

Sparkle Roll

Pure exposure to China high net worth

Not rated

Financial summary

Year to Mar.	07A	08A	09A
Turnover (HK\$m)	102.1	156.7	611.5
Net Profit (HK\$m)	11.4	6.6	(190.0)
EPS (RMB)	0.012	0.006	-
EPS Δ%	(26.3)	(48.0)	-
P/E (x)	32.4	62.4	-
P/B (x)	1.5	1.1	1.1
EV/EBITDA (x)	30.8	29.0	-
Yield (%)	1.1	0.5	3.0
ROE (%)	4.6	2.2	-
ROCE (%)	4.6	1.4	-
N. Gear. (%)	cash	cash	cash

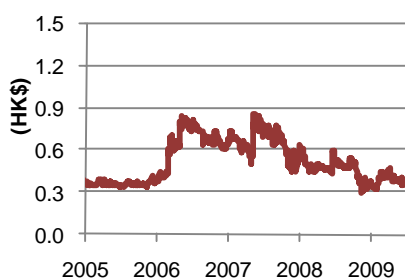
Source: Company data

Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	+3.7	-15.0	-14.6
Actual price changes (%)	+19.7	+1.3	-19.4

	08F	09F	10F
Consensus EPS (HK\$)	-	-	-
Previous forecasts (HK\$m)	-	-	-
Previous EPS (HK\$)	-	-	-

Price Chart



Kennedy Tsang

(852) 2533 3713

kennedytsang@sbie2capital.com

and is currently focused on three verticals, namely luxury automobiles, luxury watches and jewelry. Since the completion of the acquisition in Jun 2008, the company has secured distributorship agreement for luxury watch brands "Richard Mille" (Jul 2008) and "DeWitt" (Apr 2009). The company is currently working on securing distributorship for one or more jewelry brand.

Distribution business. As part of the distributorship agreement, SR is required to provide event marketing for its automobile brands and marketing for its watch brands (which they have nationwide distributorship rights). Typically, gross margin for automobiles is around 10% and for watches, up to 30%. For automobiles, the company also needs to provide after sales services and the company owns state of the art maintenance facilities for its 3 brands of Rolls Royce (1,300sqm), Bentley (1,700sqm) and Lamborghini (500sqm) in Beijing. As ownership base of the luxury autos increases, we expect maintenance services to develop into a steady recurring revenue stream for

Ticker:	0970.HK	12 mth range:	HK\$0.27-0.57
Price:	HK\$0.40	Market cap:	US\$90.5m
Target:	n.a.	Daily t/o, 3 mth:	US\$0.2m
		Free float %:	52.5%

Key points:

- * Sparkle Roll (SR) is focused on the distribution of high end luxury items in China, targeting the ultra high net worth segment
- * Its brand portfolio includes luxury auto brands Rolls Royce, Bentley, Lamborghini and luxury watch brands Richard Mille and DeWitt. We expect the company to further diversify into the jewelry vertical
- * China is the 3rd largest luxury market in the world, accounting for 18% of world luxury market in 2007. It is expected that China will account for 29-32% by 2015, becoming the 2nd largest market behind Japan
- * Despite the global financial crisis, China's luxury consumption market remained resilient in 2008
- * SR, with a proven track record, is poised to benefit as many brand owners increase their China focus as demand in other overseas markets wane. We expect SR to capitalize on its increasing bargaining power to secure more brands and enhance its portfolio

Background. Sparkle Roll (SR) is a company focused on distributing luxury products from top tier foreign brands to China's ultra high net worth segment. The company was formerly into the animation business but diversified into distribution of top tier luxury brands through the acquisition of a luxury goods distributorship business for a total consideration of HK\$402.0m, comprising 1) HK\$50.0m cash, 2) HK\$88.0m in issue of 400m shares at HK\$0.22/share and 3) HK\$264.0m in CBs. The deal included profit guarantees of HK\$55.0m for 2008 and HK\$65.0m for 2009. The acquisition was completed in Jun 2008.

Only the best for China's richest. SR is focused on the distribution of big ticket luxury goods for top tier foreign brands in China. The company's key target demographic segments are China's urban affluent and ultra high net worth. The company is one of few on the Hong Kong bourse with a pure exposure to high-end discretionary consumption in China and China's ultra high net worth segment.

Multi-brand, multi-vertical. The recently acquired entity started its distribution of luxury automobiles since 2002, but has diversified

the company. Management estimates that gross margin for maintenance services could reach around 45%. SR's major shareholder, Qi Jian Hong comes from a family of former senior government official in Beijing and over the years has developed a strong with the ultra high network demographic in China. Qi also privately holds the distributorship in China (especially Beijing) a number of other top tier brands in including Davidoff, Burberry, TSL and Emperor.

Table 1: Distributorship profile

Vertical	Brand	Term	Typical price range	Distributorship rights	Remarks
Automobiles	Rolls Royce	2 years	RMB6,000,000-8,000,000	Beijing (exclusive) plus other common areas	Beijing is best performed distributor in Asia Pacific. Unit sales were up 52% in 2008 to 52 units
	Bentley	Continuous w/ 1 year notice	RMB3,000,000-6,500,000	Beijing (exclusive) plus other common areas	Total China and HK sales of Bentley in 2008 up 53% YoY to 518 units
	Lamborghini	1+1 years	RMB3,000,000-5,000,000	Beijing (exclusive) plus other common areas	Major competitor of Ferrari. Total China sales of Lamborghini up 94% YoY to 70 units in 2008
Watches	Richard Mille	5+3 years	RMB400,000-6,000,000	PRC	
	DeWitt	5+3 years	RMB200,000-5,000,000	PRC	

Source: Company data

China is 3rd largest luxury market in the world. China's luxury market reached US\$8.0b in 2007, accounting for around 18% of global luxury consumption (2006: 12%) according to Bain & Company. Despite often being referred to as an "emerging country", China is the world's 3rd largest luxury market, behind Japan and the US. According to Asian Brand Strategy, this share is expected to reach between 29-32% by 2015. With close proximity to another key luxury market in Hong Kong (especially South China) and a thriving advertising/marketing ecosystem, which allows luxury brands to build brand equity, China has accelerated the development of its taste for luxury brands over the past few years and has a significantly larger appetite for luxury items when compared to the other BRIC countries.

China luxury market resilient in the face of global financial crisis. While the global financial crisis has severely negatively impacted on the luxury markets worldwide, China appears to have been surprisingly resilient, transforming into a bastion for growth for many of the world's top-tier brands for luxury items. Many luxury brands/goods manufacturers have recently acknowledged China as their core growth market going forward. LVMH's Louis Vuitton fashion and leather segment recorded 18% YoY revenue growth in Asia (ex-Japan) in IH 2009, citing "exceptional growth" in China. LVMH is continuing to aggressively expand its brand presence (eg. Givenchy) and retail presence (DFS and Sephora) in China. Since the end of 2008, China has become the second largest customer base for LV. PPR's luxury goods revenues were up 11% YoY for IH 2009 with its flagship brand Gucci up a higher 14% YoY. Meanwhile, in the luxury automotive segment, Rolls Royce sold 1,212 units in 2008, up 20.0% YoY. China was Rolls Royce's 3rd largest geographical market in 2008.

China high net worth inclined on luxury consumption. A recent report on private wealth by China Merchants Bank and Bain & Company estimated that by the end of 2009, China would have 320,000 people with at least RMB10m assets, up 6.0% from 2008. However, we suspect that this figure would be on the low side as we think there are many "invisible" high net worth that official studies/research have failed to capture. Contrary to those in overseas countries, the wealthy segment in China possess a higher inclination to consume luxury goods. This is mainly because the age range of the wealthy segment in China is typically younger, around 25-40, compared to more mature countries (50-70), meaning that there is lesser tendency to save. Other factors for contributing to the thriving demand include: 1) consumption behavior, which equates accumulation of luxury possessions with quality of life/social status; 2) ultra high net worth consumption patterns less affected by the global financial crisis; 3) sustained consumer optimism stemming from a general trust in the government to keep the China economy on the right growth track. A recent survey of high income earners conducted by Visa indicated that 50% of respondents tend to purchase cosmetics/perfumes on a monthly basis (Hong Kong: 35%, Taiwan: 26%), while 33% of respondents tend to buy luxury apparel/accessories on a monthly basis (Hong Kong: 29%, Taiwan: 22%).

Luxury goods distributorship business profitable. SR announced FY3/09A results recently, its maiden set of results with contribution from its new luxury goods distributorship business (~9 months contribution). Turnover reached HK\$611.5m with the luxury goods distributorship business accounting for HK\$459.2m (75.1%) of top line. For the 9 month contribution, SR sold 102 Bentleys, 26 Lamborghinis and 31 Rolls Royces. The company also sold

some 40 pieces of Richard Mille watches since securing the brand in Jul 2008. The company's new growth driving segment generated an EBIT of HK\$43.0m. Weighed down by losses in its comic/animation business and impairment (in the same segment) amounting to HK\$209.0m however, the company recorded a net loss of HK\$191.8m for FY3/09A. At end-FY3/09A, SR had cash and cash equivalents of HK\$76.9m and ST-debt amounting to HK\$33.4m. The company has no LT-debt save for the HK\$183.7m CBs issued for the acquisition of the luxury goods distributorship business.

Increasing bargaining power. In our view, we think that the current weakness in overseas markets coupled with the resilience in luxury goods consumption in China has forced many luxury brand owners to focus even more than before on driving sales (or accelerating their expansion plans) in China to sustain their company's growth. SR, being a leading distributor in luxury goods in China, with a proven track record, is poised to benefit as many brand owners would want to partner with them. Management has already noted that compared to the past, negotiation of distribution rights are progressing faster and many brands are willing to consider waiving fees for distributorship rights. We expect SR to capitalize on this to secure more brands and enhance its portfolio.

Valuation. The company is currently trading 1.0x P/B on a historical basis.

Table 1: P & L

Year to Mar (HK\$m)	07F	08F	09F
Turnover			
Luxury goods distribution	-	-	459.2
Comic publications, multimedia and others	102.1	156.7	152.3
	102.1	156.7	611.5
Cost of sales	(76.9)	(128.1)	(627.7)
Gross profit	25.2	28.7	(16.1)
Other revenue and gains	1.3	3.5	48.4
Selling and distribution costs	(2.6)	(3.3)	(29.1)
Administrative expenses	(12.3)	(19.4)	(39.6)
Other operating expenses	-	(1.0)	(132.8)
Operating profit	11.5	8.5	(169.3)
Financial costs	(0.4)	(0.2)	(16.5)
Share of loss of a jointly controlled entity	-	-	-
Share of loss of an associate	-	-	-
Pre-tax profit	11.1	8.3	(185.7)
Tax	0.3	(2.1)	(6.0)
Minority interests	-	(0.4)	1.8
Net profit	11.4	6.6	(190.0)

Source: Company data

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