

## Another major acquisition

## Hong Kong Distributions

### Li & Fung (494 HK, HK\$27.1)

### BUY (unchanged)

#### Target price: HK\$35.0 (+29.2%)

#### The acquisition.

- Li & Fung (LF) announced during the weekend another major acquisition of the global sourcing operations of Tommy Hilfiger for a cash consideration of US\$247.8m (HK\$1,933m). The consideration represents a historical P/E of 8.0x based on earnings of US\$31.0m (HK\$242.0m) in FY3/06A, which will be paid in one time and fully financed by internal reserves, since it has raised HK\$2.7b from share placement in Sept 2006. It is the second largest deal after the acquisition of Colby. The deal is expected to complete on 28<sup>th</sup> March.
- Tommy Hilfiger is one of the largest and most globally developed designer brands in the world with a prominent position in American market and a significant position in European market. It was acquired by private equity group, Apax Partners in 2005. The existing buying office, including 500 staffs will be substantially integrated into LF's organization located in H.K., Taiwan, India, Bangladesh and Sri Lanka. The acquisition will also bring in +50 licensees including apparels and other accessories under Tommy Hilfiger to LF.

#### Our take.

- The deal is very positive to LF's top-line and bottom-line growth as the current sourcing volume of Tommy Hilfiger is large with attractive margins. In FY3/06A, the sourcing volume of Tommy Hilfiger amounted to US\$703m (HK\$5,483m) in FY3/06A, which represents c.8.3% of LF's sales in FY12/06F and is expected to deliver double-digit growth in the coming years. This outsourcing arm earns an EBIT and net margins of 5.5% and 4.4% respectively, which is higher compared with LF's EBIT and net margin of 3-4%.
- However, with this sizeable acquisition, it is difficult for LF to find any meaningful acquisition targets down the road. Time is required to integrate the acquisitions done insofar. Overall order book remains strong for currently despite economic slowdown in U.S.

#### Valuation.

- Since the deal will be completed by March 2007, c. two-third of the earnings will be reflected in LF's book in FY12/07F. We have raised our earnings forecast by 4.4% and 6.1% in FY12/07F and FY12/08F respectively. We maintain our BUY recommendation and a revised target price of HK\$35.0 (prev. HK\$23.0), equivalent to 1.3x PEG in FY12/07F.

**Table 1: Financial summary**

Year to Dec	Net profit HK\$m	EPS HK\$	EPS Δ %	P/E x	P/B x	EV/EBITDA x	Yield %	ROE %	ROCE %	N. Gearing %
04A	1,530.2	0.526	24.3%	51.6	16.64	44.3	2.5	34.1	35.1	Cash
05A	1,790.9	0.557	6.1%	48.6	18.70	46.3	1.8	38.1	39.1	Cash
06F	2,532.4	0.743	33.3%	36.5	12.12	30.5	2.2	41.2	44.7	Cash
07F	3,233.7	0.948	27.7%	28.6	17.47	25.2	2.8	50.1	51.7	0.14
08F	3,773.8	1.107	16.7%	24.5	29.68	22.0	3.3	89.8	90.4	1.06

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**Table 2: Profit & Loss**

Year to Dec (HK\$m)	04A	05A	06F	07F	08F
<b>Turnover</b>	<b>47,170.6</b>	<b>55,617.4</b>	<b>68,044.5</b>	<b>83,181.3</b>	<b>98,122.5</b>
% chg	10.6	17.9	22.3	22.2	18.0
Gross profit	4,322.6	5,660.9	6,736.4	8,210.0	9,684.7
EBITDA	1,742.6	1,986.2	2,974.6	3,700.7	4,357.3
Depre./amort.	(147.5)	(129.5)	(133.5)	(152.8)	(172.0)
EBIT	1,595.0	1,856.8	2,841.1	3,548.0	4,185.3
Net int. income/(exp.)	31.7	48.2	(56.4)	11.4	(29.8)
Exceptionals	-	27.8	0.0	0.0	0.0
Associates	35.5	9.1	12.7	13.4	14.1
Jointly-controlled entit.	-	-	-	-	-
<b>Pre-tax profit</b>	<b>1,662.3</b>	<b>1,941.8</b>	<b>2,797.4</b>	<b>3,572.8</b>	<b>4,169.6</b>
Tax	(133.0)	(151.2)	(265.8)	(339.4)	(396.1)
Minority interests	0.9	0.3	0.8	0.3	0.4
<b>Net profit</b>	<b>1,530.2</b>	<b>1,790.9</b>	<b>2,532.4</b>	<b>3,233.7</b>	<b>3,773.8</b>
% chg	25.1	17.0	41.4	27.7	16.7

Source: SBI E2-Capital