Cortina Holdings Limited : SIAS Q&A for AGM 2021

Q1. The group completed the strategic acquisition of Sincere Watch Limited ("Sincere") and its subsidiaries for a purchase consideration of $84,695,000 on 16 March 2021.

At the date of the signing of the sale and purchase agreement, Sincere operated 18 boutiques in Singapore, Malaysia, Thailand and Australia. Sincere's portfolio of distributed brands includes A. Lange & Söhne, Audemars Piguet, Franck Muller, IWC, Jaeger-LeCoultre, Panerai, Omega, Vacheron Constatin and Tudor. It runs multi-brand retail under the Sincere brand in Singapore and Malaysia and under the Pendulum brand in Thailand. In addition, Sincere operates mono-brand boutiques for Franck Muller in Singapore and Australia; A. Lange & Söhne in Malaysia; and A. Lange & Söhne, Breitling and IWC in Thailand. As disclosed by the company, the acquisition would provide the group exclusive distributorship rights to the Franck Muller brand in 13 countries within Asia Pacific pursuant to the exclusive distributor agreement.

As noted in the chairman's message, the acquisition would also allow the group to benefit from cost savings and operational synergy through the cross-selling of products and pooling of resources (page 3 of the annual report).

(i) With more than 5 months since the acquisition, has the integration of Sincere been completed? Is management satisfied with the performance of Sincere since the acquisition?

A. The past 5 months had been challenging for Sincere as the COVID 19 pandemic has severely affected most of its key markets such as, Malaysia, Thailand, Singapore and even Australia which saw governments imposing lockdowns and stay-at-home orders to curb the virus outbreak.

Sincere's retail outlets in Malaysia, Thailand and Australia had to be closed and border restrictions further exacerbated the situation as tourist numbers continued to plunge.

However, the Group is not sitting idle but actively taking steps to reorganise Sincere with the aim of turning it around to profitability.

The Group intends to preserve and grow Sincere as a strong brand on its own which already enjoys an established and extensive following built over more than 6 decades.

With Cortina's expertise and proven organisational strengths, we are confident that we can maximise operational synergies that will increase our overall value to both consumers and business partners.

In terms of integration, we have already started to integrate some of Sincere's backend operations (such as IT and admin support) and this process remains ongoing. The front-end will continue to operate under the Sincere brand name.

Going forward, both Cortina and Sincere will continue to operate their retail outlets under their respective brand names to preserve their well-established brand identities and minimise brand dilution.

It is too early to comment on the performance of Sincere, but we will be working closely to improve performance in the coming months.

(ii) How long is the exclusive distributorship rights to the Franck Muller brand for the 13 countries?

A Our exclusive distribution rights to the Franck Muller brand in the various countries are not likely to end any time soon. For reasons of competition and non-disclosure obligations, we are unable to disclose the duration of our exclusive distribution rights with any of our watch brands.

(iii) Can management elaborate further on the opportunities for cross-selling? How successful is the group at cross-selling since the acquisition?

A. The acquisition of Sincere has expanded our overall portfolio of key luxury brands significantly. Customers are now able to enjoy a wider range of luxury timepieces carried by Cortina and Sincere. There are therefore many cross-selling opportunities for us to market our extensive arsenal of luxury watches between Cortina and Sincere. This however will be subject to the various agreements we have with the different watch brands that we carry.

In cases where we are unable to cross-sell a particular watch brand within the same outlet, then Cortina will refer customers to Sincere, and vice-versa.

(iv) How has the group finetuned its organic growth strategy as a result of the acquisition of Sincere? Please (re)state the key growth drivers for the next 3-5 years.

The Group's growth strategy has not changed and we will persist in our pursuit of growth via organic as well as inorganic means.

Strategic acquisitions such as Sincere, which has strong brand equity - will enhance our competitive position and enable us to scale our business readily in the region. Now with our exclusive distributorship for Franck Muller, which extends to 13 countries in the Asia-Pacific. We are granted ready access to countries which we were not able to penetrate previously.

Going forward, our growth in the next 3 to 5 years will be driven by our strong leadership position to gain market share, new customers and new markets. Our now enlarged stable of luxury brands and exclusive distributorships will open up new markets and grow our footprint in Asia-Pacific. We are also able to gain margin improvements from operating leverage and cost savings though maximising operational synergies and pooling of resources. Importantly, our business will be driven by the enduring resilience of the global luxury demand which is expected to grow from US$224.8 billion in the year 2020, to reach US$296.9 billion by 2026, growing at a CAGR of 4.8% [Source: https://www.prnewswire.com/news-releases/global-luxury-goods-market-to-reach-296-9-billion-by-2026--301301077.html].

Q2. The "Net realisable value of inventories" is a key audit matter (KAM) highlighted by the independent auditor in the Report on the audit of the financial statements (page 65). Key audit matters are those matters that, in the professional judgement of the Independent Auditor, were of most significance in the audit of the financial statements of the current period.

As noted in the KAM, for the financial year ended 31 March 2021, the group holds inventories of $214,439,000 (2020: $143,335,000) as at the end of the reporting year.

Cortina Holdings Limited.

In Note 22 (page 114 – Inventories), it can be seen that inventories increased to $214.4 million from $143.3 million a year ago, of which finished goods carried at net realizable value more than doubled to $63.8 million as at 31 March 2021, from $31.2 million.

22. INVENTORIES

	Group	
	2021 $'000	2020 $'000
Finished goods		
- at cost	150,625	112,130
- at net realisable value	63,814	31,205
Total finished goods at lower of cost and net realisable value	214,439	143,335

(i) How much of the increase in inventories could be attributed to the acquisition of Sincere? Is the group able to improve on its working capital management (especially inventory) given the economies of scale with the Sincere acquisition?

A. Sincere accounted for S$94.98 million of inventories (as per page 111 of Annual Report 2021). We are optimistic of improvements from economies of scale.

(ii) What is the reason that inventories carried at net realisable value more than doubled to $63.8 million as at 31 March 2021?

A. Stock at net realisable value increased mainly due to the Sincere acquisition.

(iii) Can management provide shareholders with a detailed breakdown of the inventory by age, by brand and by geography?

A. For reasons of competition, we are unable to share this information.

Further, it is noted in the chairman's message that Thailand is the top performing region, with Singapore, Malaysia and Taiwan having achieved stable results. In Note 4B (page 93 - Financial information by operating segments), it was disclosed that revenue for Singapore and for South East Asia declined by 21% and 9% to $206 million and $175 million respectively over the financial year.

(iv) What is the revenue generated (or revenue growth) in Thailand? Can management help shareholders understand the reasons for the strength in domestic spending and consumption in Thailand? How sustainable is this?

A. We report our geographical market data by region and not by country.

According to Reuters, Thailand's economy continued to grow in the second quarter of this year - up from the first quarter - helped by exports and government spending, but spiking COVID-19 cases will continue to batter domestic activity and tourism (Source: https://www.reuters.com/article/thailand-economy-gdp-idUSL4N2PL05N). Hence, general domestic consumer sentiment is likely to stay tepid.

However, demand for luxury goods is expected to remain robust. Statisca reported revenue in Thailand's luxury market which amounts to over US$1.5 billion in 2021 - is forecast to grow annually by 6.91% (CAGR 2021-2025) (Source: https://www.statista.com/outlook/cmo/luxury-goods/thailand).

This positive forecast bodes well for the Group, and with our strong financial position, we are well-poised to capitalise on growth opportunities arising from the acquisition of Sincere.

(v) Furthermore, how much of the top line revenue in each of the key markets can be attributed to domestic consumption?

A. Given the border closures and border restrictions imposed by governments to control the coronavirus pandemic in the region, most of our sales are generated from domestic consumers.

Q3. At the company's annual general meeting scheduled to be held on 26 August 2021, the company is proposing that shareholders approve directors' fee of $709,406 for the financial year ending 31 March 2022 (2021: S$589,875).

(i) Can the board/remuneration committee help shareholders understand the reasons for the 20% increase in directors' fees?

A. The Group's directors' fees have not changed since 2019. This is the first increase in 3 years. The Remuneration Committee (RC) reviews directors' compensation annually according to our review framework which considers a variety of factors that are structured to link rewards to the directors' role and responsibilities, corporate and individual performance. Such performance-related remuneration are also aligned with the interests of shareholders and to promote the long-term success of the company.

The 20% increase in directors' fees was recommended in view of the increased work scope and responsibilities of directors. During the negotiations to acquire Sincere, the directors were involved in discussions and meetings with the management and various professionals including financial advisers, valuers and lawyers. Following the acquisition the directors are spending more time to meet and to deliberate on issues in respect of the enlarged group size and increased complexity of operations. The enlarged group now has about double the number of subsidiaries, a total of 46 outlets (vs 22 pre-acquisition) in Singapore and the region (including new markets such as Australia) and more than 50 international brands in its portfolio (vs 35 brands pre-acquisition). In terms of headcount, the scale and size of the Group have also expanded 62% to 586.

(ii) Can the board confirm that executive directors receive directors' fees as well, on top of salaries and bonuses?

A. Yes (page 49 of the annual report).

In addition, the non-executive directors, namely Mr Lau Ping Sum Pearce, Mr Chin Sek Peng Michael and Mr Foo See Jin, are seeking two-tier votes by shareholders on their continued appointment as independent directors. The directors were first appointed on 27 June 2002, 13 September 2007 and 15 December 1972 respectively.

Accordingly, the directors have served on the board for more than 19 years, more than 13 years and more than 48 years respectively. Collectively, the three directors have served on the board for nearly 82 years. Mr Foo See Jin, Michael is also one of the founders of the group and has a 4.29% stake in the company (7.11 million shares).

(iii) How does the board avoid group-think given that the three independent directors have served on the board for nearly 82 years, along with the executive directors who have been on the board for as long as 48 years (executive chairman since 1972)?

A. We have a diverse board to enhance decision-making capability and the overall effectiveness of the Board in achieving sustainable business operation and improving shareholder value. Our Board comprises members who have diverse competencies and come from different professional and industry/business backgrounds such as financial/management consultancy, law and F&B. We believe this is in line with the requirements to avoid group-think and foster constructive exchange of ideas and business and industry insights.

The Board's view is that the extensive experience and knowledge of its key directors provide guidance, stability and continuity to steer the Group on the path to further growth. In addition, the length of their service does not interfere with their independence, judgements, roles and responsibilities to serve effectively as independent directors on the Board of the company.

The Group has also benefitted from their objectivity, strong guidance and exceptional business acumen which has resulted in delivery of positive returns to shareholders continually over the years.

(iv) What deliberations did the nominating committee have on the progressive renewal of the board? (Principle 4 of the Code of Corporate Governance 2018)

A. In terms of succession planning –the Group's Nomination Committee (NC) frequently reviews succession planning at its meetings not only of the Chairman and Board Directors but also that of Senior Management positions in the Group such as the CEO, the COO and CFO. The process and key considerations for succession planning are outlined in our Annual Report - p45.