

### Sector de-rating to continue on bad data

Slowing Chinese spending could be a double whammy to high base effect

#### Weak consumer sentiment may continue to impact jewellers' valuation

The retail sales growth of the jewellery category in HK/China slipped into negative territory in March with 8.9% y-y drop in HK and 6% y-y drop in China. Netting out the price change impact, HK still saw a 6.9% y-y drop in volume term during the month. The street has thus become more concerned about the negative magnitude of the growth in April-June quarter, which we believe could worsen over the next couple of months. The current spot gold price is about 15% lower than the level in April 2013, and 5-10% below that in May/June 2013. Assuming HK/China jewellery players can sustain similar gold demand in weight in April-June this year (unlikely), their gold sales (~60% of total sales for CTF, CSS and LF) may still see at least a 10% sales drop, in our view.

#### How negative could the jewellery category be in April-June quarter?

The data points may not be out until mid-July when Chow Tai Fook (CTF) and Luk Fook (LF) release their quarterly updates. In this report, we again try to quantify how bad the data could be in the April-June quarter. Our estimates suggest that HK retail sales in jewellery would see a 27% y-y slump in the quarter while China might see a 17% decline during the same period. If Chinese customers' spending sentiment continues to weaken, the scenario would turn even worse.

Per our estimates, CTF could see 30% SSSG decline and 23% sales decline in the Apr-June quarter, while LF could even fare worse with 35-40% decline in SSSG. Chow Sang Sang (CSS) doesn't disclose quarterly data but we see a similar trend for it, and its 1H SSSG to be 20-25% down. For 3QCY (July-Sep quarter), we may still see negative SSSG, though more moderate than in 2Q.

#### De-rating to continue; Downgrade CSS (116 HK) to Reduce, maintain Reduce on CTF (1929 HK) and Neutral on LF (590 HK)

Our forecast for China's jewellery sales growth in April was negative 29.6% y-y, which is in line with the official number of negative 30% y-y announced on 13 May. HK's data (to be announced on 3 June) could be negative 40% y-y, which could lead to another leg of de-rating for the sector, in our view. On valuations, CTF is still trading at ~14x CY14F P/E, which we believe is expensive in the current sentiment/data scenario, and should correct. CSS is trading at a 20% premium to LF and should see more downside than LF (which is trading at 8x CY14F P/E, close to its all-time low).

#### Fundamentals remain intact, wait for good price points in 2-3 months

Once again, we would like to highlight that the fundamental business for the three jewellery players remains intact, but the high base effect may negatively affect the market's sentiment and therefore drag down the valuations in the near term. We cut our target P/E multiples for CTF to 12x from 16x, and for both of CSS and LF to 9x from 12x. Hence, we downgrade CSS to Reduce (TP down to HKD15.5 from HKD25.6), and maintain Reduce on CTF (TP down to HKD9.6 from HKD12.4) and Neutral on LF (TP down to HKD21.1 from HKD32.5). Having said that, we believe good price points should emerge

### Global Markets Research

20 May 2014

#### Anchor themes

Consumption of jewellery in China is still at a nascent stage and the branded names have still not penetrated lower-tier cities. We believe long-term demographics such as a rising middle class and urbanisation should lead to secular growth for the sector.

#### Nomura vs consensus

Our FY15F bottom-line estimates for the three HK jewellery brands are 7-17% lower than consensus as we have built in weakening Chinese spending.

#### Research analysts

##### Hong Kong Retail

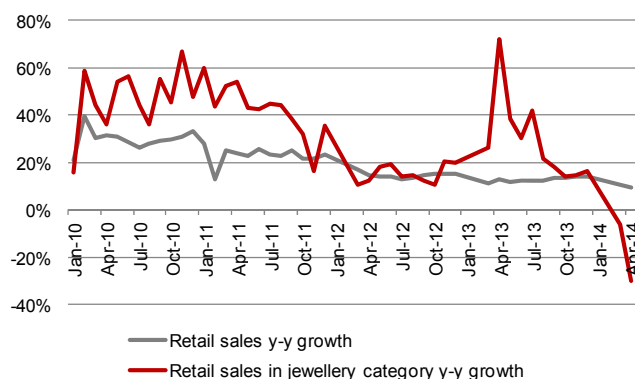
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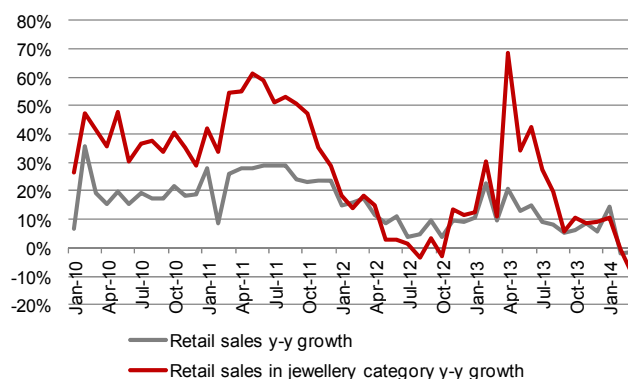
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**Fig. 1: China's retail sales growth (overall & jewellery)**

Source: CEIC, Nomura research

**Fig. 2: HK's retail sales growth (overall & jewellery)**

Source: CEIC, Nomura research

## Methodology for estimating HK/China retail sales in jewellery category

We screen HK and China retail sales in the jewellery category from 2005 to 2012 (excluding numbers in 2013 as they are outliers) and calculate the percentage difference between March and each month of April-June quarter in each year, and then take the averages to get the discrepancy.

We assume the derived average percentage gap as normalized ones between March and each month of April to June. As we have HK/China retail sales in jewellery category in March 2014, we thus can estimate such numbers in April to June for HK and China, respectively.

**Fig. 3: Nomura's estimates to HK/China retail sales in jewellery in April-June quarter**

	HK retail sales in jewellery (HKDmn)	y-y growth	China retail sales in jewellery (RMBmn)	y-y growth
Apr-14	7,862	-40.0%	21,308	-29.6%
May-14	8,493	-19.3%	24,660	-8.2%
Jun-14	8,667	-19.2%	21,408	-9.9%
Apr-Jun Quarter	25,022	-27.2%	67,377	-16.7%

Source: CEIC, Nomura estimates

Fig. 4: HK &amp; China retail sales in jewellery category &amp; Nomura's estimates

	HK retail sales in jewellery (HKDmn)	Percentage difference to March number	China retail sales in jewellery (RMBmn)	Percentage difference to March number
Mar-05	2,146		2,340	
Apr-05	2,101	-2.1%	1,870	-20.1%
May-05	2,202	2.6%	2,183	-6.7%
Jun-05	2,490	16.0%	1,843	-21.2%
Mar-06	2,514		2,546	
Apr-06	2,463	-2.0%	2,526	-0.8%
May-06	2,555	1.6%	2,791	9.6%
Jun-06	2,636	4.9%	2,218	-12.9%
Mar-07	2,682		3,440	
Apr-07	2,489	-7.2%	3,310	-3.8%
May-07	3,061	14.1%	3,830	11.3%
Jun-07	3,243	20.9%	3,180	-7.6%
Mar-08	3,488		5,150	
Apr-08	3,295	-5.5%	4,670	-9.3%
May-08	3,617	3.7%	4,950	-3.9%
Jun-08	3,838	10.0%	4,800	-6.8%
Mar-09	3,022		5,760	
Apr-09	3,209	6.2%	5,630	-2.3%
May-09	3,194	5.7%	6,950	20.7%
Jun-09	3,517	16.4%	5,870	1.9%
Mar-10	4,269		8,940	
Apr-10	4,359	2.1%	8,290	-7.3%
May-10	4,719	10.5%	11,040	23.5%
Jun-10	4,592	7.6%	9,230	3.2%
Mar-11	6,595		14,460	
Apr-11	6,758	2.5%	13,790	-4.6%
May-11	7,614	15.5%	15,170	4.9%
Jun-11	7,302	10.7%	13,540	-6.4%
Mar-12	7,810		16,470	
Apr-12	7,778	-0.4%	16,108	-2.2%
May-12	7,831	0.3%	17,950	9.0%
Jun-12	7,520	-3.7%	16,690	1.3%
Mar-13	8,681		22,990	
Apr-13	13,105	51.0%	30,260	31.6%
May-13	10,518	21.2%	26,850	16.8%
Jun-13	10,725	23.5%	23,770	3.4%
Mar-14	7,912		22,270	
	<b>Est by NMR</b>	<b>Avg</b>	<b>Est by NMR</b>	<b>Avg</b>
Apr-14	7,862	-0.6%	21,308	-4.3%
May-14	8,493	7.3%	24,660	10.7%
Jun-14	8,667	9.5%	21,408	-3.9%

Source: CEIC, Nomura estimates

## Chow Tai Fook Jewellery

1929.HK 1929 HK

EQUITY: CONSUMER RELATED

### Still downside to go

Weakening data may put further pressure on valuations, still trading much higher than trough

#### Weakening data points may continue to pressure the valuation

We further revise down CTF's earnings after our last update in mid-March, to factor in the worse-than-our-expected industry numbers, led by slowing Chinese spending as well as high base impact. We also cut CTF's target valuation multiple to 12x from 16x as a result of building in the negative growth numbers. We maintain our Reduce rating as it is still trading at a 50% premium to Chow Sang Sang and ~80% premium to Luk Fook. Its current multiple of 14x CY14F P/E is still 70% higher than trough valuations of 8.3x.

#### Fundamentals remain intact but April-June quarter an overhang

Although we still think that, fundamentally, Chow Tai Fook would outperform its rivals, the expected negative growth rates in the April-June quarter may still be an overhang given we anticipate the quantum of decline to be higher than street expectations. We estimate 23% top-line decline, and 30% SSSG decline in the April-June quarter, with turnaround in 2Q (low single digit). We do expect a strong pick-up in 2H, and believe the next quarter would present a good entry point for long-term exposure. CTF has increased A&P on wedding products recently, which we believe can bring long-term benefits to the brand image.

#### Long term, CTF's strategy on mass luxury should help business amidst changing macro as lower ticket size helps margin improvement

For CTF, the lower-priced products usually offer better margins as customers may request less markdowns. Thus, CTF's strategy towards more mass luxury and youth line products at lower average ticket sizes should gradually help its margin improvement. Margins in FY15F should improve from FY14F level due to product category normalization (less gold and more gem-set products) and product mix change (more exposure to lower tickets products), in our view.

Year-end 31 Mar	FY13	FY14F		FY15F		FY16F	
Currency (HKD)	Actual	Old	New	Old	New	Old	New
<b>Revenue (mn)</b>	57,434	78,219	77,222	84,782	78,244	96,316	86,687
<b>Reported net profit (mn)</b>	5,505	7,346	7,230	8,031	7,457	9,408	8,583
<b>Normalised net profit (mn)</b>	5,505	7,346	7,230	8,031	7,457	9,408	8,583
<b>FD normalised EPS</b>	55.05c	73.46c	72.30c	80.31c	74.57c	94.08c	85.83c
<b>FD norm. EPS growth (%)</b>	-13.2	33.4	31.3	9.3	3.1	17.2	15.1
<b>FD normalised P/E (x)</b>	18.9	N/A	14.4	N/A	14.0	N/A	12.1
<b>EV/EBITDA (x)</b>	12.3	N/A	9.9	N/A	8.4	N/A	7.6
<b>Price/book (x)</b>	3.2	N/A	2.8	N/A	2.5	N/A	2.2
<b>Dividend yield (%)</b>	2.1	N/A	2.8	N/A	2.9	N/A	3.5
<b>ROE (%)</b>	17.8	20.9	20.6	20.2	18.9	21.0	19.4
<b>Net debt/equity (%)</b>	net cash	net cash	net cash	net cash	net cash	net cash	net cash

Source: Company data, Nomura estimates

Key company data: See page 2 for company data and detailed price/index chart

### Global Markets Research

20 May 2014

<b>Rating</b> Remains	<b>Reduce</b>
<b>Target price</b> Reduced from 12.40	HKD 9.60
<b>Closing price</b> 16 May 2014	HKD 10.42
<b>Potential downside</b>	-7.9%

#### Anchor themes

The consumption of jewellery in China is at a nascent stage and branded names have still not penetrated lower-tier cities. We believe that long-term demographics such as rising middle class income and urbanisation should lead to secular growth.

#### Nomura vs consensus

Our FY15F earnings are 7% lower than consensus as we factor in weaker-than-expected Chinese spending.

#### Research analysts

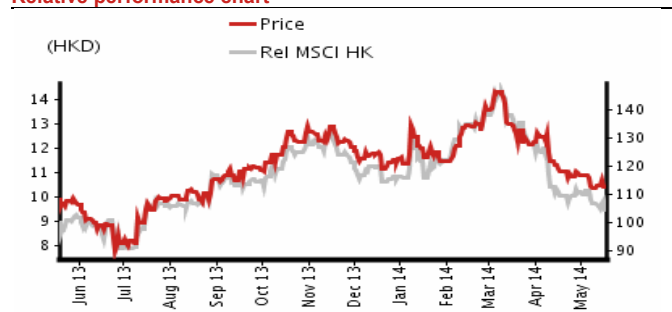
##### China Consumer Related

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# Key data on Chow Tai Fook Jewellery

## Relative performance chart



Source: Thomson Reuters, Nomura research

## Notes:

## Performance

(%)	1M	3M	12M		
Absolute (HKD)	-6.5	-19.3	5.5	M cap (USDmn)	13,442.0
Absolute (USD)	-6.4	-19.3	5.6	Free float (%)	10.6
Rel to MSCI HK	-2.6	-20.6	7.5	52-week (HKD)	14.48/7.44

## Income statement (HKDmn)

Year-end 31 Mar	FY12	FY13	FY14F	FY15F	FY16F
Revenue	56,571	57,434	77,222	78,244	86,687
Cost of goods sold	-40,123	-41,151	-56,300	-56,404	-61,794
Gross profit	16,448	16,283	20,922	21,840	24,893
SG&A	-7,919	-8,859	-11,425	-12,051	-13,647
Employee share expense					
Operating profit	8,529	7,425	9,497	9,788	11,246
EBITDA	8,931	7,931	10,107	10,476	11,999
Depreciation	-391	-495	-598	-676	-740
Amortisation	-11	-12	-12	-12	-12
EBIT	8,529	7,425	9,497	9,788	11,246
Net interest expense	-363	-330	-179	-178	-185
Associates & JCEs	0	0	0	0	0
Other income					
Earnings before tax	8,166	7,095	9,318	9,610	11,062
Income tax	-1,595	-1,417	-1,860	-1,919	-2,209
Net profit after tax	6,571	5,678	7,457	7,691	8,853
Minority interests	-230	-173	-227	-234	-270
Other items					
Preferred dividends					
Normalised NPAT	6,341	5,505	7,230	7,457	8,583
Extraordinary items					
Reported NPAT	6,341	5,505	7,230	7,457	8,583
Dividends	-1,000	-2,200	-2,892	-3,057	-3,605
Transfers to reserves	5,341	3,305	4,338	4,400	4,979

## Valuations and ratios

Reported P/E (x)	16.4	18.9	14.4	14.0	12.1
Normalised P/E (x)	16.4	18.9	14.4	14.0	12.1
FD normalised P/E (x)	16.4	18.9	14.4	14.0	12.1
Dividend yield (%)	1.0	2.1	2.8	2.9	3.5
Price/cashflow (x)	na	10.4	na	6.4	111.2
Price/book (x)	3.6	3.2	2.8	2.5	2.2
EV/EBITDA (x)	11.6	12.3	9.9	8.4	7.6
EV/EBIT (x)	12.2	13.2	10.5	9.0	8.1
Gross margin (%)	29.1	28.4	27.1	27.9	28.7
EBITDA margin (%)	15.8	13.8	13.1	13.4	13.8
EBIT margin (%)	15.1	12.9	12.3	12.5	13.0
Net margin (%)	11.2	9.6	9.4	9.5	9.9
Effective tax rate (%)	19.5	20.0	20.0	20.0	20.0
Dividend payout (%)	15.8	40.0	40.0	41.0	42.0
ROE (%)	31.5	17.8	20.6	18.9	19.4
ROA (pretax %)	28.0	20.5	23.2	23.1	26.3

## Growth (%)

Revenue	61.4	1.5	34.5	1.3	10.8
EBITDA	79.3	-11.2	27.4	3.6	14.5
Normalised EPS	0.7	-13.2	31.3	3.1	15.1
Normalised FDEPS	0.7	-13.2	31.3	3.1	15.1

Source: Company data, Nomura estimates

## Cashflow statement (HKDmn)

Year-end 31 Mar	FY12	FY13	FY14F	FY15F	FY16F
EBITDA	8,931	7,931	10,107	10,476	11,999
Change in working capital	-15,843	2,368	-12,523	5,919	-10,820
Other operating cashflow	259	-269	-98	-101	-242
Cashflow from operations	-6,654	10,030	-2,513	16,295	937
Capital expenditure	-867	-1,174	-1,280	-960	-800
Free cashflow	-7,521	8,856	-3,793	15,335	137
Reduction in investments		0	0	0	0
Net acquisitions					
Dec in other LT assets	-88	-818	571	120	60
Inc in other LT liabilities	34	748	67	-761	0
Adjustments	1,398	131	-498	784	224
CF after investing acts	-6,177	8,918	-3,653	15,478	421
Cash dividends	-4,543	-1,710	-2,564	-2,947	-3,239
Equity issue	15,525	197	0	0	0
Debt issue	7,131	-9,052	6,304	91	615
Convertible debt issue					
Others	-7,552	-36	201	-898	-542
CF from financial acts	10,560	-10,601	3,941	-3,754	-3,167
Net cashflow	4,383	-1,683	288	11,724	-2,746
Beginning cash	5,605	9,988	8,305	8,593	20,318
Ending cash	9,988	8,305	8,593	20,317	17,572
Ending net debt	-987	-7,305	-5,323	-17,048	-14,302

## Balance sheet (HKDmn)

As at 31 Mar	FY12	FY13	FY14F	FY15F	FY16F
Cash & equivalents	9,988	8,305	8,593	20,318	17,572
Marketable securities					
Accounts receivable	5,323	3,973	5,336	5,811	6,539
Inventories	29,694	27,315	38,459	28,728	38,502
Other current assets	253	185	196	196	196
Total current assets	45,258	39,777	52,585	55,052	62,809
LT investments					
Fixed assets	1,688	2,155	2,356	2,281	2,040
Goodwill					
Other intangible assets					
Other LT assets	469	1,287	716	596	536
Total assets	47,414	43,219	55,657	57,928	65,385
Short-term debt	5,574	1,000	3,270	3,270	3,270
Accounts payable	1,838	1,754	3,182	1,763	3,655
Other current liabilities	6,805	5,659	9,858	9,771	10,201
Total current liabilities	14,218	8,413	16,310	14,804	17,126
Long-term debt	3,426	0	0	0	0
Convertible debt					
Other LT liabilities	197	945	1,012	251	251
Total liabilities	17,841	9,358	17,322	15,055	17,377
Minority interest	595	935	1,072	1,211	1,368
Preferred stock					
Common stock	10,000	10,000	10,000	10,000	10,000
Retained earnings	18,978	22,926	27,263	31,662	36,640
Proposed dividends					
Other equity and reserves					
Total shareholders' equity	28,978	32,926	37,263	41,662	46,640
Total equity & liabilities	47,414	43,219	55,657	57,928	65,385

## Liquidity (x)

Current ratio	3.18	4.73	3.22	3.72	3.67
Interest cover	23.5	22.5	52.9	55.0	60.9

## Leverage

Net debt/EBITDA (x)	net cash	net cash	net cash	net cash	net cash
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash

## Per share

Reported EPS (HKD)	63.41c	55.05c	72.30c	74.57c	85.83c
Norm EPS (HKD)	63.41c	55.05c	72.30c	74.57c	85.83c
FD norm EPS (HKD)	63.41c	55.05c	72.30c	74.57c	85.83c
BVPS (HKD)	2.90	3.29	3.73	4.17	4.66
DPS (HKD)	0.10	0.22	0.29	0.31	0.36

## Activity (days)

Days receivable	27.6	29.5	22.0	26.0	26.1
Days inventory	212.8	252.8	213.2	217.4	199.1
Days payable	17.7	15.9	16.0	16.0	16.0
Cash cycle	222.7	266.4	219.2	227.4	209.1

Source: Company data, Nomura estimates

# Valuation Methodology

We value Chow Tai Fook on a blend of DCF and P/E to arrive at our target price of HKD9.6. For DCF, the WACC assumption is ~10% and the terminal growth assumption is 2%. Cash flows are discounted back to CY14F. For P/E, we cut the valuation multiple from 16x to 12x, in line with CTF's two year average (33% premium to CSS and LF which we believe is more justified), as the market sentiment and data points continue to weaken. Our revised estimates and key assumptions are exhibited below.

**Fig. 5: Key changes to Nomura estimates**

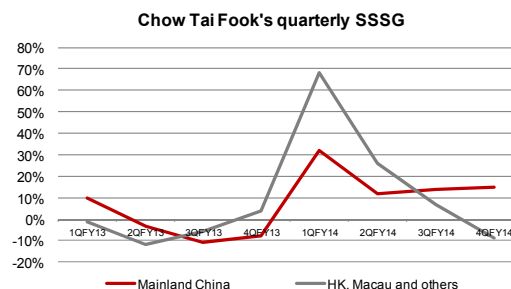
FYE in March

	FY15F		FY16F	
	Old	New	Old	New
SSSG				
China	-2%	<b>-4%</b>	7%	<b>6%</b>
HK	-7%	<b>-7%</b>	5%	<b>5%</b>
Net sales growth	8.4%	<b>1.3%</b>	13.6%	<b>10.8%</b>
Gross margins	28.1%	<b>27.9%</b>	28.3%	<b>28.7%</b>
Operating margins	12.4%	<b>12.5%</b>	12.8%	<b>13.0%</b>
Earnings growth	9.3%	<b>3.1%</b>	17.2%	<b>15.1%</b>

Source: Nomura estimates

**Fig. 6: CTF's SSSG by geography**

FYE in March



Source: Company data, Nomura research

**Fig. 7: Nomura's estimates for FY15F quarterly revenues**

Assumptions (FYE: Mar)	FY12	FY13	FY14F	FY15F
Q1 revenues	11,314	13,068	21,235	16,431
y-y growth		16%	63%	-23%
% of full year sales	20%	23%	27%	21%
Q2 revenues	12,559	12,345	16,604	17,214
y-y growth		-2%	35%	4%
% of full year sales	22%	21%	22%	22%
Q3 revenues	14,143	14,638	18,370	21,126
y-y growth		4%	26%	15%
% of full year sales	25%	25%	24%	27%
Q4 revenues	18,555	17,361	21,013	23,473
y-y growth		-6%	22%	12%
% of full year sales	33%	30%	27%	30%
Nomura full year estimates	56,571	57,434	77,222	78,244
y-y growth		2%	34%	1%

Source: Company data, Nomura estimates

**Fig. 8: HK jewellery players' SSSG**

Calendar year

SSSG, calendar year	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13	1Q14
<b>Chow Tai Fook</b>													
HK/Macau & Others			78.5%		18.3%	-1.0%	-12.0%	-6.0%	4.0%	68.0%	26.0%	7.0%	-9.0%
Mainland China			45.3%		18.7%	10.0%	-3.0%	-11.0%	-8.0%	32.0%	12.0%	14.0%	15.0%
<b>Overall</b>			<b>61.9%</b>		<b>18.7%</b>	<b>4.0%</b>	<b>-7.0%</b>	<b>-8.0%</b>	<b>-2.0%</b>	<b>48.0%</b>	<b>18.0%</b>	<b>11.0%</b>	<b>4.0%</b>
<b>Luk Fook</b>													
HK & Macau	37.0%		70.0%		22.0%		0.0%	0.0%	29.0%	83.0%	30.0%	6.3%	-12.0%
China (self-operated)	48.0%		27.0%		25.0%		12.6%	-10.0%	14.0%	117.0%	70.0%	35.6%	1.0%
<b>Overall</b>										<b>93.2%</b>	<b>42.0%</b>	<b>9.3%</b>	<b>-10.0%</b>
<b>Chow Sang Sang</b>													
Hong Kong						16.0%		2.0%		50.0%		16.0%	
China		43.0%		31.0%		8.0%		2.0%		31.0%		9.0%	

Source: Company data, Nomura research



## Chow Sang Sang Holdings

0116.HK 116 HK

EQUITY: CONSUMER RELATED

### Valuation to de-rate offering more downside

Premium to LF may shrink; retail presence and no quarterly data-point may help cushion fall

**We revise estimates to factor in weakening industry sentiment and high base; we view ~20% premium to LF unjustified**

We tweak down our numbers post FY13 results, mainly driven by the market's lukewarm performance YTD as well as weakening Chinese spending (mainland Chinese comprised 72% of overall sales in CY13). Like its peers, upcoming data points may continue to put pressure on valuations. CSS is trading at 10x CY14F P/E, still 25% higher than trough valuations and, more importantly, we think CSS's over-20% premium to Luk Fook's CY14F P/E multiple may not be justified. At the same time, CSS does not release quarterly data and while CTF and LF will release significantly negative growth in the April-June quarter, no data from CSS may help cushion the correction.

**SSSG and earnings growth could slip into negative in CY14F, which could drive down valuations; downgrade to Reduce**

CSS plans to open around 50 new stores in China in CY14 (vs 22 in CY13) and targets mid-high end customers. Although we believe more flagship or premium stores should benefit CSS in the long term, the store efficiency would inevitably be impacted amid weaker Chinese spending in the short term. We also cut our SSSG estimates in CY14 for HK and China to -7% and -3%, respectively, and expect to see a negative bottom-line growth led by both high base and weakening spending. Downgrade to Reduce.

**Over one-third of rent contracts in HK will be renewed in 2014**

CSS will have over one-third of its rent contracts coming up for renewal this year, with most falling in 2H. The rentals are expected to rise and, hence, as per management, CSS may move a couple of its ground-floor stores into one building from ground to first/second floor, which can not only offer synergies in advertising but also can save costs. We think this strategy change could help cushion the cost rise but could likely affect the footfalls to stores and influence the top-line growth.

Year-end 31 Dec	FY13		FY14F		FY15F		FY16F	
Currency (HKD)	Actual	Old	New	Old	New	Old	New	
<b>Revenue (mn)</b>	25,142	26,072	25,418	28,928	27,340		28,854	
<b>Reported net profit (mn)</b>	1,218	1,414	1,184	1,702	1,322		1,509	
<b>Normalised net profit (mn)</b>	1,218	1,414	1,184	1,702	1,322		1,509	
<b>FD normalised EPS</b>	1.80	2.09	1.75	2.51	1.95		2.23	
<b>FD norm. EPS growth (%)</b>	23.7	20.4	-2.8	20.4	11.6		14.2	
<b>FD normalised P/E (x)</b>	10.1	N/A	10.3	N/A	9.3	N/A	8.1	
<b>EV/EBITDA (x)</b>	7.3	N/A	7.1	N/A	6.6	N/A	5.2	
<b>Price/book (x)</b>	1.5	N/A	1.4	N/A	1.3	N/A	1.2	
<b>Dividend yield (%)</b>	3.8	N/A	3.7	N/A	4.1	N/A	4.7	
<b>ROE (%)</b>	16.3	17.4	14.3	18.8	14.6		15.1	
<b>Net debt/equity (%)</b>	2.0	0.1	net cash	net cash	net cash		net cash	

Source: Company data, Nomura estimates

Key company data: See page 2 for company data and detailed price/index chart

### Global Markets Research

20 May 2014

<b>Rating</b> Down from Neutral	<b>Reduce</b>
<b>Target price</b> Reduced from 25.60	HKD 15.50
<b>Closing price</b> 16 May 2014	HKD 18.10
<b>Potential downside</b>	-14.4%

### Anchor themes

Consumption of jewellery (especially diamonds) in China is still at a nascent stage and branded names have still not penetrated lower-tier cities (even for gold). We believe long-term demographics such as a rising middle class and urbanisation should lead to secular growth for the sector

### Nomura vs consensus

Our FY14F bottom-line estimates are 17% below consensus as we build in weakening mainland Chinese spending.

### Research analysts

#### China Consumer Related

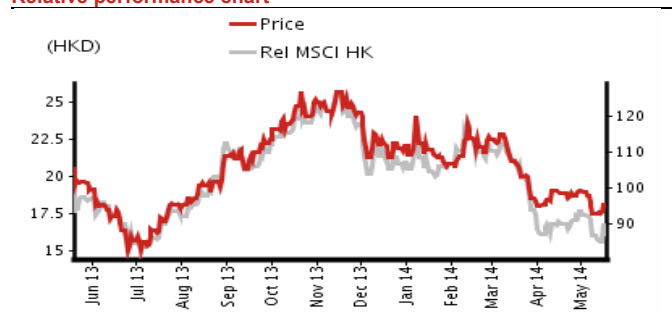
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# Key data on Chow Sang Sang Holdings

## Relative performance chart



Source: Thomson Reuters, Nomura research

## Notes:

## Performance

(%)	1M	3M	12M		
Absolute (HKD)	-4.1	-19.7	-11.7	M cap (USDmn)	1,580.6
Absolute (USD)	-4.1	-19.7	-11.6	Free float (%)	43.8
Rel to MSCI HK	-0.3	-21.0	-9.7	52-week (HKD)	26.2/15

## Income statement (HKDmn)

Year-end 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
Revenue	18,260	25,142	25,418	27,340	28,854
Cost of goods sold	-14,828	-20,935	-21,038	-22,544	-23,651
Gross profit	3,432	4,208	4,380	4,796	5,203
SG&A	-2,176	-2,665	-2,872	-3,117	-3,289
Employee share expense					
Operating profit	1,257	1,542	1,507	1,679	1,913
EBITDA	1,396	1,710	1,677	1,846	2,077
Depreciation	-140	-167	-170	-166	-163
Amortisation	0	0	0	0	0
EBIT	1,257	1,542	1,507	1,679	1,913
Net interest expense	-39	-32	-32	-32	-32
Associates & JCEs	4	2	2	2	2
Other income					
Earnings before tax	1,222	1,512	1,477	1,649	1,883
Income tax	-233	-288	-288	-322	-367
Net profit after tax	989	1,224	1,189	1,327	1,516
Minority interests	-4	-5	-5	-6	-6
Other items					
Preferred dividends					
Normalised NPAT	985	1,218	1,184	1,322	1,509
Extraordinary items					
Reported NPAT	985	1,218	1,184	1,322	1,509
Dividends	-372	-460	-447	-499	-570
Transfer to reserves	613	758	737	822	939

## Valuations and ratios

Reported P/E (x)	12.4	10.1	10.3	9.3	8.1
Normalised P/E (x)	12.4	10.1	10.3	9.3	8.1
FD normalised P/E (x)	12.4	10.1	10.3	9.3	8.1
Dividend yield (%)	3.0	3.8	3.7	4.1	4.7
Price/cashflow (x)	10.8	17.3	5.8	na	5.1
Price/book (x)	1.7	1.5	1.4	1.3	1.2
EV/EBITDA (x)	9.3	7.3	7.1	6.6	5.2
EV/EBIT (x)	10.4	8.1	7.9	7.2	5.7
Gross margin (%)	18.8	16.7	17.2	17.5	18.0
EBITDA margin (%)	7.6	6.8	6.6	6.8	7.2
EBIT margin (%)	6.9	6.1	5.9	6.1	6.6
Net margin (%)	5.4	4.8	4.7	4.8	5.2
Effective tax rate (%)	19.1	19.1	19.5	19.5	19.5
Dividend payout (%)	37.8	37.8	37.8	37.8	37.8
ROE (%)	14.7	16.3	14.3	14.6	15.1
ROA (pretax %)	13.4	15.4	14.6	15.3	16.8

## Growth (%)

Revenue	6.4	37.7	1.1	7.6	5.5
EBITDA	-11.2	22.5	-1.9	10.0	12.5
Normalised EPS	-10.3	23.7	-2.8	11.6	14.2
Normalised FDEPS	-10.3	23.7	-2.8	11.6	14.2

Source: Company data, Nomura estimates

## Cashflow statement (HKDmn)

Year-end 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
EBITDA	1,396	1,710	1,677	1,846	2,077
Change in working capital	-66	-216	-173	-1,080	334
Other operating cashflow	-191	-787	607	-1,759	-11
Cashflow from operations	1,139	708	2,111	-994	2,400
Capital expenditure	-267	-280	-180	-150	-150
Free cashflow	872	428	1,931	-1,144	2,250
Reduction in investments	-29	-26	0	0	0
Net acquisitions					
Dec in other LT assets	-70	-21	0	0	0
Inc in other LT liabilities	8	13	0	18	24
Adjustments	-57	371	-470	1,101	-128
CF after investing acts	725	765	1,461	-25	2,146
Cash dividends	-408	-460	-447	-499	-570
Equity issue					
Debt issue	-275	-79	-54	8	-19
Convertible debt issue					
Others	1	110	-398	298	-240
CF from financial acts	-681	-430	-900	-193	-829
Net cashflow	43	335	561	-218	1,317
Beginning cash	631	674	1,009	1,571	1,352
Ending cash	674	1,009	1,570	1,353	2,669
Ending net debt	727	157	-405	-186	-1,503

## Balance sheet (HKDmn)

As at 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
Cash & equivalents	674	1,009	1,571	1,352	2,669
Marketable securities					
Accounts receivable	708	741	724	924	815
Inventories	6,602	6,866	6,967	7,857	7,694
Other current assets	680	799	776	835	820
Total current assets	8,663	9,416	10,037	10,968	11,999
LT investments	208	235	235	235	235
Fixed assets	663	779	786	770	757
Goodwill					
Other intangible assets	0	0	0	0	0
Other LT assets	890	911	911	911	911
Total assets	10,426	11,342	11,970	12,884	13,902
Short-term debt	794	712	712	712	712
Accounts payable	1,073	1,198	1,102	1,126	1,156
Other current liabilities	731	808	790	835	853
Total current liabilities	2,598	2,718	2,604	2,673	2,721
Long-term debt	606	454	454	454	454
Convertible debt					
Other LT liabilities	138	152	151	169	193
Total liabilities	3,342	3,324	3,209	3,296	3,368
Minority interest	76	84	89	94	100
Preferred stock					
Common stock	169	169	169	169	169
Retained earnings	6,838	7,766	8,502	9,325	10,264
Proposed dividends					
Other equity and reserves					
Total shareholders' equity	7,007	7,935	8,672	9,494	10,433
Total equity & liabilities	10,426	11,342	11,970	12,884	13,902

## Liquidity (x)

Current ratio	3.33	3.46	3.85	4.10	4.41
Interest cover	32.1	47.9	46.9	52.2	59.5

## Leverage

Net debt/EBITDA (x)	0.52	0.09	net cash	net cash	net cash
Net debt/equity (%)	10.4	2.0	net cash	net cash	net cash

## Per share

Reported EPS (HKD)	1.45	1.80	1.75	1.95	2.23
Norm EPS (HKD)	1.45	1.80	1.75	1.95	2.23
FD norm EPS (HKD)	1.45	1.80	1.75	1.95	2.23
BVPS (HKD)	10.35	11.72	12.81	14.03	15.41
DPS (HKD)	0.55	0.68	0.66	0.74	0.84

## Activity (days)

Days receivable	13.1	10.5	10.5	11.0	11.0
Days inventory	158.2	117.4	120.0	120.0	120.3
Days payable	23.9	19.8	20.0	18.0	17.7
Cash cycle	147.4	108.1	110.6	113.0	113.7

Source: Company data, Nomura estimates

# Valuation Methodology

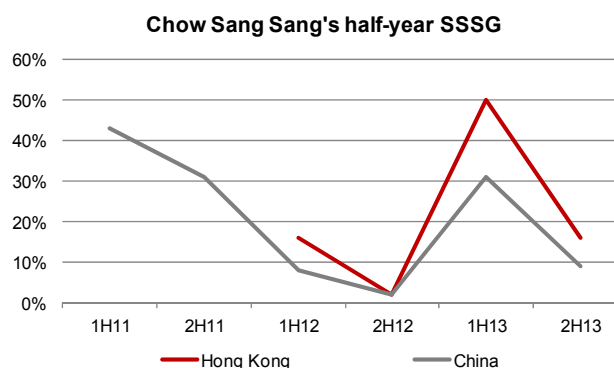
We continue to value Chow Sang Sang on a blend of DCF and P/E to arrive at our target price of HKD15.5. For DCF, our WACC assumption is ~10% and terminal growth assumption is 2%. Cash flows are discounted back to CY14F. For P/E, we cut the valuation multiple from 12x to 9x, which is in line with its two year average, as the market sentiment and data points continue to weaken. Our revised estimates and key assumptions are exhibited below.

Fig. 9: Key changes to Nomura estimates

	FY14F		FY15F	
	Old	New	Old	New
SSSG				
China	4%	-3%	7%	6%
HK	3%	-7%	9%	5%
Net sales growth	7.1%	1.1%	11.0%	7.6%
Gross margins	17.8%	17.2%	18.1%	17.5%
Operating margins	7.0%	5.9%	7.5%	6.1%
Earnings growth	20.4%	-2.8%	20.4%	11.6%

Source: Nomura estimates

Fig. 10: CSS' SSSG by geography



Source: Company data, Nomura research

Fig. 11: HK jewellery players' SSSG

Calendar year													
SSSG, calendar year	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13	1Q14
Chow Tai Fook													
HK/Macau & Others			78.5%		18.3%	-1.0%	-12.0%	-6.0%	4.0%	68.0%	26.0%	7.0%	-9.0%
Mainland China			45.3%		18.7%	10.0%	-3.0%	-11.0%	-8.0%	32.0%	12.0%	14.0%	15.0%
Overall			61.9%		18.7%	4.0%	-7.0%	-8.0%	-2.0%	48.0%	18.0%	11.0%	4.0%
Luk Fook													
HK & Macau	37.0%		70.0%		22.0%		0.0%	0.0%	29.0%	83.0%	30.0%	6.3%	-12.0%
China (self-operated)	48.0%		27.0%		25.0%		12.6%	-10.0%	14.0%	117.0%	70.0%	35.6%	1.0%
Overall										93.2%	42.0%	9.3%	-10.0%
Chow Sang Sang													
Hong Kong						16.0%		2.0%		50.0%		16.0%	
China		43.0%		31.0%		8.0%		2.0%		31.0%		9.0%	

Source: Company data, Nomura research

### Trend negative but valuations may support

Trading close to all-time low valuations may help buffer impact from negative data points

#### We tweak estimates to factor in weakening Chinese spending

We cut our SSSG estimates in FY15F for both HK and China to -8% (from 4% and 2%, respectively), and expect to see a negative top-line and bottom-line growth largely due to its extremely high base, as well as the weakening consumer sentiment. Luk Fook's store opening plan in FY15F would slow to ~180 stores in China (vs ~200 in FY14) and become more prudent in HK/Macau. Although one-fourth of HK stores' rent contracts are to be renewed this year, Luk Fook's management sees a lower pressure on the rent rise compared to last year.

#### Valuations close to all-time low; maintain Neutral

As we expect the sector to de-rate, we revise down LF's target P/E multiple to 9x from 12x, in line with other two names (CTF to 12x from 15x; CSS to 9x from 12x). However, as Luk Fook's stock price has already corrected by 30% YTD and is trading at 8x CY14F P/E (the all-time low is ~7x), at a significant discount to CSS (~10x CY14F P/E) and CTF (~14x CY14F P/E), we believe LF's valuations may likely have bottomed out. We maintain Neutral.

#### We still expect significant negative growth numbers in Apr-June quarter

As LF had a relatively higher base compared to its peers in the April-June quarter last year (SSSG 83% in HK, 117% in China), we expect it to post the deepest negative number among the three for the quarter. Per our estimates, Luk Fook's SSSG in the quarter could be a 35-40% slump this year.

#### VIP spending remains okay; lower ticket-size items should help growth

VIP customers account for ~30% of Luk Fook's overall sales and contribute significantly to the company's growth. However, the lower ticket-size items (<CNY3,000) have relatively better sell-through, and LF does have a wide range of product offerings in this category. We believe this should continue to be the growth driver for the company.

Year-end 31 Mar	FY13	FY14F		FY15F		FY16F	
Currency (HKD)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	13,412	18,483	18,345	19,858	17,715	22,224	18,917
Reported net profit (mn)	1,266	1,746	1,519	1,860	1,458	2,224	1,623
Normalised net profit (mn)	1,266	1,746	1,519	1,860	1,458	2,224	1,623
FD normalised EPS	2.15	2.96	2.58	3.16	2.48	3.78	2.75
FD norm. EPS growth (%)	-5.1	37.9	20.0	6.5	-4.0	19.6	11.3
FD normalised P/E (x)	9.6	N/A	8.0	N/A	8.3	N/A	7.5
EV/EBITDA (x)	6.8	N/A	5.3	N/A	5.2	N/A	4.3
Price/book (x)	1.9	N/A	1.6	N/A	1.4	N/A	1.3
Dividend yield (%)	4.2	N/A	5.0	N/A	4.8	N/A	5.3
ROE (%)	21.1	24.4	21.6	22.0	18.0	22.7	18.0
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash	net cash	net cash

Source: Company data, Nomura estimates

Key company data: See page 2 for company data and detailed price/index chart

### Global Markets Research

20 May 2014

<b>Rating</b> Remains	<b>Neutral</b>
<b>Target price</b> Reduced from 32.50	HKD 21.10
<b>Closing price</b> 16 May 2014	HKD 20.65
<b>Potential upside</b>	+2.2%

#### Anchor themes

Consumption of jewellery (especially diamonds) in China is still at a nascent stage and the branded names have still not penetrated lower-tier cities (even for gold). We believe long-term demographics such as a rising middle class and urbanisation should lead to secular growth for the sector.

#### Nomura vs consensus

Our FY15F earnings estimate is 13% lower than consensus to factor in the slowing Chinese spending.

#### Research analysts

##### China Consumer Related

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# Key data on Luk Fook Holdings

## Relative performance chart



## Notes:

## Performance

(%)	1M	3M	12M		
Absolute (HKD)	-7.6	-24.5	1.2	M cap (USDmn)	1,569.3
Absolute (USD)	-7.6	-24.5	1.4	Free float (%)	54.6
Rel to MSCI HK	-3.8	-25.7	3.2	52-week (HKD)	34/16.88

## Income statement (HKDmn)

Year-end 31 Mar	FY12	FY13	FY14F	FY15F	FY16F
Revenue	11,907	13,412	18,345	17,715	18,917
Cost of goods sold	-9,149	-10,582	-14,786	-14,135	-14,977
Gross profit	2,759	2,830	3,560	3,580	3,940
SG&A	-1,166	-1,306	-1,743	-1,825	-1,986
Employee share expense					
Operating profit	1,592	1,524	1,817	1,755	1,954
EBITDA	1,664	1,623	1,925	1,866	2,067
Depreciation	-70	-92	-100	-103	-105
Amortisation	-2	-6	-8	-8	-8
EBIT	1,592	1,524	1,817	1,755	1,954
Net interest expense	0	6	6	6	6
Associates & JCEs	3	-1	-1	-1	-1
Other income					
Earnings before tax	1,595	1,530	1,822	1,761	1,959
Income tax	-248	-260	-301	-299	-333
Net profit after tax	1,347	1,269	1,522	1,461	1,626
Minority interests	-13	-3	-3	-3	-3
Other items					
Preferred dividends					
Normalised NPAT	1,334	1,266	1,519	1,458	1,623
Extraordinary items					
Reported NPAT	1,334	1,266	1,519	1,458	1,623
Dividends	-541	-507	-608	-584	-649
Transfer to reserves	793	759	911	875	973

## Valuations and ratios

Reported P/E (x)	9.1	9.6	8.0	8.3	7.5
Normalised P/E (x)	9.1	9.6	8.0	8.3	7.5
FD normalised P/E (x)	9.1	9.6	8.0	8.3	7.5
Dividend yield (%)	4.4	4.2	5.0	4.8	5.3
Price/cashflow (x)	na	28.6	9.3	10.7	7.6
Price/book (x)	2.2	1.9	1.6	1.4	1.3
EV/EBITDA (x)	6.4	6.8	5.3	5.2	4.3
EV/EBIT (x)	6.7	7.2	5.6	5.5	4.5
Gross margin (%)	23.2	21.1	19.4	20.2	20.8
EBITDA margin (%)	14.0	12.1	10.5	10.5	10.9
EBIT margin (%)	13.4	11.4	9.9	9.9	10.3
Net margin (%)	11.2	9.4	8.3	8.2	8.6
Effective tax rate (%)	15.5	17.0	16.5	17.0	17.0
Dividend payout (%)	40.5	40.0	40.0	40.0	40.0
ROE (%)	29.6	21.1	21.6	18.0	18.0
ROA (pretax %)	37.5	26.3	26.3	24.2	25.7

## Growth (%)

Revenue	47.2	12.6	36.8	-3.4	6.8
EBITDA	53.7	-2.5	18.6	-3.1	10.8
Normalised EPS	42.1	-5.1	20.0	-4.0	11.3
Normalised FDEPS	42.1	-5.1	20.0	-4.0	11.3

Source: Company data, Nomura estimates

## Cashflow statement (HKDmn)

Year-end 31 Mar	FY12	FY13	FY14F	FY15F	FY16F
EBITDA	1,664	1,623	1,925	1,866	2,067
Change in working capital	-1,566	-920	-322	-435	-144
Other operating cashflow	-201	-277	-301	-291	-321
Cashflow from operations	-104	425	1,302	1,140	1,601
Capital expenditure	-94	-174	-130	-120	-120
Free cashflow	-198	251	1,172	1,020	1,481
Reduction in investments	18	30	-14	0	0
Net acquisitions					
Dec in other LT assets	-72	-176	-15	40	0
Inc in other LT liabilities	31	2	0	0	0
Adjustments	-34	17	15	-40	0
CF after investing acts	-253	125	1,157	1,020	1,481
Cash dividends	-515	-477	-608	-584	-649
Equity issue	1,340				
Debt issue	-3	0	0	0	0
Convertible debt issue					
Others	5	1	310	6	53
CF from financial acts	826	-476	-298	-578	-596
Net cashflow	573	-351	859	443	885
Beginning cash	966	1,538	1,187	2,046	2,489
Ending cash	1,539	1,187	2,046	2,488	3,373
Ending net debt	-1,538	-1,187	-2,046	-2,489	-3,373

## Balance sheet (HKDmn)

As at 31 Mar	FY12	FY13	FY14F	FY15F	FY16F
Cash & equivalents	1,538	1,187	2,046	2,489	3,373
Marketable securities					
Accounts receivable	163	317	266	297	305
Inventories	4,330	4,955	5,982	5,636	6,674
Other current assets	98	227	233	213	227
Total current assets	6,129	6,686	8,527	8,634	10,579
LT investments	62	32	47	47	47
Fixed assets	395	516	545	560	574
Goodwill					
Other intangible assets					
Other LT assets	152	327	342	302	302
Total assets	6,738	7,562	9,461	9,543	11,501
Short-term debt					
Accounts payable	877	938	1,598	827	1,743
Other current liabilities	139	66	66	66	66
Total current liabilities	1,016	1,004	1,664	892	1,808
Long-term debt					
Convertible debt					
Other LT liabilities	78	80	80	80	80
Total liabilities	1,094	1,084	1,744	973	1,889
Minority interest	49	53	56	59	62
Preferred stock					
Common stock	2,582	2,582	2,582	2,582	2,582
Retained earnings	2,760	3,560	4,471	5,346	6,319
Proposed dividends	253	283	608	584	649
Other equity and reserves					
Total shareholders' equity	5,596	6,425	7,661	8,511	9,550
Total equity & liabilities	6,738	7,562	9,461	9,543	11,501

## Liquidity (x)

Current ratio	6.03	6.66	5.12	9.68	5.85
Interest cover	na	na	na	na	na

## Leverage

Net debt/EBITDA (x)	net cash	net cash	net cash	net cash	net cash
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash

## Per share

Reported EPS (HKD)	2.26	2.15	2.58	2.48	2.75
Norm EPS (HKD)	2.26	2.15	2.58	2.48	2.75
FD norm EPS (HKD)	2.26	2.15	2.58	2.48	2.75
BVPS (HKD)	9.50	10.91	13.00	14.45	16.21
DPS (HKD)	0.92	0.86	1.03	0.99	1.10

## Activity (days)

Days receivable	4.2	6.5	5.8	5.8	5.8
Days inventory	138.9	160.2	135.0	150.0	150.4
Days payable	31.2	31.3	31.3	31.3	31.4
Cash cycle	111.8	135.4	109.5	124.5	124.8

Source: Company data, Nomura estimates

# Valuation methodology

We continue to value Luk Fook on a blend of DCF and P/E to arrive at our TP of HKD21.1. For our DCF, the WACC assumption is ~12% and our terminal growth assumption is 2%. Cash flows are discounted back to CY14F. For P/E, we cut the valuation multiple from 12x to 9x, in line with its three year average, as the market sentiment and data points continue to weaken. Our revised estimates and key assumptions are exhibited below.

**Fig. 12: Key changes to Nomura estimates**

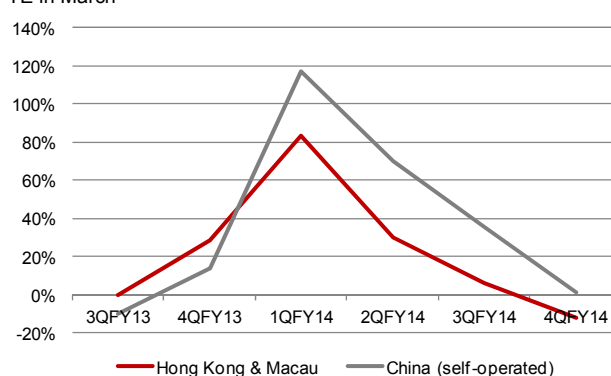
FYE in March

	FY15F		FY16F	
	Old	New	Old	New
SSSG				
China	2%	-8%	8%	6%
HK	4%	-8%	10%	5%
Net sales growth	7.4%	-3.4%	11.9%	6.8%
Gross margins	20.9%	20.2%	21.7%	20.8%
Operating margins	11.3%	9.9%	12.1%	10.3%
Earnings growth	6.5%	-4.0%	19.6%	11.3%

Source: Nomura estimates

**Fig. 13: Luk Fook's SSSG by geography**

FYE in March



Source: Company data, Nomura research

**Fig. 14: HK jewellery players' SSSG**

Calendar year

SSSG, calendar year	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13	1Q14
<b>Chow Tai Fook</b>													
HK/Macau & Others			78.5%		18.3%	-1.0%	-12.0%	-6.0%	4.0%	68.0%	26.0%	7.0%	-9.0%
Mainland China			45.3%		18.7%	10.0%	-3.0%	-11.0%	-8.0%	32.0%	12.0%	14.0%	15.0%
<b>Overall</b>			<b>61.9%</b>		<b>18.7%</b>	<b>4.0%</b>	<b>-7.0%</b>	<b>-8.0%</b>	<b>-2.0%</b>	<b>48.0%</b>	<b>18.0%</b>	<b>11.0%</b>	<b>4.0%</b>
<b>Luk Fook</b>													
HK & Macau	37.0%		70.0%		22.0%		0.0%	0.0%	29.0%	83.0%	30.0%	6.3%	-12.0%
China (self-operated)	48.0%		27.0%		25.0%		12.6%	-10.0%	14.0%	117.0%	70.0%	35.6%	1.0%
<b>Overall</b>										<b>93.2%</b>	<b>42.0%</b>	<b>9.3%</b>	<b>-10.0%</b>
<b>Chow Sang Sang</b>													
Hong Kong						16.0%		2.0%		50.0%		16.0%	
China		43.0%		31.0%		8.0%		2.0%		31.0%		9.0%	

Source: Company data, Nomura research

# Appendix A-1

## Analyst Certification

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### Materially mentioned issuers

Issuer	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Chow Sang Sang Holdings	116 HK	HKD 18.05	19-May-2014	Reduce	N/A	
Chow Tai Fook Jewellery	1929 HK	HKD 10.36	19-May-2014	Reduce	N/A	
Luk Fook Holdings	590 HK	HKD 20.50	19-May-2014	Neutral	N/A	

### Chow Sang Sang Holdings (116 HK)

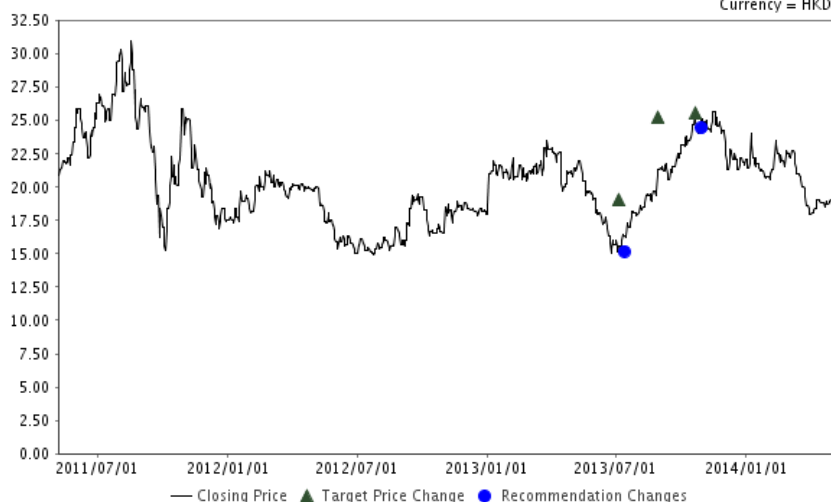
HKD 18.05 (19-May-2014) Reduce (Sector rating: N/A)

Rating and target price chart (three year history)

Chow Sang Sang Holdings

As of 05-May-2014  
Currency = HKD

Date	Rating	Target price	Closing price
22-Oct-13	Neutral		24.90
22-Oct-13		25.60	24.90
30-Aug-13		25.30	21.35
05-Jul-13	Buy		15.62
05-Jul-13		19.10	15.62



Source: ThomsonReuters, Nomura research

For explanation of ratings refer to the stock rating keys located after chart(s)

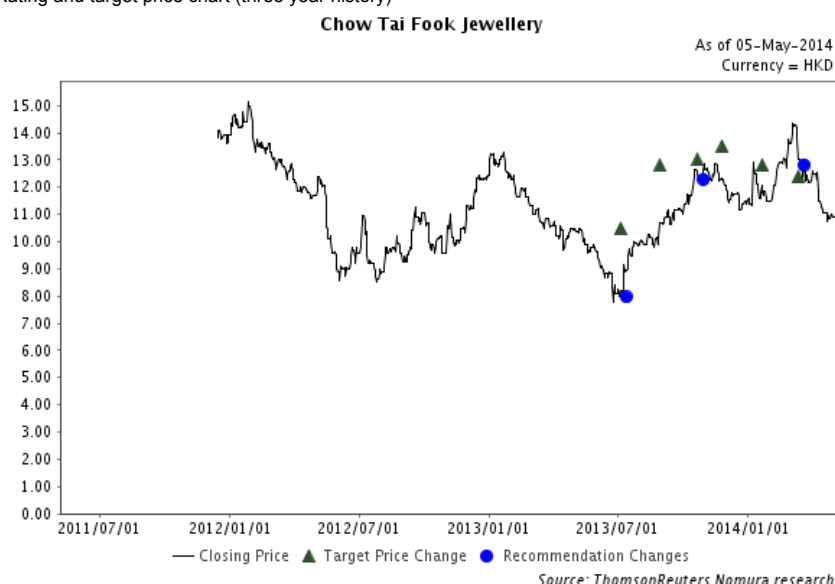
**Valuation Methodology** We continue to value Chow Sang Sang on a blend of DCF and P/E to arrive at our target price of HKD15.5. For DCF, our WACC assumption is ~10% and terminal growth assumption is 2%. Cash flows are discounted back to CY14F. For P/E, we use a multiple of 9x to CY14 EPS estimate of HKD1.75 as the stock has re-rated. The benchmark index for this stock is MSCI HK.

**Risks that may impede the achievement of the target price** Key upside risk for CSS may arise from a significant pickup in mainland Chinese spending that leads to a better-than-consensus data points in FY14/15.



**Chow Tai Fook Jewellery (1929 HK)****HKD 10.36 (19-May-2014)** Reduce (Sector rating: N/A)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
13-Mar-14	Reduce		13.04
13-Mar-14		12.40	13.04
21-Jan-14		12.80	12.04
26-Nov-13		13.50	12.30
22-Oct-13	Neutral		12.50
22-Oct-13		13.00	12.50
30-Aug-13		12.80	10.70
05-Jul-13	Buy		8.17
05-Jul-13		10.50	8.17

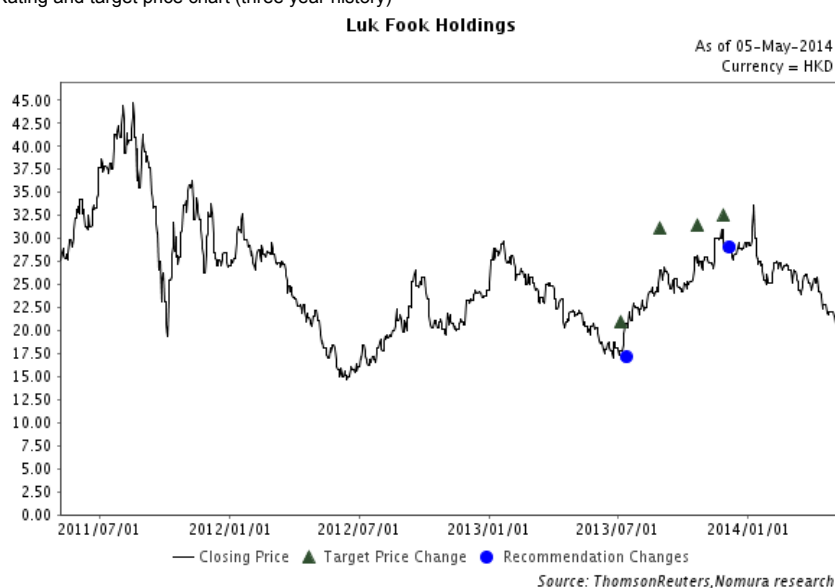
For explanation of ratings refer to the stock rating keys located after chart(s)

**Valuation Methodology** We value Chow Tai Fook on a blend of DCF and P/E to arrive at our target price of HKD9.6. For DCF, the WACC assumption is ~10% and the terminal growth assumption is 2%. Cash flows are discounted back to CY14F. For P/E, we use a multiple of 12x to the CY14 EPS estimate of HKD0.74. The benchmark index for this stock is MSCI HK.

**Risks that may impede the achievement of the target price** Key upside risks for Chow Tai Fook may arise from a significant sales boost (should be even better than April 2013) in China, and better-than-expected sell-through in gem-set products.

**Luk Fook Holdings (590 HK)****HKD 20.50 (19-May-2014)** Neutral (Sector rating: N/A)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
28-Nov-13	Neutral		29.70
28-Nov-13		32.50	29.70
22-Oct-13		31.50	28.10
30-Aug-13		31.10	26.50
05-Jul-13	Buy		17.76
05-Jul-13		21.00	17.76

For explanation of ratings refer to the stock rating keys located after chart(s)

**Valuation Methodology** We continue to value Luk Fook on a blend of DCF and P/E to arrive at our TP of HKD 21.1. For our DCF, the WACC assumption is ~12% and our terminal growth assumption is 2%. Cash flows are discounted back to CY14F. For P/E, we use multiple of 9x to the CY14 EPS of HKD2.5. The benchmark index for this stock is MSCI HK.

**Risks that may impede the achievement of the target price** Key risks for Luk Fook may arise from a significantly economic slowdown in China, weaker consumer sentiment and slowing spending of Chinese tourists to Hong Kong. Luk Fook's gold hedged position is the lowest among the three HK jewellery brands; hence, if gold price drops substantially from current levels, it would have a significant impact on the company. A significant surge in gem-set sales would bring an upside risk.

## Rating and target price changes

Issuer	Ticker	Old stock rating	New stock rating	Old target price	New target price
Chow Sang Sang Holdings	116 HK	Neutral	Reduce	HKD 25.60	HKD 15.50
Chow Tai Fook Jewellery	1929 HK	Reduce	Reduce	HKD 12.40	HKD 9.60
Luk Fook Holdings	590 HK	Neutral	Neutral	HKD 32.50	HKD 21.10

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