

Li & Fung

Promotions are the new norm; not an inspiring FY15

Li & Fung reported weak FY14 results, with sales flat and COP down 18% y/y, 3.8% below our estimate. Weak results should not be a surprise, given the highly promotional retail environment in 2014 and particularly weak Europe trading. Management noted that margin weakness in 2014 was due mainly to investments and a business mix shift, with low-margin agency business outperforming high-margin principal business. Management expects the promotional environment to be the new norm, but also shared some optimism related to the oil price decline and its positive impact on 2H15 orders. With management indicating 2015 to be promotional and the agency business continuing to outperform principal, we turn more cautious on margin improvement in FY15. We cut our FY15 sales and COP estimates by 1% and 8%, respectively. We now expect c6% sales and c12% COP growth in FY15 and believe the stock trades at a relatively stretched c17.9x P/E, based on our revised FY15 estimates. Despite the decline in COP, Li & Fung kept DPS flat, and we maintain our Neutral rating, supported mainly by the dividend yield.

- **Weak trading business:** Trading business posted flat turnover, with the U.S. flat, Europe slightly down and Asia up 2% y/y. Margins were weak due to investments and business shifting to agency. As a result, FY14 COP declined c20% y/y. For FY15, we build in 5% sales growth, helped by a stronger 2H and a 20bps improvement in COP margin, as we expect operating expenses to increase LSD, given that major investments were done in FY14.
- **Solid logistics top line, but COP margin down:** The logistics business posted solid 66% growth in turnover. However, the mix change to lower-margin global freight business (following CCL integration) from in-country logistics dragged down the COP margin by 160bps in FY14. We expect top-line growth to remain strong and margins stable for the logistics business.

Li & Fung (Reuters: 0494.HK, Bloomberg: 494 HK)

\$ in mn, year-end Dec	FY12A	FY13A	FY14A	FY15E	FY16E
Revenue (\$ mn)	20,222	19,026	19,288	20,515	21,678
Net Profit (\$ mn)	617	726	441	480	549
EPS (\$)	0.07	0.09	0.05	0.06	0.07
Recurring EPS (\$)	0.06	0.06	0.05	0.06	0.07
DPS (\$)	0.04	0.05	0.05	0.05	0.06
Revenue growth (%)	1.0%	(5.9%)	1.4%	6.4%	5.7%
Net Profit growth (%)	(9.4%)	17.5%	(39.2%)	8.8%	14.2%
Recurring profit growth	(19.5%)	7.1%	(21.9%)	14.4%	14.2%
EPS growth (%)	(11.6%)	16.6%	(39.2%)	8.8%	14.2%
ROE	11.1%	10.1%	9.7%	15.3%	17.0%
ROA	4.4%	4.4%	4.0%	5.6%	6.2%
P/E (x)	17.1	16.1	20.6	18.0	15.8
P/BV (x)	1.7	1.6	2.8	2.7	2.6
EV/EBITDA (x)	91.5	69.4	75.6	86.8	78.9
Dividend Yield	3.9%	5.1%	5.1%	5.1%	5.6%

Source: Company data, Bloomberg, J.P. Morgan estimates.

Neutral

0494.HK, 494 HK

Price: HK\$8.03

▼ Price Target: HK\$7.50
Previous: HK\$8.00

Hong Kong Apparel Retailing

Ebru Sener Kurumlu ^{AC}

(852) 2800-8521

ebru.sener@jpmorgan.com

Bloomberg JPMA KURUMLU <GO>

Shen Li, CFA

(852) 2800 8523

shen.w.li@jpmorgan.com

George Hsu

(852) 2800-8559

george.hsu@jpmorgan.com

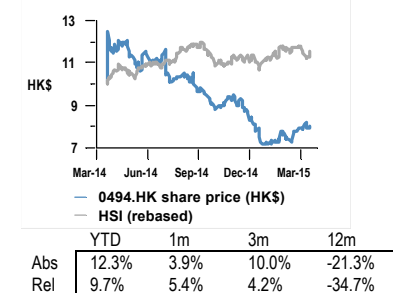
Dylan Chu

(852) 2800-8537

dylan.chu@jpmorgan.com

J.P. Morgan Securities (Asia Pacific) Limited

Price Performance



Company Data

Shares O/S (mn)	8,287
Market Cap (\$ mn)	8,576
Market Cap (\$ mn)	8,576
Price (HK\$)	8.03
Date Of Price	19 Mar 15
Free Float(%)	65.8%
3M - Avg daily vol (mn)	25.96
3M - Avg daily val (HK\$ mn)	195.60
3M - Avg daily val (\$ mn)	25.2
HSI	24,468.89
Exchange Rate	7.76
Price Target End Date	31-Dec-15
Price Target (HK\$)	7.50

See page 7 for analyst certification and important disclosures, including non-US analyst disclosures.

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<p>Key catalyst for the stock price: Re-rating from better orders and margin outlook and upside to dividend payout</p>	<p>Upside risks to our view: Higher-than-expected growth in trading business in 2015 Margin improvement better than expected for trading business</p>	<p>Downside risks to our view: Notable operating deleverage impacting 2014 earnings 2015 recovery in U.S. orders not coming through as expected Europe remains particularly weak, dragging down overall performance</p>
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Key financial metrics	FY13A	FY14A	FY15E	FY16E
Revenues (LC)	19,026	19,288	20,515	21,678
Revenue growth (%)	-5.9%	1.4%	6.4%	5.7%
EBITDA (LC)	922	839	728	798
EBITDA margin (%)	4.8%	4.3%	3.5%	3.7%
Tax rate (%)	10.1%	9.4%	9.4%	9.4%
Net profit (LC)	726	441	480	549
EPS (LC)	0.09	0.05	0.06	0.07
EPS growth (%)	16.6%	-39.2%	8.8%	14.2%
DPS (LC)	0.05	0.05	0.05	0.06
BVPS (LC)	0.66	0.37	0.38	0.39
Operating cash flow (LC mn)	853	638	740	798
Free cash flow (LC mn)	882	654	778	831
Interest cover (X)	9.4	8.5	8.5	9.8
Net margin (%)	3.8%	2.3%	2.3%	2.5%
Sales/assets (X)	1.6x	1.8x	2.4x	2.5x
Debt/equity (%)	42.1%	56.0%	53.3%	50.2%
Net debt/equity (%)	33.8%	38.7%	32.4%	24.6%
ROE (%)	10.1%	9.7%	15.3%	17.0%
Key model assumptions	FY13A	FY14A	FY15E	FY16E
Sales growth	-5.9%	1.4%	6.4%	5.7%
Gross margin	11.7%	11.3%	11.4%	11.6%
Operating margin	4.3%	3.8%	3.0%	3.1%

Source: Company and J.P. Morgan estimates.

Sensitivity analysis	EBITDA		EPS	
	FY15E	FY16E	FY15E	FY16E
Sensitivity to				
2% decrease in sales	-67.2%	-63.9%	-85.4%	-79.0%
1% decrease in GM	-3.8%	-3.7%	-3.8%	-3.7%
1% decrease in opex % of sales	2.9%	2.8%	2.9%	2.8%

Source: J.P. Morgan estimates.

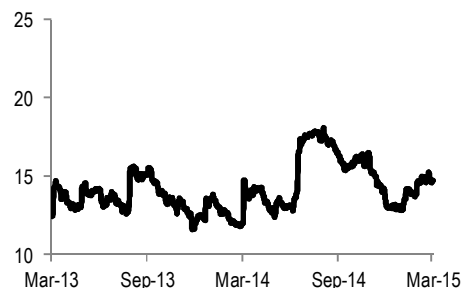
Comparative metrics	CMP (LC)	Mkt cap (\$M)	P/E		EV/EBITDA		P/BV		YTD stock perf.
			FY15E	FY16E	FY15E	FY16E	FY15E	FY16E	
LI & FUNG LTD	8.0	8,653	15.2x	13.8x	11.1x	10.1x	2.2x	2.1x	10.6%
MAKALOT INDUSTRI	211.5	1,283	19.4x	15.9x	NA	NA	5.3x	4.3x	25.1%
ECLAT TEXTILE CO	381.5	3,163	26.3x	20.3x	NA	NA	8.5x	7.0x	18.8%
SHENZHOU INTL GP	31.7	5,707	15.9x	13.8x	9.9x	8.5x	2.7x	2.4x	23.6%

Source: Bloomberg, J.P. Morgan estimates.

Valuation and price target basis

Our Dec-15 PT of HK\$7.50 is based on a 16.5x one-year forward P/E. This is a 30% discount to the five-year average P/E of 23.5x before 2008 (when brands group income was relatively small). We apply the discount to reflect a slower earnings growth profile. Our PT is revised down due to earnings cuts.

Li & Fung - Forward P/E



Source: Bloomberg, Company and J.P. Morgan estimates.

JPM vs. consensus, change in estimates

EPS	FY15E	FY16E
JPM old	0.06	0.07
JPM new	0.06	0.07
% chg	-5.5%	-7.6%
Consensus	0.07	0.08

Source: Bloomberg, J.P. Morgan estimates.

Table 1: Estimate revisions

US\$ in millions	Old		New		% Change	
	FY15E	FY16E	FY15E	FY16E	FY15E	FY16E
Revenue	20,809	22,330	20,515	21,678	-1.4%	-2.9%
Revenue growth y/y	7.2%	7.3%	6.4%	5.7%		
Gross profit	2,498	2,722	2,333	2,521	-6.6%	-7.4%
Gross margin	12.0%	12.2%	11.4%	11.6%		
EBIT	656	741	610	678	-6.9%	-8.5%
Core Operating Profit (COP)	739	829	676	747	-8.4%	-9.8%
COP margin	3.5%	3.7%	3.3%	3.4%		
NPAT	508	594	480	549	-5.5%	-7.6%
NPAT growth y/y	30.1%	16.9%	8.9%	14.2%		
Diluted EPS	0.06	0.07	0.06	0.07	-5.5%	-7.6%

Source: J.P. Morgan estimates.

Table 2: 2H14 results vs. J.P. Morgan estimates

US\$ in millions	2H13A	2H14A	% chg y/y	2H14E	Actual/Est
Sales	10,559	10,579	0.2%	10,702	-1.2%
Gross profit	1,264	1,214	-4.0%	1,309	-7.3%
Gross margin	12.0%	11.5%		12.2%	
Total operating expenses	-821	-872	6.2%	-960	-9.1%
as % of sales	-7.8%	-8.2%		-9.0%	
Operating profit	593	524	-11.6%	349	50.1%
Operating margin	5.6%	5.0%		3.3%	
Other revenues	46	35	-22.5%	52	-31.7%
COP reported by the company	489	377	-22.8%	401	-5.9%
COP margin	4.6%	3.6%		3.7%	
Write back of acquisition payable	113	78		0	
Net interest income	-52	-46		-39	16.1%
Profit of associates	0	1		0	
Pre-tax profit	565	384	-32.0%	332	15.6%
Tax	-45	-40	-10.7%	-37	7.2%
Tax rate	-8.0%	-10.5%		-11.3%	
Net profit	520	344	-33.9%	295	16.7%
Attributable to Perpetual security holders	-15	-15		-15	0.0%
Minority interest	0	1		-1	
Attributable net profit	667	330	-50.5%	279	18.1%
Net margin	6.3%	3.1%		2.6%	
Recurring net profit	392	252	-35.7%	279	-9.8%
Recurring net profit margin	3.7%	2.4%		2.6%	

Source: J.P. Morgan estimates, Company data.

Table 3: FY14 results vs. J.P. Morgan estimates

US\$ in millions	FY13A	FY14A	% chg y/y	FY14E	Actual/Est
Sales	19,026	19,288	1.4%	19,412	-0.6%
Gross profit	2,219	2,182	-1.7%	2,276	-4.2%
Gross margin	11.7%	11.3%		11.7%	
Total operating expenses as % of sales	-1,557 -8.2%	-1,640 -8.5%	5.3%	-1,728 -8.9%	-5.1%
Operating profit	812	724	-10.9%	549	31.9%
Operating margin	4.3%	3.8%		2.8%	
Other revenues	75	63	-16.7%	79	-20.7%
COP reported by the company	737	604	-18.0%	628	-3.8%
COP margin	3.9%	3.1%		3.2%	
Write back of acquisition payable	113	176		98	
Net interest income	-98	-98		-92	6.9%
Profit of associates	0	1		1	
Pre-tax profit	714	627	-12.2%	575	9.0%
Tax	-72	-59	-18.0%	-56	4.8%
Tax rate	-10.1%	-9.4%		-9.8%	
Net profit	642	568	-11.5%	519	9.5%
Attributable to Perpetual security holders	-30	-30		-30	
Minority interest	0	2		0	
Attributable net profit	725	441	-39.2%	391	13.0%
Net margin	3.8%	2.3%		2.0%	
Recurring net profit	537	420	-21.8%	391	7.5%
Recurring net profit margin	2.8%	2.2%		2.0%	

Source: J.P. Morgan estimates, Company data.

Investment Thesis, Valuation and Risks

Li & Fung (Neutral; Price Target: HK\$7.50)

Investment Thesis

We cut our FY15 sales and COP estimates by 1% and 8%, respectively. We now expect c6% sales and c12% COP growth in FY15 and believe the stock trades at a relatively stretched P/E of c17.9x, based on our revised FY15 estimates. Despite the decline in COP, Li & Fung kept DPS flat, and we maintain our Neutral rating, supported mainly by the dividend yield.

Valuation

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Risks to Rating and Price Target

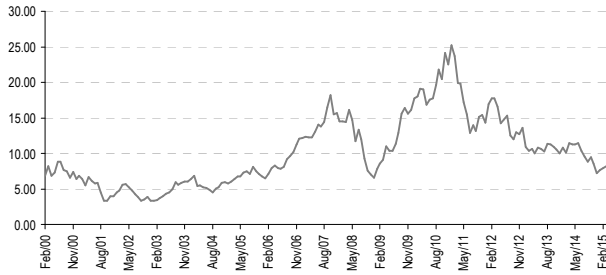
Risks to our rating and price target on the downside are an unexpected decline in trading margins and a slowdown in trading top-line growth. On the upside, risks include higher-than-expected growth in the trading business.

JPM Q-Profile
Li & Fung Limited (HONG KONG / Consumer Discretionary)
 As Of: 13-Mar-2015

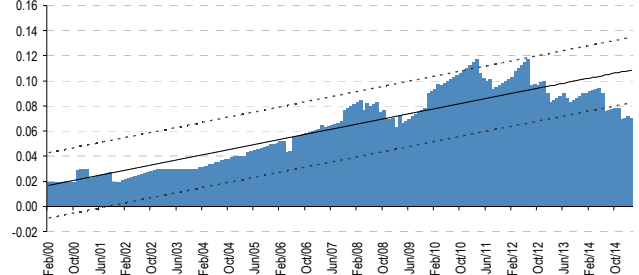
Global Equity Quantitative Analysis

Quant_Strategy@jpmorgan.com

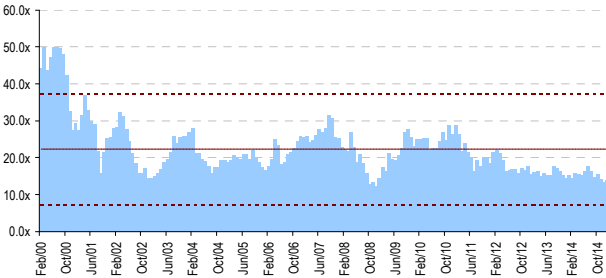
Local Share Price Current: **8.22**



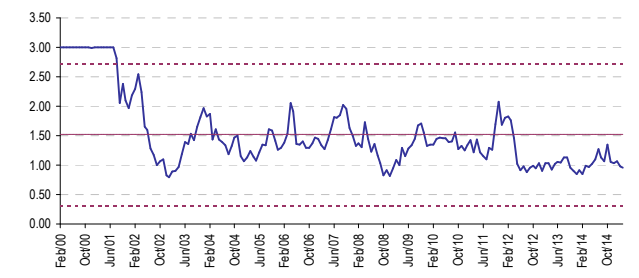
12 Mth Forward EPS Current: **0.07**



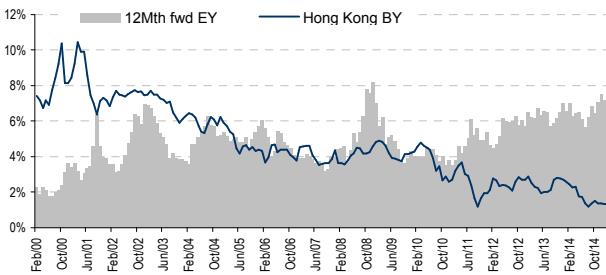
PE (1Yr Forward) Current: **15.1x**



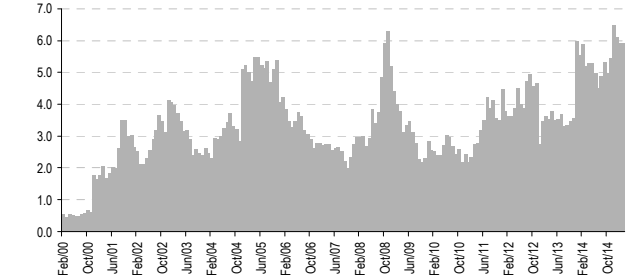
P/E Relative to Hong Kong Index Current: **0.96**



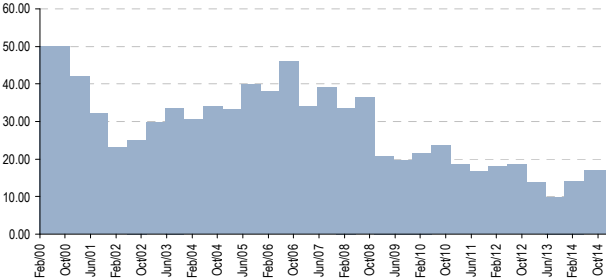
Earnings Yield (& Local Bond Yield) Current: **7%**



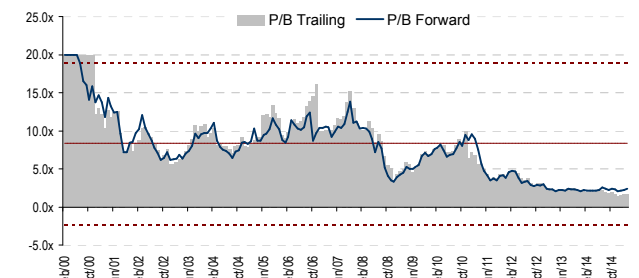
Dividend Yield (Trailing) Current: **5.93**



ROE (Trailing) Current: **16.86**



Price/Book (Value) Current: **1.7x**



Summary

Li & Fung Limited		TICKER 494 HK		As Of: 13-Mar-15							
HONG KONG				Local Price: 8.22							
Consumer Discretionary				EPS: 0.07							
	Latest	Min	Max	Median	Average	2 S.D.+	2 S.D. -	% to Min	% to Max	% to Med	% to Avg
12mth Forward PE	15.07x	12.24	50.00	20.99	22.36	37.43	7.29	-19%	232%	39%	48%
P/BV (Trailing)	1.67	1.48	25.00	8.00	8.34	18.95	-2.28	-12%	1398%	379%	399%
Dividend Yield (Trailing)	5.93x	0.47	6.47	3.20	3.36	5.91	0.81	-92%	9%	-46%	-43%
ROE (Trailing)	16.86	9.94	50.00	29.84	28.25	49.76	6.74	-41%	197%	77%	68%

Source: Bloomberg, Reuters Global Fundamentals, IBES CONSENSUS, JPMorgan Quantitative & Derivative Strategy

Li & Fung: Summary of Financials

Income Statement							Cash flow statement						
\$ in millions, year end Dec	FY12	FY13	FY14	FY15E	FY16E	FY17E	\$ in millions, year end Dec	FY12	FY13	FY14	FY15E	FY16E	FY17E
Revenues	20,222	19,026	19,288	20,515	21,678	22,982	PBT	672	714	627	562	637	721
% change Y/Y	1.0%	(5.9%)	1.4%	6.4%	5.7%	6.0%	Depr. & amortization	285	111	115	117	119	121
Gross Profit	2,868	2,219	2,182	2,333	2,521	2,742	Change in working capital	(60)	97	28	29	21	21
% change Y/Y	(4.0%)	(22.6%)	(1.7%)	6.9%	8.1%	8.8%	Tax & Other	(75)	(60)	(55)	(53)	(60)	(68)
Gross margin	14.2%	11.7%	11.3%	11.4%	11.6%	11.9%	Cash flow from operations	586	853	638	740	798	871
Other operating income	-	150	182	-	-	-	Capex	(176)	(59)	(73)	(40)	(40)	(40)
EBITDA	701	922	839	728	798	875	Sale of assets	42	0	0	0	0	0
% change Y/Y	(31.3%)	31.6%	(9.1%)	(13.2%)	9.6%	9.7%	Acquisition of subsidiaries/intangibles	(292)	0	0	0	0	0
EBITDA Margin	3.5%	4.8%	4.3%	3.5%	3.7%	3.8%	Other	(337)	(219)	(285)	(38)	(29)	(21)
EBIT	416	812	723	610	678	754	Cash flow from investing	(763)	(278)	(358)	(78)	(69)	(61)
% change Y/Y	(47.7%)	95.3%	(10.9%)	(15.6%)	11.1%	11.1%	Equity raised/(repaid)	1,064	2	0	0	0	0
EBIT Margin	2.1%	4.3%	3.8%	3.0%	3.1%	3.3%	Debt raised/(repaid)	0	(40)	(59)	0	0	0
Net Interest	(119)	(98)	(98)	(86)	(82)	(77)	Dividends paid	(525)	(332)	(507)	(440)	(458)	(506)
Share of JVs	1	0	1	1	1	1	Other	(110)	(94)	(95)	(94)	(92)	(90)
Other non operating income	375	150	182	36	39	43	Cash flow from financing	428	(465)	(661)	(534)	(550)	(596)
Earnings before tax	672	714	627	562	637	721	FX gain/(loss)	3	3	(4)	0	0	0
% change Y/Y	(12.9%)	6.2%	(12.2%)	(10.4%)	13.4%	13.1%	Net change in cash	254	113	(385)	128	178	214
Tax	(54)	(72)	(59)	(53)	(60)	(68)	Ending cash	680	459	539	666	844	1,058
as % of EBT	8.0%	10.1%	9.4%	9.4%	9.4%	9.4%	DPS	0.04	0.05	0.05	0.05	0.06	0.06
Minorities	(1)	(30)	(28)	(28)	(28)	(28)							
Net income (reported)	617	726	441	480	549	625							
% change Y/Y	(9.4%)	17.5%	(39.2%)	8.8%	14.2%	13.8%							
Recurring Net Income	502	538	420	480	549	625							
% change Y/Y	(19.5%)	7.1%	(21.9%)	14.4%	14.2%	13.8%							
EPS (reported)	0.07	0.09	0.05	0.06	0.07	0.07							
% change Y/Y	(11.6%)	16.6%	(39.2%)	8.8%	14.2%	13.8%							
Recurring EPS	0.06	0.06	0.05	0.06	0.07	0.07							
% change Y/Y	(21.5%)	6.2%	(21.9%)	14.4%	14.2%	13.8%							
Balance sheet							Ratio Analysis						
\$ in millions, year end Dec	FY12	FY13	FY14	FY15E	FY16E	FY17E	\$ in millions, year end Dec	FY12	FY13	FY14	FY15E	FY16E	FY17E
Cash and cash equivalents	680	460	539	666	844	1,058	Gross margin	14.2%	11.7%	11.3%	11.4%	11.6%	11.9%
Accounts receivable	2,243	2,221	1,864	1,983	2,095	2,221	EBITDA margin	3.5%	4.8%	4.3%	3.5%	3.7%	3.8%
Inventories	939	1,100	565	601	633	669	Operating Margin	2.1%	4.3%	3.8%	3.0%	3.1%	3.3%
Others	518	517	857	878	898	921	Net margin	2.5%	2.8%	2.2%	2.3%	2.5%	2.7%
Current assets	4,380	4,298	3,825	4,128	4,471	4,869	Recurring net profit margin	2.5%	2.8%	2.2%	2.3%	2.5%	2.7%
Goodwill	-	-	-	-	-	-	Sales growth	1.0%	(5.9%)	1.4%	6.4%	5.7%	6.0%
Intangible assets	7,058	7,609	4,349	4,298	4,246	4,194	Net profit growth	(9.4%)	17.5%	(39.2%)	8.8%	14.2%	13.8%
Long term investments	71	14	18	18	18	18	Recurring net profit growth	(19.5%)	7.1%	(21.9%)	14.4%	14.2%	13.8%
Net fixed assets	419	440	245	219	191	162	EPS growth	(11.6%)	16.6%	(39.2%)	8.8%	14.2%	13.8%
Other assets	90	91	40	40	40	40	Interest coverage (x)	5.9	9.4	8.5	8.5	9.8	11.4
Total Assets	12,018	12,451	8,477	8,703	8,966	9,283	Net debt to equity	39.2%	33.8%	38.7%	32.4%	24.6%	16.4%
Liabilities							Sales/assets	1.8	1.6	1.8	2.4	2.5	2.5
Short-term loans	118	94	163	163	163	163	Assets/equity	253.4%	229.4%	242.2%	273.9%	273.5%	271.4%
Trade & other payables	2,458	2,552	2,561	2,722	2,868	3,030	ROE	11.1%	10.1%	9.7%	15.3%	17.0%	18.6%
Others	1,298	1,421	977	1,021	1,060	1,104	ROCE	5.2%	9.3%	10.3%	11.4%	12.5%	13.7%
Total current liabilities	3,874	4,067	3,701	3,906	4,092	4,297							
Long-term debt	2,574	2,243	1,578	1,532	1,492	1,458							
Others	433	590	87	87	87	87							
Total Liabilities	6,881	6,901	5,367	5,525	5,671	5,843							
Minorities	11	10	9	7	6	5							
Shareholders' equity	5,127	5,540	3,101	3,170	3,289	3,436							
BVPS	0.62	0.66	0.37	0.38	0.39	0.41							

Source: Company reports and J.P. Morgan estimates.

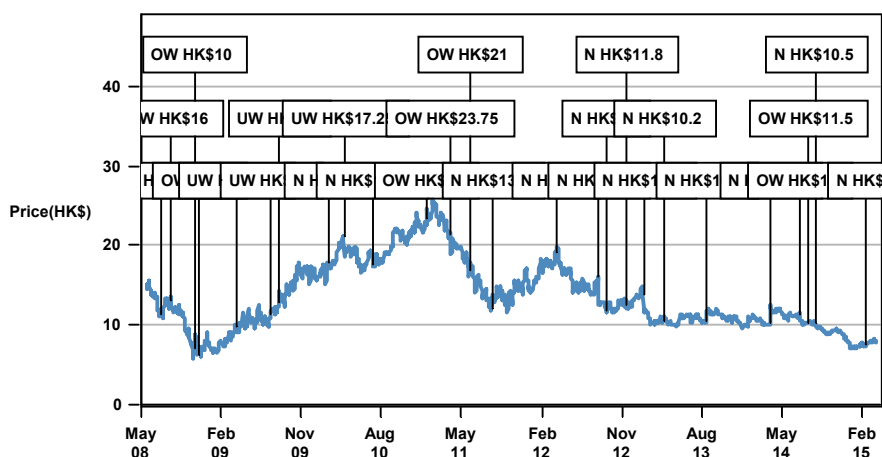
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Li & Fung (0494.HK, 494 HK) Price Chart



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Jul 09, 2008.

Date	Rating	Share Price (HK\$)	Price Target (HK\$)
09-Jul-08	OW	11.32	17.50
14-Aug-08	OW	13.10	16.00
29-Oct-08	OW	7.05	10.00
12-Nov-08	OW	6.39	9.00
26-Mar-09	UW	9.75	8.25
20-Jul-09	UW	11.42	10.00
14-Aug-09	UW	12.72	11.00
29-Jan-10	N	17.80	17.00
24-Mar-10	UW	21.02	17.25
05-Jul-10	N	17.52	18.25
03-Jan-11	OW	23.38	27.00
25-Mar-11	OW	21.48	23.75
30-May-11	OW	16.82	21.00
12-Aug-11	N	12.00	13.50
23-Mar-12	N	18.98	20.00
10-Aug-12	N	15.98	16.50
06-Sep-12	N	11.92	12.00
15-Nov-12	N	12.66	11.80
13-Jan-13	N	13.88	11.50
22-Mar-13	N	10.56	10.20
14-Aug-13	N	10.54	10.50
21-Mar-14	N	10.30	11.30
29-Jun-14	OW	11.34	11.00
26-Jul-14	OW	10.38	11.50
22-Aug-14	N	10.38	10.50
08-Feb-15	N	7.46	8.00

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