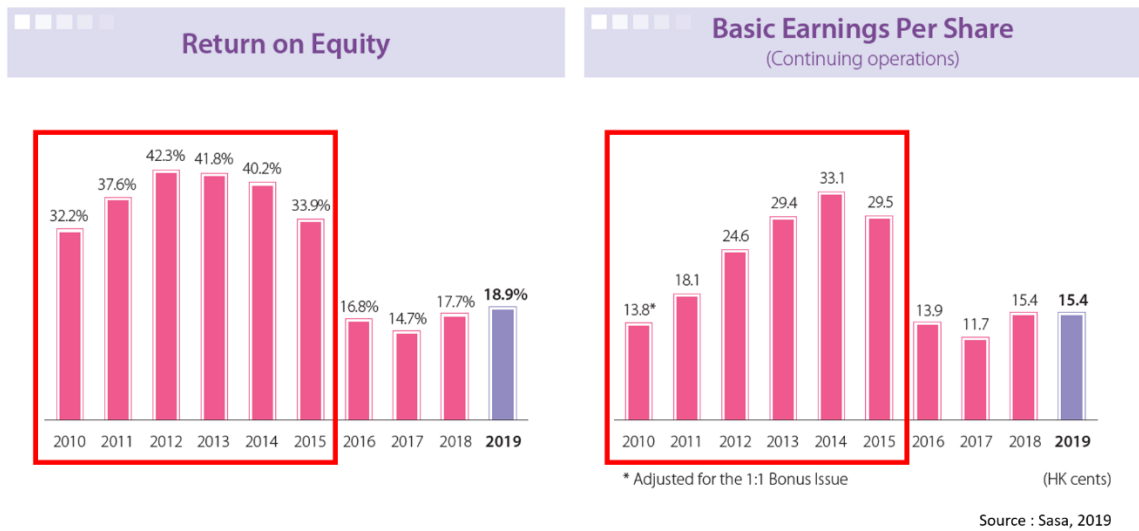


Figure 1 illustrated the opening stock price of Sasa as at the first trading date in the recent 21 years to evaluate its stock trend. Investors sought after Sasa stocks cannot be sustained after its initial public listing and its stocks trading volume fluctuated from less than 1 million to more than 100 million over the observed period (Yahoo Finance, 2021). Although Sasa stock price had been performing under the trendline most of the time after listing, Sasa market value had experienced favorable period during 2011 – 2015 due to the change in tourist policy in Hong Kong.

The Hong Kong government proposed to increase the number of mainland tourists visiting the city to strengthen the economy after being heavily hit by the financial crisis in 2008. The impose of Multiple Entry Individual Visit Endorsements in 2009 for the Shenzhen residents which brought many visitors' arrival had brought huge benefit to the Hong Kong economy (Sung et al., 2015) and significantly increased Sasa turnover and profit during the period. Before such policy was tightened in 2015 due to the social and security issues brought by the massive number of tourists (HKSAR, 2015), Sasa experienced the most favorable business environment and achieved the highest return for investors as shown in Figure 2 since listing which helped to boost the company's market value.

Figure 2 Historical financial performance of Sasa

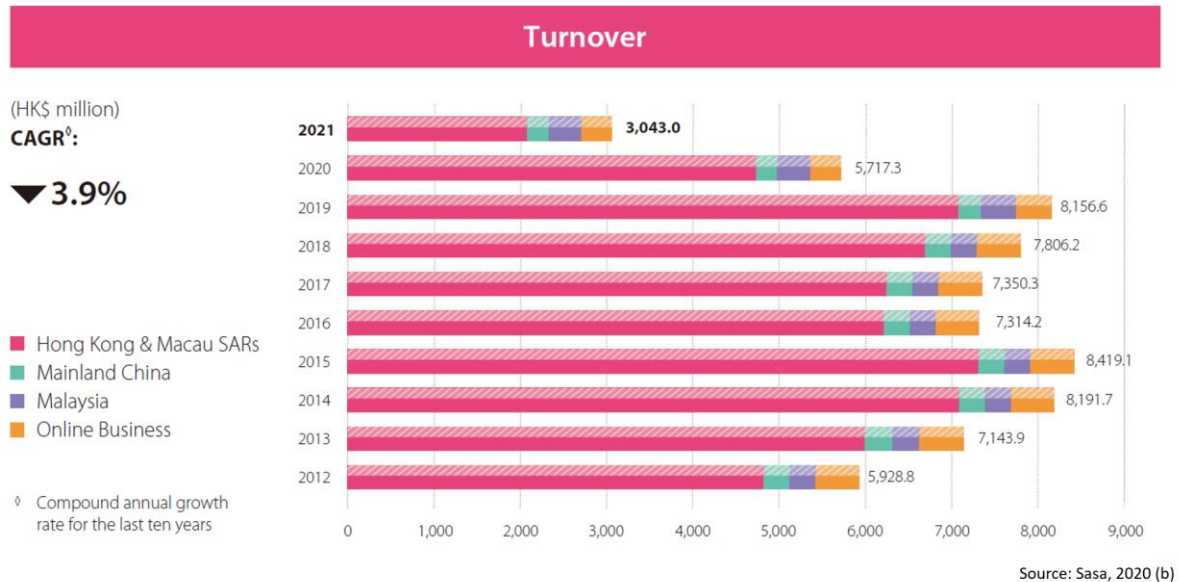


The stock price of Sasa had immediately reflected the impact on the reduction in mainland visitors and its performance had once again dropped below the trendline since 2016. By reference to Figure 1, Sasa market value even declined further during 2020 – 2021 as the retail business was materially influenced by the social unrest and Covid-19 pandemic in Hong Kong, and within the recent 20 years of business, Sasa has first generated negative return for investors in the latest 2 fiscal years (Sasa, 2021(b)). As of 6 August 2021, Sasa achieved a market capacity of HKD 5.8 billion with a closing stock price of HKD 1.87 per share, which was still far below the trendline as illustrated in Figure 1.

1.3 Operational review of Sasa

Sasa has been heavily focusing on the beauty retail business in Hong Kong. According to Figure 3, within 10 fiscal years, its turnover was solely generated from retail and wholesale of beauty products and a majority portion arose from Hong Kong and Macau region.

Figure 3 Sasa turnover in 10 fiscal years
Continuing operations



Therefore, the business performance of the company is largely depending on the retail environment in Hong Kong and Sasa financial results and market value will be very sensitive to any changes in the local market. Meanwhile, Sasa needs to face a very competitive cosmetics retail market in Hong Kong, not only local retail rivals like Bonjour and Colourmix, but also cosmetic department stores such as FACES and Beauty Bazaar as well as international beauty brands store-based retailing like L' Occitane and Shiseido.

However, the retail market in Hong Kong was not favorable to these beauty retailers since the decline in tourism (Trading Economics, 2021) starting from the social unrest in 2019, and the situation got even worse by different boarder restrictions and social distancing measures imposed during the Covid-19 pandemic. The store-based retailing has been hugely impacted by the adverse circumstances in which Sasa turnover in Hong Kong dropped 34.6% and 58.1% respectively in 2019/20 and 2020/21 (Sasa, 2021(b), 2020). Thus, beauty retailers are starting to shift their business strategy from store-based retailing to e-commerce, and O2O mode operation will take a major role in Sasa future business development to diversify the dependence in stores retailing (Sasa, 2021(b)).

2. Financial analysis of beauty industry

Financial analysis of Sasa is performed by reference to the company's 3 fiscal years performance, together with the latest financial ratio from its beauty products retail rivals, Bonjour Holdings Limited (Stock code: 0653.HK) and L'Occitane International S.A. (Stock code: 0973.HK), to evaluate Sasa's business performance within the industry.

2.1 Bankruptcy Index

Altman's Z-Score model is an effective tool to predict the probability of bankruptcy (Altman et al., 2014), which corporates with a z-score less than 1.80 has a high chance of bankruptcy whereas corporates with a z-score more than 3 have healthy financial position. The results by adopting Altman's Z-Score model to the beauty products retailers are as follow:

Table 1 Altman's Z-Score Model

		2018/19 HK\$'000	Sasa 2019/20 HK\$'000	2020/21 HK\$'000	Bonjour 2020 HK\$'000	L' Occitane 2020/21 HK\$'000
Net current assets	note	2,024,807	927,908	731,551	(116,549)	(722,194)
Total assets		3,406,480	3,267,187	2,510,882	1,027,546	22,769,798
Retain earnings		2,177,048	1,353,993	1,019,824	138,040	8,395,784
EBIT		582,297	(535,978)	(385,032)	(217,302)	2,007,349
Stock price	(i)	2.54	1.12	1.83	0.15	21.65
Number of stock (in thousands)		3,095,602	3,103,189	3,103,189	3,412,566	1,476,965
Total liabilities		919,872	1,602,875	1,180,739	858,998	11,107,326
Sales		8,156,597	5,717,283	3,043,029	538,788	14,024,070
Altman's Z-Score	=	1.2*A + 1.4*B + 3.3*C + 0.6*D + 0.999*E				
		2018/19	Sasa 2019/20	2020/21	Bonjour 2020	L' Occitane 2020/21
A	Working Capita/Total Assets	0.59	0.28	0.29	(0.11)	(0.03)
B	Retained Earnings/Total Assets	0.64	0.41	0.41	0.13	0.37
C	EBIT/Total Assets	0.17	(0.16)	(0.15)	(0.21)	0.09
D	(Stock price*no. of stock)/Total Liabilities	8.54	2.17	4.81	0.60	2.88
E	Sales/Total Assets	2.39	1.75	1.21	0.52	0.62
	Z-score	9.69	3.43	4.51	0.24	3.11

Note

(i) The adjusted closing price as at year ended date is selected

Source: Sasa, 2021(b), 2020; Bonjour, 2020; L'Occitane, 2021

Even Sasa's z-score dropped significantly from 9.49 to 3.43 in 2018/19 and 2019/20 and rebounded to 4.51 in the latest fiscal year, the financial position of the company is still relatively strong as its z-score outperformed its rivals, where the bankruptcy probability of Sasa consistently to be low throughout the last 3 fiscal years.

2.2 Profitability level

Analyzing corporate financial performance is a direct way to assess its economic efficiency and profitability ratios are one of the key indicators to evaluate the entities' earning ability (Hada and Mihalcea, 2020). To understand Sasa's business performance within the beauty retail market, profitability ratios of the three selected companies are illustrated in the following to prioritize the capability to generate profit under the same market condition.

Table 2 Profitability indicators

		Sasa			Bonjour	L' Occitane
		2018/19	2019/20	2020/21	2020	2020/21
Gross Profit Margin	(Sales-COS)/Sales	40.66%	36.42%	34.57%	32.13%	83.05%
Net Profit Margin	Net income after tax/Sales	6.02%	-8.31%	-11.81%	-47.96%	10.21%
EBITDA Margin	EBITDA/Sales	8.45%	5.77%	4.28%	-55.60%	26.12%

Source: Sasa, 2021(b), 2020; Bonjour, 2020; L'Occitane, 2021

Table 2 illustrated that Sasa had a gradual decline in gross profit margin since 2018/19 and reached 34.57% in the latest fiscal year, but its gross profit result was similar to Bonjour which was 32.13% in 2020, since both companies share a closer business pattern that acts as local retail distributors of different beauty brands. L'Occitane gross profit margin outperformed its rivals by approximately 50% by selling its own brand products in a more globalized market. This indicates that L'Occitane which manufactures and sells its own brands in a global network could possibly enjoy benefits from economies of scale to lower its production cost as compared to local cosmetic distributors like Sasa and Bonjour (Kim, 2021).

The net profit margin as shown in Table 2 demonstrated that Sasa had the same declining trend as gross profit margin in the 3 fiscal years, and the company cannot sustain a positive net profit since 2019/20 even though its net profit margin at -11.81% in 2020/21 was not the worst among the observed companies. However, when using EBITDA margin as an indicator, Sasa managed to keep the ratio at a similar range, i.e. between 4% - 9%, throughout the fiscal years. Such financial performance can be explained by the impact of a non-operation event, in which a significant increase in depreciation due to the change in accounting policy has materially taken up the company's net profit, resulting in Sasa suffered from financial loss in the latest 2 fiscal years. By comparing the ratios to the

competitors, the proportion of interest, tax, depreciation and amortization of Sasa attributed to its turnover is similar to L'Occitane. Both companies achieved approximately 16% of increase by reference to the companies' own net profit margin and EBITA margin indicates that even these expenses have led Sasa to a net loss position, the expenses portions were kept close to industry benchmark.

2.3 Liquidity and efficiency level

The liquidity ratios measure a corporate's ability to settle obligations with its assets in a short period of time (Rashid, 2018) and the efficiency ratios can show the turnover frequency of a company's operating cycle (Santosuosso, 2014). To evaluate the performances of Sasa in the mentioned areas, liquidity and efficiency ratios of the company and its rivals are calculated and compared as follow:

Table 3 Liquidity and efficiency indicators

		Sasa			Bonjour	L'Occitane
		2018/19	2019/20	2020/21	2020	2020/21
Current Ratio	current assets/current liabilities	3.34	1.87	1.86	0.85	0.91
Quick Ratio	(CA - inventory)/current liabilities	1.71	0.93	0.96	0.72	0.69
Cash Ratio	cash/current liabilities	0.64	0.53	0.59	0.03	0.47
Inventory Ratio						
Inventory Turnover	COS/inventory	3.42	3.61	2.60	3.76	1.31
Days' sales in inventory	365/inventory turnover	106.61	101.01	140.43	97.13	278.41
Receivables Ratio						
Receivables Turnover	sales/trade receivables	72.37	94.32	39.53	72.18	11.36
Average collection period	365/receivables turnover	5.04	3.87	9.23	5.06	32.12
Payables Ratio						
Creditors' Ratio	closing TP/COS*365	35.56	22.02	53.20	23.69	226.32
Operating period	inventory period + collection period	111.66	104.88	149.67	102.19	310.53
Cash period	operating period - payment period	76.10	82.86	96.46	78.50	84.21

Source: Sasa, 2021(b), 2020; Bonjour, 2020; L'Occitane, 2021

The liquidity level of the beauty retailers can be analyzed by the current, quick and cash ratios as illustrated by Table 3, in which the higher the ratios representing a better ability to settle its liabilities by assets that can be quickly converted into cash. Although Sasa current, quick and cash ratios had slightly declined in 2019/20 and 2020/21, its ratios were still outperforming within the industry, in particular current ratio at 1.86 in the latest fiscal year which was higher than the rivals by 1, can indicate that Sasa has a stronger capability to offset its obligations in a short period of time.

A corporate can improve the cashflow if there is a higher turnover in inventories and receivables and a lower frequency in payables while analyzing efficiency indicators can evaluate the companies' effectiveness in cash generation during its operation. Sasa performance in inventories, receivables and payables turnover reached its weakest position in 2020/21 among the 3 fiscal years as shown in Table 3, but the company still sustain to rank in the middle within the market. Since L'Occitane is an international beauty brand, it can have a stronger bargaining power on payment terms in receivables and payables as compared to local beauty products distributors like Sasa and Bonjour to achieve more favorable turnover ratios. In contrasts, Sasa and Bonjour can maintain a higher turnover frequency in inventories due to their business nature as compared to L'Occitane which manufactured its own products.

Meanwhile, turnover in inventories, receivables and payables directly influence the operation and cash period of the beauty product retailers. Even though Sasa operating period, i.e. 149.67 days, position in the middle range within the industry, its cash period of 96.46 days ranked last among its rivals. This indicates that Sasa has room to improve its turnover days, in particular to perform a better control in stock level to lower the days' sale in inventory, to keep its operating and cash period align with its competitors.

2.4 Solvency level

Solvency ratios do not only act as an indicator to predict a corporate's bankruptcy possibility but also provide signs of evidence in forecasting future profitability (Ibendahl, 2016). The higher the ratios explain a company more depends on debt raising to run the business. Different from the liquidity ratios, solvency ratios are more focusing on the long-term financing ability.

Table 4 Solvency indicators

			Sasa			Bonjour	L' Occitane
		Note	2018/19	2019/20	2020/21	2020	2020/21
Total Debt Ratio	total liabilities/total assets		0.27	0.49	0.47	0.84	0.49
Debt/Equity	total liabilities/total equities		0.37	0.96	0.89	5.10	0.95
Long Term Debt Ratio	non-current liabilities/total equity	i	-	-	-	-	0.03
Equity Multiplier	total assets/total equity		1.37	1.96	1.89	6.10	1.95

Source: Sasa, 2021(b), 2020; Bonjour, 2020; L'Occitane, 2021

Note

(i) Since Sasa has no interest-bearing loan, non-current liabilities is not calculated in long term debt ratio

Table 4 illustrated that Sasa performed relatively stable throughout 3 fiscal years, and even its debt ratios, i.e. total debt ratio of 0.47; debt to equity ratio of 0.89; and equity multiplier at 1.89, had slightly increased towards the end of the observed period, it managed to keep at the same level with L'Occitane. Both companies demonstrated that the business is heavily supported by equity with its low ratios, in contrast with Bonjour which all ratios recorded several times higher than the others. This explains that Sasa has a strong capability to support its operation by self-generating funds, including accumulated profit from the previous years which forms part of the company's equity. The company's healthy financial status does not require any long-term debt to finance its business means that it has a low probability to face solvency issues in the near future.

2.5 Stock market prospects

As being a listed company, Sasa stock value will be evaluated from time to time by investors using various indicators before making acquisition decisions. Financial ratios are one of the tools to analyze the worthiness of a company's stock (Fadli and Hongbing, 2020).

Table 5 Stock market prospect indicators

		Sasa			Bonjour	L'Occitane
		2018/19	2019/20	2020/21	2020	2020/21
Return on Assets	Net income after tax/Total assets	14.41%	-14.54%	-14.31%	-25.15%	6.29%
Return on Equity	Net income after tax/Total equity	19.74%	-28.55%	-27.01%	-153.32%	12.28%
Total Asset Turnover	sales/total assets	2.39	1.75	1.21	0.52	0.62
Market Capitalization (in million)		7,859.73	3,475.57	5,678.84	511.88	31,976.29
PE Ratio		16.01	(7.32)	(15.81)	(1.98)	22.33
Market-to-book ratio		3.16	2.09	4.27	3.04	2.74

Source: Sasa, 2021(b), 2020; Bonjour, 2020; L'Occitane, 2021

Investors will be interested in a company's ability to generate return from its assets before investment. Since Sasa was suffering from net losses in the recent fiscal years, the negative return of assets and return of equity ratios can hardly attract the investors' attention. By reference to Table 5, although Sasa ability to generate earnings from its assets and equity was weaker than L'Occitane, its performance was way better than Bonjour and suggesting Sasa is still competitive within the beauty retail market. Meanwhile, by looking into Sasa total asset turnover, its capability to generate sales through its assets was still the highest among its rivals despite the recent drop in the latest fiscal year.

Yet, the market value of Sasa is also an important factor rank its stock worthiness. Sasa market capitalization was HKD 5.7 trillion which positioned the company in the middle among its competitors. Influenced by the net losses caused by the change in the business environment, Sasa could only obtain a negative earnings per shares HKD -0.12, the lowest P/E ratio of -15.81 in the compared companies, together with the highest market-to-book value among the competitors which indicated the company held less valuable assets. These reflected negative to low return to investors, which is an unfavorable sign on the worthiness of Sasa stock and may bring their hesitation to purchase in the stock market.

To conclude, Sasa profitability and stock market prospects have been heavily hit by the decline in retail business in recent years. The company profit-generating ability could be considered as an adverse indicator of its value. However, Sasa can sustain a relatively strong position within the industry by taking into account the cash-generating aspects through analyzing the bankruptcy, liquidity and solvency indicators. Thus, the financial status of Sasa can still be regarded as relatively favorable by reference to the peer

companies. Yet, such financial position cannot last long if the management fails to locate the operation weakness through evaluating the financial ratios and provide immediate action to enhance business performances. In particular, it is critical to impose effective business strategies and control procedures to strengthen the company's earning ability and operating efficiency by reference to Sasa current status, as a result to improve underperforming areas like profitability, operating turnovers and stock value.

3. Corporate governance of Sasa

The value of a corporate can be evaluated not only through financial performance, but also the effectiveness of corporate governance imposed in the operation (Mulyadi, Sihabudin and Sinaga, 2020). Sound corporate governance could enhance the company value by balancing the company stakeholders' interests and build brand equity to raise attractiveness to potential investors (Islam, 2019). Sasa corporate governance is analyzed and compared to the best practice in the following to evaluate its effectiveness.

3.1 The formation of board of directors

The role of chairman and chief executive can be separately identified to manage the board and the daily business management respectively in which the division of responsibilities can enhance a balance of authority in an organization (HKEX, 2021(a)). Yet, both positions in Sasa are held by the same individual Dr. Kwok, together with Dr. Kwok's spouse acting as the vice-chairman (Sasa, 2021(b)), could demonstrate weaknesses in the segregation of duties and form a one-sided power structure at the board level.

To enhance corporate governance, Sasa could diversify the unbalanced power structure by forming a board with more directors to dilute the founders' voting right during board meetings. The current board is formed by 8 directors and has just met the minimum requirement in the listing rules with 3 independent non-executive directors ("INEDs") attributing slightly more than 1/3 of the board of directors (HKEX, 2021(b)). The expansion of the board could strengthen the balance of power but at the same time increase the cost of directors' salaries and fees.

Meanwhile, the INEDs serve as an independent element on the board to exercise independent judgement, in which long-term appointment of the same individual, i.e. 9 years, will lower the independence function since a continuous relationship has been developed with the company (HKEX, 2021(a)). However, for the board of Sasa, 2 out of 3 INEDs have been serving the company for over 9 years (Sasa, 2021(b)) which could weaken their monitoring function by losing outsider perspective angle with their length of services. Thus, the company should actively look for capable individuals to make replacements for strengthening the function of INEDs.

3.2 Remuneration of directors

To enhance the executive directors acting for the best interest of the development of the company, it is recommended that a significant proportion of the remuneration of executive directors should be rewarded by connecting to the performance of the business and individuals (HKEX, 2021(a)). By reference to the directors' emoluments of Sasa as of 31 March 2021, the basic salaries and allowances attributed to 90% of the executive directors' total emoluments for the year (Sasa, 2021(b)) which walks away from the recommended best practices.

Although it is understandable that a low basic salary and allowance portion could increase the difficulty to retain capable individuals to lead the company, a low percentage of rewards linked to performance, i.e. 10%, could reduce the motive of the executive directors to actively further develop the business. The remuneration committee of Sasa should reconsider a more balanced remuneration package for each executive director to ensure it is attractive to retain talents and at the same time can encourage appropriate strategic decisions are timely proposed for business growth.

3.3 Risk management and internal control

The management of a company is responsible for the design, implementation and monitoring of the risk management and internal controls and ensure the systems are appropriate and effective (HKEX, 2021(a)). It is recommended that a timely confirmation from the management on the effectiveness of such systems should provide to the board for overseeing. Yet related disclosure cannot be found in Sasa annual report and the

stakeholders are uncertain whether the company has proceeded with such procedures in risk management and internal control. Therefore, it is better for Sasa to disclose the management confirmation process in the annual report if it has already been imposed, or immediately enforce such procedures if it is yet to adopt.

4. Investment appraisal on enhancing retail digitization

Due to the social unrest and health crisis which brought magnificent attack to the store-based retailing, Sasa has proposed a digitized business pattern by engaging more technology into the operation (Sasa, 2021(b)). This section performs an assessment on the enhancement in the retail technology for expanding Sasa online business and four analytical tools will be used to evaluate the worthiness of the proposed project. The background information of the project is as follow:

Table 6 Development of e-commerce platform

				Note
System development initial cost	10% of sales of last fiscal year	(in HK\$'000)	50,131	(i)
System maintenance	3% of system initial cost per annum	(in HK\$'000)	1,504	(ii)
Remark:				
Depreciation	- Equipment, furniture and fixtures		5 years	(iii)
Sales	- First sales growth rate over the operating period		45.44%	(iv)
	- Ultimate growth rate (3yr onwards)		2.4%	(v)
EBITDA			1.69%	(iv)
Operation period			5 years	(vi)
Note				
(i) Since there is no information on Sasa initial investment cost on retail technology upgrading, the initial cost of the system development will be estimated as 10% of revenue generated from online business in latest fiscal year (Appendix 1).				
(ii) It is suggested that the repair and maintenance cost should be kept at 3% of the asset value (Social Channel, 2019)				
(iii) According to the company's accounting policies by reference to annual report (Sasa, 2021(b)).				
(iv) Since Sasa started to focus on the development of its e-commerce platform in the last fiscal year, the growth rate and EBITDA in 2020/21 is used to project the expansion on online sales (Appendix 1).				
(v) According to International Monetary Fund, Hong Kong inflation forecast in 2023 onwards is 2.4% (IMF, 2021).				
(vi) Sasa online business has started for 5 fiscal years (Appendix 1), therefore the operation of the new investment will set 5 years as another benchmark to evaluate the business.				

4.1 Accounting Rate of Return

Accounting rate of return (“ARR”) is a way to illustrate the percentage rate of return expected from an investment on its initial cost. By using ARR to calculate can identify the profitability of the mentioned project before making investment decision.

Table 7 Accounting rate of return

	HK'000
Total profit in 5 years	30,658 (Appendix 2)
Average ARR (A)	6,132
Initial cost (B)	50,131
ARR (A/B)	12.23%

By reference to Table 7, the ARR illustrated that the investment is a profitable project which is expected to generate earnings accounting for 12.23% of the initial cost each year. The result is a positive sign for the management to consider commencing the project.

However, ARR can only act as a preliminary analytical tool to review the investment since it is a very simplified and quick method to understand the return of the project which ignored the time value of money, and will bring deviation to some profitable long-term investments. Thus, the management should also perform other evaluation before making investment decision.

4.2 Net present value

Net present value (“NPV”) is a way to measure a project value stands at the current period by taking into account the initial cost offsetting by the discounted future cashflow generated from the investment to analyze the worthiness of project, in which project with negative NPV should be excluded from the investment plan since no cash inflow can be obtained.

Table 8 Net present value

Rate:		5.17% (ROA in 2020/21)				
In HK'000	Initial cost	1 Yr	2 Yr	3 Yr	4 Yr	5 Yr
Casflow	(50,131)	10,465	15,152	15,512	15,881	16,258 (Appendix 3)
Present Value	(50,131)	9,951	13,700	13,337	12,983	12,639
NPV	Total PV - initial cost	12,479				

By evaluating Sasa proposed online business expansion project, the investment is expected to generate an NPV of over HKD 12 million in five years representing the expansion is a profitable project. Thus, this is a positive indicator for the management to make an investment decision.

However, the management also needs to take other factors into consideration even the proposed project has a positive NPV, since many assumptions such as discount rate and the cashflow forecast is projected in the calculation (Gaspars-Wieloch, 2019), in which any underestimation could adverse the NPV result and lead to a wrong investment decision making.

4.3 Internal rate of return

Internal rate of return (“IRR”) has a close correlation to NPV, in which IRR is to identify the discount rate which can lead to a zero NPV of a project, and a project will be rejected if it has a rate of return higher than its IRR (Mellichamp, 2017). The investment project of Sasa has an IRR of 7.68%, which is higher than its rate of return of 5.17% as illustrated in Table 8. According to the analytical tools, both IRR and NPV demonstrate that the project meets the acceptance criteria, which provide additional analytical basis for the management to initiate the investment.

IRR is a relatively simple way to communicate with stakeholders. Yet, similar to NPV, IRR also highly depended on estimations in the calculation which the rate can be misconstrued if the ongoing project deviates from the initial assumption. Therefore, it is better for the management to prepare several scenarios on the potential project, to understand the varies arising from the change in assumptions and fully locate the underlying investment risk.

4.4 Payback period

Payback period is a straightforward calculation to analysis the length of time required to cover the initial investment cost and a shorter payback period is more attractive to the investors. The payback period of Sasa online business expansion project is calculated as follow:

Table 9 Payback period						
	Initial cost	1 Yr	2 Yr	3 Yr	4 Yr	5 Yr
Casflow	(50,131)	10,465	15,152	15,512	15,881	16,258 (Appendix 3)
Cumulative net cash flow		(39,666)	(24,514)	(9,001)	6,880	23,138
				Yr	Mths	
			Payback period	3	7	

According to Table 9, the project's payback period is 3 years and 7 months, which indicates that the initial cost can be recovered within the operation period.

However, the payback period neglected the profitability level after the initial cost has settled, which is likely to reject projects with a long payback period but a high profit earning ability afterwards. Meanwhile the time value of money is not considered in the calculation of the payback period. Therefore, it is unlikely that the payback period can be used as a sole analytical tool to evaluate the worthiness of an investment.

To conclude, by reference to four different analytical tools to evaluate the profitability of Sasa expansion project, positive indicators are obtained giving a higher intention for the management to accept the investment.

4.5 Raise of capital for the business expansion plan

To finance the business expansion, Sasa can look for external sources of funding either by debt or equity. As explained in Section 2.5, the recent stock market prospect indicators of Sasa were not particularly attractive to new investors and the market value of Sasa stock is comparatively low by reference to its historical record as mentioned in Section 1.2, the management may face more obstacles when looking for funds in the equity market, which include reduction in potential investors and increase in the cost of equity, i.e. 10% as of 2020/21 fiscal year ended, resulting from its less favorable equity performance.

In contrast, it may be more advantageous for Sasa to finance by debt since the company has relatively low debt ratios as illustrated in Table 4, together with recently low borrowing rate in the debt market, i.e. from 1.25% to HIBOR + 4.5% (Bonjour, 2020), in which even the project is supported by debt it is still profitable due to its higher IRR as compared to the borrowing rate. Furthermore, the management could have more bargaining power with the financial institutions on term loans by reference to its favorable debt ratios to reduce the cost of debt.

5. Financing management of Sasa

As mentioned in the previous section, external fundraising could be obtained from the debt or equity market. By assuming Sasa needs to raise a one-off capital amount to 3% of its total assets, i.e. HKD 75 million, the following will identify the impact on Sasa financial with different financing options.

If the management decided to raise capital from the equity market, Sasa will not have the obligation to repay the raised amount and no additional financial burden is imposed to the company. Yet, as the management choose to use some of the company's shares in exchange for capital, the existing shareholders will face a dilution in shareholdings which reduce their voting right portion in the future development of the company. By reference to the existing shareholding structure of Sasa, the founders of the company are the substantial shareholders of the company as mentioned in Section 1.1 and their willingness in diluting their influential status may be low due to their long-term contribution to the company. Using the latest market capitalization as of 31 March 2021 in Table 5, an additional HKD 75 million capital would only have attributed to 1.3% of its existing value of HKD 5.7 trillion, indicates that the one-off finance will not have a material impact on the shareholding structure even if the entire funding is finance in the equity market.

On the other hand, raising a term loan of HKD 75 million from financial institutions can be another option for Sasa management to take into consideration. Unlike equity financing in which the company needs to build a long-term relationship with the equity holder and require ongoing profit sharing and dividend payout in return, the company's connection with the debt issuers will end when the term loan is fully settled. Yet, even though debt financing has a fixed repayment schedule which is easier for cashflow forecasting, an

interest-bearing loan can be influenced by time-to-time interest movement which varies the cost of debt incurred. The existing debt market condition is relatively attractive to fundraising since the HIBOR rate is experiencing a downward trend which reduces the interest burden of the borrower. By taking the current industry benchmark range from 1.25% to HIBOR + 4.5% (Bonjour, 2020) with a 3 month HIBOR of 0.14411% (HKAB, 2021), assuming Sasa entering into a long-term loan with the highest borrowing rate HIBOR + 4.5% and no material fluctuation in HIBOR over the loan period, the company will bear an interest of approximately HKD 3 million per annum. The incurred interest expense is subject to tax deduction which could offset the cost bearing on debt financing.

The impact on different financing methods is indicated as follow:

Table 10 Comparison of financial indicators in different sources of financing

	Before financing	Debt financing	Equity financing
Cost of capital	-	4.64%	10.0%
Total Debt Ratio	0.47	0.49	0.46
Debt/Equity	0.89	0.94	0.84
Long Term Debt Ratio	-	0.06	-
Equity Multiplier	1.89	1.94	1.84
Net Profit Margin	-11.81%	-11.89%	-11.81%

Source: Sasa, 2021(b)

Table 10 illustrated that equity financing has no impact or even improve the solvency ratios and net profit margin with its repayment obligation free features, but it has a much higher cost of equity rate, i.e. more than 5%, as compared to debt issuing. Meanwhile, even though loan financing has adverse influence on the financial ratio, the impact on Sasa as shown in Table 10 is mild.

Since both financing methods have no significant varies in the financial ratios, it is suggested that the company should take into account the option that could generate a lower weighted average cost of capital (“WACC”) as the decision benchmark.

Table 11 Comparison of WACC in different sources of financing

	Note						
Fund raising amount	(i)	75,000.00	HK'000				
WACC =(E / V * Re) + (D / V * Rd (1-Tc))							
		Before financing		Debt financing		Equity financing	
E =MV of the firm's equity		5,678,836.71	HK'000	5,678,836.71	HK'000	5,753,836.71	HK'000
D =MV of the firm's debt		-	HK'000	75,000.00	HK'000	-	HK'000
V =E + D		5,678,836.71	HK'000	5,753,836.71	HK'000	5,753,836.71	HK'000
Re =Cost of equity		10.0%		10.0%		10.0%	
Rd =Cost of debt	(ii)	-		4.64%		-	
Tc =Corporate tax rate		16.5%		16.5%		16.5%	
WACC		10.0%		9.92%		10.0%	
Source: Sasa, 2021(b)							

Source: Sasa, 2021(b)

Note

(i) Assuming the capital amount is equivalent to the market value in both debt and equity market

(ii) By reference to Bonjour (2020) highest borrowing rate

According to the calculation, 100% debt financing achieved a slightly lower WACC, therefore it is recommended that Sasa should choose term loan as the one-off capital raising.

6. One year audit schedule

After the performing the financial review, the implementation of the recommendations as mentioned above would be prioritized and allocated in each quarter as follow:

Table 12 Implementation of the proposed recommendation

Quarter 1	Quarter 2	Quarter 3	Quarter 4
- Raise capital from financial institutions	- Upgrading online system funded by term loan	- Implement and integrate the system into the online business	- Commencement of the expanded online business
- Review inventory control and identify underlying issues	- Modify the internal control procedures according to the identified issues and set achievable KPIs	- Implementation of new internal control procedures	- Monitor and review the inventory control and ensure new procedures are implemented accordingly and KPIs are achieved
- Review directors' remuneration package	- Seek for capable talents to join the board of directors and replace long-time serving INEDs	- Appoint new directors	- Confirmation from the management on the effectiveness of risk management and internal controls

The commencement of online business expansion is the top priority among the recommendations as to offset the decline in store-based retail sales since the net loss status has significant impact on many financial ratios as shown in Section 2. A successful online business could strengthen the company's earnings further which can hopefully change the net loss positions in two consecutive fiscal years. Meanwhile, a better developed e-commerce network can reduce the location boundaries and ease its business concentration in the Hong Kong and Macau market.

At the same time, it is also important to enhance the inventory turnover as this can influence the effectiveness of existing operations. The improvement in inventory control not only could shorten the operating and cash period, but tight monitoring can also help to reduce the inventory cost incurred in daily transactions that can increase the profit margin.

Even though it is suggested that the corporate governance of Sasa should be more closely performed according to the best practice, such enhancement can be rank at a lower priority since the existing board still shows the capability to lead the company to sustain a relatively healthy financial status in the industry, in which the board structure demonstrated a certain degree of effectiveness on its business performance.

7. Conclusion

Sasa is one of the leading beauty product retailers in the market with its long history and established retail networking throughout the years. Although Sasa has been suffered from negative profit in recent years due to the adverse conditions in the retail environment, by comparing the financial status with its rivals the company's position in the market still shows robust.

However, there are still rooms to improve Sasa business performance, in particular, it is critical for the company to adverse its net loss status by investing further in the online business by debt financing. Meanwhile, the management also needs to put more afford into strengthening the company's inventory control to enhance its operating efficiency to keep up with the industry benchmark.

Furthermore, the management should also take further steps on corporate governance to sustain best practice, including restructuring the board of directors and revise the directors' remuneration package, together with adopting more comprehensive reporting procedures, to demonstrate a well-structured control is established in Sasa.

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Appendix

1 Financial performance of online business

	2020/21	2019/20	2018/19	2017/18	2016/17
In HK\$'000					
Revenue	501,305	344,671	391,829	383,345	475,189
(Loss)/Profit	8,791	(39,736)	(26,461)	(28,267)	(67,144)
Capital expenditure	170	8,299	662	2,002	1,817
Finance costs	-	-	-	-	-
Income tax (credit)/expense	(706)	(11,126)	(9,946)	(9,033)	(12,640)
Depreciation					
Property, plant and equipment	408	2,591	1,664	2,446	2,132
Right-of-use assets	-	-	-	-	-
Non-current assets	3,235	1,706	6,935	2,763	3,207
Current assets	166,947	95,195	115,493	132,316	151,726
Total assets	170,182	96,901	122,428	135,079	154,933
Revenue growth	45.44%	-12.04%	2.21%	-19.33%	N/A
EBITDA	1.69%	-14.00%	-8.87%	-9.09%	-16.34%
ROA	5.17%	-41.01%	-21.61%	-20.93%	-43.34%

Source: Sasa, 2021(b), 2019, 2017

2 Projection of profit for the operation period

Initial year		HK\$'000					
Total sales		501,305					
Profit/(loss) for the period (in HK\$'000)			1 Yr	2 Yr	3 Yr	4 Yr	5 Yr
Sales	Average sales per store x (1+growth rate) (note)	729,121	1,060,466	1,085,917	1,111,979	1,138,666	
EBITDA	Sales x EBITDA	12,353	17,966	18,397	18,839	19,291	
Depreciation	Online system / 5	(10,026)	(10,026)	(10,026)	(10,026)	(10,026)	
	EBIT	2,327	7,940	8,371	8,813	9,265	
Tax expenses	Hong Kong profit tax 16.5%	(384)	(1,310)	(1,381)	(1,454)	(1,529)	
	Profit for the year	1,943	6,630	6,990	7,359	7,736	

Note: Ultimate growth rate will use starting from 3yr onwards

3 Projection of cashflow for the operation period

(in HK\$'000)	Initial cost	1 Yr	2 Yr	3 Yr	4 Yr	5 Yr
EBITDA		12,353	17,966	18,397	18,839	19,291
Working capital - system maintenance cost		(1,504)	(1,504)	(1,504)	(1,504)	(1,504)
Tax expenses		(384)	(1,310)	(1,381)	(1,454)	(1,529)
Cashflow:	(50,131)	10,465	15,152	15,512	15,881	16,258