

## I.T: Dressing for success

### Recommendation: BUY (unchanged)

### Hong Kong Retail

Price	HK\$2.27	Year to Net profit	EPS	EPS	P/E	P/B	EV/EBITDA	Yield	ROE	ROCE	N. Gear.	
Target price	HK\$3.55 (+56.4%)	Feb	HK\$m	HK\$	Δ %	x	x	x	%	%	%	
12 mth range	HK\$1.25-3.18	06A	122.3	0.118	(25.3)	19.2	3.92	2.5	2.1	18.6	19.1	Cash
Market cap.	US\$336.0m	07A	122.5	0.118	0.0	19.3	3.16	2.1	2.2	18.2	19.4	Cash
Daily t/o, 3 mth	US\$1.08m	08F	164.8	0.152	28.8	14.9	2.27	1.6	3.1	15.6	19.4	Cash
Free float %	41.2%	09F	208.3	0.180	18.4	12.6	2.02	0.9	4.0	16.6	19.9	Cash
Ticker	0999.HK/999 HK	10F	258.9	0.224	51.7	10.1	1.83	0.6	4.9	19.9	20.5	Cash

Relative to Hang Seng Index (1 mth, 3 mth, 12 mth): -0.1, +0.3%, +26.8%

Actual price changes (1 mth, 3 mth, 12 mth): -5.8%, -13.7%, +46.5%

Consensus EPS (08F-09F): HK\$0.164, HK\$0.205

Previous forecasts (08F-09F): HK\$162.3m (\$0.156), HK\$203.8m (\$0.196), HK\$237.2m (\$0.228)

### Key points:

- Potential department store JV with Galeries Lafayette.
- GSIT acquisition completed.
- More than 40 stores planned in China in FY02/09F and 50 in FY02/10F.
- China to drive growth - sales to rise 54.2% in FY02/09F and 42.2% in FY12/10F.
- Hong Kong growth steady at 19.2% in FY12/08F, 12.9% in FY12/09F and 11.4% in FY02/10F.
- Net profit to grow at a three-year CAGR of 25.3% in FY02/08F-02/10F.
- Target price raise to HK\$3.55, based on a 19.7x P/E FY02/09F.

**JV with Galeries Lafayette.** On 1 Dec 2007, I.T entered into a non-binding MoU with Galeries Lafayette to form a 10-year JV to set up, manage and operate department stores under the “Galeries Lafayette” name in China. The exclusive nine-month agreement does not include projects in Shanghai, duty free shops and retail points in domestic airports. The companies are looking for locations in Beijing and Macau to set up their first department store. Once the lease terms are agreed, I.T and Galeries Lafayette will negotiate their JV.

**Galeries Lafayette - background.** Established in 1895, this leading department store in France offers private-label and designer apparel under biggest names in fashion, such as Christian Lacroix, Jean-Paul Gaultier, Valentino and Yves Saint Laurent. The company runs 64 department stores in France and Germany (total 500,000 sqm) and employs about 1,200 staff. Its total retail sales including VAT reached €2.4b in 2006.

**Future prospects.** I.T plans to invest up to HK\$200.0m to open two department stores in Beijing and Macau (including inventories) by end-2008 or in 2009. No contribution is expected before 2010. The company aims to negotiate leases of at least 10 years. Unlike traditional department store, 40% of its revenue will be generated by direct sales, which offer higher gross margin than concessions sales.

**Completion of GSIT acquisition.** I.T completed the acquisition of the remaining 50% in GSIT Ltd, its 50:50 JV with Glorious Sun (393 HK) on 29 Nov 2007, therefore only three months of GSIT’s results will be consolidated in FY02/08F. The JV is involved in the wholesale and retail of I.T’s international, licensed and in-house brands and French Connection in China and Taiwan. I.T bought the stake for a total of HK\$263.0m (HK\$80.0m in cash and the issue of 102.8m shares priced at HK\$1.78 each - 28 Sep closing price), which represented 9.9% of its basic share capital. At the same time, I.T purchased from Glorious Sun its Nanjing and Macao stores for HK\$20.0m in cash. GSIT was valued at HK\$526.1m, which represents 1.34x of revenue in 12 months to 31 Jul 2007.

**China expansion.** The company plans to open 40-50 stores per year and enter China’s first-tier and second-tier cities. We forecast that the company will have 102 stores in China in FY02/08F (total area: 192,700 sqf), 143 in FY02/09F (266,100 sqf) and 193 in FY02/10F (356,100 sqf). The target of tripling the area of self-managed stores to 450,000 sqf (at about 40.0% a year) will be reached in FY02/11F. We expect first net profit contributions from these new stores in FY02/10F. We expect I.T’s China sales to reach HK\$105.0m in FY02/08F

(5.4% of total turnover), HK\$647.6m (23.9%) in FY02/09F and HK\$920.5m (28.6%) in FY02/10F. China operations should break even in FY02/08F, as strong top line growth and increasing revenue based begins to offset operating cost. We forecast a same store sales growth around 30.0% in the next three years.

**Table 1: Distribution network of self-managed stores**

	FY02/07A	FY02/08F	FY02/09F	FY02/10F
<b>Hong Kong</b>				
Self-managed stores	156	166	169	175
Total floor area of self-managed stores	296,200 sqf	315,200 sqf	320,200 sqf	333,000 sqf
<b>China</b>				
Self-managed stores	104	102	143	193
Total floor area of self-managed stores	189,800 sqf	192,700 sqf	266,100 sqf	356,100 sqf
<b>Total</b>	<b>260</b>	<b>268</b>	<b>312</b>	<b>368</b>

Source: Company data, SBI E2-Capital

**Hong Kong – steady growth.** We expect Hong Kong revenue to increase 19.2% YoY to HK\$1,824.0m in FY02/08F, 12.9% to HK\$2,058.8m in FY02/09F and 11.4% to HK\$2,293.8m in FY02/10F. The sales of in-house brands increased 50.9% in 1H FY02/08A and the trend is expected to continue in 2H. In-house brands are Hong Kong operations' key growth driver and should account for 45.4% of the total in FY02/08F, 49.4% in FY02/09F and 51.0% in FY02/10F. The company plans to increase the number of stores 5.0-10.0% a year (average 10 stores) and the footage of stores.

**Margin climb.** We expect Hong Kong's overall gross margin to reach 59.0% in FY02/08F, 59.7% in FY02/09F and 60.1% in FY02/10F boosted by the rising sales of high-margin (65.0-70.0%) in-house brands. China's overall gross margin should reach 54.0% FY02/08F, 54.2% in FY02/09F and 54.8% in FY02/10F, as I.T's retail operations (higher margin) are expanding faster than franchise operations. As a result, its overall gross margin should reach 58.7% in FY02/08F, 58.4% in FY02/09F and 58.6% in FY02/10F.

### 3Q FY02/08 results recap

- **China - strengthening.** Total retail sales grew 15.0% in 3Q (47.0% YoY in first nine months) and same-store sales 16.0% YoY (30.0% in first nine months). The slower 3Q retail sales growth was mainly due to lower orders (some shops were closed for renovation) and efforts to clear old inventory, which eroded the gross margin. We expect the winter collection (launched in November) to boost growth in 4Q FY02/08F.
- **Hong Kong - better than expected.** Total retail sales rose 31.0% in 3Q (24.0% in first nine months) and same-store sales 23.0% YoY (19.0% in first nine months), mainly due to strong sales of in-house brands. Chocolate and Vanilla Suite contributed more than 7.0% of total sales and same-store sales of b+ab and 5cm both grew 40.0% in 3Q FY02/08A. In total, same-store sales of in-house brands rose 30.0% YoY.

**Table 2 : 3Q growth in Hong Kong and China**

YoY growth rate (%)	Total retail sales		Same-store sales	
	3Q FY02/08A	1-3Q FY02/08A	3Q FY02/08A	1-3Q FY02/08A
Hong Kong	31.0	24.0	23.0	19.0
China	15.0	47.0	16.0	30.0

Source: Company data

**Valuation.** Given its robust sales in Hong Kong and future strong growth in China, we expect I.T's net profit to grow at a CAGR of 25.3% in FY02/08F-02/10F. We estimate its net profit will increase 34.5% to HK\$164.8m in FY02/08F, 26.5% to HK\$208.5m in FY02/09F and 24.3% to HK\$259.2m in FY02/10F. The counter is currently trading at 14.9x P/E and 12.6x P/E, respectively based on our FY02/08F and FY02/09F net profit estimate. Using the sum-of-the parts method, we raise our target price to HK\$3.55 (from HK\$3.50), which represents 19.7x P/E in FY02/09F and is based on an earnings multiple of 14.7x P/E for Hong Kong operations and 31.0x P/E for the China segment.

**Table 3: Peer valuation**

Name	Ticker	Price (HK\$)	Market Cap. (US\$m)	P/E (x) 1-yr fwd	P/E (x ) 2-yr fwd	ROE (%)	PEG 1-yr fwd (%)	Yield (%)
<b>HK retailers</b>								
Dickson Concept	113 HK	5.75	274.5	9.5	7.5	13.7	0.95	5.1
Esprit	330 HK	98.40	15,676.8	18.5	15.4	48.9	0.77	1.7
YGM	375 HK	5.20	102.6	6.3	n.a.	16.8	n.a.	7.7
Glorious Sun	393 HK	4.08	554.2	14.2	12.8	16.0	0.99	4.2
Bauhaus	483 HK	1.68	77.4	8.4	6.7	18.4	n.a.	2.9
Giordano	709 HK	3.09	590.9	14.8	13.1	10.0	0.73	117.9
Lifestyle	1212 HK	20.00	4,374.4	34.6	32.7	20.6	1.22	1.4
<b>Average</b>				<b>15.2</b>	<b>14.7</b>	<b>20.6</b>	<b>0.93</b>	<b>20.1</b>
<b>PRC retailers</b>								
Ports	589 HK	23.00	1,647.5	32.6	25.3	30.4	0.99	1.6
Prime Success	210 HK	4.25	892.4	18.1	14.2	33.8	0.65	0.6
Belle	1880 HK	9.45	10,227.0	41.1	33.3	56.4	0.91	n.a.
Li Ning	2331 HK	24.85	3,308.8	57.7	39.2	23.0	1.30	0.7
Parkson	3368 HK	75.50	5,393.6	61.9	43.1	23.0	1.41	1.1
<b>Average</b>				<b>42.3</b>	<b>31.0</b>	<b>33.3</b>	<b>1.05</b>	<b>1.0</b>

Source: Bloomberg, SBI E2-Capital

**Table 4: P&L**

Year to Feb (HK\$m)	FY02/06A	FY02/07A	FY02/08F	FY02/09F	FY02/10F
<b>Revenue</b>					
Hong Kong	1,314.4	1,530.8	1,824.0	2,058.8	2,293.8
China	-	-	105.0	647.6	920.5
<b>Total revenue</b>	<b>1,314.4</b>	<b>1,530.8</b>	<b>1,929.0</b>	<b>2,706.4</b>	<b>3,214.4</b>
Cost of sales	(540.2)	(640.5)	(796.9)	(1,126.6)	(1,332.0)
<b>Gross profit</b>	<b>774.2</b>	<b>890.3</b>	<b>1,132.1</b>	<b>1,579.8</b>	<b>1,882.3</b>
Other gains/(losses)	(0.3)	(4.3)	-	-	-
Operating expenses	(642.6)	(749.9)	(952.8)	(1,348.2)	(1,591.4)
<b>Operating profit</b>	<b>131.4</b>	<b>136.1</b>	<b>179.3</b>	<b>231.6</b>	<b>291.0</b>
Finance costs - net	(1.7)	(0.6)	(4.4)	(4.8)	(5.3)
Share of losses of jointly controlled entities	4.2	(3.9)	5.0	6.3	7.5
<b>Profit before tax</b>	<b>150.6</b>	<b>148.2</b>	<b>198.3</b>	<b>253.2</b>	<b>315.3</b>
Income tax	(28.3)	(25.7)	(33.5)	(44.9)	(56.4)
<b>Profit for the year</b>	<b>122.3</b>	<b>122.5</b>	<b>164.8</b>	<b>208.3</b>	<b>258.9</b>
Dividends	49.9	52.0	82.4	104.1	129.5

Source: Company data, SBI E2-Capital

P & L (HK\$ m)	06A	07A	08F	09F	10F
<b>Year to Feb</b>					
<b>Turnover</b>	<b>1,314.4</b>	<b>1,530.8</b>	<b>1,929.0</b>	<b>2,706.4</b>	<b>3,214.4</b>
% chg	26.3	16.5	26.0	40.3	18.8
Gross profit	774.2	890.3	1,132.1	1,579.8	1,882.3
EBITDA	199.8	208.6	268.2	362.3	421.2
Depre./amort.	(51.8)	(55.9)	(70.6)	(110.6)	(108.1)
EBIT	148.0	152.7	197.6	251.7	313.1
Net int. income/(exp.)	(1.7)	(0.6)	(4.4)	(4.8)	(5.3)
Exceptionals	-	-	-	-	-
Associates	4.2	(3.9)	5.0	6.3	7.5
Jointly-controlled entit.	-	-	-	-	-
<b>Pre-tax profit</b>	<b>150.6</b>	<b>148.2</b>	<b>198.3</b>	<b>253.2</b>	<b>315.3</b>
Tax	(28.3)	(25.7)	(33.5)	(44.9)	(56.4)
Minority interests	-	-	-	-	-
<b>Net profit</b>	<b>122.3</b>	<b>122.5</b>	<b>164.8</b>	<b>208.3</b>	<b>258.9</b>
% chg	9.8	0.2	34.5	26.4	24.3
Dividends	49.9	52.0	82.4	104.1	129.5
Retained earnings	72.4	70.5	247.2	312.4	388.4
EPS - Basic	0.118	0.118	0.152	0.180	0.224
EPS - F.D.	0.118	0.117	0.143	0.180	0.224
DPS	0.048	0.050	0.071	0.090	0.112
No. sh.s o/s (m) - W.A.	1,035.5	1,039.3	1,083.9	1,154.7	1,154.7
No. sh.s o/s (m) - Y.E.	1,035.5	1,039.3	1,154.7	1,154.7	1,154.7
No. sh.s o/s (m) - F.D.	1,040.8	1,044.2	1,154.7	1,154.7	1,154.7
<b>Margins (%)</b>					
Gross	58.9	58.2	58.7	58.4	58.6
EBITDA	15.2	13.6	13.9	13.4	13.1
EBIT	11.3	10.0	10.2	9.3	9.7
Pre-tax	11.5	9.7	10.3	9.4	9.8
Net	9.3	8.0	8.5	7.7	8.1
<b>Balance Sheet (HK\$ m)</b>					
<b>Year to Feb</b>					
Fixed assets	97.2	93.2	178.4	282.9	399.7
Intangible assets	19.2	14.8	39.0	42.9	47.1
Other LT assets	96.8	147.7	342.7	376.9	414.6
Cash	424.9	364.8	357.9	260.0	176.0
Accounts receivable	52.3	91.3	167.2	234.6	278.6
Other receivables	-	-	-	-	-
Inventories	147.4	196.3	334.3	469.0	557.0
Due from related co.s	44.6	82.4	0.4	0.4	0.4
Other current assets	0.8	2.6	40.1	44.2	48.6
<b>Total assets</b>	<b>883.2</b>	<b>993.1</b>	<b>1,459.9</b>	<b>1,710.7</b>	<b>1,922.1</b>
Accounts payable	(48.2)	(66.8)	(109.7)	(155.0)	(183.3)
Other payable	(62.7)	(71.7)	(128.0)	(180.9)	(213.9)
Tax payable	(9.9)	(19.4)	(37.5)	(47.9)	(59.7)
Due to related co.s	-	-	(15.4)	(16.9)	(18.6)
ST debts	-	-	-	-	-
Other current liab.	(2.4)	(0.4)	-	-	-
LT debts	-	-	-	-	-
Other LT liabilities	(12.6)	(8.1)	(13.4)	(13.9)	(14.5)
<b>Total liabilities</b>	<b>(135.8)</b>	<b>(166.4)</b>	<b>(303.9)</b>	<b>(414.7)</b>	<b>(490.0)</b>
Share capital	103.9	103.9	103.9	103.9	103.9
Reserves	643.5	722.8	1,052.1	1,192.1	1,328.1
<b>Shareholders' funds</b>	<b>747.4</b>	<b>826.7</b>	<b>1,156.0</b>	<b>1,296.0</b>	<b>1,432.0</b>
Minority interest	-	-	-	-	-
<b>Total</b>	<b>747.4</b>	<b>826.7</b>	<b>1,156.0</b>	<b>1,296.0</b>	<b>1,432.0</b>
Capital employed	747.4	826.7	1,156.0	1,296.0	1,432.0
Net (debt)/cash	424.9	364.8	357.9	260.0	176.0
<b>Cash Flow (HK\$ m)</b>					
<b>Year to Feb</b>					
EBIT	148.0	152.7	197.6	251.7	313.1
Depre./amort.	51.8	55.9	70.6	110.6	108.1
Net int. paid	(1.7)	(0.6)	(4.4)	(4.8)	(5.3)
Tax paid	(24.4)	(23.1)	(19.3)	(34.9)	(45.0)
Dividends received	-	-	-	-	-
<b>Gross cashflow</b>	<b>173.7</b>	<b>184.9</b>	<b>244.5</b>	<b>322.6</b>	<b>370.9</b>
Chgs. in working cap.	(35.2)	(80.3)	(48.2)	(103.8)	(103.8)
<b>Operating cashflow</b>	<b>138.5</b>	<b>104.6</b>	<b>196.4</b>	<b>218.8</b>	<b>267.2</b>
Capex	(110.7)	(42.4)	(388.0)	(215.0)	(225.0)
<b>Free cashflow</b>	<b>27.9</b>	<b>62.2</b>	<b>(191.6)</b>	<b>3.8</b>	<b>42.2</b>
Dividends paid	(44.6)	(49.9)	(82.4)	(104.1)	(129.5)
Net distribution to MI	-	-	(0.2)	-	-
Investments	(110.7)	(42.4)	(388.0)	(215.0)	(225.0)
Disposals	-	0.7	-	-	-
New shares	73.3	0.1	183.0	-	-
Others	99.2	(30.7)	472.3	217.4	228.3
<b>Net cashflow</b>	<b>45.1</b>	<b>(60.1)</b>	<b>(6.9)</b>	<b>(97.9)</b>	<b>(84.0)</b>
Net (debt)/cash - Beg.	379.8	424.9	364.8	357.9	260.0
Net (debt)/cash - End.	424.9	364.8	357.9	260.0	176.0
<b>Interim Results (HK\$ m)</b>	<b>06A</b>	<b>07A</b>	<b>08A</b>		
<b>Six months to Sep</b>					
<b>Turnover</b>	<b>568.1</b>	<b>673.3</b>	<b>808.0</b>		
% chg	37.4	18.5	20.0		
Profit from operations	41.4	45.9	54.2		
Interest expenses	(1.0)	(0.3)	(0.1)		
Associates	-	-	-		
Jointly-controlled entit.	(1.9)	(8.3)	(0.9)		
<b>Pre-tax profit</b>	<b>38.5</b>	<b>37.3</b>	<b>53.2</b>		
Tax	(8.3)	(6.1)	(9.1)		
Minority interests	-	-	-		
<b>Net profit</b>	<b>30.2</b>	<b>31.2</b>	<b>44.1</b>		
% chg	(8.3)	3.4	41.3		
EPS (HK\$) - W.A.	0.029	0.030	0.042		
DPS (HK\$)	-	-	0.021		
<b>Shareholding Structure</b>					
				<b>Shares o/s (m)</b>	<b>%</b>
Sham Kar Wai & Family				672.1	58.8
Glorious Sun Hlgs BVI Ltd				102.8	9.9
Arisaig Partners Ltd				100.2	8.8
Public				279.6	22.5
<b>Total</b>				<b>1,154.7</b>	<b>100.0</b>
<b>Background</b>					
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 <a href="http://www.izzue.com">http://www.izzue.com</a> . 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.					
<b>Key Ratios</b>	<b>06A</b>	<b>07A</b>	<b>08F</b>	<b>09F</b>	<b>10F</b>
Net gearing	Cash	Cash	Cash	Cash	Cash
NET ROE	18.2	15.6	16.6	17.0	19.0
EBIT ROCE	19.4	19.4	19.9	20.5	23.0
Dividend payout ratio	(40.8)	(42.4)	(50.0)	(50.0)	(50.0)
Effective tax rate	18.8	17.3	16.9	17.7	17.9
Net interest cover. (x)	88.9	254.5	45.3	52.4	59.3
A/R days	12.7	17.1	24.5	27.1	29.1
A/P days	30.1	32.8	40.4	42.9	46.4
Inventory days	84.0	97.9	121.5	130.1	140.6

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