

Chow Tai Fook (1929 HK)

Hold

Target price: HK\$9.40



Albert Yip, CFA

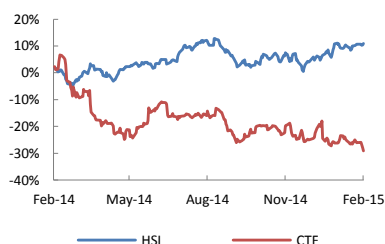
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Stock performance



Source: Bloomberg

Key data

Feb 26 close (HK\$)	9.52
Shares in issue (m)	10,000
Major shareholder	Cheng Yu Tung Family (89.3%)
Market cap (HK\$ bn)	95.2
3M avg. vol. (m)	5.1
52W high/low (HK\$)	14.48/9.50

Source: Bloomberg

Weak CNY sales; downgrade to Hold on lowered earnings outlook

CNY sales data CTF reported sales figures for the CNY period (Feb 5-22: covering the 14 days prior to and the first 4 days of the CNY). Overall SSS fell 4% YoY. SSS in HK & Macau declined by 29% YoY. China SSS increased 11% YoY. Total RSV rose 9% YoY. HK & Macau RSV dropped 24% YoY. China RSV climbed 22% YoY.

HK & Macau market remained weak SSS disappointed due to soft mainland visitor arrivals, weak high-end gem-set sales and a high volume base for gold products. We expect SSS in Jan & Feb to be similar to the CNY figure, with no improvement seen during the months compared to the -21% SSS in 3QFY15. Gem-set SSS fell 17% YoY mainly driven by an ASP decline on volume growth in mass-market items (ASP <HK\$100,000). Gem-set SSS was better than that for gold products (-38% SSS) during the period.

China market recovering The strong SSS growth in China during CNY (+11% YoY) was mainly due to the fact that Valentine's Day fell within the holiday period this year. While gem-set SSS jumped 62% YoY, gold SSS fell 2% on a high volume base. We expect a single-digit overall SSS decline during Jan & Feb as Chinese consumers prefer shopping during the holiday period. However, this will still be an improvement from the -15% YoY growth seen in 3QFY15.

Product mix improvement During the CNY period, gem-set SSS rose 26% YoY while gold SSS fell 14%. This was due to Valentine's Day, in our view. We expect gem-set sales to have outperformed gold in Jan & Feb.

Downgrade from Accumulate to Hold We believe management may miss its target of narrowing the overall SSS decline to a single-digit fall in 4QFY15. We cut our FY15/16/17 net profit forecasts by 2%/10%/11% mainly to reflect the continuing weak HK & Macau market. We lower our SSS estimates for HK & Macau from -23%/8%/5% to -27%/0%/3% and China SSS from -13%/8%/7% to -14%/6%/5%. We cut our TP from HK\$11.60 to HK\$9.40, based on 14x FY16E P/E (previously 15.6x). We believe our TP is fair based on our FY15E P/B and ROE analysis for the consumer sector (figure 5). The increase in the number of mainland Chinese and HK consumers travelling overseas during the long holidays negatively affected HK & Macau SSS in Dec 2014 and Feb this year. Looking into FY16, we anticipate a gradual recovery in HK & Macau SSS given the lack of long holidays in 1HFY16 and the low comparable base for 2HFY16. That said, we still expect CTF's HK & Macau SSS to underperform peers due to store cannibalization. While we also expect Luk Fook and Chow Sang Sang to have seen weak CNY sales in HK, we believe they will post better SSS than CTF due to their focus on mass-market gem-set products and their lower exposure to Macau.

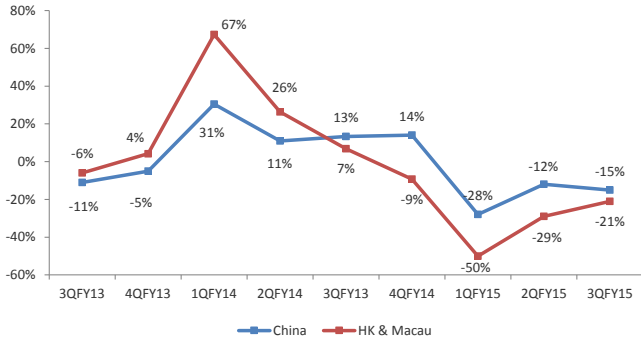
Potential positive catalysts 1) Individual Visitor Scheme widened to more mainland cities; 2) HK store network optimization; 3) better than expected recovery in China.

Stock valuation

Year-end	Turnover	Net profit	EPS	EPS YoY	P/E	Yield	BPS	P/B	ROE
March	(HK\$ m)	(HK\$ m)	(HK\$)	(%)		(%)	(HK\$)		(%)
2013	57,434	5,505	0.551	-20	17.3	2.3	3.3	2.9	17.8
2014	77,407	7,272	0.727	32	13.1	3.8	3.7	2.6	20.7
2015E	67,534	6,054	0.605	-17	15.7	2.5	4.1	2.3	15.6
2016E	73,157	6,690	0.669	11	14.2	2.8	4.5	2.1	15.7
2017E	78,938	7,421	0.742	11	12.8	3.1	4.9	1.9	15.8

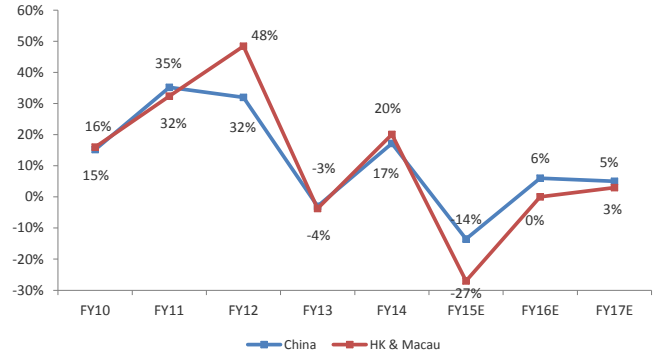
Sources: Company data, GF Securities (HK)

Figure 1: Quarterly SSS trend



Sources: Company data, GF Securities (HK)

Figure 2: SSS growth



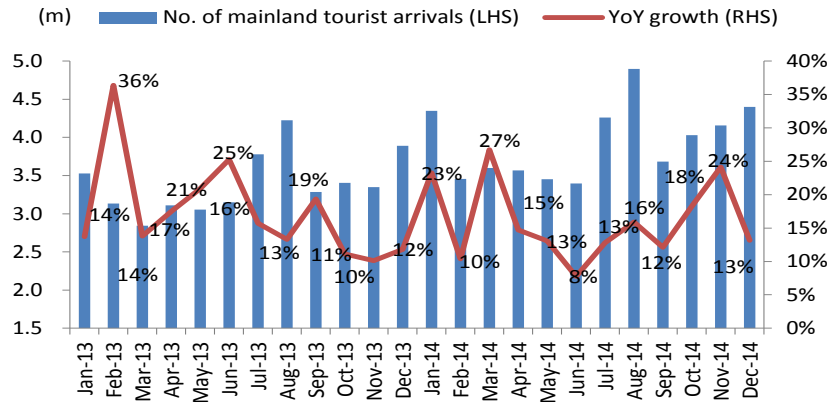
Sources: Company data, GF Securities (HK)

Figure 3: HK and Macau jewelry retail sales growth comparison

YoY (%)	2013	1Q14	2Q14	3Q14	9M14
HK	23%	1%	-32%	-10%	-15%
Macau	30%	15%	-22%	-15%	-8%

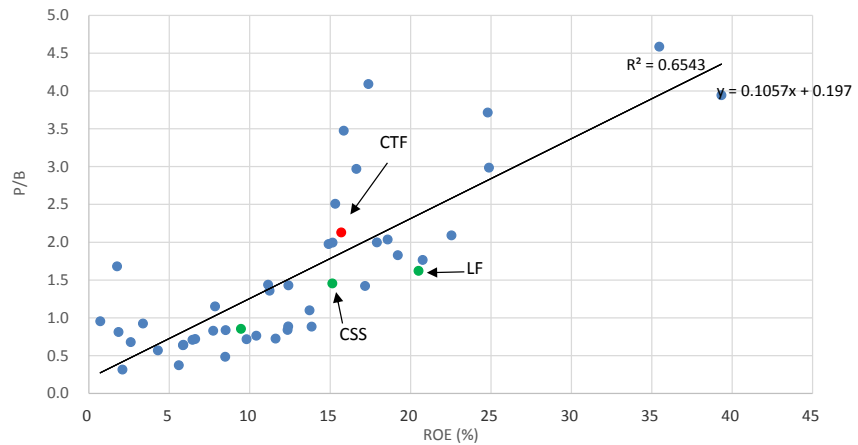
Sources: HK Census and Statistics Department, Macau DSEC

Figure 4: Mainland Chinese tourist arrivals in Hong Kong



Sources: HKTb

Figure 5: Analysis of consumer sector's ROE and P/B in FY15E



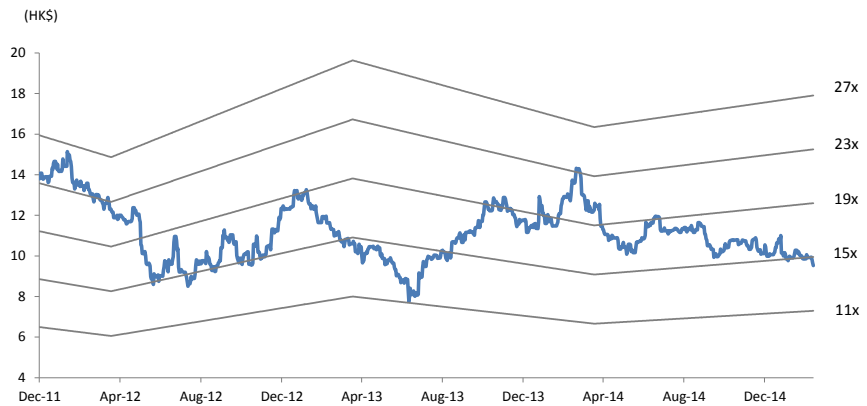
Sources: Bloomberg estimates, GF Securities (HK) estimates

Figure 6: Key assumptions

(HK\$m)	FY13	FY14	FY15E	FY16E	FY17E
Total revenue	57,434	77,407	67,534	73,157	78,938
growth %	1.5%	34.8%	-12.8%	8.3%	7.9%
- HK, Macau and other Asian markets	27,126	35,259	27,631	28,539	29,388
growth %	10.5%	30.0%	-21.6%	3.3%	3.0%
store growth (%)	10.5%	6.7%	7.1%	0.8%	0.8%
SSS (%)	-3.7%	20.1%	-27.0%	0.0%	3.0%
- China jewellery	29,099	40,516	37,838	42,538	47,313
growth %	-9.1%	39.2%	-6.6%	12.4%	11.2%
store growth (%)	13.3%	11.5%	10.4%	9.2%	8.2%
SSS (%)	-3.0%	17.2%	-13.5%	6.0%	5.0%
- China watches	1,210	1,632	2,065	2,080	2,238
growth %	na	34.9%	26.5%	0.7%	7.6%
store growth (%)	8.3%	50.5%	-10.9%	8.2%	7.6%
Gross profit	16,283	21,152	20,684	22,268	24,159
Gross margin (%)	28.4%	27.3%	30.6%	30.4%	30.6%
Sales mix (%)					
gold	57.4%	61.2%	52.0%	52.5%	52.0%
gem-set	22.9%	21.1%	28.4%	29.5%	30.0%
platinum and karat gold	14.5%	13.4%	14.6%	14.0%	14.0%
watches	5.2%	4.3%	5.0%	4.0%	4.0%
SG&A expenses ratio (%)	16.0%	15.8%	19.1%	19.0%	18.8%
Operating profit	7,317	9,255	7,906	8,634	9,625
growth %	-13.3%	26.5%	-14.6%	9.2%	11.5%
OP margin (%)	12.7%	12.0%	11.7%	11.8%	12.2%
Net profit	5,505	7,272	6,054	6,690	7,421
growth %	-13.2%	32.1%	-16.7%	10.5%	10.9%
Net profit margin (%)	9.6%	9.4%	9.0%	9.1%	9.4%
Payout ratio (%)	40%	50%	40%	40%	40%

Sources: Company data, GF Securities (HK) estimates

Figure 7: P/E band



Sources: Bloomberg, GF Securities (HK) estimates

Figure 8: Financial statements

Profit & loss (HK\$m)					
Year ended 31 Mar	FY13	FY14	FY15E	FY16E	FY17E
Revenue	57,434	77,407	67,534	73,157	78,938
Cost of sales	(41,151)	(56,255)	(46,849)	(50,889)	(54,779)
Gross profit	16,283	21,152	20,684	22,268	24,159
Other income	188	218	242	272	305
SG&A expenses	(9,181)	(12,207)	(12,929)	(13,869)	(14,801)
Other gains and losses	27	130	0	0	0
Other expenses	(1)	(38)	(91)	(38)	(38)
Operating profit	7,317	9,255	7,906	8,634	9,625
Net finance cost	(222)	(89)	(157)	(63)	(103)
Share of profit/(loss) of JV	0	(3)	(5)	(3)	0
Profit before tax	7,095	9,163	7,743	8,568	9,522
Income tax expense	(1,417)	(1,714)	(1,601)	(1,794)	(2,012)
Non-controlling interests	(173)	(177)	(89)	(84)	(88)
Net profit	5,505	7,272	6,054	6,690	7,421
EPS (HK\$)	0.55	0.73	0.61	0.67	0.74
Growth rates (%)					
Revenue	2	35	(13)	8	8
Net profit	(13)	32	(17)	11	11
EPS	(20)	32	(17)	11	11
Margin & ratios (%)					
Gross profit margin	28.4	27.3	30.6	30.4	30.6
OP margin	12.7	12.0	11.7	11.8	12.2
Net profit margin	9.6	9.4	9.0	9.1	9.4
Effective tax rate	20.0	18.7	20.6	20.8	21.0
Payout ratio	40.0	49.5	40.0	40.0	40.0

Cash flow statement					
Year ended 31 Mar	FY13	FY14	FY15E	FY16E	FY17E
Profit before tax	7,095	9,163	7,743	8,568	9,522
Net finance cost	222	89	157	63	103
Share of (profit)/loss of JV	0	3	5	3	0
Others	(123)	(450)	(17)	12	12
Depreciation and amortization	507	663	808	1,123	1,174
Share option expenses	0	0	0	0	0
Change of working capital	3,794	(13,610)	10,731	(4,910)	(4,816)
Tax paid	(1,464)	(1,278)	(1,657)	(1,697)	(1,903)
Operating cash flow	10,030	(5,420)	17,771	3,162	4,092
Capex	(1,174)	(1,368)	(3,900)	(2,200)	(1,200)
Interest received	63	122	197	225	237
Disposals	19	21	0	0	0
Acquisitions	(27)	0	(1,170)	0	0
Change in term deposits	0	(500)	0	0	0
Change in pledged deposits	(9)	21	0	0	0
Others	15	(23)	0	0	0
Investing cash flow	(1,113)	(1,727)	(4,873)	(1,975)	(963)
Change of bank borrowings	(8,017)	5,297	(4,300)	2,000	0
Change of gold loans	(706)	6,376	(2,762)	672	597
Dividend paid	(1,710)	(3,350)	(3,011)	(2,549)	(2,822)
Interest paid	(330)	(175)	(354)	(287)	(340)
Others	139	72	0	0	0
Financing cash flow	(10,623)	8,221	(10,427)	(164)	(2,565)
Net change of cash flow	(1,705)	1,074	2,471	1,022	564
Forex changes	22	88	0	0	0

Balance sheet (HK\$m)					
Year ended 31 Mar	FY13	FY14	FY15E	FY16E	FY17E
Fixed assets					
PPE	2,155	3,054	6,160	7,251	7,291
Prepaid lease payments	172	175	175	160	146
Deposit paid for acquisition of PPE	464	284	284	284	284
Investment in a JV	14	11	6	3	3
Loan receivables	23	37	37	37	37
Goodwill	0	0	585	585	585
Deferred tax assets	613	703	703	703	703
	3,442	4,263	7,949	9,023	9,048
Current assets					
Inventories	27,315	42,544	31,888	36,715	41,498
A/C receivables	3,048	3,146	2,745	2,973	3,208
Deposits and prepayments	924	1,727	1,506	1,632	1,761
Loan receivables	135	145	145	145	145
Others	24	22	585	585	585
Pledged deposit	26	5	5	5	5
Term deposit	0	500	500	500	500
Cash and cash equivalents	8,305	9,467	11,937	12,960	13,524
	39,777	57,554	49,311	55,515	61,226
Total assets	43,219	61,817	57,260	64,537	70,274
Current liabilities					
A/C payables	249	1,234	925	1,005	1,081
Other payables	1,504	2,894	2,657	2,849	3,103
Amount due to non-controlling shareholders of subsidiaries	351	228	228	228	228
Tax liabilities	472	1,064	640	718	805
Bank borrowing	1,000	6,300	2,000	4,000	4,000
Gold loans	4,836	10,787	8,025	8,696	9,293
	8,413	22,507	14,475	17,495	18,511
Non-current liabilities					
Deferred tax liabilities	694	633	633	633	633
Retirement benefit obligations	251	225	236	248	260
	945	858	869	881	893
Equity					
Shareholders' equity	32,926	37,173	40,548	44,709	49,330
Non-controlling interests	935	1,279	1,368	1,452	1,540
	33,861	38,452	41,916	46,161	50,870
Total liabilities & equity	43,219	61,817	57,260	64,537	70,274

Financial ratios (HK\$m)					
Year ended 31 Mar	FY13	FY14	FY15E	FY16E	FY17E
Current ratio	4.7	2.6	3.4	3.2	3.3
Quick ratio	1.5	0.7	1.2	1.1	1.1
A/C receivable turnover days	23	15	16	14	14
A/C payable turnover days	3	5	8	7	7
Inventory turnover days	253	227	290	246	261
Asset turnover	1.3	1.3	1.2	1.1	1.1
Total assets/total equity	1.3	1.6	1.4	1.4	1.4
Net gearing (%)	net cash	19	net cash	net cash	net cash
ROE (%)	17.8	20.7	15.6	15.7	15.8
ROA (%)	12.1	13.8	10.2	11.0	11.0

Sources: Company data, GF Securities (HK) estimates

Rating definitions

Benchmark: Hong Kong Hang Seng Index

Time horizon: 12 months

Company ratings

Buy	Stock expected to outperform benchmark by more than 15%
Accumulate	Stock expected to outperform benchmark by more than 5% but not more than 15%
Hold	Expected stock relative performance ranges between -5% and 5%
Underperform	Stock expected to underperform benchmark by more than 5%

Sector ratings

Positive	Sector expected to outperform benchmark by more than 10%
Neutral	Expected sector relative performance ranges between -10% and 10%
Cautious	Sector expected to underperform benchmark by more than 10%

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