



Larry Jewelry

Data

Price (28/02/2012)	HK\$0.7
Issued shares	864mn
Market cap	HK\$614mn
52week high/low	HK\$1.95/0.43
Ave.turnover(3m)	2.08mn

Major shareholders:

Fullink Mgmt (20.93%)

Galaxy Asset(19.71%)

Stock performance

	1M	3M	YTD
Absolute	-5.4%	-4.1%	-7.9%
Rel(HSI)	-11.6%	-24.4%	-25.3%



Source: Bloomberg

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Larry Jewelry International (8351)-Unrated

We aware the group has made several strategic moves in recent weeks. If the moves are successful, the group will be in fast-growing track in coming years. Although the group is in early stage of these strategic developments, the stock price has not factored in this tremendous upside potential.

Three strategic moves

- Secure upstream supply of quality “Lazare” diamond from Lazare Kaplan
- Expand downstream markets by penetrating into Greater China market via strategic cooperation with a luxury product retail chain operator which has over 100 outlets in this region
- Arrange HK\$72mn CB (strike HK\$0.8/share) to finance expansion of business and avoid short-term dilution effect.

Current business model is solid but not attractive

Based on its existing sales network in HK and Singapore, we expect its sales will grow by 67% CAGR in 2011-2013 due to re-focus of business on high-end jewelry products and efforts to improve operating efficiency. However, its long-term growth momentum will be constrained by its geographical coverage. The group needs to expand its business coverage to sustain high growth momentum.

To be a niche play in Greater China market

The group will become a small and beautiful play in fine jewelry retailing industry in the Greater China market if it is successfully rolling out its expansion plans. To differentiate its products from big players such as Chow Tai Fook and Luk Fook, the group has to secure supply of quality diamond. The product differentiation strategy is a crucial factor to maintain the edge and establish its “Larry” brand. Cooperation with an existing high end retail chain operator will allow the group to penetrate into the Greater China market in short period of time and with marginal increase in capital expenditures.

Valuation

Based on the existing business model (HK & Singapore operation), we estimate its FD EPS at HK 4.60cents and HK 6.38cents (up 38.7% yoy) for FY2012 and FY2013 respectively. The stock is trading at 15.2x PE FY2012, higher than its listed peers in HK. Hence, its stock price has not priced in the additional value from recent strategic moves to secure upstream supply of quality diamond and expand downstream sales network in the Greater China market.

Financial Summary

(HK\$ mn)	03/11	12/11 F	12/12 F	12/13 F
Sales	48.7	252.1	570.6	699.0
Chg (yoy)	2.99%	418.12%	126.35%	22.51%
Net profit	(19.4)	(11.0)	43.9	60.9
Chg (yoy)	-	-	-	38.69%
Basic EPS(HK cents)	(3.050)	(1.273)	5.079	7.044
FD EPS (HK cents)	(3.050)	(1.153)	4.600	6.380
P/E	-	-	15.22	10.97

Source: Company data, ABCI Securities estimates



Company introduction

Transform from wholesale to retailing

Larry Jewelry International Co Ltd (“the group”) (formerly Eternite International) was engaged in wholesale business of jewelry products over the world. The group acquired a mid-to-high end jewelry retailer “Larry Jewelry” to expand its business to jewelry retailing in HK and Singapore in Jul 2011. Upon completion of the acquisition, the group will focus on the fine jewelry retailing business with high margin and profit growth. We expect the jewelry wholesale business will be phased out by the end of 2012.

Larry Jewelry background

Larry is a long-established retail brand in the fine jewelry market in HK and Singapore with ASP of HK\$55,000(Luk Fook non-gold jewelry ASP is HK\$15,000 and Emperor Watch&Jewelry non-gold jewelry ASP is HK\$24,000). It is the distributor for top-selling Lazare jewelry in Singapore and one of 3 jewelers in HK recognized by De Beers to sell Forevermark diamonds. The group has been appointed by Lazare Kaplan International Inc. as its distributor to import and distribute Lazare Diamond in HK from 2012. Currently, there are 4 Larry Jewelry shops in HK and 2 in Singapore located in high traffic flow, middle-to-high end shopping districts.

The acquisition of Larry Jewelry

The acquisition of Larry Jewelry was completed in July 2011 at a total consideration of HK\$400mn(HK\$250mn was paid in cash and the balance of HK\$150mn was settled by 1-year term promissory note with annual interest rate of 3.5%). In addition, the deal included a profit guarantee by which total profit after tax for two successive fiscal years will not less than HK\$70mn in aggregate. We view the valuation of the acquisition is reasonable:

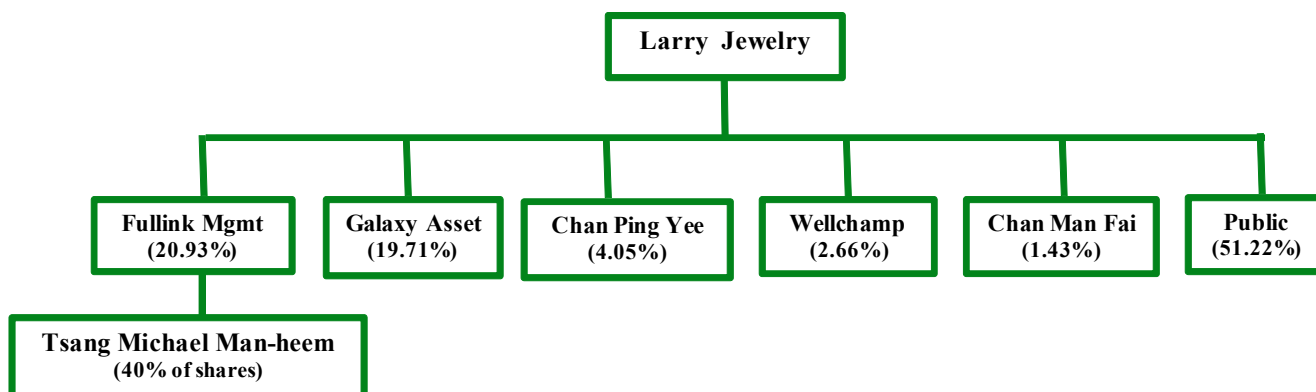
- FY 2012 PE is less than 11.4x, based on the profit guarantee for two successive fiscal years will not less than HK\$70mn, equating average of HK\$35mn for FY 2012.
- 1.6x price to inventory considering HK\$250mn valuation of jewelry at cost.

Shareholder structure

As at 28 Feb 2012, the top 2 shareholders of the group are Fullink Management (20.93% of shares) and Galaxy Asset (19.71% of shares). We expect more fund raising activities ahead as Galaxy Asset is one of the major shareholder.



Chart 1: Shareholders structure



Note: Chan Man Fai is the director of Galaxy and Chairman of the company

Conservative self-store opening and cooperate with existing high- end retail chain

The management adopt a conservative store opening strategy as Larry targets high-end customers that unlike mass market retailers (Luk Fook and Chow Sang Sang). The group will gradually lift the sales per store in HK by increasing PRC clients in HK stores and lower inventory turnover days to 7-9 months from 1 year. PRC clients currently make up less than 50% of revenue in HK store. The management targets to increase the proportion of PRC clients to 60%-70% that is in line with its peers.

Recently the company announced it has been in negotiation with a retail chain for luxury products with a view to entering into a co-operation agreement in respect of promote the “Larry Jewelry” brand in the Greater China region. The retail chain operates over 100 shops in the Greater China region. It is also expected that the first specialty store with the retail chain will be established in HK in the first half of 2012. Cooperation with existing high end retail chain operator will allow the group to penetrate into the Greater China market in short period of time and without marginal increase in capital expenditures.

Chart 2: No. of store and sales growth per store

No. of store	2010	2011	2012F	2013F
HK	3.00	4.00	4.00	5.00
Singapore	2.00	2.00	2.00	2.00
Total	5.00	6.00	6.00	7.00
HK	196.00	300.53	345.61	462.79
Sales per store(HK\$ mn)	65.33	75.13	86.40	99.36
SSSG	24.8%	15.0%	15.0%	15.0%
Singapore	209.00	214.24	224.95	236.20
Sales per store(HK\$ mn)	104.00	107.12	112.48	118.10
SSSG	3.0%	5.0%	5.0%	5.0%

Source: Company data, ABCI Securities

Financial forecast

The group’s sales will be boosted by Larry Jewelry acquisition. We



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expect its sales will grow by 67% CAGR in 2011-2013 and achieve to HK\$699.0mn in FY 2013 from HK\$252.1mn in FY 2011. With the improvement of operating efficiency, we predict the sales per store in HK will increase from HK\$65.33mn p.a. to HK\$99.36mn p.a., in line with its sales per store in Singapore. We expect its gross profit margin and net profit margin will lift up to 30% and 8.7% in FY2013.

Chart 3: Financial forecast

(HK\$ mn)	03/10	03/11	12/11 F	12/12 F	12/13 F
Sales	47.2	48.7	252.1	570.6	699.0
COGS	(28.1)	(35.3)	(179.4)	(399.4)	(489.3)
Gross profit	19.1	13.3	72.7	171.2	209.7
SG&A expenses	(9.1)	(31.7)	(80.0)	(113.0)	(136.3)
Operating profit	10.0	(18.4)	(7.1)	58.2	73.4
Finance income	0.0	0.0	0.0	0.0	0.0
Finance costs	0.0	(0.0)	(3.9)	(5.3)	0.0
Pre-tax profit	10.0	(18.4)	(11.0)	52.9	73.4
Tax	(2.1)	(0.9)	0.0	(9.0)	(12.5)
Net profit	7.9	(19.4)	(11.0)	43.9	60.9
Net profit attributable to shareholders	7.9	(19.4)	(11.0)	43.9	60.9
Minority interest	0.0	0.0	0.0	0.0	0.0
Diluted EPS (HK cents)	2.000	(3.050)	(1.273)	5.079	7.044
FD EPS after CB issued (HK cents)	2.000	(3.050)	(1.153)	4.600	6.380
Margin & growth					
Gross profit margin	40.5%	27.4%	28.8%	30.0%	30.0%
Operating profit margin	21.2%	-37.8%	-2.8%	10.2%	10.5%
Net profit margin	16.8%	-39.8%	-4.4%	7.7%	8.7%
Sales growth	6.0%	3.0%	418.1%	126.4%	22.5%
Gross profit growth	16.8%	-30.3%	445.5%	135.5%	22.5%
Operating profit growth	-	-	-	-	26.1%
Net profit growth	-	-	-	-	38.7%
EPS growth	-	-	-	-	38.7%

Source: Company data, ABCI Securities

Peer comparison

The HK Jewelry & Watch listed companies are trading at 6x-13x PE of FY 2012. The average PE of listed Jewelry & Watch company is 11x. Based on the existing business model (HK & Singapore operation), we estimate its FD EPS at HK 4.60cents and HK 6.38cents (up 38.7% yoy) for FY2012 and FY2013 respectively. The stock is trading at 15.2x PE FY2012, higher than its listed peers in HK. Hence, its stock price has not priced in the additional value from recent strategic moves to secure upstream supply of quality diamond and expand downstream sales network in the Greater China market.



Chart 4: Peers comparison

Code	Name	HKD	Price	Market cap (mn)	2011 PE	2012 PE	ROE	ROA
8351	LARRY JEWELRY	HKD	0.70	605	-	15.2	-	-
116	CHOW SANG SANG	HKD	20.75	14,046	12.9	10.9	17.8%	13.3%
3389	HENGDELI	HKD	3.38	14,866	15.9	13.3	16.6%	8.3%
590	LUK FOOK HLDGS	HKD	28.30	16,672	11.8	10.6	32.1%	25.4%
398	ORIENTAL WATCH	HKD	3.77	2,151	7.0	6.1	15.1%	12.1%
887	EMPEROR WATCH	HKD	1.14	7,659	13.1	10.6	18.5%	15.8%

Source: Bloomberg, ABCI Securities

More fund raising ahead to strength its financial position and future expansion

The group launched a series of fund raising activities in past 2 years. According to the interim report at 30 September 2011, the group had cash and bank balances of approx. HK\$165.6mn and total borrowings amounted to HK\$343.3mn. Net gearing ratio increased from zero as at 31 Mar 2011 to 89% as at 30 Sep 2011. Its Liabilities/equity ratio edged up to 228.1% at 30 Sep 2011 compared with 3.9% as at 31 Mar 2011. The management may have financing pressure for raising funds to repay bank loan as HK\$225mn bank loan will be due on Jul 2012. On 24th Feb 2012, the company announced to issue 2-years CB with annual interest rate of 3%. The conversion price of the CB is HK\$0.80 per share. If all the CB are issued, the company would raise approx. HK\$72mn to implement its working capital.

Chart 5: Recent fund raising and M&A activities

Date	Fund raising activities
Oct 2009	Listed on the GEM board and raised HK\$20mn by placing out 80mn shares at HK\$0.25
Apr 2010	Raised HK\$19.6mn via top-up placement of 72mn shares at HK\$0.28. Galaxy Asset subscribed 53mn shares
Nov to Dec 2010	Galaxy, Fullink, Wellchamp and Mr Chan acquired 305mn shares from the controlling shareholders at HK\$0.5
Mar to Apr 2011	Raised HK\$49.6mn by placement of 64.5mn shares at HK\$0.553.
Aug 2011	Acquired Larry Jewelry at the total consideration of HK\$400mn. HK\$250 mn paid in cash and the balance of HK\$150mn was settled by 1 year term promissory note with annual interest rate of 3.5%
Jul 2011	Raised HK\$54mn by issue 3-years CB with annual interest rate of 2% and exercise price of HK\$1.50
Aug 2011	Shareholder Fullink subscribed 61.8 shares and raised hk\$46.1mn for the group
Sep 2011	Acquired Parkwell Group at the consideration of HK\$5.5mn. HK\$3.5mn paid in cash and HK\$2.0mn by issuance of a 3-year term, zero-coupon CB with exercise price of HK\$1.0
Sep 2011	Raised HK\$54.4mn by issue 72.7mn new shares at HK\$0.75
Dec 2011	Raised HK\$ 23.3mn by issue 30.7mn new shares at HK\$0.76
Feb 2012(book open)	Issue 2-years CB with annual interest rate of 3% to raise HK\$72mn and exercise price of HK\$0.8

Source: Company data



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Disclosures

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