



CHINA  
DEVELOPMENT  
FINANCIAL

# The Hour Glass

(HG SP/HRGS.SI)

## Time is money

Megan Choo / 65 6202 1190 / megan.choo@kgi.com

- The Hour Glass Limited is a specialty luxury watch retail group with multi-brand and standalone boutiques in the Asia Pacific Region. The group also owns Watches of Switzerland, a watch retail chain in Singapore that deals in mid-tier to high-end Swiss timepieces.
- **Power in luxury goods.** Bain & Company estimates that luxury goods spending will hit record levels in 2022, while price hikes for luxury products will continue to occur, with some hitting double-digit increases.
- **Asia's consumers to spearhead global consumption growth.** Offering a US\$10 trillion opportunity, Asian consumers are expected to account for half of global consumption growth in the next decade, according to estimates by McKinsey.
- **Quick recovery from Covid-19.** Swiss watch exports hit a 5-year high in 2021, representing a gain of 31.4% YoY. On the consumption side, Singapore's retail sales recorded a blockbuster growth in 2021, snapping a 3-year losing streak. Meanwhile, retail sales in both Malaysia and Thailand are on a path of recovery and are almost back to pre-pandemic levels.
- **Initiate with Outperform and S\$2.32 target price.**

| Financials & Key Operating Statistics |         |         |         |         |         |
|---------------------------------------|---------|---------|---------|---------|---------|
| YE Mar (S\$'000)                      | 2020    | 2021    | 2022F   | 2023F   | 2024F   |
| Revenue                               | 749,451 | 742,931 | 802,365 | 826,436 | 851,230 |
| PATMI                                 | 76,051  | 82,470  | 91,181  | 93,014  | 94,901  |
| EPS (cents)                           | 10.8    | 11.7    | 13.0    | 13.3    | 13.6    |
| EPS growth (%)                        |         | 8.6     | 11.3    | 2.0     | 2.0     |
| P/E (x)                               | 18.0    | 16.6    | 14.9    | 14.6    | 14.3    |
| DPS (Sing cents)                      | 2.0     | 6.0     | 4.3     | 4.4     | 4.5     |
| Div Yield (Y%)                        | 1.0%    | 3.1%    | 2.2%    | 2.3%    | 2.3%    |
| Net Profit Margin (%)                 | 10.1%   | 11.1%   | 11.4%   | 11.3%   | 11.1%   |
| Net Gearing (%)                       | (19.0%) | (20.5%) | (20.9%) | (21.2%) | (21.4%) |
| P/B (x)                               | 2.2     | 2.0     | 1.8     | 1.7     | 1.5     |
| ROE (%)                               | 12.4%   | 12.2%   | 12.3%   | 11.6%   | 11.0%   |

Source: Company data, KGI Research

**Company background.** The Hour Glass is one of the world's leading specialist watch retailers with an established presence of 50 boutiques in twelve key cities in the Asia Pacific region. The company's network of multi-brand and standalone brand boutiques are strategically located in key luxury retail corridors of Singapore, Hong Kong, Tokyo, Sydney, Melbourne, Brisbane, Auckland, Kuala Lumpur, Bangkok, Phuket, Hanoi and Ho Chi Minh.

**1H22 Financials: A strong start.** Revenue rose 63% YoY to S\$472mn for the half year ended 30 September 2021 (YE 31 March 2022) while net profit after tax surged 110% YoY to S\$63.5mn in 1H22. This was mainly due to improved gross margins at 29.3% in 1H22 compared to the previous period at 26.2%. Bottom-line was boosted by an increase in share of results of associates which doubled to S\$6.6mn in 1H22. As a result, basic and diluted EPS for 1H22 more than doubled to 8.95 Sing Cents compared to 4.22 Sing Cents in 1H21.

| Outperform - Initiation     |        |                               |
|-----------------------------|--------|-------------------------------|
| Price as of 16 Feb 22 (SGD) | 2.01   | <b>Performance (Absolute)</b> |
| 12M TP (\$)                 | 2.32   | 1 Month (%) 0.0               |
| Previous TP (\$)            | -      | 3 Month (%) 0.0               |
| Upside, incl div (%)        | 17.7   | 12 Month (%) 163.9            |
| Trading data                |        | Perf. vs STI Index (Red)      |
| Mkt Cap (\$mn)              | 1,375  |                               |
| Issued Shares (mn)          | 684.00 |                               |
| Vol - 3M Daily avg (mn)     | 0.3    |                               |
| Val - 3M Daily avg (\$mn)   | 0.6    |                               |
| Free Float (%)              | 0.3    |                               |
| Major Shareholders          |        | Previous Recommendations      |
| Dr Henry Tay                | 53.7%  |                               |
| Fidelity                    | 10.0%  |                               |

**The pure desire for luxury goods.** With travel and social gatherings still limited in many parts of the world, the shift from spending on experiences to goods is likely to stick around for another year. After growing 4% between 2019 and 2021, Bain & Company estimates luxury goods sales will increase from €283 billion (S\$428 billion) in 2021 to between €300 billion (S\$454 billion) and €310 billion (S\$469 billion) in 2022.

**Asia's road to recovery.** Geographically, Southeast Asia and Oceania (Australia and New Zealand) contributes over 80% to the company's total revenue. Singapore registered strong growth in consumer spending power despite the ongoing pandemic, evident from the retail sales index for watches and jewellery reaching a 5-year high in December 2021. Thailand and Malaysia on the other hand, are expected to catch up in 2022 with the reopening of foreign borders.

**Resilient industry shielded from inflation.** The Hour Glass's retail trade business has largely been resilient in the face of inflation running the hottest in almost 40 years. Rising costs are easily passed down to consumers as demand for luxury items continues to remain strong.

**Valuation & Action:** We initiate The Hour Glass with an Outperform recommendation and a TP of S\$2.32. Our TP is based on a discounted cash flow, taking into account a WACC rate of 10.5% and terminal growth rate of 2%.

**Risks:** Exchange rate risks due to overseas operations; Supply-chain woes might persist moving forward into 2022; Covid-19 uncertainties may lead to worsening of state or border restrictions.

## Table of Contents

|  |    |
|--|----|
| Investment thesis.....                                       | 3  |
| Asia’s consumers to spearhead global consumption growth..... | 3  |
| Luxury goods spending to hit record levels in 2022 .....     | 5  |
| Stable industry amidst inflation fears .....                 | 6  |
| Industry Outlook.....  | 7  |
| Peer Comparison .....  | 8  |
| Company Background.....                                      | 11 |
| Valuations .....   | 9  |
| Base Case Valuation .....                                    | 9  |
| Bear Case Valuation .....                                    | 10 |
| Key Risks .....  | 12 |
| Financial Summary.....                                       | 13 |

## Investment thesis

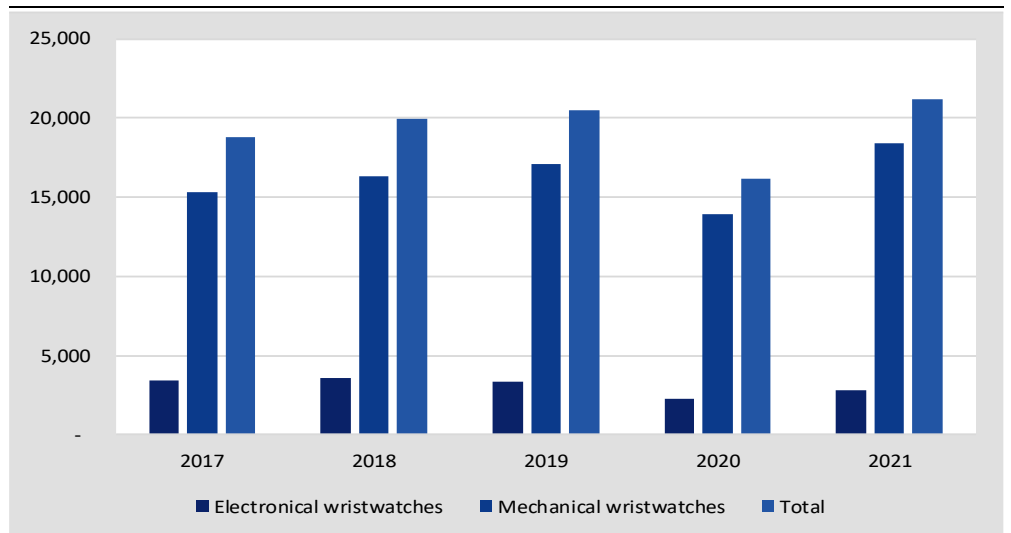
### Asia’s consumers to spearhead global consumption growth

According to a report from McKinsey, Asian consumers are expected to account for half of global consumption growth in the next decade, offering a US\$10 trillion opportunity. Strong prospects for consumption in the region reflect falling rates of poverty and rising incomes and spending power. The number of households below the middle class with limited discretionary consumption power is expected to fall by 60%.

Given that Southeast Asia and Oceania (Australia and New Zealand) contributes over 80% to the Hour Glass’s total revenue, Southeast Asia is one of the company’s key drivers with over 40 outlets across the region. The expected convergence of income divide in Asia over the next decade inevitably opens up a larger target audience for the company to possibly acquire.

**Rise in Swiss watch exports.** As reported by the Federation of the Swiss Watch Industry, the total watch exports which consists of electrical and mechanical wristwatches hit a 5-year high of CHF21.2 billion in 2021, representing a YoY gain of 31.4%. However, this was mainly due to the low base in 2020 due to the Covid-19 pandemic which impeded demand. Compared to pre-pandemic 2019, 2021’s total watch exports gained a modest 3.5% YoY.

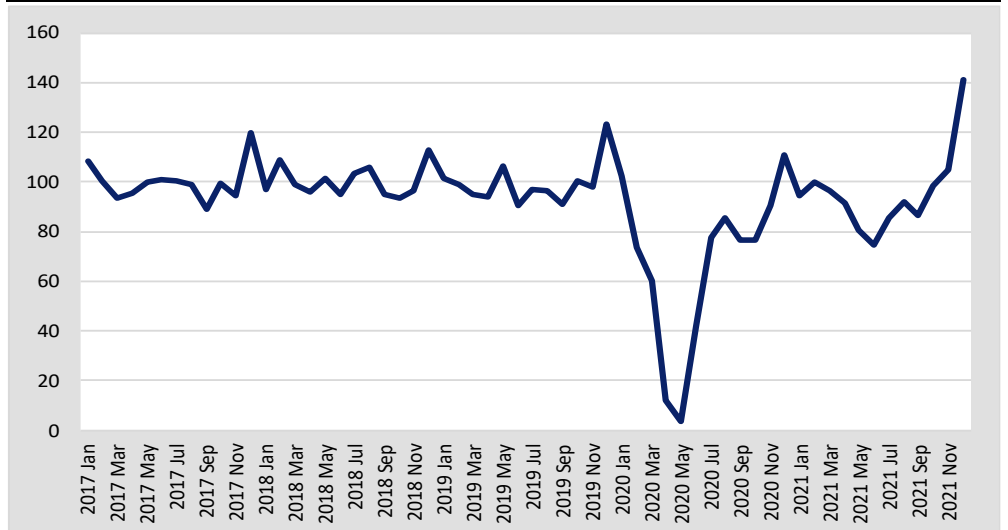
Figure 1: Swiss Watch Exports (CHF’mn)



Source: Federation of the Swiss Watch Industry

**Power in luxury goods.** Singapore retail sales surged 11.1% YoY in 2021, reversing the previous year’s 15.3% decline and snapping a 3-year losing streak. The rebound was supported by the year-end shopping spree, as retail sales expanded 6.7% YoY in December, picking up from the 2.2% rise in the month before. According to the Singapore Department of Statistics, the retail sales index for watches and jewellery regained momentum sharply from the dip in mid-2020 as a result of Covid-19 and has surpassed pre-pandemic levels to date. In the last quarter of 2021, the index spiked sharply and reached a 5-year high of 141.25 in December, mainly attributable to the festive season shopping frenzy.

Figure 2: Singapore Retail Sales Index: Watches & Jewellery (Current Prices, Monthly)



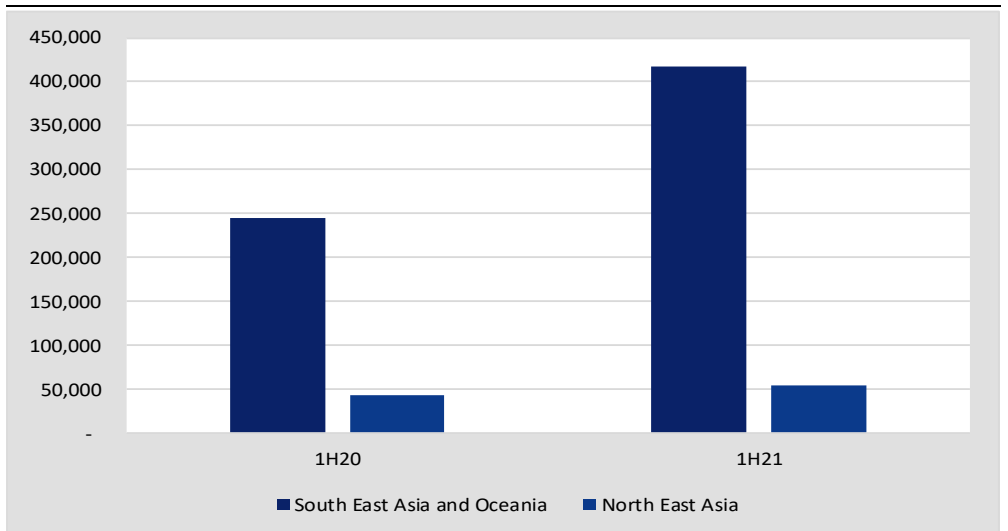
Source: Singapore Department of Statistics

**Recovery in SEA economies: Thailand and Malaysia.** Geographically, Southeast Asia and Oceania (Australia and New Zealand) contributes over 80% to the company’s total revenue. Among Southeast Asian countries, Hour Glass has the largest presence in Singapore with close to 20 boutiques, while Thailand and Malaysia are ranked second with close to 10 boutiques in each country. Even though Thailand and Malaysia’s economy were relatively depressed over the past two years and were lagging behind Singapore, 2022 might just prove to be the key turning point as Southeast Asia begins to aggressively open up. Pent up demand is expected to boost the influx of travelers, thereby lifting the overall retail trade sector.

**Thailand.** According to data from the Bank of Thailand, Thailand’s retail sales index is on a path to recovery and is almost back to pre-pandemic levels. Recently, Thailand restarted its quarantine-free entry program for vaccinated travelers after a five-week suspension, as the tourism-dependent kingdom hopes to boost its ailing economy.

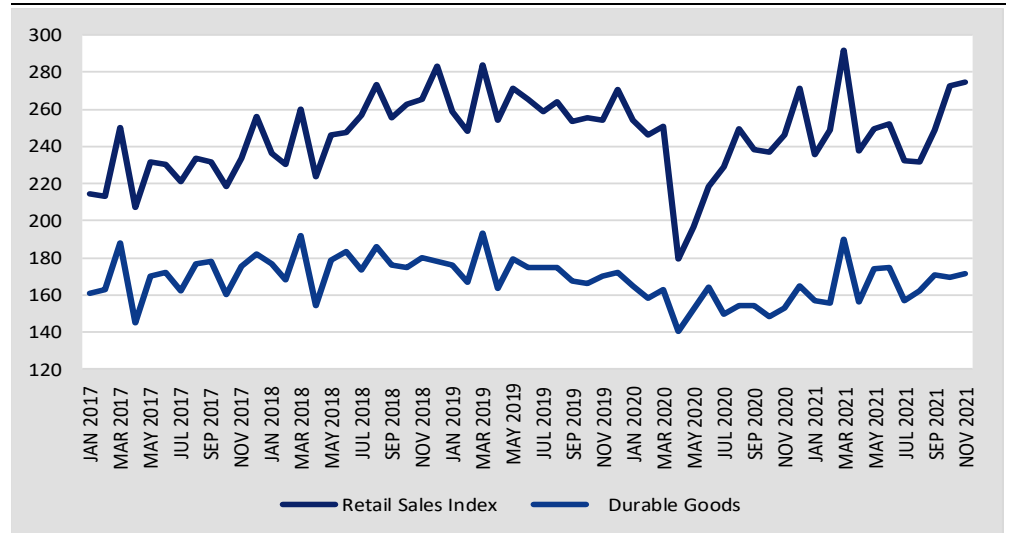
**Malaysia.** Malaysia’s wholesale and retail trade recorded the highest monthly sales value amounting to RM120.5 billion in December, with annual sales recording a 4% growth to reach RM1.3 trillion in 2021 compared with the preceding year. Recently, Malaysia’s National Recovery Council has agreed to fully open the country’s borders by March to support the country’s economic recovery. Borders would be open to all countries without the need for mandatory quarantine.

Figure 3: Geographical revenue spread (\$S’000)



Source: Company Reports

Figure 4: Thailand Retail Sales Index: Total Retail Sales; Durable Goods



Source: Bank of Thailand

### Luxury goods spending to hit record levels in 2022

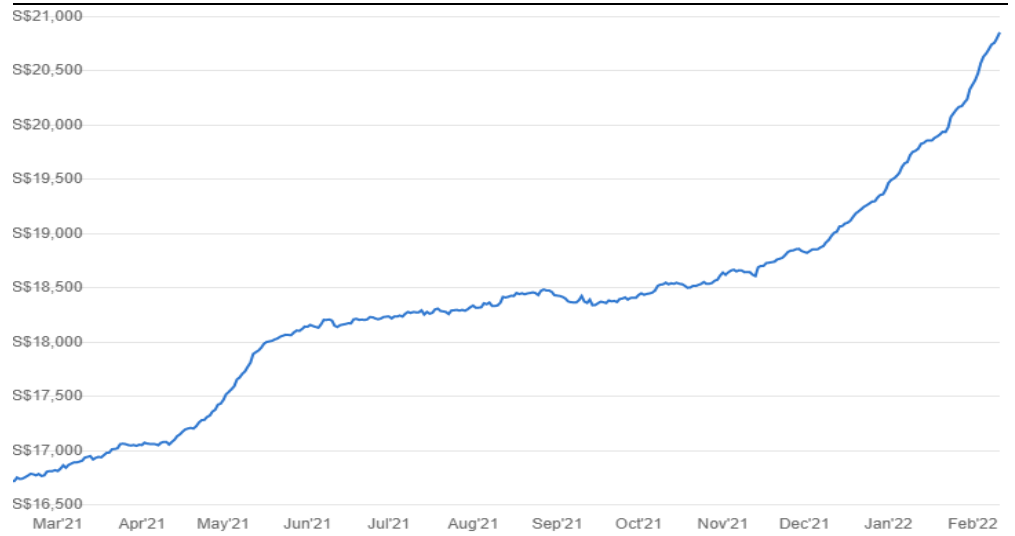
Among the trend forecasts for 2022, experts predict that luxury goods spending will hit record levels and surpass pre-pandemic levels, while price hikes for luxury products will continue to occur, with some hitting double-digit increases. Despite the ongoing challenges posed by Covid-19 and economic headwinds in China, large, conglomerate-backed brands with their vast geographic reach have gained significantly. However, smaller players have struggled, sold up or gone bankrupt. After growing 4% between 2019 and 2021, Bain estimates sales will increase from €283 billion (S\$428 billion) in 2021 to between €300 billion (S\$454 billion) and €310 billion (S\$469 billion) in 2022.

In a survey of wealth managers to ultra-high net worth individuals conducted by Knight Frank, it was found that watches were the single most popular collecting category for 79% of wealthy Singaporean families, followed by other “passion” investments, with art and wine tied at 57%. Watches have transcended the luxury goods market and are increasingly viewed as a serious collectible and even a store of value.

**Price appreciation.** After remaining stable for years, luxury brands including Louis Vuitton, Hermes and Chanel raised prices during the pandemic (in the UK Chanel’s classic flap bag is now £6,630, or S\$12,066, up 40% from early 2020). With material and labour costs rising, price hikes will likely continue into 2022. However, brands are often able to pass on rising costs to consumers and even if volume growth normalises, top-line should still remain strong.

According to yearly data, the average market price of 30 popular Rolex models have been on a steady uptrend. Prices have risen approximately 24.7% in mid-February 2022 as compared to a year ago. Patek Philippe has risen close to 50% to an average of S\$126.5k compared to a year ago.

**Figure 5: Rolex market price in the secondhand watch market (S\$)**



Source: WatchCharts

### Stable industry amidst an inflationary environment

The Federal Reserve said it is likely to hike interest rates in March and reaffirmed plans to end its bond purchases that month in what US central bank chief Jerome Powell pledged will be a sustained battle to tame inflation.

**The recent buzz: Inflation.** Locally in Singapore, latest official data showed overall inflation in December edged up to 4% from November’s 3.8%, hitting a near nine-year high. In response to sky-high inflation rates in Singapore, the central bank said on January 25 it will “raise slightly” the rate of appreciation of the Sing dollar nominal effective exchange rate policy band. Doing so effectively allows the Singapore dollar to appreciate, making imports cheaper and hence defending the purchasing power of Singapore consumers and businesses.

**Pricing power.** Residing in a cyclical industry, The Hour Glass’s retail trade business is shielded from inflation and interest rate hike fears. Rising costs are easily passed down to consumers as demand continues to remain strong. Enhanced innovation and new designs are reigniting demand across luxury goods, enabling pricing opportunities in the marketplace and lowering resistance. Luxury goods companies have also more tightly aligned inventories to demand forecasts to ensure that there continues to be much less reduced pricing, with discounting often phased out.

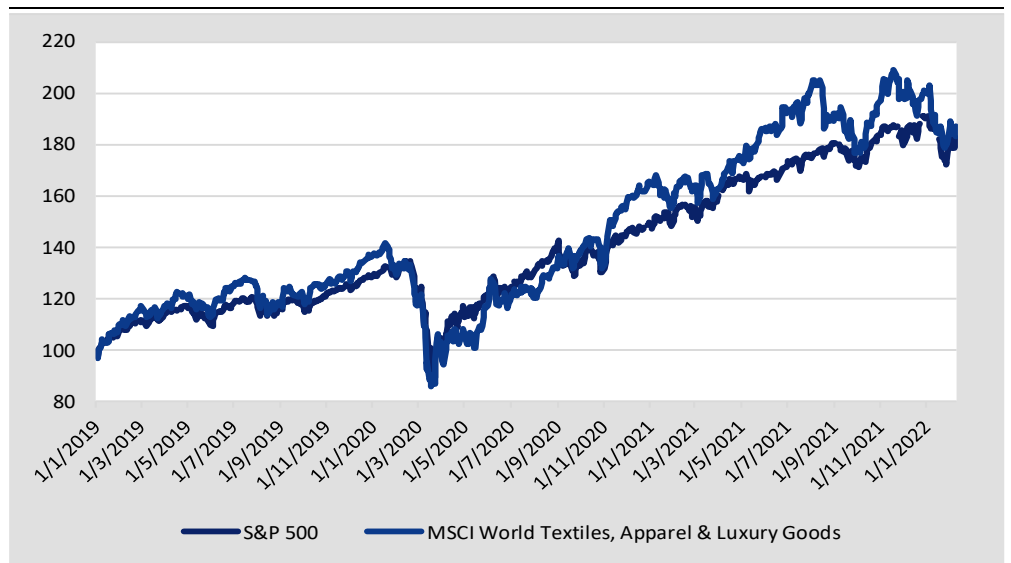
## Industry Outlook

**Earnings speak louder than words.** Negative sentiment linked to China social-reform uncertainties and global supply chain pressures dragged on the share performance of luxury goods in the third quarter of 2021. However, fundamentals of these companies remain solidly intact as the recent earnings of some of the largest luxury goods companies were better-than-expected. Recently, Richemont Group posted consensus-defying quarterly sales, heralding higher full-year earnings. Group sales for the last quarter of December amounted to 5.66 billion euros, representing a 32% YoY increase. Results were driven by the outperformance of the mainstay jewellery division, which houses powerhouse brands Cartier and Van Cleef & Arpels.

**China reopening to be a big push.** As a result of China’s zero-covid policy and tight border restrictions, Chinese consumers are spending more on luxury goods at home, as reported by Bain & Company. Sales of personal luxury goods in mainland China rose by 36% to 471 billion yuan in 2021 from the prior year, which is more than double the 234 billion yuan in luxury goods spending in 2019 before the pandemic. Being a large consumer of luxury goods, pent up demand is expected to fuel the overseas luxury goods sector in the event China starts to relax its border restrictions.

**Outperformance of MSCI Apparel & Luxury Index.** Starting from September 2020, The MSCI Apparel & Luxury Index has significantly outperformed the S&P 500 Index. Albeit some price corrections in the market recently, the index is still approximately 2.3% higher than the S&P 500 Index as of early February 2022, signifying the strength in the retail sector it might just be the beginning of another sector rotation into cyclical stocks in light of the upcoming rate hike in March 2022.

Figure 6: MSCI Apparel & Luxury Index VS S&P 500 Index



Source: Bloomberg

## Peer Comparison

**Singapore peers.** The Hour Glass has only one Singapore-listed peer, Cortina Holdings Ltd, which operates as a retailer and distributor of luxury timepieces and accessories across the Asia Pacific region. Cortina operates in Singapore, Malaysia, Thailand, Indonesia, Hong Kong and Taiwan. Notable brands under the company include Cartier, IWC, Jaeger-LeCoultre, Longines, Omega, Patek Philippe, Rolex, TAG Heuer and Franck Muller. Cortina is currently trading at a 12M P/E of 13.3x, a premium of approximately 14.7% to Hour Glass’s 12M P/E of 11.6x. Hour Glass is also trading at a more attractive historical P/B of 2x, a 20% discount to Cortina’s P/B of 2.5x.

**Hong-Kong peers.** The Hour Glass’s closest Hong-Kong listed peer is Oriental Watch Holdings, which has an extensive retail shop network in the Greater China area. The Group operates a total of 12 shops in Hong Kong SAR and Macau SAR, including Oriental Watch Company, La Suisse Watch Company, Rolex, Tudor and Breitling Boutiques. The Group currently carries various prestigious brands, in particular, famous Swiss brands such as Rolex, Tudor, Vacheron Constantin, IWC, Jaeger-LeCoultre and Omega. Oriental Watch Holdings is currently trading at 12M P/E of 6.5x, which is trading at approximately a 56% discount to Hour Glass.

Figure 7: Peer comparison table

| Bloomberg Ticker                      | Company Name                | Last Price (Local \$) | Currency Adj. Market Cap (US\$ m) | Dividend Yield (%) |       | Net Gearing (%) | P/E (x)     |           | P/B (x)    | 6M Average Daily Trading Volume (Local \$) | Price Performance (YTD) |  |
|---------------------------------------|-----------------------------|-----------------------|-----------------------------------|--------------------|-------|-----------------|-------------|-----------|------------|--|-------------------------|--|
|                                       |                             |                       |                                   | FY20               | FY21F |                 | 12M         | Forward   |            |  |                         |  |
| HG SP                                 | HOUR GLASS LTD/THE          | SGD 2.01              | 1,022                             | 6.3                | -     | -7.2            | 12.2        | NA        | 2.1        | 708  | -1.5                    |  |
| <b>Singapore Peers</b>                |                             |                       |                                   |                    |       |                 |             |           |            |  |                         |  |
| CTN SP                                | CORTINA HOLDINGS            | SGD 4.10              | 505                               | 1.8                | -     | 2.3             | 13.4        | na        | 2.5        | 28   | -4.7                    |  |
| <b>HK Peers (Watch retailers)</b>     |                             |                       |                                   |                    |       |                 |             |           |            |  |                         |  |
| 256 HK                                | CITYCHAMP WATCH & JEWELLERY | 1.16                  | 647                               | 0.0                | -     | -126.5          | na          | na        | 1.2        | 3,476                                      | -24.2                   |  |
| 398 HK                                | ORIENTAL WATCH HOLDINGS     | 4.57                  | 285                               | 4.6                | -     | -35.1           | 6.7         | na        | 1.3        | 7,784                                      | -6.4                    |  |
| 3389 HK                               | HENGDELI HOLDINGS LTD       | 0.28                  | 157                               | 0.0                | -     | -35.1           | na          | na        | 0.3        | 1,526                                      | -3.5                    |  |
| 887 HK                                | EMPEROR WATCH & JEWELLERY   | 0.20                  | 173                               | 0.0                | -     | 14.4            | 4.8         | na        | 0.3        | 573  | -2.9                    |  |
| 444 HK                                | SINCERE WATCH HK LTD        | 0.05                  | 39                                | 0.0                | -     | 21.3            | na          | na        | 0.5        | 44   | 11.1                    |  |
| <b>HK Peers (Watch manufacturers)</b> |                             |                       |                                   |                    |       |                 |             |           |            |  |                         |  |
| 2033 HK                               | TIME WATCH INVESTMENTS LTD  | 0.60                  | 159                               | 0.0                | -     | -37.3           | 4.8         | na        | 0.5        | 264  | -14.3                   |  |
| 1856 HK                               | ERNEST BOREL HOLDINGS LTD   | 2.50                  | 111                               | 0.0                | -     | 15.5            | 130.0       | na        | 6.2        | 209  | 0.0                     |  |
| <b>Simple average</b>                 |                             |                       |                                   |                    |       |                 | <b>46.5</b> | <b>na</b> | <b>1.6</b> |  |                         |  |

Source: Bloomberg



## Valuations

We used a discounted cash flow model with a conservative set of assumptions to obtain the target price of the company. We applied a 10.5% WACC rate with a 2% terminal growth rate.

**Revenue and gross profit.** Revenue is projected at a growth rate of 8% in FY22, given the company's strong first half results. For FY23 onwards, we used a 3% growth rate, which is near the 4% historical growth rate of the company's revenue. The company's gross profit margin has been growing at a healthy pace, from 24.2% in FY18 to 29.2% in FY21. We used 1H22's gross profit margin of 29.3% to project cost of sales for FY22 onwards.

| S\$ '000 (YE Mar)              | 2018           | 2019           | 2020           | 2021           | 2022           | 2023           | 2024           | 2025           | 2026           |
|--------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Revenue                        | 691,645        | 720,925        | 749,451        | 742,931        | 802,365        | 826,436        | 851,230        | 876,766        | 903,069        |
| Cost of sales                  | (524,590)      | (526,404)      | (533,615)      | (525,639)      | (567,225)      | (584,242)      | (601,769)      | (619,822)      | (638,417)      |
| <b>Gross Profit</b>            | <b>167,055</b> | <b>194,521</b> | <b>215,836</b> | <b>217,292</b> | <b>235,140</b> | <b>242,194</b> | <b>249,460</b> | <b>256,944</b> | <b>264,652</b> |
| Operating expenses/income      | (104,258)      | (109,935)      | (122,433)      | (102,857)      | (126,181)      | (129,966)      | (133,865)      | (137,881)      | (142,018)      |
| Operating income               | 62,797         | 84,586         | 93,403         | 114,435        | 108,959        | 112,228        | 115,595        | 119,063        | 122,635        |
| Tax                            | (14,034)       | (18,645)       | (17,717)       | (25,353)       | (19,099)       | (19,481)       | (19,881)       | (20,299)       | (20,736)       |
| <b>NOPAT</b>                   | <b>48,763</b>  | <b>65,941</b>  | <b>75,686</b>  | <b>89,082</b>  | <b>89,860</b>  | <b>92,747</b>  | <b>95,714</b>  | <b>98,764</b>  | <b>101,899</b> |
| Depreciation and amortization  | 7,173          | 6,052          | 32,927         | 34,775         | 35,049         | 36,100         | 37,183         | 38,299         | 39,448         |
| Capital expenditure            | (5,781)        | (18,476)       | (15,868)       | (12,505)       | (8,422)        | (8,675)        | (8,935)        | (9,203)        | (9,479)        |
| Changes in net working capital | 22,250         | (7,523)        | 11,102         | 47,410         | -              | -              | -              | -              | -              |
| <b>Free Cash Flow</b>          | <b>72,405</b>  | <b>45,994</b>  | <b>103,847</b> | <b>158,762</b> | <b>116,487</b> | <b>120,173</b> | <b>123,962</b> | <b>127,860</b> | <b>131,867</b> |

## Base Case Valuation

We derive a S\$2.32 fair value in our base case valuation based on the discounted cash flow until year 5.

| In Millions of SGD                               | Mar 18 A  | Mar 19 A  | Mar 20 A   | Mar 21 A   | Mar 22 E   | Mar 23 E   | Mar 24 E   | Mar 25 E   | Mar 26 E   |
|--|-----------|-----------|------------|------------|------------|------------|------------|------------|------------|
| <b>(-) Free Cash Flow</b>                        | <b>72</b> | <b>46</b> | <b>104</b> | <b>159</b> | <b>116</b> | <b>120</b> | <b>124</b> | <b>128</b> | <b>132</b> |
| % YoY Growth                                     | 13%       | -36%      | 126%       | 53%        | -27%       | 3%         | 3%         | 3%         | 3%         |
| % of the Free Cash Flow to be discounted         |           |           |            |            | 12%        | 100%       | 100%       | 100%       | 100%       |
| Period for Discount Factor (Mid-Year Convention) |           |           |            |            | 0.06       | 0.62       | 1.62       | 2.62       | 3.62       |
| Discount Factor @ 10.5% WACC                     |           |           |            |            | 0.99       | 0.94       | 0.85       | 0.77       | 0.70       |
| <b>Present Value of Free Cash Flow (5 Years)</b> |           |           |            |            | <b>14</b>  | <b>113</b> | <b>106</b> | <b>99</b>  | <b>92</b>  |

| Perpetuity Growth Method - Value per Share          |              |
|---|--------------|
| Free Cash Flow at Year 5                            | 132          |
| WACC  | 10.5%        |
| Perpetuity Growth Rate                              | 2.0%         |
| Perpetuity Value at End of Year 5                   | 1,583        |
| Present Value of Perpetuity (@ 10.5% WACC)          | 961          |
| (+) Present Value of Free Cash Flows (@ 10.5% WACC) | 620          |
| <b>(-) Current Enterprise Value</b>                 | <b>1,581</b> |
| Short Term Debt                                     | 148          |
| (+) Long Term Debt                                  | 78           |
| (-) Cash and Marketable Securities                  | 247          |
| (-) Current Net Debt                                | (21)         |
| (-) Current Preferred and Minority Interest         | 16           |
| <b>(-) Equity Value</b>                             | <b>1,586</b> |
| Shares outstanding                                  | 684          |
| <b>Estimated Value per Share (SGD)</b>              | <b>2.32</b>  |
| Current Price (SGD)                                 | 2.02         |
| <b>Estimated Upside</b>                             | <b>15%</b>   |

## Bear Case Valuation

We assumed a 20% lower free cash flow from FY2023E to FY2026E in our bear case valuation with a WACC of 10.5% and terminal growth rate of 2%. The bear case valuation results in a target price of S\$2.04.

| In Millions of SGD                               | Mar 16 A | Mar 17 A | Mar 18 A | Mar 19 A | Mar 20 A | Mar 21 A | Mar 22 E  | Mar 23 E  | Mar 24 E  | Mar 25 E  | Mar 26 E  |
|--|----------|----------|----------|----------|----------|----------|-----------|-----------|-----------|-----------|-----------|
| (=) Free Cash Flow                               | 17       | 64       | 72       | 46       | 104      | 159      | 116       | 96        | 99        | 102       | 106       |
| % YoY Growth                                     |          | 279%     | 13%      | -36%     | 126%     | 53%      | -27%      | -17%      | 3%        | 3%        | 4%        |
| % of the Free Cash Flow to be discounted         |          |          |          |          |          |          | 12%       | 100%      | 100%      | 100%      | 100%      |
| Period for Discount Factor (Mid-Year Convention) |          |          |          |          |          |          | 0.06      | 0.62      | 1.62      | 2.62      | 3.62      |
| Discount Factor @ 10.5% WACC                     |          |          |          |          |          |          | 0.99      | 0.94      | 0.85      | 0.77      | 0.70      |
| <b>Present Value of Free Cash Flow (5 Years)</b> |          |          |          |          |          |          | <b>14</b> | <b>90</b> | <b>84</b> | <b>79</b> | <b>74</b> |

| Perpetuity Growth Method - Value per Share          |              |
|---|--------------|
| Free Cash Flow at Year 5                            | 106          |
| WACC  | 10.5%        |
| Perpetuity Growth Rate                              | 2.0%         |
| Perpetuity Value at End of Year 5                   | 1,272        |
| Present Value of Perpetuity (@ 10.5% WACC)          | 772          |
| (+) Present Value of Free Cash Flows (@ 10.5% WACC) | 620          |
| <b>(=) Current Enterprise Value</b>                 | <b>1,393</b> |
| Short Term Debt                                     | 148          |
| (+) Long Term Debt                                  | 78           |
| (-) Cash and Marketable Securities                  | 247          |
| (-) Current Net Debt                                | (21)         |
| (-) Current Preferred and Minority Interest         | 16           |
| (=) Equity Value                                    | 1,398        |
| Shares outstanding                                  | 684          |
| <b>Estimated Value per Share (SGD)</b>              | <b>2.04</b>  |
| Current Price (SGD)                                 | 2.02         |
| <b>Estimated Upside</b>                             | <b>1%</b>    |

## Company Background

The Hour Glass is one of the world's leading specialist watch retailers with an established presence of 50 boutiques in twelve key cities in the Asia Pacific region. The company's network of multi-brand and standalone brand boutiques are all strategically located in the key luxury retail corridors in Singapore, Hong Kong, Tokyo, Sydney, Melbourne, Brisbane, Auckland, Kuala Lumpur, Bangkok, Phuket, Hanoi and Ho Chi Minh. The group also owns Watches of Switzerland, a watch retail chain in Singapore that deals in mid-tier to high-end Swiss timepieces.

**Big brands.** The Hour Glass carries various top luxury watch brands such as Rolex, Patek Philippe, Audemars Piguet, Hublot and Omega.



## Key Risks

**Uncertainties in Covid-19.** Residing in a brick-and-mortar retail business, Hour Glass is sensitive to the development of the Covid-19 pandemic. The business is exposed to uncertainty of further tightening of state and foreign borders, which will impede top-line growth should Covid-19 conditions worsen. We have seen the evolution of the virus into various variants such as Delta and Omicron. Even though vaccinations prove to reduce the complications of the virus, the uncertainty of future developments remain.

**Exchange rate risks.** Given that Hour Glass operates in various Asian countries and the Oceania region, the company is exposed to various exchange rate risks.

**Bottom-line sensitive to revaluation gains/losses.** Given that Hour Glass possess investment properties, bottom-line is sensitive to revaluation changes which will impact net profit and EPS.

**Supply-chain woes.** Supply chain issues are not new, but Covid-19 can be thought of as the catalyst for the global economic situation we find ourselves in today. Considering that all parts of the world have not been affected equally by the pandemic, recovery rates are also differentiated. Mixed views regarding supply chain issues persisting into 2022 might pose as unprecedented challenges to many businesses worldwide, as they seek to tackle the problem. Given the overall strong consistent demand for luxury goods/watches, performance of companies might be affected if they cannot keep up with the overwhelming desire.

## Financial Summary

| FYE 31 March                                      |                  |                 |                  |                  |                  |
|---|------------------|-----------------|------------------|------------------|------------------|
| INCOME STATEMENT (\$S'000)                        | 2020             | 2021            | 2022F            | 2023F            | 2024F            |
| <b>Revenue</b>                                    | <b>749,451</b>   | <b>742,931</b>  | <b>802,365</b>   | <b>826,436</b>   | <b>851,230</b>   |
| Cost of sales                                     | (533,615)        | (525,639)       | (567,225)        | (584,242)        | (601,769)        |
| <b>Gross Profit</b>                               | <b>215,836</b>   | <b>217,292</b>  | <b>235,140</b>   | <b>242,194</b>   | <b>249,460</b>   |
| Other income                                      | 6,072            | 8,858           | 8,210            | 8,456            | 8,710            |
| Salaries and employees benefits                   | (51,746)         | (47,016)        | (51,893)         | (53,450)         | (55,054)         |
| Depreciation of property, plant and equipment     | (5,242)          | (7,782)         | (7,571)          | (7,798)          | (8,032)          |
| Depreciation of ROU assets                        | (27,685)         | (26,993)        | (27,478)         | (28,302)         | (29,151)         |
| Selling and promotion expenses                    | (22,352)         | (15,300)        | (20,618)         | (21,237)         | (21,874)         |
| Rental expenses                                   | (4,350)          | (1,509)         | (3,375)          | (3,476)          | (3,580)          |
| Foreign exchange loss                             | 1,017            | (211)           | 388              | 399              | 411              |
| Other operating expenses                          | (18,561)         | (13,434)        | (15,634)         | (16,103)         | (16,586)         |
| Share of results of associates                    | 6,486            | 9,388           | -                | -                | -                |
| Fair value loss on investment properties          | (918)            | (9,997)         | -                | -                | -                |
| <b>Profit from operation</b>                      | <b>98,557</b>    | <b>113,296</b>  | <b>117,169</b>   | <b>120,684</b>   | <b>124,305</b>   |
| Net finance (expense)/income                      | (3,481)          | (3,405)         | (4,821)          | (6,128)          | (7,475)          |
| <b>Profit before income tax</b>                   | <b>95,076</b>    | <b>109,891</b>  | <b>112,348</b>   | <b>114,556</b>   | <b>116,830</b>   |
| Income tax expense                                | (17,717)         | (25,353)        | (19,099)         | (19,475)         | (19,861)         |
| <b>Profit</b>                                     | <b>77,359</b>    | <b>84,538</b>   | <b>93,249</b>    | <b>95,082</b>    | <b>96,969</b>    |
| NCI   | 1,308            | 2,068           | 2,068            | 2,068            | 2,068            |
| <b>PATMI</b>                                      | <b>76,051</b>    | <b>82,470</b>   | <b>91,181</b>    | <b>93,014</b>    | <b>94,901</b>    |
| BALANCE SHEET (\$S'000)                           | 2020             | 2021            | 2022F            | 2023F            | 2024F            |
| Inventories                                       | 286,425          | 259,096         | 259,096          | 259,096          | 259,096          |
| Trade and other receivables                       | 20,301           | 15,625          | 15,625           | 15,625           | 15,625           |
| Prepaid operating expenses                        | 1,229            | 989             | 989              | 989              | 989              |
| Amounts due from associates                       | 74               | 109             | 109              | 109              | 109              |
| Cash and cash equivalents                         | 183,131          | 247,872         | 300,767          | 354,912          | 410,043          |
| <b>Total current assets</b>                       | <b>491,160</b>   | <b>523,691</b>  | <b>576,586</b>   | <b>630,731</b>   | <b>685,862</b>   |
| Property, plant and equipment                     | 96,714           | 145,509         | 146,360          | 147,237          | 148,140          |
| ROU Assets  | 103,313          | 86,834          | 59,356           | 31,054           | 1,903            |
| Investment properties                             | 96,511           | 143,739         | 216,771          | 291,994          | 369,474          |
| Intangible assets                                 | 15,287           | 15,439          | 14,563           | 13,395           | 12,227           |
| Other non-current assets                          | 53,585           | 55,713          | 55,713           | 55,713           | 55,713           |
| <b>Total non-current assets</b>                   | <b>365,410</b>   | <b>447,234</b>  | <b>492,763</b>   | <b>539,393</b>   | <b>587,456</b>   |
| <b>Total assets</b>                               | <b>856,570</b>   | <b>970,925</b>  | <b>1,069,349</b> | <b>1,170,124</b> | <b>1,273,318</b> |
| Loans and borrowings                              | 64,467           | 105,121         | 142,693          | 181,392          | 221,252          |
| Trade and other payables                          | 49,307           | 60,359          | 60,359           | 60,359           | 60,359           |
| Lease liabilities                                 | 25,856           | 22,769          | 22,769           | 22,769           | 22,769           |
| Other current liabilities                         | 11,592           | 16,314          | 16,314           | 16,314           | 16,314           |
| <b>Total current liabilities</b>                  | <b>151,222</b>   | <b>204,563</b>  | <b>242,135</b>   | <b>280,834</b>   | <b>320,694</b>   |
| Lease liabilities                                 | 81,487           | 69,622          | 69,622           | 69,622           | 69,622           |
| Other non-current liabilities                     | 1,078            | 1,416           | 1,416            | 1,416            | 1,416            |
| <b>Total non-current liabilities</b>              | <b>82,565</b>    | <b>71,038</b>   | <b>71,038</b>    | <b>71,038</b>    | <b>71,038</b>    |
| <b>Total liabilities</b>                          | <b>233,787</b>   | <b>275,601</b>  | <b>313,173</b>   | <b>351,872</b>   | <b>391,732</b>   |
| Unitholders' funds and reserves                   | 622,783          | 695,324         | 756,176          | 818,251          | 881,586          |
| <b>Total liabilities and equity</b>               | <b>856,570</b>   | <b>970,925</b>  | <b>1,069,349</b> | <b>1,170,124</b> | <b>1,273,318</b> |
| CASH FLOW STATEMENT (\$S'000)                     | 2020             | 2021            | 2022F            | 2023F            | 2024F            |
| <b>Profit for the year</b>                        | <b>95,076</b>    | <b>109,891</b>  | <b>112,348</b>   | <b>114,556</b>   | <b>116,830</b>   |
| Adjustments                                       | 26,186           | 39,527          | 41,037           | 43,396           | 45,826           |
| <b>Operating cash flows before WC changes</b>     | <b>121,262</b>   | <b>149,418</b>  | <b>153,386</b>   | <b>157,952</b>   | <b>162,656</b>   |
| Changes in working capital                        | 11,102           | 47,410          | -                | -                | -                |
| Income taxes paid                                 | (20,557)         | (19,643)        | (19,099)         | (19,475)         | (19,861)         |
| Net interest expense                              | (1,653)          | (2,788)         | (4,821)          | (6,128)          | (7,475)          |
| <b>Cash flows from operations</b>                 | <b>110,154</b>   | <b>174,397</b>  | <b>129,466</b>   | <b>132,350</b>   | <b>135,320</b>   |
| Acquisition of a business                         | (18,917)         | -               | -                | -                | -                |
| Additions to intangible assets                    | (482)            | (156)           | (292)            | -                | -                |
| Purchase of property, plant and equipment         | (15,868)         | (12,505)        | (8,422)          | (8,675)          | (8,935)          |
| Purchase of investment properties                 | (82,971)         | (72,753)        | (73,032)         | (75,223)         | (77,480)         |
| Other investing cashflow                          | 982              | 2,332           | 280              | -                | -                |
| <b>Cash flows from investing activities</b>       | <b>(117,256)</b> | <b>(83,082)</b> | <b>(81,466)</b>  | <b>(83,898)</b>  | <b>(86,415)</b>  |
| Net proceeds from loans and borrowings            | 54,409           | 30,118          | 37,572           | 38,699           | 39,860           |
| Payment of lease liabilities                      | (25,197)         | (25,471)        | -                | -                | -                |
| Dividends paid on ordinary shares                 | (21,150)         | (28,159)        | (30,329)         | (30,938)         | (31,566)         |
| Dividends paid to non-controlling interests       | (280)            | (704)           | -                | -                | -                |
| Other financing cashflow                          | (361)            | -               | -                | -                | -                |
| <b>Cash flows from financing activities</b>       | <b>7,421</b>     | <b>(24,216)</b> | <b>7,243</b>     | <b>7,761</b>     | <b>8,294</b>     |
| <b>Net increase in cash</b>                       | <b>319</b>       | <b>67,099</b>   | <b>55,243</b>    | <b>56,213</b>    | <b>57,199</b>    |
| Effect of exchange rate fluctuations on cash held | 1,841            | (2,358)         | (2,348)          | (2,068)          | (2,068)          |
| Cash and cash equivalents at 1 April              | 180,971          | 183,131         | 247,872          | 300,767          | 354,912          |
| <b>Ending cash</b>                                | <b>183,131</b>   | <b>247,872</b>  | <b>300,767</b>   | <b>354,912</b>   | <b>410,043</b>   |
| KEY RATIOS  | 2020             | 2021            | 2022F            | 2023F            | 2024F            |
| DPS (SGD cents)                                   | 2.00             | 6.00            | 4.34             | 4.43             | 4.52             |
| Dividend yield (%)                                | 1.0              | 3.1             | 2.2              | 2.3              | 2.3              |
| NAV per share (SGD cents)                         | 88.3             | 98.8            | 108.2            | 117.0            | 126.1            |
| Price/NAV (x)                                     | 2.2              | 2.0             | 1.8              | 1.7              | 1.5              |
| <b>Profitability</b>                              |                  |                 |                  |                  |                  |
| Gross Margin (%)                                  | 28.8             | 29.2            | 29.3             | 29.3             | 29.3             |
| Net Margin (%)                                    | 10.1             | 11.1            | 11.4             | 11.3             | 11.1             |
| ROA (%)   | 9.0              | 8.7             | 8.7              | 8.1              | 7.6              |
| ROE (%)   | 12.4             | 12.2            | 12.3             | 11.6             | 11.0             |
| <b>Financial Structure</b>                        |                  |                 |                  |                  |                  |
| Interest Coverage Ratio (x)                       | 28.3             | 33.3            | 24.3             | 19.7             | 16.6             |
| Gearing Ratio (%)                                 | (19.0)           | (20.5)          | (20.9)           | (21.2)           | (21.4)           |

| KGI's Ratings | Rating                  | Definition  |
|---------------|-------------------------|---|
|               | <b>Outperform (OP)</b>  | We take a positive view on the stock. The stock is expected to outperform the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.  |
|               | <b>Neutral (N)</b>      | We take a neutral view on the stock. The stock is expected to perform in line with the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.   |
|               | <b>Underperform (U)</b> | We take a negative view on the stock. The stock is expected to underperform the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon   |
|               | <b>Not Rated (NR)</b>   | The stock is not rated by KGI Securities.   |
|               | <b>Restricted (R)</b>   | KGI policy and/or applicable law regulations preclude certain types of communications, including an investment recommendation, during the course of KGI's engagement in an investment banking transaction and in certain other circumstances. |

**Disclaimer** This report is provided for information only and is not an offer or a solicitation to deal in securities or to enter into any legal relations, nor an advice or a recommendation with respect to such securities. This report is prepared for general circulation. It does not have regard to the specific investment objectives, financial situation and the particular needs of any recipient hereof. You should independently evaluate particular investments and consult an independent financial adviser before dealing in any securities mentioned in this report.

This report is confidential. This report may not be published, circulated, reproduced or distributed and/or redistributed in whole or in part by any recipient of this report to any other person without the prior written consent of KGI Securities. This report is not intended for distribution and/or redistribution, publication to or use by any person in any jurisdiction outside Singapore or any other jurisdiction as KGI Securities may determine in its absolute discretion, where the distribution, publication or use of this report would be contrary to applicable law or would subject KGI Securities and its connected persons (as defined in the Financial Advisers Act, Chapter 110 of Singapore) to any registration, licensing or other requirements within such jurisdiction.

The information or views in the report ("Information") has been obtained or derived from sources believed by KGI Securities to be reliable. However, KGI Securities makes no representation as to the accuracy or completeness of such sources or the Information and KGI Securities accepts no liability whatsoever for any loss or damage arising from the use of or reliance on the Information. KGI Securities and its connected persons may have issued other reports expressing views different from the Information and all views expressed in all reports of KGI Securities and its connected persons are subject to change without notice. KGI Securities reserves the right to act upon or use the Information at any time, including before its publication herein.

Except as otherwise indicated below, (1) KGI Securities, its connected persons and its officers, employees and representatives may, to the extent permitted by law, transact with, perform or provide broking, underwriting, corporate finance-related or other services for or solicit business from, the subject corporation(s) referred to in this report; (2) KGI Securities, its connected persons and its officers, employees and representatives may also, to the extent permitted by law, transact with, perform or provide broking or other services for or solicit business from, other persons in respect of dealings in the securities referred to in this report or other investments related thereto; and (3) the officers, employees and representatives of KGI Securities may also serve on the board of directors or in trustee positions with the subject corporation(s) referred to in this report. (All of the foregoing is hereafter referred to as the "Subject Business".)

However, as of the date of this report, neither KGI Securities nor its representative(s) who produced this report (each a "research analyst"), has any proprietary position or material interest in, and KGI Securities does not make any market in, the securities which are recommended in this report.

Each research analyst of KGI Securities who produced this report hereby certifies that (1) the views expressed in this report accurately reflect his/her personal views about all of the subject corporation(s) and securities in this report; (2) the report was produced independently by him/her; (3) he/she does not carry out, whether for himself/herself or on behalf of KGI Securities or any other person, any of the Subject Business involving any of the subject corporation(s) or securities referred to in this report; and (4) he/she has not received and will not receive any compensation that is directly or indirectly related or linked to the recommendations or views expressed in this report or to any sales, trading, dealing or corporate finance advisory services or transaction in respect of the securities in this report. However, the compensation received by each such research analyst is based upon various factors, including KGI Securities' total revenues, a portion of which are generated from KGI Securities' business of dealing in securities.

Copyright 2022. KGI Securities (Singapore) Pte. Ltd. All rights reserved.