

I.T. (999 HK)



BUY (unchanged)

Not all bad news

Key points:

- Sales up 20-30% in October after slow August and September growth
- Correction year for China operations after full consolidation of GSIT
- Diversification into shopping mall management planned in FY02/10F
- Hong Kong's economic slowdown the biggest near-term risk
- Net profit estimates cut to HK\$183.5m for FY02/09F and HK\$240.1m for FY02/10F
- Our revised sum-of-the-part target price of HK\$1.80 (previously HK\$3.30) represents 8.0x FY2/10F P/E.

Cautious about HK's retail outlook. The company said HK's retail market has become more challenging since 1H of 2008 due to a combination of: 1) slowing local economy and 2) recent hot weather spell, which discouraged shopping activities. Its YoY sales growth in August and September was slow but picked up (20-30%) in early October as the weather cooled and stores stepped up promotion activities.

Cautious lease contracts renewal. I.T said it planned to delay signing of new rental agreements until year-end in order to negotiate favorable terms. In 1H FY02/09, the company renewed around 1/6 of its store rental leases with rental increases per sqf averaging 25%. The main thrust of its store expansion in Hong Kong and China is likely to come at the financial year-end, as the management waits for rental rate increases to subside. While delaying top line contributions from new stores, the move will ease the company's rental cost burden. We expect rental pressure (as a percentage of turnover) in Hong Kong to remain considerable in FY02/09F, before easing in FY02/10F and boosting margins.

China ops ramp up delay. After the full consolidation of GSIT in 4Q FY02/08A, we expect a consolidation year for I.Ts' China operations as the company undertakes some strategic reviews, internal restructuring and rationalizes the operating costs of the former JV. I.T currently operates 122 stores in China covering around 230,000sqf. While profitable, we expect the China operations to deliver nominal contributions to I.Ts' bottom line in FY02/09F and cut our operating profit estimates for the China division to HK\$7.1m on lower sales growth and increased operating costs.

Store expansion to continue. I.T currently has 177 stores in HK (172 at end 1H FY02/08) and 122 in China (104), in line with our expectations. It aims to open another three stores in Hong Kong and five stores in China by year-end. Its capex budget for FY02/09F is HK\$130m (HK: HK\$50m, China: HK\$80m).

Looking beyond the current business model. The company is looking beyond its current business model in China to leverage its multi-brand competitive advantage by diversifying into managed

Hong Kong Retail

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Stock data

Price	HK\$0.72
Target price	HK\$1.80 (+154%)
12 mth range	HK\$0.69-3.18
Market cap.	US\$107.3m
Daily t/o, 3 mth	US\$0.149m
Free float %	24.3%
Ticker	999.HK/999 HK

Financial summary

Year to Dec	07A	08A	09F	10F	11F
T/O (HK\$m)	1,530.8	2,021.3	2,760.8	3,160.1	3,700.9
NP (HK\$m)	122.4	171.0	183.5	240.1	322.4
EPS (HK\$m)	0.118	0.160	0.172	0.225	0.302
EPS Δ %	0.1%	36.0%	7.3%	30.8%	34.3%
P/E (x)	6.3	4.6	4.3	3.3	2.5
P/B (x)	0.93	0.65	0.61	0.55	0.49
EV/EBITDA (x)	16.2	11.5	11.4	8.4	5.9
Yield (%)	6.8%	14.3%	12.8%	16.7%	22.4%
ROE (%)	15.6%	16.7%	14.5%	17.6%	21.3%
ROCE (%)	17.3%	19.6%	16.2%	19.3%	23.5%
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	-44.4	-53.8	-37.0
Actual price changes (%)	+33.9	-57.0	-62.8
	09F	10F	11F
Consensus EPS (HK\$)	0.184	0.214	0.225
Previous forecasts (HK\$m)	208.3	258.9	320.2
Previous EPS (HK\$)	0.180	0.224	0.277

Price Chart



store operations. It is exploring the possibility of acquiring a 100,000sqf building in Shanghai through a leasehold agreement and turning it into a boutique mini shopping mall. We expect the company to retain around 40.0% of the surface for the 40 key brands in its portfolio of over 300, and allocate the rest to third party brands under concession agreements. Should this deal materialize, capex will increase significantly in FY02/10F. We are positive on I.Ts' potential diversification strategy, despite sketchy details.

Contribution from Galleries Lafayette JV not until FY02/11. I.Ts' JV with Galleries Lafayette remains in progress, with site selection currently underway. We expect this to take time and do not expect any contribution until FY02/11F. We believe the partnership will be positive for I.T as it will 1) aid diversification of revenue sources; 2) bring a large panel of luxury apparel brands into its portfolio and 3) allow the company to break into the high margin cosmetics sector.

Target price cut to HK\$1.80, maintain BUY. We remain positive on the long-term outlook of I.T though acknowledge that the company faces some near-term pressure from: 1) weakening economic growth and 2) slower-than-expected ramp up of its China operations. We cut our net profit estimates by 14.2% to HK\$183.5m for FY02/09F and 13.4% to HK\$240.1m for FY02/10F. Our revised sum-of-the-part target price of HK\$1.80 (previously HK\$3.30) represents 8.0x FY2/10F P/E. The company is due to announce its interim results at end-October.

Table 1: P&L

Year to Feb (HK\$m)	07A	08A	09F	10F	11F
Revenue	1,530.8	2,021.3	2,760.8	3,160.1	3,700.0
Cost of sales	(640.5)	(819.4)	(1,129.9)	(1,293.6)	(1,514.1)
Gross profit	890.3	1,201.9	1,630.9	1,866.5	2,186.8
Other gains/(losses)	(4.3)	1.9	2.6	3.0	3.5
Operating expenses	(749.9)	(1,002.0)	(1,428.8)	(1,606.0)	(1,834.2)
Operating profit	136.1	201.8	204.7	263.5	356.1
Finance costs - net	(0.6)	(0.8)	(0.8)	(0.5)	(0.5)
Interest income	16.6	14.4	20.0	29.0	36.8
Share of losses of jointly controlled entities	(3.9)	(4.8)	2.0	3.5	4.4
Profit before tax	148.2	210.5	225.8	295.5	396.8
Income tax	(25.7)	(39.5)	(42.4)	(55.5)	(74.5)
Profit for the year	122.5	171.0	183.5	240.1	322.4
Dividends	52.0	120.0	110.1	144.0	193.4

Source: Company data, SBI E2-Capital

P & L (HK\$m)	07A	08A	09F	10F	11F
Year to Dec					
Turnover	1,530.8	2,021.3	2,760.8	3,160.1	3,700.9
% chg	16.5%	32.0%	36.6%	14.5%	17.1%
Gross profit	890.3	1,201.9	1,630.9	1,866.5	2,186.8
EBITDA	191.9	275.3	269.7	366.0	517.2
Depre./amort.	(55.9)	(73.6)	(65.1)	(102.4)	(161.0)
EBIT	136.0	201.8	204.7	263.5	356.1
Net int. income/(exp.)	16.0	13.6	19.2	28.5	36.3
Exceptionals	-	-	-	-	-
Associates	-	-	-	-	-
Jointly-controlled entit.	(3.9)	(4.8)	2.0	3.5	4.4
Pre-tax profit	148.1	210.5	225.8	295.5	396.8
Tax	(25.7)	(39.5)	(42.4)	(55.5)	(74.5)
Minority interests	-	-	-	-	-
Net profit	122.4	171.0	183.5	240.1	322.4
% chg	0.1%	39.7%	7.3%	30.8%	34.3%
Dividends	(52.0)	(120.0)	(100.9)	(132.0)	(177.3)
Retained earnings	70.4	51.0	82.6	108.0	145.1
EPS (HK\$) - Basic	0.118	0.160	0.172	0.225	0.302
EPS (HK\$) - F.D.	0.118	0.160	0.172	0.225	0.302
DPS (HK\$)	0.117	0.159	0.171	0.223	0.300
No. sh.s o/s (m) - W.A.	1,039.3	1,067.9	1,067.9	1,067.9	1,067.9
No. sh.s o/s (m) - Y.E.	1,039.3	1,067.9	1,067.9	1,067.9	1,067.9
No. sh.s o/s (m) - F.D.	1,044.2	1,074.2	1,074.2	1,074.2	1,074.2
Margins (%)					
Gross	58.2	59.5	59.1	59.1	59.1
EBITDA	12.5	13.6	9.8	11.6	14.0
EBIT	8.9	10.0	7.4	8.3	9.6
Pre-tax	9.7	10.4	8.2	9.4	10.7
Net	8.0	8.5	6.6	7.6	8.7
Balance Sheet (HK\$m)					
Year to Dec					
Fixed assets	93.2	179.9	266.4	345.5	505.7
Intangible assets	14.8	311.9	301.7	290.5	278.1
Other LT assets	147.7	129.8	152.4	164.8	182.1
Cash	364.8	424.2	325.1	344.0	312.5
Accounts receivable	9.3	27.9	38.1	43.6	51.0
Other receivables	82.0	110.7	151.2	173.1	202.7
Inventories	196.3	323.7	442.2	506.1	592.7
Due from related co.s	82.4	41.1	45.2	49.7	54.7
Other current assets	2.6	3.3	3.5	3.8	4.1
Total assets	993.1	1,552.4	1,725.8	1,921.0	2,183.6
Accounts payable	(66.8)	(121.8)	(166.4)	(190.5)	(223.1)
Other payable	(71.6)	(140.2)	(191.5)	(219.2)	(256.7)
Tax payable	(19.4)	(30.5)	(32.7)	(42.8)	(57.5)
Due to related co.s	-	(15.6)	(18.7)	(22.4)	(26.9)
ST debts	-	(10.0)	-	-	-
Other current liab.	(0.4)	-	-	-	-
LT debts	-	-	-	-	-
Other LT liabilities	(8.1)	(13.4)	(14.3)	(15.3)	(16.4)
Total liabilities	(166.4)	(331.6)	(423.7)	(490.3)	(580.6)
Share capital	104.0	115.5	117.7	120.2	122.6
Reserves	722.8	1,105.4	1,184.4	1,310.6	1,480.4
Shareholders' funds	826.8	1,220.8	1,302.1	1,430.8	1,603.0
Minority interest	-	-	-	-	-
Total	826.8	1,220.8	1,302.1	1,430.8	1,603.0
Capital employed	826.8	1,230.8	1,302.1	1,430.8	1,603.0
Net (debt)/cash	364.8	414.2	325.1	344.0	312.5
Cash Flow (HK\$m)					
Year to Dec					
EBIT	136.0	201.8	204.7	263.5	356.1
Depre./amort.	55.9	73.6	65.1	102.4	161.0
Net int. paid	16.0	13.6	19.2	28.5	36.3
Tax paid	(23.3)	(2.2)	(37.6)	(50.1)	(68.6)
Dividends received	-	-	-	-	-
Gross cashflow	184.7	286.7	251.3	344.3	484.9
Chgs. in working cap.	(80.3)	(75.9)	(87.9)	(42.0)	(59.7)
Operating cashflow	104.3	210.8	163.4	302.4	425.3
Capex	(46.4)	(94.7)	(145.0)	(175.0)	(315.0)
Free cashflow	57.9	116.1	18.4	127.4	110.3
Dividends paid	(49.9)	(73.8)	(116.5)	(106.6)	(140.3)
Net distribution to MI	-	-	-	-	-
Investments	(72.9)	(20.8)	(5.6)	(7.3)	(8.3)
Disposals	0.7	(1.4)	1.8	2.5	3.6
New shares	0.1	(0.4)	-	-	-
Change in loans	-	-	-	-	-
Others	4.0	39.7	2.8	2.9	3.2
Net cashflow	(60.1)	59.4	(99.1)	18.9	(31.5)
Net (debt)/cash - Beg.	424.9	364.8	424.2	325.1	344.0
Net (debt)/cash - End.	364.8	424.2	325.1	344.0	312.5
Interim Results (HK\$m)	07A	08A			
Six months to Jun					
Turnover	673.3	808.0			
% chg		20.0%			
Profit from operations	37.5	44.1			
Interest expenses	8.1	10.0			
Associates	-	-			
Jointly-controlled entit.	(8.3)	(0.9)			
Pre-tax profit	37.3	53.2			
Tax	(6.1)	(9.1)			
Minority interests	-	-			
Net profit	31.2	44.1			
% chg		41.4%			
EPS (HK\$) - Basic	0.030	0.042			
DPS (HK\$)	-	0.021			
Shareholding Structure					
			Shares o/s (m)	%	
Sham Kar Wai & Family			672.07	58.2	
Glorious Sun Hlgs BVI Ltd			102.83	8.9	
Arisaig Partners Ltd			100.20	8.6	
Public			280.90	24.3	
Total			1,156.00	100.0	
Background					
Established in 1988, I.T is well-established as a trend setter in the fashion apparel retail market in Hong Kong. The Group is principally engaged in the retail sales of international brands such as Tsumori Chisato, licensed brands including Arnold and Palmer, i.t loves mickey and in-house brands, like b+ab and http://www.izzue.com . The Group operates FCUK stores in Hong Kong in a JV with French Connection since Nov 2003. Through GSIT, a JV with Glorious Sun, the Group operates the same business in the PRC.					
Key Ratios	07A	08A	09F	10F	11F
Net gearing (%)	Cash	Cash	Cash	Cash	Cash
Net ROE (%)	15.6	16.7	14.5	17.6	21.3
EBIT ROCE (%)	17.3	19.6	16.2	19.3	23.5
Dividend payout (%)	42.5	70.2	55.0	55.0	55.0
Effective tax rate (%)	17.4	18.8	18.8	18.8	18.8
Net interest coverage (x)	na	na	na	na	na
A/R turnover (days)	1.9	3.4	4.4	4.7	4.7
A/P turnover (days)	13.7	17.0	19.1	20.6	20.4
Stock turnover (days)	98.2	115.8	123.7	133.8	132.4

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