



LEVEL 7 ASSESSMENT SPECIFICATION

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Academic honesty / referencing:	Academic honesty is required. In the main body of your submission you must give credit to authors on whose research and ideas your work is based. Append to your submission a reference list that indicates the books, articles, etc. that you have used, cited or quoted in order to complete this assessment.		

Tse Sui Luen Jewellery (International) Limited

TSL | 謝瑞麟

T S L | 謝 瑞 麟

Student Name: Chan Shuk Yan
(Student ID number: 1921901)

University of Wales
Trinity Saint David

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Executive Summary

This study is an analysis of Hong Kong listed company Tse Sui Luen Jewellery (International) Limited (“TSL | 謝瑞麟”) (Stock Code 417). This paper contains the financial of the company comparing to Chow Tai Fook Jewellery Group Limited (CTF) and Luk Fook Jewellery (LF) both operating in the same industry as TSL. The first chapter discusses the background of TSL by evaluating its operating business, current environment, and its company structure. The second chapter is a financial analysis that looks at its financial structure, ability to pay debt, operations profitability, growth capacity and stock market prospects. The third chapter is an evaluation of the company’s capital structure while the fourth chapter looks at its new project of developing new production line in Mainland China (PRC). The fifth chapter analysis financing and capital management, sixth chapter gives recommendation and audit program while the last charter gives a conclusion and recommendation.

Introduction

Company Background

Tse Sui Luen Jewellery (International) Limited (“TSL | 謝瑞麟 or the Group” HKSE stock code: 417) (“TSL”), incorporated in Bermuda with limited liability is one of the largest jewellers in Asia, that is principally engaged in jewellery design, manufacturing, trading, retailing and wholesaling. TSL | 謝瑞麟 Group was founded by Mr. Tse Sui Luen – a legend in the HK Jewellery Industry – in the 1960’s and listed on the Hong Kong Exchange in 1987. With the headquarters established in Hong Kong, TSL | 謝瑞麟 currently operates over 450 jewellery boutiques spanning over 130 cities in Hong Kong, PRC, Macau and Kuala Lumpur (TSL Group, 2019). The company’s major shareholder is Partner Logistic Limited which is ultimately owned by Tse Tat Fung, Tommy and his spouse Yau On Yee, Annie (“Annie Yau”), chairman of the company.

Overview of Business

TSL is a major jeweller in the PRC and Hong Kong, the principal products are mass luxury and high-end luxury jewellery, including gem-set jewellery, platinum/karat gold products and gold products. The company operates through retail, wholesale and e-commerce and the major markets are Hong Kong, Macau, PRC and Malaysia.

Today Business Environment and Historical Performance

“Clouded by external challenges including the aggravated tensions between the US and China, sociopolitical unrest in Hong Kong, the worldwide COVID-19 outbreak and a general downturn in consumer sentiment, the Group’s results for the year ended 31 March 2020 (FY 2019/20) have been negatively and significantly impacted”, (TSL, 2020).

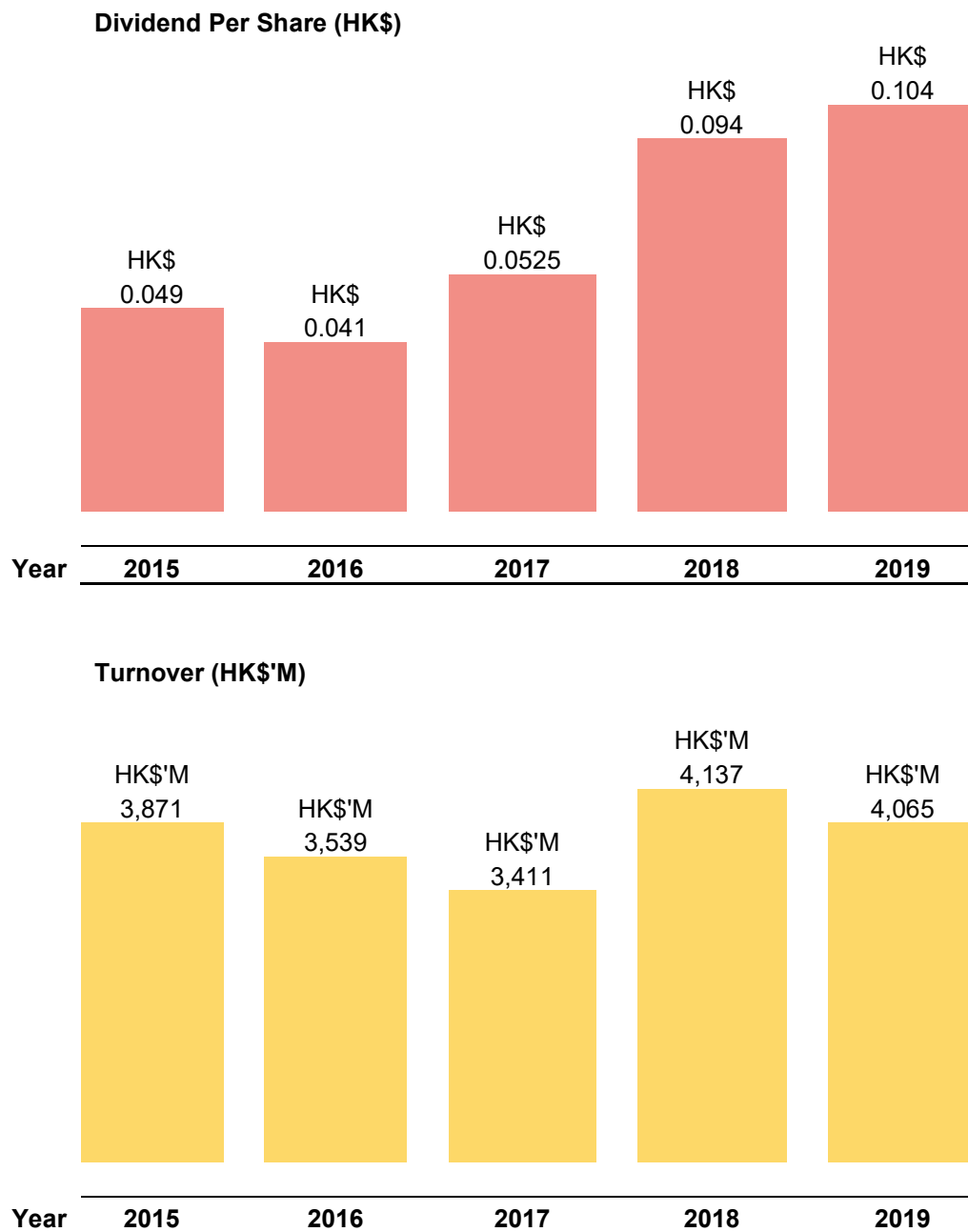
During the FY2019/20, the Group’s turnover was HK\$2,913.8 million, representing a decrease of 28.3% from HK\$4,064.9 million for FY2018/19. Loss for FY2019/20 of HK\$89.7 million as compared to profit of HK\$54.2 million for FY2018/19. In response to the turbulent retail market, the Group acted swiftly and adopted various cost saving measures including ongoing negotiations

with landlords for rental relief or reduction, minimization of operating costs and store network streamlining (TSL, Press Release, 23 June 2020). However, in last few years from 2015 to 2019), the financial result of the company has been gradually improved. Below charts showing the company for their performance over the last few years.

Operating Business Overview

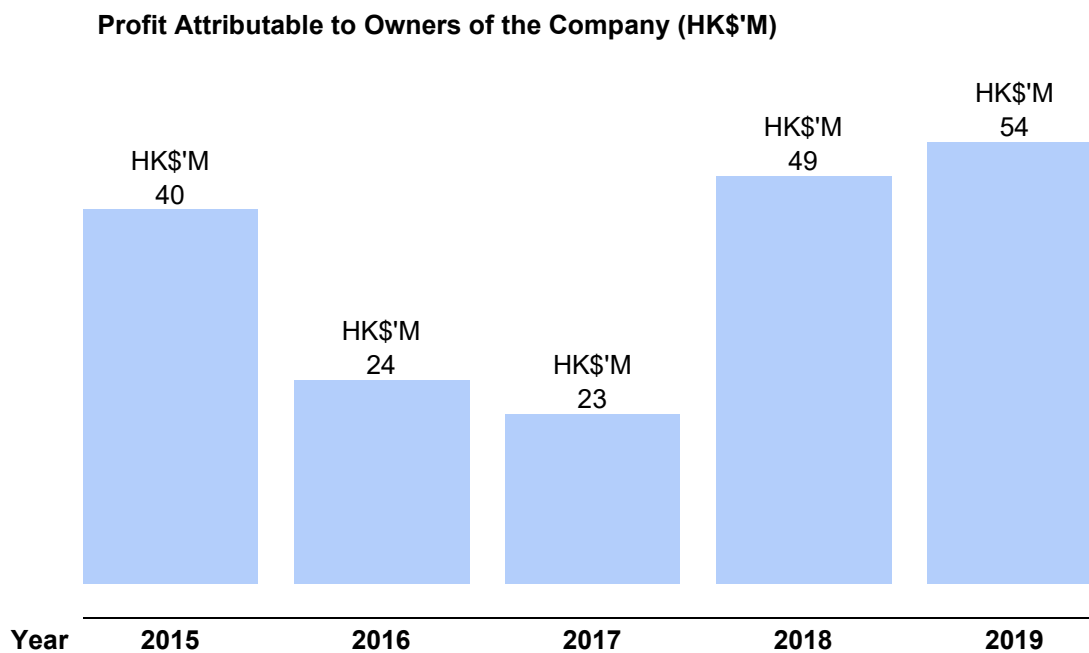
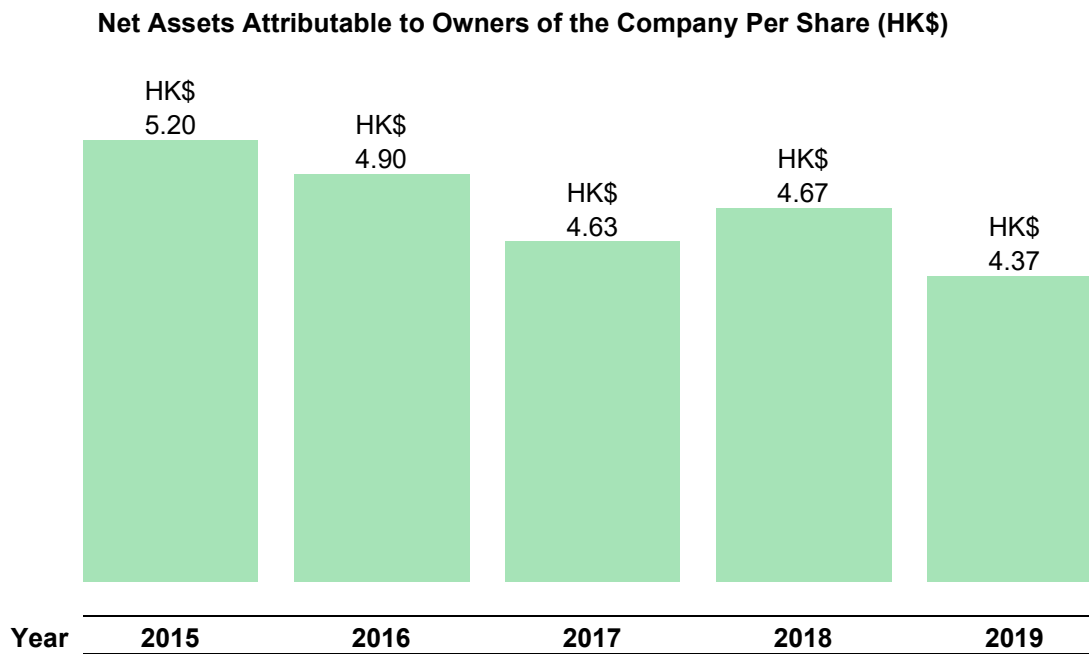
Looking ahead, many uncertainties continue to blight the prospect, the company will continue to adopt a prudent approach and reinforce cost control measures to weather such tough business environment, which may potentially impede the performance for an extended a period of time (TSL, 2020).

Graph: 1.1 Financial highlights – Dividend per Share & Turnover:



Source: TSL, 2019 Annual Report

Graph: 1.2 Financial highlights – Net Assets Attributable to Owners of the Company Per Share & Profit Attributable to Owners of The Company:



Source: TSL, 2019 Annual Report

Market position against competitors

Chart below provide an overview of the brand positioning of key jewellery brands in the PRC:

Chart 1.3 Market position against competitors

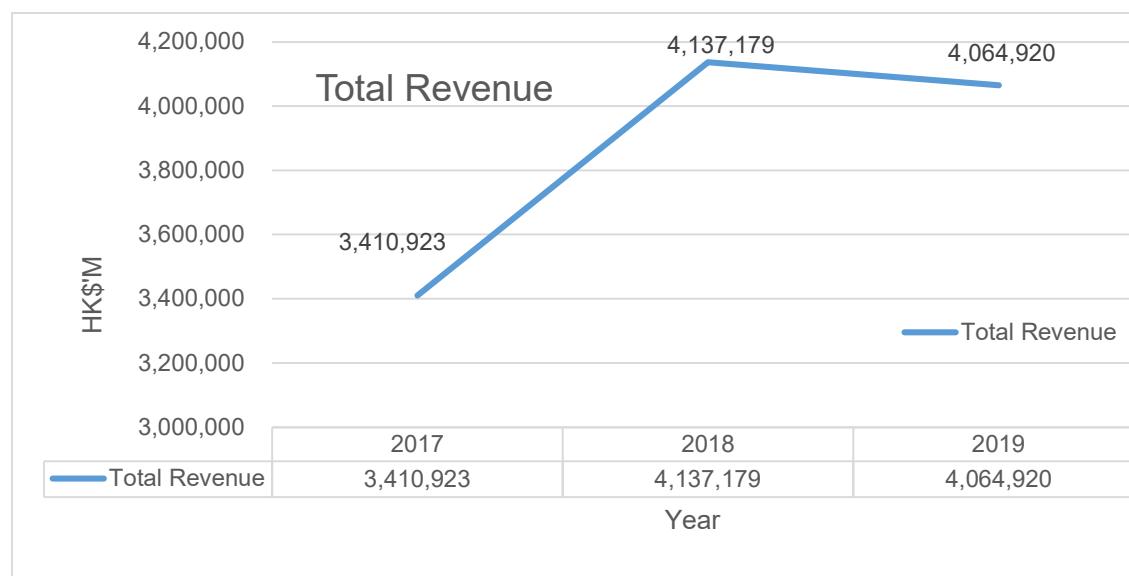
EXHIBIT 1: Jewelry brand positioning in the PRC



Sources: Frost & Sullivan Report; Chow Tai Fook; BNP Paribas

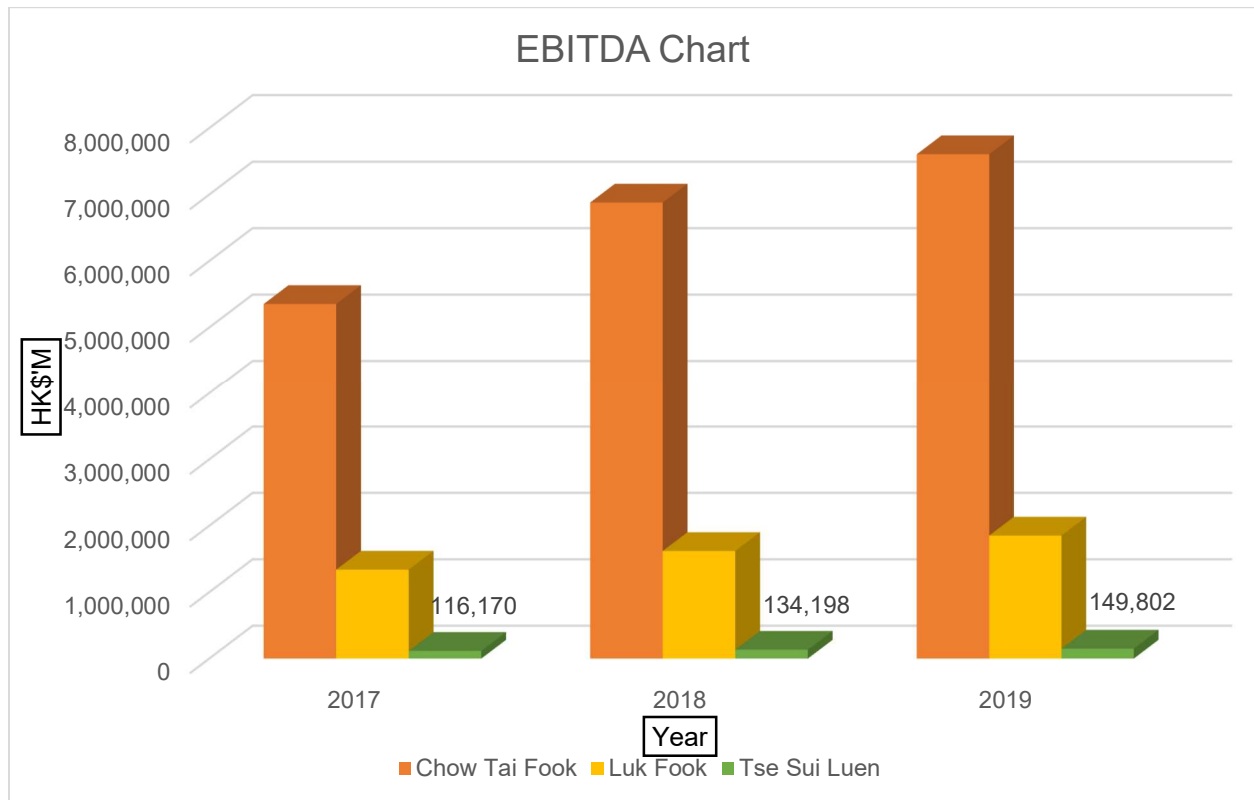
Source: Chow Tai Fook Jewellery Group Ltd, IPO booklet published on December 2011.

Graph 1.4 Tse Sui Luen 3 years (2017, 2018 & 2019) revenue



Source: TSL, 2017, 2018 & 2019 Annual Report

Chart 1.5 EBITA: Tse Sui Luen, Chow Tai Fook & Luk Fook, 3 years (2017, 2018 & 2019)



Source: Tse Sui Luen, 2017, 2018 & 2019; Chow Tai Fook, 2017, 2018 & 2019; Luk Fook, 2017, 2018 & 2019's Annual Reports.

Research comparison company information

This study is used of three comparison of TSL, Chow Tai Fook Jewellery Group Limited (Stock code: 1929) (“CTF”) and Luk Fook Holdings Company Limited (Stock code: 590). These 3 companies have same nature of business. (Table 1.6). Because TSL recorded a loss in FY2019/20, for a more meaningful comparison purpose I have used financial years ended 2017, 2018 and 2019.

Table 1.6 Company Background Information

Company name	Tse Sui Luen	Chow Tai Fook	Luk Fook
Company Logo			
Stock code	417	1929	590
Business Nature	Jewellery Business		
Market value (HKD)	219.28 Million	81.9 Billion	9.79 Billion
PE	N/A	15.75	11.27
Major Market	Hong Kong, China & Macau		
Number of Stores	450	101	859

Source: Yahoo Finance, Stock market closing date on 11 August 2020.

Source: Tse Sui Luen, 2019; Chow Tai Fook, 2019; Luk Fook, 2019 Annual Report.

Major developments in recent years and challenges ahead

The decline in the Group’s retail sales was mainly due to the escalating US-China trade tension, which had caused a slowdown in China’s economy dating back to the beginning of the Year, as well as the sudden outbreak of COVID-19, which sent sales plummeting as the country locked down in response. The Group recorded a year-on-year decrease of 20.8% in the turnover of its self-operated stores in Mainland China, with same store sales growth being minus 21.3%. The Group believes that e-business will become a significant and sustainable source of sales revenue. In recent years, its e-business has been steadily growing and achieved a 17.2% year-on-year increase in turnover for the Year. (TSL, 2020).

Financial Analysis

1. Analysis of listed companies' bankruptcy index Z-Score

Table no. 1.7 Calculation of Z score of the listed companies

Company Name	Chow Tai Fook ("CTF")	Luk Fook	Tse Sui Luen ("TSL")		
HK\$'000	2019	2019	2019	2018	2017
Net Current Assets	26,306,800	8,684,355	826,970	1,357,135	1,468,640
Total Assets	62,237,100	14,423,572	2,457,147	2,553,850	2,629,568
Retained earnings	11,547,300	7,846,536	727,794	696,654	669,113
EBIT	6,639,600	1,853,042	149,802	134,198	116,170
Stock value (HKD)	0.00794	0.02645	0.00175	0.0022	0.0025
No. of Stock	10,000,000,000	587,107,850	248,551,651	246,836,860	210,336,221
Total Liabilities	30,834,100	3,860,656	1,371,437	1,401,036	1,655,286
Sales	66,660,900	15,859,990	4,064,920	4,137,179	3,410,923

	Chow Tai Fook	Luk Fook	Tse Sui Luen ("TSL")		
	2019	2019	2019	2018	2017
A	0.42	0.60	0.34	0.53	0.56
B	0.19	0.54	0.30	0.27	0.25
C	0.11	0.13	0.06	0.05	0.04
D	2.58	4.02	0.32	0.39	0.32
E	1.07	1.10	1.65	1.62	1.30
Z score	3.73	5.42	2.86	3.04	2.66

Z-score: $Z = 1.2A + 1.4B + 3.3C + 0.6D + 0.999E$

Note: A = Working Capital/ Total Assets; B = Retained Earnings/ Total Assets; C = EBIT Earnings Before Interests & Tax / Total Assets; D = (Stock Value x Total number of stocks) / Total Liabilities; E = Sales / Total Assets

Source: From This Research

The Altman Z-score (Calandro, 2007) is a formula for determining whether a company is headed for bankruptcy. In which, a score below 1.8 means it is likely the company is headed for bankruptcy, while companies with scores above 3 are not likely to go bankrupt. TSL in FY2017 and FY2019's Z-score was higher than 1.8 but (TSL, 2017; 2018; 2019) reduced slightly from FY2018 3.04 to FY2019 2.86 (Table 1.7). Overall, the company is maintaining a financial health and less likely to experience bankruptcy. Investors may consider purchasing Luk Fook's stock rather than CTF and TSL because its Z-score FY2019 was much higher than 3.

2. Profitability Ratios Analysis

Table no. 1.8 Profitability ratios “Revenue, Gross, Operating Profit and EBITA”

	Chow Tai Fook	Luk Fook	Tse Sui Luen (TSL)		
	For Y.E 31 Mar	For Y.E 31 Mar	For the year ended 31 Mar		
	2,019	2,019	2,019	2,018	2,017
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Total Revenue	66,660,900	15,859,990	4,064,920	4,137,179	3,410,923
Gross profit	18,601,800	4,033,836	1,619,362	1,631,506	1,526,720
Profit for the Year	4,684,000	1,503,655	54,167	49,508	23,204
EBITDA	7,606,000	1,853,042	149,802	134,198	116,170
EBITDA Margin	11.41%	11.68%	3.69%	3.24%	3.41%
Gross Profit Margin	27.91%	25.43%	39.84%	39.44%	44.76%
Net Profit Margin	7.03%	9.48%	1.33%	1.20%	0.68%

Note: TSL has changed financial year end from 28 Feb to 31 March, as a result, year-end 2018 covered thirteen months from 1 March 2017 to 31 March 2018.

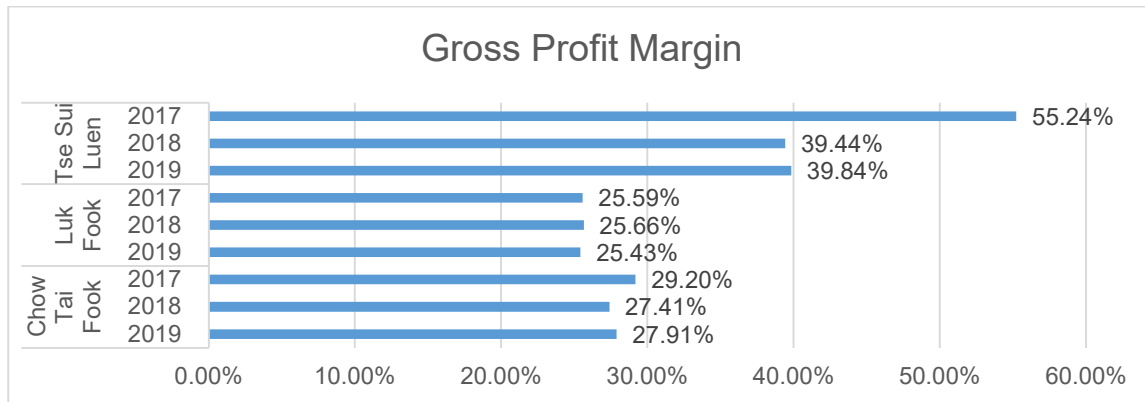
Source: Tse Sui Luen, 2017, 2018 & 2019; Chow Tai Fook, 2019; Luk Fook, 2019 Annual Report.

3. Gross Profit and Net Profit Margin

TSL has a higher gross profit margin than CTF and Luk Fook but has a lower net profit margin. The reasons are mainly due to (i) selling channel and (ii) product differential. In compare with Luk Fook, in FY2019, retail business of TSL account for total revenue of 76% verse Luk Fook of 40.5%. It is commonly understood that profit margin on retail business should be higher than the wholesale business. In addition, TSL mainly focused on the sales of fine jewellery products, gold products sales were only account for a small portion. Whereas, CTF sales on gold products account for 61% while jewellery products only about 23% for FY2019. This explains why TSL has higher gross profit margin than CTF (Table 1.8).

In contrast, due to economic of scale in terms of revenue, the net profit margin of Luk Fook and CTF was 4.9 times and 16.7 times respectively over TSL. Which mainly due to TSL’s operating costs, consist of selling, distribution and administrative expenses are higher than the two companies. In FY2019, Selling, distribution and administrative expenses of TSL was accounted for 36% of its revenue, whereas Luk Fook and CTF were accounted for 15% and 18% respectively.

Figure 1.9 Gross Profit Margin



Source: From This Research

Table no. 2.0 Total Asset Turnover, Return on Assets (ROA) and Return on Equity (ROE)

	Chow Tai Fook For Y.E 31 Mar	Luk Fook For Y.E 31 Mar	Tse Sui Luen (TSL) For the year ended 31 Mar		
	2,019	2,019	2,019	2,018	2,017
Total Asset Turnover	1.07	1.10	1.65	1.62	1.30
Return on Assets	7.53%	10.42%	2.20%	1.94%	0.88%
Return on Equity	14.92%	14.24%	4.99%	4.29%	2.38%

Note: TSL has changed financial year end from 28 Feb to 31 March, as a result, year-end 2018 covered thirteen months from 1 March 2017 to 31 March 2018.

Source: From This Research

4. Total Asset Turnover

TSL has higher ratio than its peer competitors in past three years, particularly for FY2018 and FY2019, the ratio was 1.62 and 1.65 (Table 2.0), respectively. Whereas both Luk Fook and CTF were 1.1. Which means TSL was more efficient in using its assets to generate sales.

5. Return on Assets (“ROA”)

The ROA of TSL has improved in last 3 years from 0.88% in FY2017 to 2.2% in FY2019 (Table2.0) but still lower than its competitors. That indicated the company is earning less return on its investment in assets. It also shows the company may not effectively managing its assets to produce of net profit. This also constant with the net profit margin as disclosed above that the company has greater Gross profit but less Net Profit margin. Return on Equity (“ROE”)

Return on Equity (“ROE”)

In the past three years, TSL’s has gradually improved its ROE from 2.38% in 2017 to 4.99% in FY2019 (Table 2.0). However, it still has a poorer return than CTF and Luk Fook due to low net profit margin. From investor’s point of view, they might not be happy with the company’s performance as their return on investment is lower than other two companies.

Financial Structure

1. Paying Debt Ability

Table no. 2.1 Paying Debt: Gearing Ratio, Total Debt Ratio, Debt/Equity Ratio and Long-Term Debt Ratio

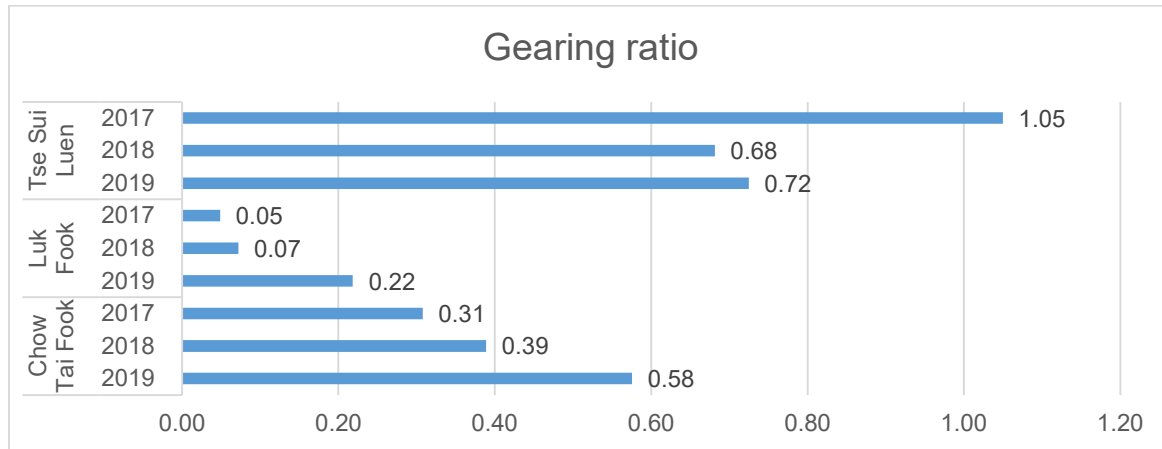
	Tse Sui Luen (TSL)			TSL	CTF	Luk Fook	3 Companies
	For the year ended 31 Mar			(2017 - 2019) 3 years average			
	2,019	2,018	2,017				
Gearing Ratio	0.72	0.68	1.05	0.82	0.42	0.11	0.45
Current ratio	1.61	2.41	2.61	2.21	2.34	4.87	3.14
Quick Ratio	0.55	0.70	0.99	0.75	0.68	1.27	0.90
Cash Ratio	0.19	0.28	0.36	0.27	0.39	0.92	0.53
Total Debt Ratio	0.56	0.55	0.63	0.58	0.42	0.20	0.40
Debt / Equity Ratio	1.26	1.22	1.70	1.39	0.73	0.26	0.79
Long Term Debt Ratio	0.00	0.35	0.73	0.36	0.05	0.00	0.14

Source: From This Research

2. Gearing Ratio

TSL has relied more on debt than equity for operating its business during the years so its gearing ratio is the highest among the peers. However, the company has been progressively improving, from 1.05 in FY2017 to 0.72 in FY2019 (Table 2.1). Nevertheless, TSL should be careful when the economic and business is on the downturn because they may have trouble meeting their debt repayment schedule and could risk bankruptcy in worst case.

Figure 2.2 Gearing Ratio

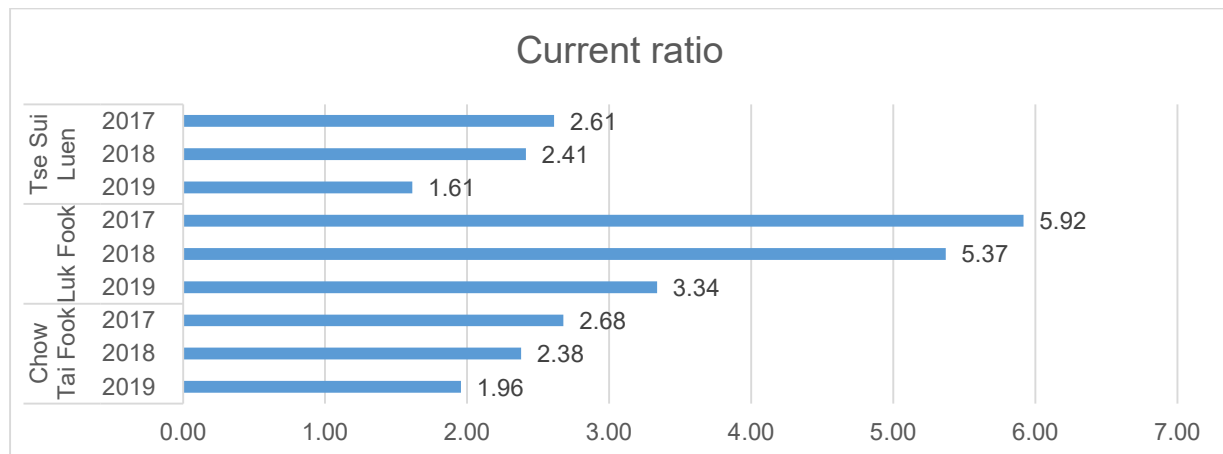


Source: From This Research

3. Current Ratio

In FY2019, TSL has reallocated HK\$408m of long-term bank loan to short term bank and thus increased the short-term bank loan from HK\$ 376m in FY2017 & FY2018 to HK\$787m in FY2019 (Table 2.3), representing increase of 109%. Hence, its current ratio has been decreased from 2.61 in FY2017 to 1.61 in FY2019 (Table 2.3). TSL's current ratio is similar with CTF in all the three years but much weaker than Luk Fook.

Figure 2.3 Current Ratio

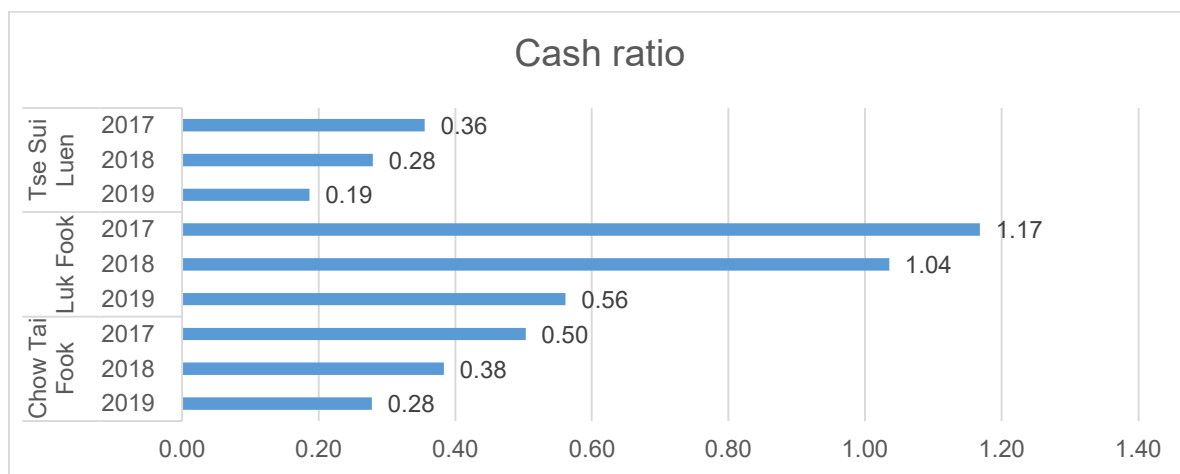


Source: From This Research

4. Cash Ratio:

The cash balance of TSL been decreased from FY2017 of \$324m to \$251 in FY2019 (TSL, 2017; 2018; 2019). In contrast, the current liabilities have been increased from \$911m in FY2017 to \$1,345m in FY2019. Hence, the cash ratio has been decreased from 0.36 in FY2017 to 0.19 in FY2019 (Figure 2.4), representing decreased of 47%. Which means TSL has less ability to pay off its current liability when become due. TSL also has less ability than its peer competitor to pay off short term liability. In which, Luk Fook was 0.56 and CTF was 0.28 in FY2019 (Figure 2.4). Suggest TSL should reserve more cash to pay off its current liabilities in the future.

Figure 2.4 Cash Ratio

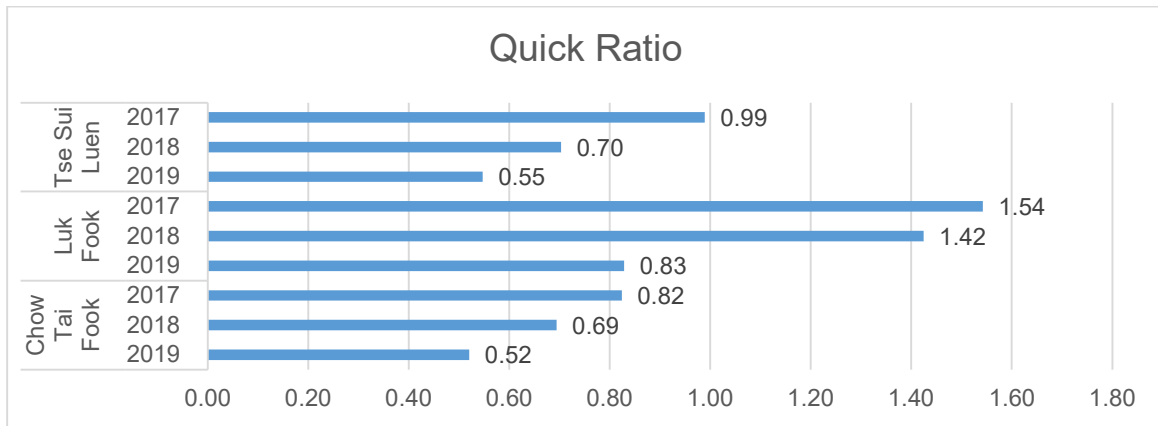


Source: From This Research

5. Quick Ratio

TSL's quick ratio has been dropped from 0.99 in FY2017 to 0.7 in 2018 and 0.55 in FY2019 (Figure 2.5), mostly due to the increased of short-term bank loan in FY2019. Luk Fook has maintained stronger quick ratio among the peer in past three years, which has 0.83 in FY2019 (Figure 2.5), which is 0.28 higher than TSL because the company has lesser current liabilities.

Figure 2.5 Quick Ratio

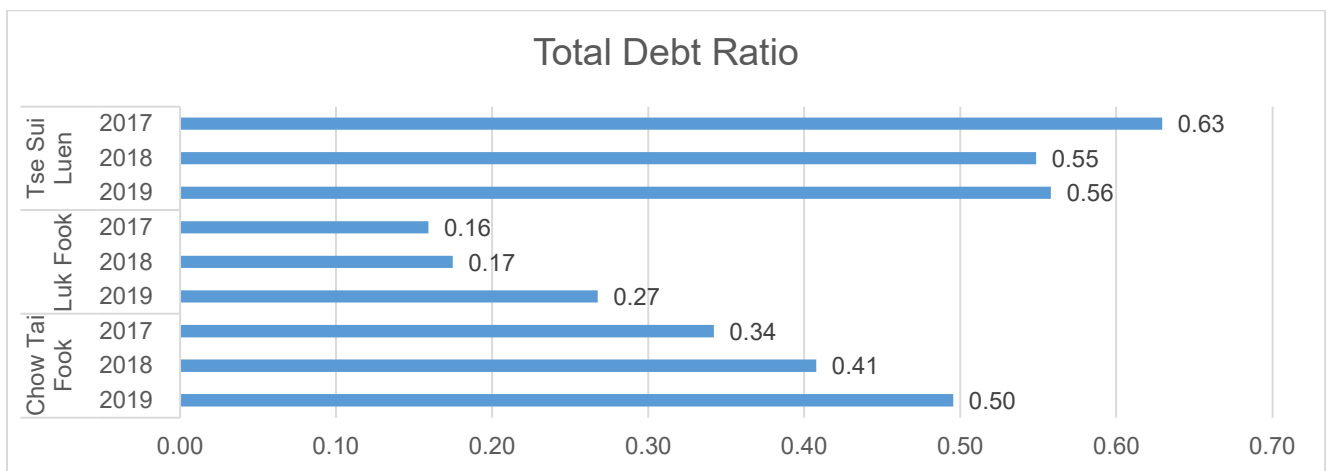


Source: From This Research

6. Total Debt Ratio

TSL's total debt ratio is greater than 0.5 (Figure 2.5) indicated that the company is more leveraged than CTF and Luk Fook. The higher the ratio, the greater risk will be associated with the company's operation and may lower the borrowing capacity. Higher total debt ratio means TSL's operation which is highly depends on the debt and hence the company may have to pay more interest expenses than the other two companies. This may be one of the reasons resulting TSL's net profit margin is lower than CTF and Luk Fook.

Figure 2.6 Total Debt Ratio

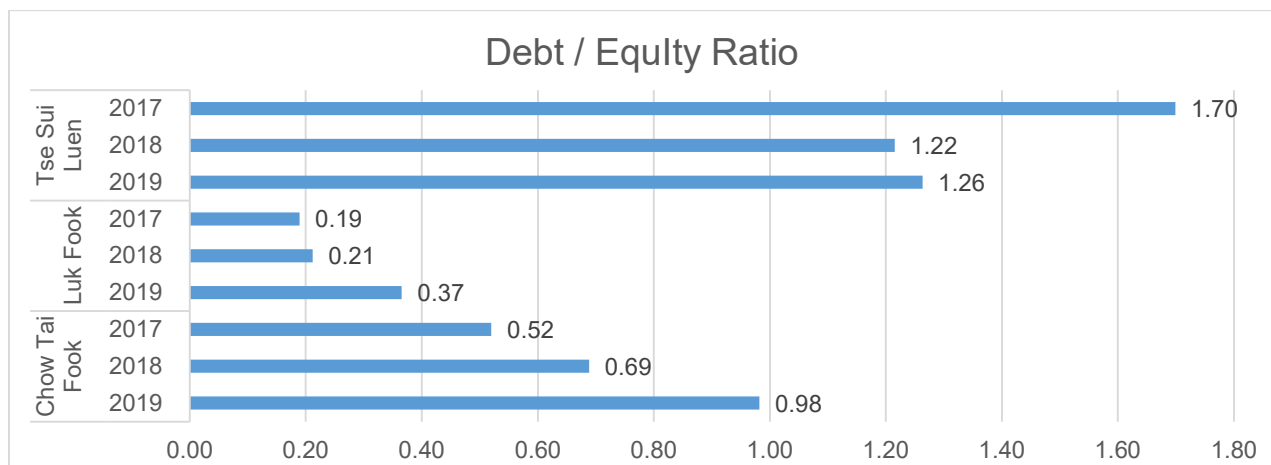


Source: From This Research

7. Debt/Equity Ratio

As mentioned above, TSL's has a higher debt than other two companies resulting its debt to equity is higher than the market average rate of 0.79. Higher Debt to equity ratio means TSL is considered higher risk than other two companies from creditors point of view because it shows that the investors funded the operation is less than the creditors. This is will mostly likely increase the borrowing costs and flexibility for funding capability.

Figure 2.7 Debt/Equity ratio



Source: From This Research

8. Long Term Debt Ratio

TSL's gradually reduced its long-term bank loan from long term to a short term and thus the debt ratio has declined from 0.73 in FY2017 to zero in FY2019. This is not a good indicator because the company has re-allocated part of the bank borrowing from long term to short term, means they have shorter time, i.e. less than 12 months to repay the loan if the bank demand repayment.

9. Asset Conversion Cycle (Activity Ratios)

Table no. 3.0 Stock Turnover, Debtor Collection, Creditor Payment Period & Cash Cycle

	Tse Sui Luen (TSL)			TSL	CTF	Luk Fook	3 Companies
	For the year ended 31 Mar			(2017 - 2019) 3 years average			
	2,019	2,018	2,017				
Stock Turnover Ratio	214	239	286	247	297	275	273
Debtor Collection Period	13	17	25	18	37	8	21
Creditor Payment Period	81	82	112	92	70	36	66
Cash Cycle	147	173	200	173	265	247	228

From this research

9.1 Stock Turnover Ratio

In general, retailers should have a longer stock return than other business, such as wholesale or manufacture business due to large proportion of their stocks were displayed inside the counters of the retail shop. TSL's stock turnover is the shortest compare with CTF and Luk Fook, which means the company can turn the stocks into sales in a shorter period. It also shows that the company can effectively sell the stocks it buys.

9.2 Debtor Collection Period

TSL's has improved its receivable days from 25 in FY2017 to 13 days in FY2019 (Table 3.0) and its average debtor collection period, at 18 days is slightly better than the average of 21 days. It is commonly understood that as a retailer, most of the sales were received in cash and should not incurred any account receivable. However, except for retail business, all the three companies have a wholesale and/or franchise business. In which they may act as a wholesaler and sale the goods with credit terms to franchisees then to end customers.

9.3 Creditor Payment Period

TSL is paying suppliers more frequently and shorter the period, from 112 days in FY2017 to 81 days in FY2019 but still longer than average of 66 days (Table 3.0). This may be an indicator of the company is improving its financial condition. Longer payment period can be benefit for the company as they may have more flexible for other operation fund purposes. In contrast, from supplier's view, they will add a certain interest and risk premium on its products for selling to a company with longer payment period. Eventually may reduce the company's profitability by paying more on the same materials or products.

9.4 Cash Cycle

The cash conversion cycle is a metric that expresses the time it takes for a company to convert its investments in inventory and other resources into cash flows from sales. Usually, shorter the period is almost always good, it means the company sell its inventory and received the cash in a shorter period. TSL's cash cycle is the shortest among the three which indicated the company is more efficient in buy the inventory, sell it and received cash from customers.

10. Stock Market Prospects

Table no.3.1 Earnings Per Share, Share Price, P/E Ratio, Book Value/Share & Market book ratio.

	Tse Sui Luen (TSL) For the year ended 31 Mar			TSL (2017 - 2019)	CTF 3 years average	Luk Fook	3 companies
	2,019	2,018	2,017				
Earnings per share (HK\$)	0.22	0.20	0.11	0.18	0.40	2.21	0.93
Share Price (HK\$)	1.75	2.20	2.49	2.15	8.14	26.55	12.28
P/E Ratio (times)	8.0	11.0	22.5	13.84	20.73	12.22	15.60
Book Value/Share (HK\$)	9.89	10.35	12.50	10.91	5.64	21.19	12.58
Market to book ratio (times)	0.18	0.21	0.20	0.20	1.45	1.27	0.97

Source: From this research

During the past 3 years, TSL's Earnings per share (EPS) has significantly increased from \$0.11 in FY2017 to \$0.22 in FY2019 (Table 3.1 (Badea, et al., 2014)), representing increase of 100%. However, its share price did not go up as EPS. In contrast, the share price of TSL has been decreased from \$2.49 in FY2017 to \$1.75 in 2019, dropped almost 30%. This indicated that EPS may not be a key consideration for investors when they are making the investment decision or explain that TSL is not an attractive company for investment. Due to higher EPS but lower share price, TSL's average P/E ratio is the lower than the average of 15.6.

When investing in a company, P/E ratio is one of major consideration as it reflected the earning capacity and its share price. Which in general, lower the PE ratio is more attractive to investors than higher P/E especially for some traditional business. On this assumption, TSL may be considered as a worth company to invest. However, if we take a deep look into its balance sheet, bank borrowing was more than other companies and thus has higher gearing ratio and debt ratio among the peer. When economic is in downturn and the company cannot keep it earning power to generate the sales and profit, may face difficulty to repay the loan when becomes due. Taking

consideration of all above factors and the risk level, TSL may consider is not an attractive company for investment.

Tse Sui Luen (TSL) Corporate Governance assessment

Corporate governance (“CG”) broadly refers to the mechanisms, processes, and relations by which corporates are controlled and directed (Goergen & Marc, 2012).

HKEX understand the importance of CG and to maintain Hong Kong’s reputation as a major international finance center and capital market. In view of that, HKEX revised the Corporate Governance Code in 2012, from a “recommendation” to as mandatory “comply or explain” requirement in the Annual report.

A. Criteria in Assessing Corporate Governance of TSL

Since CG also provides the framework for attaining a company’s objective, it encompasses practically every sphere of management, from action plans and internal controls to performance measurement and corporate disclosure (Badea, et al., 2014). The below are the major criteria in assessing its CG.

Table no. 3.2 Return of Asset (ROA), Equity Multiplier and Return on Equity (ROE)

Company name:	Tse Sui Luen			Chow Tai Fook			Luk Fook		
Year:	2019	2018	2017	2019	2018	2017	2019	2018	2017
ROA (after tax %)	2.20%	1.94%	0.88%	7.5%	7.3%	6.4%	10.4%	11.2%	9.6%
Equity Multiplier	2.26	2.22	2.7	1.98	1.69	1.52	1.37	1.21	1.19
ROE (after tax %)	4.99%	4.29%	2.38%	14.92 %	12.34%	9.73%	14.24%	13.55%	11.42%

Source: From this research

Maximizing the Interests of Stakeholders – ROA and ROE give investors an idea of how effectively the company is converting the money it has to invest into net income. The higher the number would be the better, because the company is earning more money on less investment (Brace, K., 2015).

In the past three years, TSL’s has gradually improved its ROE from 2.38% in FY2017 to 4.99% in FY2019. However, it still has a poorer return than CTF and Luk Fook due to its low net profit margin. From investor’s point of view, they might not be happy with the company’s performance as their return on investment is lower than other two companies. The ROA of TSL has improved

in last 3 years from 0.88% in FY2017 to 2.20% in FY2019 but still lower than its competitors. That indicated they are earning less return on its investment in assets. It also shows they may not effectively manage its assets to produce net profit. This consistent with the net profit margin as disclosed above the company has greater Gross profit but less Net Profit margin.

According to “OECD Survey of CG Frameworks in Asia”, approximately 75% of listed companies of Hong Kong in 2012 had a dominant shareholder (e.g. an individual/family) owning 30% or more of the issued shares (OECD, 2015)

TSL is one of the typical family owned listed companies in Hong Kong, Tse’s family has been the major shareholder and key management of the company since its IPO in 1987. This may be particular risk for a listed company since its lack of transparency and governance. In fact, in 2005, 11 persons of the company, including the former chairman, deputy chairman and chief executive officer (“CEO”), finance director and certain senior executives have been arrested by ICAC with charged in relation to an illegal commission scheme between 1996 to 2005 and suspected misappropriation of the company’s funds totaling over HK\$2.5 million (ICAC, pdf file ICAC050422, accessed 3 Aug 2020). Eventually, in 2008, some of them have been sentenced to jail for a ranging from three years to five years for conspiracies to offer illegal commissions totaling \$170 million to employees of travel agencies, embezzlement, and tax fraud (ICAC, pdf file ICAC080509, accessed Aug 2020).

Overall, TSL has generally fulfilled all the code provisions in accordance with HKEX, except for the code 2.1, that the role of chairman and CEO should not be performed by the same individual, Mrs. Annie Yau is the chairman and CEO. (TSL, 2020).

B. Recommendations for Improvement

Despite TSL has complied with HKEX codes of CG, few recommendations for TSL to enhance its corporate governance are: -

C. Decentralizing the Decision Power of the Board of Directors – According to TSL’s Annual Report 2018/2019, the Board has established the Audit, Remuneration and Nomination Committees, each with mandate to oversee aspects of the affairs of the Company. The company may also establish a “Risk Committee” to periodically review the effectiveness and monitor

management's performance against the entity's risk management framework, In other word, the company should decentralize or segregate the duties of its existing management team by appointing few external people to take certain management positions.

D. Empowering Internal Control – TSL has Internal Audit (“IA”) department to review its internal control and operation system in determining the risk and weakness areas of the company. The company also engaged an independent consulting firm to assist the IA department to perform the duties. Nevertheless, I would suggest TSL adopt the following approach to strength its IA function: -

1. Instead of paying consultant fee to external firm to assist its internal IA department, the company may consider hiring more qualified internal auditors to perform the audit job. Because, IA is rather different with external audit which required deep knowledge in operation systems of the company.
2. The company stated that IA Department will review the audit plan with audit committee yearly. I recommend the company should disclose the IA yearly audit plan and its audit findings for improvement and recommendations on the annual report. So, the public has more information what the IA has performed during the year and understanding the risk areas if any.

E. Enhancing Risk Management - “whistleblower policy” is widely adopted by many large organizations which encouraged employees to speak up about any unlawful, unethical, or irresponsible behavior within the organization. As a listed company and its scandal history, TSL may consider setting up a whistleblower policy and ensure the board and audit committee should be properly informed if there are any unlawful incidents.

F. Director and senior management remuneration policy – TSL's FY2020 recorded a loss of HK\$89.7 million, whereas FY2019 profit of HK\$54.2 million. Despite the net loss for FY2020, two of the executive director's (“ED”) still received salary of. HK\$7.4m, whereas in FY2019, received HK\$8.5 salary and HK\$3.2 bonus. The salary received by the ED for FY2020 only decreased of HK\$1.1 million despite the company recorded a huge loss during the year. I could therefore recommend the ED and senior management salary should be linked

with the company performance. In which, the remuneration packages for ED and other senior executives should include an appropriate balance of fixed remuneration and performance-based remuneration.

Investment Project Appraisal

The management of TSL is fully aware and believes of e-business will become a significant and sustainable source of sales revenue. In recent years, its e-business has been steadily growth and achieved a 17.2% year-on- year increase in turnover. (TSL, 2020). In view of the importance of e-business for the business development in the future, I would propose the company to setting up a new facility to manufacture different products mainly on fashion jeweler targeting young generation through on-line and off-line sales channels. The new product line will be enriching TSL's brand portfolio to cater today's ever-changing customer expectations. My proposal summary is: -

Estimated Project Total Cost

Table 3.3 Estimated project total cost

Project expense breakdown assumption		HK\$'M
Inventory	60%	121.9
Buildings	20%	40.6
Furniture, fixtures & equipmen	10%	20.3
Plant and machinery	10%	20.3
Total		203.2

- Other general assumptions / basic information:

Table 3.4 Depreciation & Sales Growth Rate

Basic / Assumptions:		Remarks / Sources	
Depreciation expense			
Buildings	20 years	TSL depreciation policy	
Furniture, fixtures & equipment	5 years	TSL depreciation policy	
Plant and machinery	5 years	TSL depreciation policy	
Sales growth rate	10%	TSL 2017 - 2019 average growth rate	
EBITDA Margin	3.44%	TSL 2019	
Investment period	20 years	Based on Building depreciation basis	

Source: From this research

Profit and Loss and Cashflow projection

Table 3.5 Profit and Loss and Cashflow projection

Profit and Loss projection						
Projection Year		Year 1	Year 2	Year 3	Year 4	Year 5
		HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M
Sales*		336.2	369.1	405.2	444.8	488.2
EBITDA		11.6	12.7	14.0	15.3	16.8
Depreciation expense (Total)						
Buildings		(2.0)	(2.0)	(2.0)	(2.0)	(2.0)
Furniture, fixtures & equipment		(4.1)	(4.1)	(4.1)	(4.1)	(4.1)
Plant and machinery		(4.1)	(4.1)	(4.1)	(4.1)	(4.1)
EBIT		1.4	2.6	3.8	5.2	6.7
Income tax expense 16.5%		(0.2)	(0.4)	(0.6)	(0.9)	(1.1)
Profit after tax		1.2	2.1	3.2	4.3	5.6
Cash Flow projection						
Projection Year	Initial	Year 1	Year 2	Year 3	Year 4	Year 5
EBITDA		11.6	12.7	14.0	15.3	16.8
Tax		(0.2)	(0.4)	(0.6)	(0.9)	(1.1)
Cashflow from Operations	(203.20)	11.3	12.3	13.3	14.5	15.7

Assumptions:

- *Annual sales are calculated at TSL's 2019 Total Assets Turnover ratio of 1.65 times total assets, i.e. HK\$203.2 million with annual growth rate of 10%, $(1.65 \times 203.2\text{m}) \times 10\%$
- Assuming no interest expenses for the new project as not yet decided the source of funding.

ARR and NPV calculation

Table 3.6 ARR& NPV

ARR	HK'M	
Total profit for 20 years	472.0	A
Average ARR	23.6	B = A / 20yrs
Initial cost	203.20	C
ARR Ratio	11.6%	=B/C

Years	Cashflow in/(out)	PV of cashflow
	HK\$'M	HK\$'M
Initial	(203.2)	(203.2)
1	11.3	11.1
2	12.3	11.8
3	13.3	12.5
4	14.5	13.3
5	15.7	14.1
6 - 20	496.2	362.7
NPV		222.2
NPV = Total PV for 20 years less Initial cost		

The ratio for PV is with reference to TSL 2019 ROA of 2.2%.

Payback Period and IRR

Payback period for the project would be approx. 11 years and 3 months and IRR are approx. 9%. (Table 3.6).

Analysis of the proposed project

Based on the estimation with reference to TSL history financial information, the proposed project payback period is about 11 years and 3 months, which is consider as reasonable payback period for a retail business. The proposed project with expected ARR of 11.6% is significantly higher than the current return on assets of 2.2%. Mainly because assuming the project does not have any other assets except for the Inventory, buildings, Plant and machinery. The NPV is positive with estimated of HK\$ 222.2 million, it indicates its earning from the project is more than the initial investment cost, the project is considered acceptable.

Apart from the return on investment, the proposed expansion will also benefit the medium- and long-term growth of the company as a whole and this will further expand its business activities into the PRC jewelry retail market.

Taking consideration of existing economic environment and low interest rate, suggest the company finance the funding by bank borrowing.

Financing (Fund management)

The proposed project would require initial capital of HK\$203.2 million, of which 121.9 million will be provided by internal resource. The balance of HK\$81.3m (TSL 2019/20 total assets * 3%) will be required to raise from external, below with various ways for consideration: -

Table 3.7 Financing (Fund Management)

	Tse Sui Luen (TSL)				Chow Tai Fook	Luk Fook
	2017	2018	2019		2019	2019
	HK\$'000	HK\$'000	HK\$'000		HK\$'000	HK\$'000
Cash and cash Equivalents	323,657	268,073	251,242		7,640,600	2,086,522
Bank Loans	1,022,900	785,535	786,989		18,068,200	2,306,113
Cash Ratio	36.0%	28.0%	19.0%		28.0%	56.0%
Retain profit	23,204	49,508	54,161		4,684,000	1,503,655
Net Debt ratio (i)	72.0%	45.0%	49.0%		58.0%	22.0%
Net Interest Expenses (ii)	58,556	40,955	60,499		287,600	4,200
Net Interest expenses / turnover (iii)	1.7%	1.0%	1.5%		0.4%	0.0%

Notes: -

- (i) Net Debt Ratio: (Bank loans – Cash) / Equity
- (ii) Net Interest Expenses: Interest income less interest expense
- (iii) Net Interest Expenses Ratio: Net Interest Expenses / Turnover

1. Bank Borrowing

TSL can negotiate with its existing banks for an additional banking facility to finance the proposed project. Bank borrowing may be considered as an easier way to obtain the fund. However, it will increase the company's liability and lower the net profit with increase of interest expenses yearly. With reference to TSL 2019/20 annual report, unsecured bank loan interest rate between 3.32%–4.83% per year, we take the average of 4.08% annually. Annual interest on the principal amount of HK\$81.3 would be \$3.3 million. However, under the current economic environment, the banks may adopt tighter credit for providing facilities to companies with retail business.

2. Issue of new shares

Alternatively, the company can consider issuing new shares to existing or potential investors. By issuing of shares to new shareholders represents an opportunity to raise capital while broadening its shareholders basis. Also, it allows the company to strengthen its balance sheet (increase of cash) without facing the increasing of liabilities and interest expenses. TSL share price as at 10 August 2020 of HK\$0.89, assuming the new shares will be issued at 10% discount, i.e \$0.8. The company needs to issue approx. 101.6 million shares, account for 40.8% of its existing number of shares i.e *TSL 2019/20 annual report page 180, no. of existing shares of 249,182,030.*

However, in view of the downward trend of the historical trading price of the company's shares, there is uncertainty of existence of a market to attract shareholders unless offer a very large discount of the issued price. The effect will be diminished the existing shareholders percentage and earnings per share.

3. Issue of convertible bond

The company may also consider issuing a long term i.e 7 years convertible bonds to institutional investors. At the maturity, the bond holders have option to convert the bonds into company's shares at agreed fixed share price or redeem it into cash. The bonds should have a coupon rate, similar to the interest expenses but should be lower as the bonds holders have a right to converted it into shares when the share price of the company is higher than the determined conversion price. However, based on TSL's market capitalization and its business nature under current market environment, it could be difficult to attract investors unless offer a higher coupon rate or favorable share conversion price.

4. Venture Capital

Another options for raising the fund is by way of "Venture capital", which mainly provided by venture capital firms. Apart from the funds that they provide, venture capitalists also give the advice on how to improve the profitability of the business. In return, they normally required a higher rate of return.

Proposed Funding

Having considered above fund raising alternatives for the project and the benefits and cost of each options. In addition, under the current economic environment and the downward trend of the company's shares, it is difficult for TSL to issue new shares or convertible bonds. In view of that bank borrowing seems a best option to finance the capital requirement. Possible financial effects of the bank borrowing of HK\$ 81.3 will be: -

According to TSL 2019 annual report, the Group's total bank borrowing and total liabilities were HK\$787.0 million and HK\$1,371.4 million, respectively. The Company's gearing ratio and leverage ratio was 0.72 and 5.25, respectively. With the increase of bank loan

HK\$81.3 million, both gearing ratios will be raised to 0.8 and 5.8, respectively. In contrast, the current ratio will be decreased from 1.61 to 1.58. Debt /Equity ratio will be increased from 1.26 to 1.34.

The annual interest expense will also be increased of HK\$3.3 million, which means the net interest expenses in FY2019 will be increased from HK\$60.5 million to HK\$63.8 million. The interest expense ratio will also be increased from 1.5% to 1.6%.

Recommendations for financial review

Improve profitability – despite the company has a higher gross margin than its peer, their net gross margin is much lower. The management must review the group structure, operating flow, and reduce operating costs. One of the methods is linked the management and director's remuneration with the company's profitability.

Prepare a strategic plan with 1- 5 years goal – TSL has lower net profit margin than its peer, resulting its ROA and ROE are also lower than CTF and Luk Fook. Suggest the company set up a 1 to 5 years strategy plan, clearly define the goals and how the company accomplish it. The goal not only define how to increase the revenue but also maximize its profit by the assets invested in. The management should constantly review the plan so that they are aware whether the results match with the goal or not.

Improve paying debt ability – the company's gearing, current and quick ratios are all significantly higher than its peer. It means the company overall ability to paying its current liabilities is lower than CTF and Luk Fook. This is particular risk when the performance of company is in downturn and does not have sufficient cashflow to meet the debt. The company must take initiative steps to improve its cash balance and/or reduce the bank borrowing.

One of the methods to increase its funding is to have strategic alliances with certain key investors to expand its franchise business in PRC. Instead of just selling the inventory to the franchisee, the company could consider set up joint venture (J.V) company with those

investors. In which, the company could speed up the expansion of franchise network and have partner contribute part of its capital into the J.V.

Conclusion

From the investor perspective, after understand TSL's (i) financial performance; (ii), high debt level; (iii) financial ratios analysis, (iv) share price performance and (v) future prospect, I would suggest the company is not worth to invest. Especially during this period, the revenue and profit has been decreased significantly and hence its cashflow may not be sufficient for its operation and interest expense. In addition, the company has too much debt, it is not easy to fulfil the obligations when the loan is due. Overall, I could consider TSL is a risky company to invest.

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