

Stelux Holdings (84 HK)

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Company Update

BUY

UNCHANGED

Close price: **HK\$2.53**
Target Price: **HK\$2.92 (+15%)**
Prior TP: **HK\$2.50**

Key Data

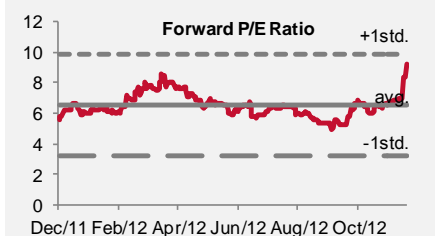
HKEx code	84
12 Months High (HK\$)	2.62
12 Month Low (HK\$)	1.10
3M Avg Dail Vol. (mn)	2.03
Issue Share (mn)	1,046.47
Market Cap (HK\$m)	2,647.58
Fiscal Year	03/2012
Major shareholder (s)	Joseph Wong (50.1%)

Source: Company data, Bloomberg, OP Research
Closing price are as of 3/12/2012

Price Chart



PE



Company Profile

Stelux is principally engaged in the retailing of mid-range priced watch and optical products under the respective brand names, "City Chain" and "Optical 88", in HK, Macau, China, and SE Asia.

China operation improvement on the way

- We transfer coverage of Stelux (84 HK) to analyst Terence Lok.
- Stelux announced 1HFY13 result with 8% yoy increase in net profit. We remain positive on the longer term China business improvement.
- We reiterate BUY with a higher TP HK\$2.92, equivalent to 9x FY14E PE, implying 15% upside to current price.

Slightly went under our 1HFY13 net profit forecast. Stelux announced FY1H13 net profit of HK\$ 125mn, 8% yoy increase, which slightly went under our forecast due to weaker topline contribution from the PRC segment. We, therefore, cut our FY13 net profit by 12% to factor in the effect of demand. However we remain long term positive on Stelux with the PRC operation improvement. Therefore we increase the topline of FY14/15 by 7%/20% respectively.

City Chain business in the right direction. City Chain topline increased by 10% yoy to HK\$ 593mn where overall Greater China sees a larger revenue contribution. The EBIT also turned positive in the SE Asia with the recovery from Thailand and stable growth in Malaysia. Overall GP margin has improved by 1.4ppt, thanks to the house brand performance.

Optical 88 businesses remain stable. Optical 88's topline increases 6%yoy to HK\$593mn. Despite a drop of EBIT margin in optical 88 businesses, the cost was incurred from initial development of 'EGG' boutique stores and higher rental as we have forecasted 17% as topline for the FY13.

Valuation: We maintain our Buy recommendation with a higher target price of HK\$ 2.92. We employ rolling forward FY14 EPS to recommend our target price, implying 9x P/E multiple. We think the company average historically traded around 6-7x P/E where we think Stelux deserve a premium as we believe a larger room of improvement from China business along with the strategic partnership with Boyu Capital. Along 30% dividend payout in 1H13, we believe Stelux is fairly defensive stock given its mid-range priced watch & optical market position.

Exhibit 1: Forecast and Valuation

Year to Mar (HK\$ mn)	FY11A	FY12A	FY13E	FY14E	FY15E
Revenue	2,705.6	3,330.9	3,611.0	4,672.1	5,931.5
Growth (%)	14.2	23.1	8.4	29.4	27.0
Net Profit	130.8	250.3	243.6	370.6	529.7
Growth (%)	446.1	91.4	(2.7)	52.1	42.9
Diluted EPS (HK\$)	0.137	0.263	0.256	0.325	0.464
EPS growth (%)	446.1	91.4	(2.7)	26.8	42.9
Change to previous EPS (%)			0.0	(12.3)	(7.5)
Consensus EPS (HK\$)			0.256	0.325	0.464
ROE (%)	14.2	23.1	19.2	24.6	29.5
P/E (x)	18.4	9.6	9.9	7.8	5.5
P/B (x)	2.4	2.0	1.8	1.5	1.2
Yield (%)	1.4	3.6	3.0	3.8	5.5
DPS (HK\$)	0.036	0.090	0.077	0.097	0.139

Source: Bloomberg, OP Research

Exhibit 2: 1H13 revenue breakdown by segment

	1H13 (HK\$ mn)	1H12 (HK\$ mn)	Change %
City Chain - watch retail			
Greater China	598	508	+18%
SE Asia	254	238	+7%
Sub-total	852	746	+14%
Optical 88 - optical retail			
Greater China	393	370	+7%
SE Asia	154	149	+1%
Sub-total	547	519	+5%
Wholesale			
Greater China	151	138	+9%
SE Asia	65.1	62	+5%
Sub-total	217	200	+9%
Group turnover			
Greater China	1218	1095	+11%
SE Asia	522	492	+6%
Grand total	1740	1587	+10%

Source: Company data, OP Research

Exhibit 3: Earning Revision table

	FY13E			FY14E		
	New	Old	% Chg	New	Old	% Chg
Revenue	3,611	3,828	(5.7)	4,672	4,348	7.5
Gross profit	2,221	2,354	(5.7)	2,897	2,674	8.3
Opex	(1,925)	(2,029)	(5.1)	(2,434)	(2,274)	7.0
EBIT	324	354	(8.4)	491	428	14.7
Net Profit	244	278	(12.4)	371	334	11.0
Diluted EPS (HK\$)	0.256	0.292	(12.3)	0.325	0.351	(7.5)

Source: OP research

Strategic Partnership with Boyu Capital:

Stelux has entered strategic partnership with Boyu Capital which will make a strategic investment in Stelux through HK\$371mn convertible bonds. The number of shares under convertible bonds would be approximately 15% of total enlarged share capital with a conversion price per share of HK\$1.95 along 2 non-executive directors would be nominated by Boyu Capital. Why CB? Management believes that currently the company still has relatively sufficient cash flow for operation, and cash does not required immediately.

In order to enhance business in China, Stelux will appoint a China COO to monitor its business plan in near future. With management believe 52% of stores are breakeven out of 127 stores, in our opinion, such agreement with Boyu Capital would able to further expand in tier 3-4 cities with local knowledge. This would be seen as a long term catalyst for Stelux. The advice from Boyu Capital would strengthen China core retail business and achieving profitable growth.

Exhibit 4: Highlight of subscription

Principal amount	HK\$ 371mn of convertible bonds due in 5 years from the date of issue
No. of shares issued under convertible bonds	190,268,999 (15.38% of total enlarged share capital)
Conversion price per share	HK\$1.95
Interest coupon	Higher of 3.5 p.a. of outstanding principal or dividend payable by company
Conversion period	18 months following the date of issue to 5 years from the date of issue
Directorship	2 non-executive directors nominated by Boyu Capital

Source: Company

Who is Boyu Capital?

Boyu Capital is a leading China-focused private investment firm with over US\$1 billion under management. The team is led by Louis Cheung, former General Manager of Ping An Group and Mary Ma, former managing director of TPG Capital.

Financial Summary

Year to Mar	FY11A	FY12A	FY13E	FY14E	FY15E
Income Statement (HK\$ mn)					
City Chain	1,416	1,804	1,971	2,645	3,567
Optical 88	931	1,101	1,146	1,457	1,710
Wholesales & others	358	426	494	569	654
Turnover	2,706	3,331	3,611	4,672	5,931
YoY%	14	23	8	29	27
COGS	(1,047)	(1,276)	(1,390)	(1,775)	(2,254)
Gross profit	1,659	2,055	2,221	2,897	3,678
Gross margin	61.3%	61.7%	61.5%	62.0%	62.0%
Other income	47	38	28	28	28
Selling & distribution	(1,179)	(1,414)	(1,524)	(1,925)	(2,379)
Admin	(274)	(324)	(354)	(449)	(558)
Other opex	(61)	(35)	(47)	(61)	(77)
Total opex	(1,514)	(1,774)	(1,925)	(2,434)	(3,013)
Operating profit (EBIT)	192	320	324	491	693
Operating margin	7.1%	9.6%	9.0%	10.5%	11.7%
Provisions	0	0	0	0	0
Finance costs	(9)	(9)	(23)	(26)	(29)
Profit after financing costs	183	310	302	464	664
Associated companies & JVs	0	0	0	0	0
Pre-tax profit	183	310	302	464	664
Tax	(51)	(59)	(57)	(93)	(133)
Minority interests	(1)	(1)	(1)	(1)	(1)
Net profit	131	250	244	371	530
YoY%	446	91	(3)	52	43
Net margin	4.8%	7.5%	6.7%	7.9%	8.9%
EBITDA	265	336	357	541	770
EBITDA margin	9.8%	10.1%	9.9%	11.6%	13.0%
EPS (HK\$)	0.137	0.263	0.256	0.325	0.464
YoY%	446	91	(3)	27	43
DPS (HK\$)	0.036	0.090	0.077	0.097	0.139
Cash Flow (HK\$ mn)					
EBITDA	265	336	357	541	770
Chg in working cap	(5)	(182)	(46)	(262)	(318)
Others	47	30	10	10	0
Operating cash	307	184	321	290	452
Interests paid	(9)	(9)	(10)	(13)	(16)
Tax	(43)	(28)	(45)	(57)	(93)
Net cash from operations	254	147	267	219	343
Capex	(92)	(190)	(126)	(234)	(297)
Investments	1	0	0	0	0
Dividends received	0	0	0	0	0
Sales of assets	4	0	0	0	0
Interests received	0	0	0	0	0
Others	(19)	0	0	0	0
Investing cash	(106)	(190)	(126)	(233)	(296)
FCF	148	(43)	140	(14)	47
Issue of shares	0	0	0	0	0
Buy-back	0	0	0	0	0
Minority interests	0	0	0	0	0
Dividends paid	(21)	(56)	(89)	(83)	(113)
Net change in bank loans	(96)	71	0	371	(86)
Others	4	23	0	0	0
Financing cash	(114)	37	(89)	288	(198)
Net change in cash	35	(6)	51	274	(151)
Exchange rate or other Adj	(22)	0	0	0	0
Opening cash	213	226	220	272	546
Closing cash	226	220	272	546	394
CFPS (HK\$)	0.267	0.154	0.280	0.192	0.300

Source: Company, OP Research

Year to Mar	FY11A	FY12A	FY13E	FY14E	FY15E
Ratios					
Gross margin (%)	61.3	61.7	61.5	62.0	62.0
Operating margin (%)	7.1	9.6	9.0	10.5	11.7
Net margin (%)	4.8	7.5	6.7	7.9	8.9
Selling & dist'n exp/Sales (%)	43.6	42.4	42.2	41.2	40.1
Admin exp/Sales (%)	10.1	9.7	9.8	9.6	9.4
Payout ratio (%)	26.2	34.2	30.0	30.0	30.0
Effective tax (%)	28.1	19.1	19.0	20.0	20.0
Total debt/equity (%)	44.2	43.0	37.3	53.1	41.0
Net debt/equity (%)	21.4	24.3	17.3	20.1	20.6
Current ratio (x)	1.6	1.6	1.7	2.0	1.9
Quick ratio (x)	0.7	0.6	0.7	0.9	0.8
Inventory T/O (days)	271	271	271	271	271
AR T/O (days)	45	45	45	45	45
AP T/O (days)	148	148	148	148	148
Cash conversion cycle (days)	168	168	168	168	168
Asset turnover (x)	1.5	1.6	1.5	1.6	1.7
Financial leverage (x)	2.0	1.9	1.9	1.9	2.0
EBIT margin (%)	7.1	9.6	9.0	10.5	11.7
Interest burden (x)	1.0	1.0	0.9	0.9	1.0
Tax burden (x)	0.7	0.8	0.8	0.8	0.8
Return on equity (%)	14.2	23.1	19.2	24.6	29.5
ROIC (%)	11.6	19.4	17.1	21.9	25.6
Balance Sheet (HK\$ mn)					
Fixed assets	373	443	544	734	961
Intangible assets & goodwill	26	60	0	0	0
Associated companies & JVs	0	0	0	0	0
Long-term investments	15	16	16	16	16
Other non-current assets	129	126	182	157	0
Non-current assets	543	645	742	907	976
Inventories	777	1,009	1,032	1,319	1,674
AR	337	456	450	582	739
Prepayments & deposits	0	0	0	0	0
Other current assets	0	0	0	0	0
Cash	226	221	272	546	395
Current assets	1,341	1,685	1,755	2,447	2,808
AP	426	594	565	722	916
Tax	28	45	57	93	133
Accruals & other payables	0	0	0	0	0
Bank loans & leases	370	423	423	423	423
CB & othe debts	0	0	0	0	0
Other current liabilities	0	0	0	0	0
Current liabilities	824	1,061	1,045	1,237	1,472
Bank loans & leases	68	86	86	86	0
CB & othe debts	0	0	0	371	371
Deferred tax & others	2	3	3	3	3
MI	0	0	1	2	3
Non-current liabilities	70	88	89	461	377
Total net assets	990	1,181	1,362	1,656	1,936
Shareholder's equity	990	1,181	1,362	1,656	1,936
Share capital	95	95	95	95	95
Reserves	895	1,086	1,267	1,561	1,841
BVPS (HK\$)	1.04	1.24	1.43	1.74	2.03
Total debts	438	508	508	879	794
Net cash/(debts)	(211)	(287)	(236)	(333)	(399)

Exhibit 5: Peer Group Comparison

Company	Ticker	Price	Mkt	3-mth	PER						EPS			EV/		EV/	Net	Gross	Net	ROE	ROE	Sh px	Sh px	
			cap	avg	t/o	Hist (x)	FY1 (x)	FY2 (x)	YoY%	FY1	EPS	FY2	3-Yr	EPS	PEG	Div yld	Div yld	P/B	P/B	Ebitda	Ebitda			gearing
Stelux Hldg Intl	84 HK	2.53	342	0.5	9.6	9.9	7.8	-2.7	26.8	20.8	0.50	3.0	3.8	2.04	1.77	7.4	6.5	24.3	61.7	7.5	23.2	20.9	37.5	63.2
HSI		21,767.85			11.1	11.4	10.5	(2.2)	8.9	5.3	2.16	3.3	3.4	1.45	1.41						13.0	12.3	(1.6)	11.3
HSCEI		10,458.91			8.6	8.6	7.9	(0.2)	9.7	5.8	1.48	3.6	3.7	1.35	1.29						15.7	15.0	(3.5)	12.6
CSI300		2,108.85			10.6	9.8	8.5	7.8	15.6	12.9	0.76	2.4	2.4	1.51	1.43						14.2	14.6	(8.6)	(5.4)
Adjusted sector avg*					13.8	12.4	10.2	-8.6	22.4	14.51	0.92	3.6	3.5	4.2	3.60	7.6	8.0	1.3	37.9	9.2	22.5	27.4	3.3	14.4
Oriental Watch	398 HK	2.83	208	0.6	6.0	7.5	6.5	-19.4	15.3	1.9	0.61	3.9	3.1	0.72	0.63	7.4	7.3	14.3	21.0	4.2	8.3	9.3	9.3	24.1
Hengdeli Holding	3389 HK	2.75	1,559	4.8	11.9	12.5	11.2	(4.3)	11.9	7.7	1.63	2.9	3.0	1.88	1.74	9.4	8.6	6.6	25.1	7.2	19.1	15.5	(3.8)	32.2
Emperor Watch &	887 HK	0.90	780	2.7	9.3	11.8	9.6	(22)	23.7	30.4	0.39	2.9	2.6	1.52	1.45	7.2	8.9	0.0	28.8	10.7	15.7	13.0	8.4	20.0
I.T Ltd	999 HK	3.21	509	0.9	8.2	9.1	7.3	(10)	25.6	11.2	0.82	4.0	3.4	1.73	1.59	4.9	4.9	0.0	61.7	8.2	22.9	18.2	(3.6)	(11.1)
Sa Sa Intl Hldgs	178 HK	6.24	2,274	3.8	25.4	21.2	17.7	20	19.7	18.7	1.14	2.8	3.3	10.77	9.14	18.0	14.6	0.0	45.2	10.8	46.2	46.0	13.7	22.1
Bonjour Hldgs	653 HK	1.00	386	0.5	12.5	14.7	11.0	(15)	33.8	10.9	1.35	5.5	5.5	10.80	8.85	8.9	10.3	0.0	45.7	9.2	70.2	62.4	(3.8)	(1.0)

* Outliners and "N/A" entries are in red and excl. from the calculation of averages

Source: Bloomberg, OP Research

Our recent reports

Date	Company / Sector	Stock Code	Title	Rating	Analyst
03/12/2012	Chow Tai Fook	1929	1HFY13 interim result updates	SELL	Terence Lok
03/12/2012	Luk Fook	590	1HFY13 interim result updates	HOLD	Terence Lok
03/12/2012	SPT Energy	1251	New Kazakh Order Surprise	BUY	Alan Lau
27/11/2012	Antonoil	3337	Block Order Surprise from Sinopec	BUY	Alan Lau
27/11/2012	Dongfeng Motor	489	The new Dongfeng-Renault JV	BUY	Vivien Chan
23/11/2012	Oriental Watch	398	Interim result FY2013 updates	HOLD	Terence Lok
23/11/2012	China All Access	633	Penetrating into China smartphone market as a leading handset component supply chain play	BUY	Yuji Fung
21/11/2012	China Oil & Gas Service and Eq.	-	The Hatching Upstream Players	BUY	Alan Lau
21/11/2012	Sunny Optical	2382	Oct shipments on track. Downgrade to HOLD	HOLD	Yuji Fung
20/11/2012	Tingyi Holding	322	Fierce competition ahead	HOLD	Tracy Sun
16/11/2012	Samson Holding	531	Key takeaway from Roadshow	NR	Terence Lok
14/11/2012	Biostime	1112	Takeaways from Macau forum, POSITIVE	BUY	Tracy Sun
13/11/2012	Great Wall Motor	2333	October sales growth in-line	HOLD	Vivien Chan
09/11/2012	Geely Auto	175	SUV sales recorded monthly high	BUY	Vivien Chan
08/11/2012	China All Access	633	Second largest shareholder reduce stake	BUY	Yuji Fung
08/11/2012	TCL COMM	2618	Oct shipments inline	SELL	Yuji Fung
08/11/2012	TCL Multimedia	1070	Oct LCD TV shipments was well on track	BUY	Yuji Fung
06/11/2012	Dongfeng Motor	489	October sales slower than expected	BUY	Vivien Chan
06/11/2012	China dairy Sector	-	Fresh!	BUY	Tracy Sun
05/11/2012	China Oil & Gas Sector	-	The New Gas Consumption Policy	-	Alan Lau
05/11/2012	China Solar Sector	-	Who's next ?	-	Alan Lau
01/11/2012	Hong Kong Jewellery Retailers	-	Weak consumption demand in mid-term	-	Terence Lok
29/10/2012	TCL COMM	2618	Loss making 3Q12	SELL	Yuji Fung
29/10/2012	TCL Multimedia	1070	In-line 9M12 results	BUY	Yuji Fung
26/10/2012	Great Wall Motor	2333	Higher ASP and lower admin cost boost 3Q12 earnings	HOLD	Vivien Chan
24/10/2012	Dongfeng Motor	489	New JV set up	BUY	Vivien Chan
22/10/2012	Sunny Optical	2382	Sept shipments on track	BUY	Yuji Fung

Historical recommendations and target price: Stelux Holdings (84 HK)

(as of 3/12/2012)



1	15 Dec 2011	BUY, Target price HK\$1.84
2	24 Apr 2012	BUY, Target price change HK\$2.50

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Buy (B)	We expect this stock outperform the relevant benchmark greater than 15% over the next 12 months.
Hold (H)	We expect this stock to perform in line with the relevant benchmark over the next 12 months.
Sell (S)	We expect this stock to underperform the relevant benchmark greater than 15% over the next 12 month.
Relevant Benchmark	Represents the stock closing price as at the date quoted in this report.

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