

Larry Jewelry International

Shining luster in a raw stone

to summarize...

- Larry released 3Q operating result on 9 Nov Morning, result indicated operation improvement. Group's operating loss to sales ratio narrowed by 15.8pp.
- Turnover dropped by 5% QoQ to HK\$73.6m or increased by 35% YoY, while net loss dropped by 48% QoQ and 58% YoY to HK\$15.7m.
- Operation update: Larry launched the first showroom in Beijing, first step to develop the domestic luxury market under the 'Larry Jewelry' brand.
- To celebrate 45th anniversary of Larry Jewelry, company launched a new collection namely "L'Cosmo".
- For the 4Q outlook, we expect turnaround from operating loss to profit resulting from seasonal peak in a year coupled with branding reward.
- We currently have a BUY rating on Larry at TP HK\$0.8.

What's new? Larry Jewelry (Larry) released 3Q result on 9/11 morning. Sales performance was sound despite below-expectation market growth. We see some degree of operation improvement that retails segment loss narrowed by 40% YoY to HK\$9.4m. In general, group's gross profit increased by 20% QoQ to HK\$25.1m with margin increased by 7.2pp QoQ to 34.1%, while operating loss to sales ratio narrowed by 15.8pp QoQ to 14.0%. For the 4Q FY12/12F, we expect to see in a turnaround from retail segment operating loss due to the seasonal peak in Oct to Dec. We have a BUY rating with TP HK\$0.8.

3Q result review. For the 3Q period, Hong Kong luxury market indicated a general slowdown as a result of China economy slowdown, EUR currency depreciation and global economy downturn. Larry's 3Q retails sale was mostly in-line with market performance, sales was down by 5% QoQ to HK\$73.8m. Despite top-line declined, gross profit increased by 20% QoQ to HK\$25.1m with gross margin improved by 7.2pp QoQ to 34.1%. The result might reflect Larry maintained ASP as compared to peers discount sales to boost sales volume during the period.

In terms of operation expenses, overall sales, distribution and administrative expenses dropped by 18% QoQ to HK\$36.5m with SG&A expenses to sales ratio lowered by 7.4pp YoY to 49.6%. In particular, 3Q rental expenses increased by 5% QoQ to HK\$12.2m, denoted 16.5% of group turnover, while employee benefit expenses increased by 9% QoQ to HK\$9.0m represented 12% of turnover. Yet, 2Q reported a non-recurring loss on redemption convertible notes of HK\$5.2m and fair value loss on financial assets of HK\$8.8m. Adjusted net profit before tax for non-recurring expenses and fair value change improved 23% QoQ to HK\$12.5m.

Table 1. Operating Result 4Q11A-3Q12A

HK\$m	4Q 11A	QoQ	1Q 12A	QoQ	2Q 12A	QoQ	3Q 12A	QoQ
Retail sales	139.0	1.6x	88.4	(36%)	77.4	(12%)	73.8	(5%)
Other	4.7	1.5x	4.2	(11%)	0.4	(90%)	(0.2)	-
Group	143.7	1.6x	92.6	(36%)	77.7	(16%)	73.6	(5%)
Gross profit	23.6	1.7	21.9	(7%)	20.9	(5%)	25.1	20%
Operating Loss	(22.4)	(25%)	(6.7)	(70%)	(23.1)	2.5	(10.3)	(56%)
Net loss	(31.4)	(15%)	(14.9)	(53%)	(30.3)	1.0	(15.7)	(48%)
Gross margin	16%		24%		27%		34%	
Oper loss margin	-16%		-7%		-30%		-14%	
Net loss margin	-22%		-16%		-39%		-21%	
SG&A to sales ratio	32%		37%		57%		50%	

Source: SBI E2-Capital, Larry Jewelry

Ticker	8351 HK
Rating	BUY
Price (HK\$)	0.39
Target Price (HK\$)	0.8
12m Price Range (HK\$)	0.37 – 0.98
Market cap. (US\$m)	50.9
Daily t/o (US\$m)	0.8
Free float (%)	36.61

Financial summary

Year to Dec	Adjusted 11A	12F	13F
Turnover (HK\$m)	209.6	537.1	669.9
Net Profit (HK\$m)	(91.8)	40.1	70.2
EPS (HK\$ cent)	(9.0)	4.01	6.89
P/E (x)	-	9.9	5.6
P/B (x) pre-CB	1.4	1.5	1.5
EV/EBITDA (x)	-	6.6	4.2
Yield (%)	-	-	-
ROE (%)	-	15.2	26.0
ROCE (%)	-	15.2	26.1
N. Gear. (%)	N.Cash	N. Cash	2.5

Source: SBI E2-Capital

	12F	13F	14F
Consensus EPS (US\$)	-	-	-
Previous earnings (US\$m)	-	-	-
Previous EPS (US\$)	-	-	-

Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	38.1	46.0	(25.3)
Actual price changes (%)	43.0	56.9	(18.1)



Source: Bloomberg

Research Team

(852) 2533 3700
sbie2research@sbie2capital.com

Business update – launching first VIP lounge in Beijing. As committed to develop the domestic market, LJ executed the first step to establish the first VIP Lounge under the Larry Jewelry brand in Beijing. The VIP showroom is situated in a strategic location that near the prime luxury shopping district of Beijing. It is covers by landmark shopping malls, such as Oriental Plaza and Jinbao Place. The lounge is targeted to commence operation in 1Q 13F. Yet, Larry has launched a mew collection namely “L’Cosmo” in Sep 2011A and hosted several VIP events to promote the brand ‘Larry Lewelry. Illustration 1 shows the latest collection of L’ Cosmo:

Illustration 1. Location of the VIP Lounge



Print ads in newspapers and magazines

A model presents the L' Cosmo collection of diamond jewelry.

Source: SBI E2-Capital, Larry Jewelry

Market update and peer valuation. As a result of persistent sluggish global economy especially domestic economy slowdown, consumer discretionary sector in general has underperformed the market expectation. Market growth rate appeared to increase at slower pace comparing to previous periods. Luxury retailers in Hong Kong have reported low double digit/ high single digit growth for the 1H/ first nine months result in 2012, in contrary to high double digit growth in previous years. For instance, Sincere Watch (444 HK) recently announced a profit warning for the 1H FY03/13F, while Tse Sui Luen (417 HK) expects to record 60~70% down in profit for 1H FY02/13F. Other luxury goods retailers, such as, LVMH's 3Q profit lower market expectation than market expectation by 1pp by 6%, while Burberry's 1H FY09/13A profit increased by 8% as compared previous growth rate of 30% YoY. Table 2 shows the peer comparison of luxury goods sector:

Table 2. Peers comparison table

Company	Ticker	FY end	Market cap (US\$m)	Cur P/E (x)	P/E 13F	P/BV (x)	ROE (%)
<u>Jewelry</u>							
Chow Tai Fook Je	1929 HK	03/2011	13,908.8	15.7	16.3	3.7	31.5
Chow Sang Sang	116 HK	12/2011	1,582.6	11.9	9.5	1.9	18.2
Tse Sui Luen Jew	417 HK	02/2011	112.4	8.2	-	0.9	18.6
King Fook	280 HK	03/2011	65.1	14.1	-	0.6	3.7
<u>Watch</u>							
Emperor Watch & Jew	887 HK	12/2011	719.5	9.3	8.5	1.4	20.5
Oriental Watch	398 HK	03/2011	182.6	8.6	6.7	0.7	8.3
Sincere Watch	444 HK	03/2011	130.6	7.3	-	2.3	36.7
<u>Fashion</u>							
Prada	1913 HK	01/2012	20,981.0	37.7	27.3	9.0	28.5
Joyce Boutique	647 HK	03/2011	121.5	6.3	-	1.3	22.5
Milan Station	1150 HK	12/2011	48.7	27.1	11.2	1.0	19.0

Source: Bloomberg

Our view and valuation. 3Q result indicated operation was scaling up with improvement in COGS and SG&A expenses. For the 4Q, we are hoping to see a turnaround from an operating loss to operating profit in the retails segment, supported by extensive marketing campaign, as well as seasonal high. In the longer term, Larry is launching a new brand series to penetrate into mid-range luxury market with emphasis on domestic market, while we believe Larry brand original sales growth will leverage on increase of market awareness and strategic cooperation with Oriental Watch (398 HK); details please refer to previous reports. Industry peer trading at current P/E of average 14.6x and forward P/E of 13.3x. Our current forecast and target price largely depend on 4Q performance, which is subject to further review.

Table 3. Financial result for the first nine months.

HK\$m, 2012	1Q	2Q	3Q	1Q~3Q
Revenue	92.6	77.7	73.6	244.0
COGS	(70.8)	(56.8)	(48.5)	(176.1)
Gross profit	21.9	20.9	25.1	67.8
Other income	5.4	0.2	1.1	6.8
Distribution costs	(18.2)	(18.3)	(18.9)	(55.5)
Administrative expenses	(15.8)	(25.9)	(17.6)	(59.3)
Operating loss	(6.7)	(23.1)	(10.3)	(40.1)
finance costs	(8.4)	(7.1)	(4.8)	(20.3)
LBT	(15.0)	(30.3)	(15.1)	(60.4)
tax	0.2	(0.1)	(0.6)	(0.4)
Net loss	(14.9)	(30.3)	(15.7)	(60.9)

Source: SBI E2-Capital, Larry Jewelry

Disclosure of interests: SBI E2-Capital Financial Services Limited acted as placing agent for Larry Jewelry International Company Limited (formerly known as Eternite International Company Limited) (stock code: 8351) in March 2012.

SBI E2-Capital Financial Services Limited acted as sub placing agent and placing agent for Larry Jewelry International Company Limited (formerly known as Eternite International Company Limited) (stock code: 8351) February 2012.

SBI E2-Capital is a dedicated small/mid cap investment banking/ stockbrokerage house. Find our research on: sbie2capital.com, thomsononeanalytics.com, factset.com and multex.com

SBI E2-Capital stock ratings:

STRONG BUY : absolute upside of >50% over the next three months

BUY : absolute upside of >10% over the next six months

HOLD : absolute return of -10% to +10% over the next six months

SELL : absolute downside of >10% over the next six months

Investors should assume that SBI E2-Capital is seeking or will seek investment banking or other related businesses with the companies in this report.

Analyst certification: The views expressed in this report accurately reflect the analyst's personal views of the subject securities and that the analyst has not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

Disclaimer: This research report is not an offer to sell or the solicitation of an offer to buy or subscribe for any securities. The securities referred to in this report may not be eligible for sale in some jurisdictions. The information contained in this report has been compiled by the Research Department of SBI E2-Capital Financial Services Limited ('SBI E2-Capital') from sources that it believes to be reliable but no representation, warranty or guarantee is made or given by SBI E2-Capital or any other person as to its accuracy or completeness. All opinions and estimates expressed in this report are (unless otherwise indicated) entirely those of SBI E2-Capital as of the date of this report only and are subject to change without notice. Neither SBI E2-Capital nor any other person, accepts any liability whatsoever for any loss howsoever arising from any use of this report or its contents or otherwise arising in connection therewith. Each recipient of this report shall be solely responsible for making its own independent investigation of the business, financial condition and prospects of the companies referred to in this report. SBI E2-Capital and their respective officers, directors and employees, including persons involved in the preparation or issuance of this report, may from time to time (1) have positions in, and buy or sell, the securities of companies referred to in this report (or related investments); (2) have a consulting, investment banking or broking relationship with any company referred to in this report; and (3) to the extent permitted under applicable law, have acted upon or used the information contained or referred to in this report including effecting transactions for their own account in an investment (or related investment) in respect of any company referred to in this report, prior to or immediately following its publication. This report may not have been distributed to all recipients at the same time. This report is issued only for the information of and may only be distributed to professional investors and dealers in securities and must not be copied, published, reproduced or redistributed (in whole or in part) by any recipient for any purpose. This report is distributed in Hong Kong by SBI E2-Capital. Any recipient of this report who requires further information regarding any securities referred to in this report should contact the relevant office of SBI E2-Capital located in such recipient's home jurisdiction.

Copyright © SBI E2-Capital Financial Services Limited. All rights reserved.