

I.T.

Expect to recover

to summarize...

- Hong Kong retail market started reovering from September 2009, which would be a positive sign for the development of I.T.
- China retail market is keeping growth while I.T. currently has 114 self-management I.T. 's brand stores in China.
- Revenue increased only 5.2% in 1H FY02/09A while the net profit increased 198.3% mainly because of some non-operation items.
- Expect the 2H FY02/10F could have a better growth than 1H FY02/09 with estimated 14.4% YoY growth in top line.
- Without the goodwill impairment effect and recovery of global economics, we expect that the net profit to be HK\$148.2m for FY02/10F and HK\$175.4m for FY02/11F.

- BUY call with target price of HK\$1.98.

Hong Kong retail market started recovering from September 2009. The statistic from HKSAR government Census and statistics department shows that the retail sales in Hong Kong started to have a positive YoY growth in September 2009 after a 7 months negative YoY growth. The retail sales increased 16.1% YoY in December 2009 with sales volume up 11.4% YoY. Although the high base of comparison due to the timing of the Chinese New Year, which fell in January in 2009 but February in 2010, the retail sales increase estimated to be 6.6% YoY for January 2010 with 3.2% volume YoY growth. With 70.9% of total revenue from Hong Kong in 1H FY02/10A, we would expect that the company is possible to show a much better performance in 2H than 1H.

China retail market keeps growing. Although affected by the financial crisis, the total value of retail market in China has 15.6% YoY growth based on the data released by the National Bureau of Statistics of China. Also, the statistics from China's Ministry of Commerce show that the retail sales during the week of Chinese New Year increased 17.2% comparing the Chinese New Year week last year. Some newspaper reports said that it has been observed that the growth was mainly driven by the ASP growth. Although I.T. has taken a cautious development strategy for expansion in China, its management has been actively exploring potential breakout opportunities. By the end of August 2009, the company has opened 147 I.T.'s brand store including 114 self managed stores and 33 franchised stores.

1H FY02/10A results. For 1H FY12/10A, the revenue increased 5.2% YoY to HK\$1,214.6m while the net profit increased 198.3% YoY to HK\$44.8m. The gross margin narrowed 2.0 pcp YoY to 58.8%. The results in different market are quite diversified:

- Hong Kong Market. The revenue decreased 1.2% YoY to HK\$879.9m accounting for 70.9% of total revenue, but the operating profit increased 317.3% YoY to HK\$69.1m. The gross margin squeezed 2.6 pcp YoY to 59.5%. The top line was down because of the financial crisis while the gross margin decreased because of decreasing in ASP and increasing rental cost. However, the operation profit was up mainly because of the tight control of operating expenses, such as headquarter expenses and advertisement, and one-off sponsorship of HK\$13.2m.
- Mainland China Market. The revenue increased 21.4% YoY to HK\$322.2m accounting for 25.9% of total revenue while the company recorded an operating loss of HK\$17.4m. The top line growth was mainly because the same store sales increase of 16.4% YoY while the in-house brand sales increased 36.3% YoY and international brand sales increased 23.4% YoY.

Please refer to important disclosures at the end of this report

Ticker	999 HK
Rating	BUY(from HOLD)
Price (HK\$)	1.41
Target Price (HK\$)	1.98(+38%)
12m Price Range (HK\$)	0.40-1.61
Market cap. (US\$m)	208.9
Daily t/o (US\$m)	0.3
Free float (%)	30.7

Financial summary

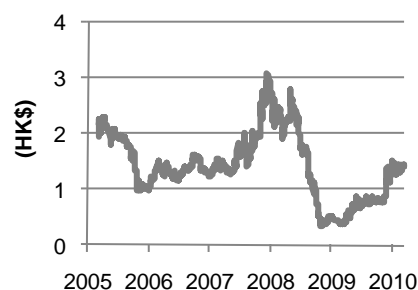
Year to Feb	08A	09A	10F	11F	12F
Turnover (HK\$m)	2,021.32	733.33	018.33	462.53	808.7
Net Profit (HK\$m)	171.0	42.5	148.2	175.4	186.8
EPS (HK\$)	0.159	0.037	0.128	0.152	0.162
P/E (x)	8.9	38.4	11.0	9.3	8.7
P/B (x)	1.2	1.3	1.2	1.0	0.9
EV/EBITDA (x)	4.0	5.4	3.8	2.9	2.3
Yield (%)	8.0	-	-	-	-
ROE (%)	16.7	3.5	11.3	11.8	11.3
ROCE (%)	19.6	5.6	12.8	13.7	13.1
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

Source: SBI/Bloomberg

	10F	11F	12F
Consensus EPS (HK\$)	0.100	0.150	0.190
Previous earnings (HK\$m)	83.7	175.1	-
Previous EPS (HK\$)	0.066	0.138	-

Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	+4.0	+21.4	+113.4
Actual price changes (%)	+6.8	+20.5	+248.1



Source: Bloomberg

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The gross profit decreased 3.7 pcp YoY to 51.9% affected by the lower ASP and increasing rental expenses. The operating loss was mainly because of: 1) increase of non-cash depreciation charge of HK\$11m; 2) the operating expenses.

- Other Market. The revenue from other market increased 165.1% YoY to HK\$39.5m while it reported an operating profit of HK\$1.9m from loss of HK\$5.7m. We think the growth was mainly come from its new opened stores in France.

Table 1. 1H FY02/10A financial analysis

	1HFY02/10			1HFY02/09			YoY(%)
	Revenue (HK\$m)	Gross Margin(%)	Operating Margin (%)	Revenue (HK\$m)	Gross Margin(%)	Operating Margin (%)	
6months to August							
Hong Kong Retail	879.9	55.9	7.9	900.0	62.1	1.8	(2.2)
Mainland China Retail	322.2	51.9	loss	265.3	55.6	1.9	21.4
Other Market	39.5	-	4.9	14.9	-	loss	165.1
Total	1241.6	58.8	4.3	1180.2	60.8	1.3	5.2

Source: Company data

Table 2. 1H FY02/10A store coverage

	Self-managed		Franchised	
	By Aug 2009	By Feb 2009	By Aug 2009	By Feb 2009
6months to August				
Hong Kong				
I.T.	167	176		
FCUK IT*	6	7		
ZIT H.K.*	1	1		
Mainland China				
I.T.	114	112	33	42
FCIT China*	14	15	3	6
Other Market				
I.T.	16	17	17	19
FCIT Macau*	2	2		

*50% owned joint venture of the company

Source: Company data

Introducing our estimate. Based on current market environment, we updated our estimate from our previous report issued in February 2009 when we did not expect the market to recover so quickly. Our current estimate for I.T.'s sales to be HK\$3,018.3m in FY02/2010F and 3,462.5m in FY02/2011F while its net profit to be HK\$148.2m in FY02/2010F and HK\$175.4m in FY02/2011F. The estimate for each market is as follows:

- Hong Kong Market. We assume that the sales of in-house brand in 2H FY02/10F would increase 10.0% YoY and international brand increase 5% YoY benefiting from recovered market to get the total sales in FY02/10 of HK\$2,089.9m. The sales in FY02/11 would increase 12.0% for in-house brand and 8.0% for international brand in FY02/11F to get the total sales in FY02/11 of HK\$2,290.1.
- Mainland China Market. We assume that the sales of in-house brand in 2H FY02/10F would increase 37.0% YoY and international brand increase 25% YoY following up the growth trend in 1H FY02/10 to get the total sales in FY02/10 of HK\$777.2m. The sales in FY02/11 would increase 30.0% for in-house brand and 15.0% for international brand in FY02/11F to get the total sales in FY02/11 of HK\$945.6m.
- Other Market. We expect that the revenue from other market will keep high growth with its low base, We assume the revenue would increased 60.0% YoY to HK\$151.2m for 2H FY02/10F while revenue would increase 50% YoY to HK\$226.8m for FY02/11.

We estimate that the gross margin would get increased to 60.4% in 2H FY02/10F from 57.6% in the same period last year thanks for the economy recovering to allow the company to sell the product in a higher average selling price and the gross margin would improve further to 60.7% for FY02/11F. We assume that the operating expenses accounting for total sales would be at 54.6% for FY02/10F and 54.7% for FY02/11F. Based on our talk with the management, the impairment of goodwill of HK\$59.6m in 2HFY02/09A and HK\$4.1m in 1H FY02/10A would be one-off items.

Our forecasted net profit would be HK\$148.2m for FY02/10F and HK\$175.4m for FY02/11F. Our current estimate is based on the company's existing development strategy. The new development of the company's strategy, particularly its strategy towards the market in mainland China, could possibly affect our current estimate.

Upgrade to BUY from HOLD. Based on WACC of 13.0% and terminal growth rate of 1%, our DCF derived fair value for the counter is HK\$2.2 per share. We apply for a 10% discount on this fair value in considering its current liquidity level to get HK\$1.98, representing 15.4x FY02/10F and 13.0x FY02/11F. We upgrade our call for the counter from HOLD to BUY. The counter is currently trading at 11.0x FY02/10F P/E, which is 48.4% and 36.4% discount to the average of its other peers of 21.3x one year and 17.3x two year forward P/E respectively.

Table 3. Valuation comparison

Company name	Ticker	Mkt cap (US\$m)	Last Price (Local)	His P/E (x)	1-Yr P/E (x)	2-Yr P/E (x)	PB (x)	Est ROE (%)
PORTS DESIGN LTD	589 HK	1533.5	21.2	23.6	22.4	19.2	7.9	41.3
BOSIDENG INTL	3998 HK	1715.0	1.7	15.5	12.9	12.3	1.9	10.9
CHINA LILANG LTD	1234 HK	1069.9	7.0	31.5	24.3	19.6	-	52.7
TRINITY LTD	891 HK	1191.5	5.9	539.4	52.2	41.3	-	8.0
ESPRIT HLDGS	330 HK	9647.4	58.8	16.3	15.1	12.9	4.4	31.3
GIORDANO INTL	709 HK	470.7	2.5	29.6	22.8	15.7	2.0	16.5
GLORIOUS SUN ENT	393 HK	377.8	2.8	54.1	10.1	8.4	1.6	4.3
TEXWINCA HLDG	321 HK	1354.0	7.9	11.8	10.5	9.1	2.4	21.6
<i>Average</i>				<i>90.2</i>	<i>21.3</i>	<i>17.3</i>		

Source: Bloomberg

Table 4. P & L

Year to Feb (HK\$m)	08A	09A	10F	11F	12F
Revenue	2,021.3	2,733.3	3,018.3	3,462.5	3,808.7
Cost of sales	(819.4)	(1,121.6)	(1,216.1)	(1,359.4)	(1,483.9)
Gross profit	1,201.9	1,611.7	1,802.2	2,103.1	2,324.8
Other gains/(losses)	1.9	(11.1)	29.7	2.0	-
Impairment of goodwill	-	(59.6)	(4.1)	-	-
Operating expenses	(1,002.0)	(1,468.9)	(1,647.5)	(1,894.6)	(2,102.4)
Operating profit	201.7	72.1	180.3	210.5	222.4
Finance income	13.6	2.8	1.5	4.6	6.5
profit from JV	(4.8)	3.9	3.5	4.2	4.6
Profit before tax	210.5	78.9	185.3	219.2	233.5
Income tax expense	(39.5)	(36.4)	(37.1)	(43.8)	(46.7)
Net profit	171.0	42.5	148.2	175.4	186.8

Source: Company data

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