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Specialty Stores (GICS) | Luxury Goods (Citi)
Asia Pacific | Hong Kong

Chow Sang Sang (0116.HK)

Analyzed Non-Rated Snapshot

■ **Company Overview** — YTD in 2013, CSS has recorded mid-to-high teens SSS in both HK and China and further cited that discounting pressures had eased in these markets. Notably, this growth had been led by (1) higher volumes to average priced items while sales volumes of higher-ticket items remains fairly flat according to mgt and (2) better sales to tourists in HK (Chinese tourists account for >53% of CSS' HK sales), which mgt expects to continue into 2013. In line with trends cited by peers like CTF (see [Chow Tai Fook Jewellery Group \(1929.HK\) - Improving Trends in Jan-Feb13 In Line With Expectations](#)) and LF (see [Luk Fook \(0590.HK\) - HK CNY Jewelry Sales Better China As Expected](#)), HK SSS were stronger than China SSS, led by higher sales of gold products. CSS, which derives 5% of its sales (or HK\$743mn) from watches, had further cited good watch sales over the last four months particularly for mid-end watches. On the topic of giftings, mgt cited that the company had not seen any impact, i.e., it had not seen lower gold sales, which it deemed more vulnerable than gem-set jewelry to the clamp-down on giftings as valuation of the former is easier to ascertain. We will revert with more on the industry trends post our F4T lunch this week (28Mar, Thurs) with LF. *(For more details on the event, please contact your Citigroup representative.)*

■ **Business Strategy** — CSS is looking at better SSS in 2013 than 2012, during which it recorded SSS of 9% for HK and 12% for China. Gold is expected to remain the dominant product in 2013 (overall: 62% of sales) where HK's gold sales accounted for 60-61% of its local sales (2ppt higher than 2011) & China at 64% (similar to 2011). As at 31 Dec 2012, CSS's retail network comprised 318 CHOW SANG SANG branded POS and 34 Emphasis Jewellery branded POS, which represented a YoY increase of 15% to its retail network. The increase was driven by net openings of 47 CHOW SANG SANG branded POS during the year which mgt concurred with more closures in 2012 due to the weaker operating environment. Mgt expects that there will be no more than 50 net openings in 2013.

■ **Industry Overview** — 2012 had proved to be a year filled with erratic sales trends (and volatile expectations) for the jewelers. As highlighted in our report [China Luxury Retailing - Rolling Over Recovery Expectations to 2Q13](#), we hold the view that there is now greater visibility to support an earlier recovery of sales in HK over China under the lower base effect. We concur with the near-term headwinds from (1) lackluster gold price movements that cloud buying sentiment and margins of hard luxury retailers; (2) ongoing anti-corruption campaign by the new Chinese government that appears to be affecting purchases of luxury gifts; and (3) policy changes that may affect Chinese-led tourism and/or luxury goods purchases in key markets like HK. That said, we believe the longer-term real demand for luxury goods by the Chinese is strong enough to withstand the near-term overhang from policy directives/changes.

Price (22 Mar 13)	HK\$23.00
Shares Outstanding	677M
Free Float (%)	44
Fiscal Year End	31 Dec
Market Cap	HK\$15,569M US\$2,005M

Price Performance (RIC: 0116.HK, BB: 116 HK)



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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Indicating Improving Outlook Into 2013

- **Competitive Analysis** — CSS' net factory in China is slated to commence operation in mid 2013 and mgt is optimistic on its greater efficiency ahead as this factory will help shorten its supply chain time lag and delivery. The company will also be housing more state-of-the art machinery. Upgrades will also be taking place at its HK factory. Into 2013, mgt sees capex of cHK\$250mn, slightly lower than the HK\$267mn incurred in 2012.
- **Recent Results** — CSS reported FY12 net profit (NP growth) decline of 10% YoY to HK\$946mn, which was 4% above consensus estimates. Stripping out the higher other income, which saw an 80% YoY growth on dividend income from the company's investment in HKSE (0388.HK) shares & higher fair value gain on its investment properties & some additional gains from sale of raw diamonds, adj. NP would have declined >12% YoY, largely in line with the market's expectations. Retailing profits declined 16% YoY (2H12 decline of 13% YoY was more moderate than the 19% YoY decline in 1H12), in part due to the lower gains from gold price movements (2012: cHK\$40mn, 2011: cHK\$200mn).
- **Strengths** — Based on our calculations for net gearing (less cash & equiv.), CSS brought down its net gearing to c18%% as at end 2012 vs. c23% as at 1H12. The end-2012 level was also lower than the 23% as at end 2011. As at end 2012, CSS held about HK\$6.6bn of inventories, similar levels to end-2011 while 5% higher than levels in 1H12 which did not come as a surprise given the peak sales season into 1Q13. The lower sales momentum throughout the year led to a slight increase in inventory (inv) TO days, rising to 158 days for the year (2011: 146 days; 1H12: 151days). However, retail TO actually declined about 10 days to 206 days according to mgt.
- **Weaknesses** — The support to CSS' gross margin (GM) of 18.8% in 2012, held at similar levels to 2011 of 19.0%, was brought about by a lower contribution from the company's physical metals trading and securities brokerage business during the year as a result of the weaker macro environment in 2012. These businesses traditionally generate lower margin than the retailing operations. AR TO days were slightly higher at 13 days (2011: 11 days; 1H12: 12 days) following the company's increased retail network and contribution from China.

Appendix A-1

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53%	49%	45%	60%	49%	55%

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