

I.T (999 HK)

Buy (maintained)

Target price: HK\$3.60

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Key takeaways from post-results NDR

During the meeting we hosted yesterday, the key focus was on why the Japan subsidiary's growth has been so strong, China market growth potential and the challenges for the HK retail market. Management considers its 300+ brand portfolio and strong relationships with international brands to be unique in the market, and believes this would be difficult for peers to replicate. Investors appear to demand stronger growth from the China market given the company's brand resources and expertise. We maintain our Buy rating and target price of HK\$3.60, still based on 11.3x FY18E P/E (historical average).

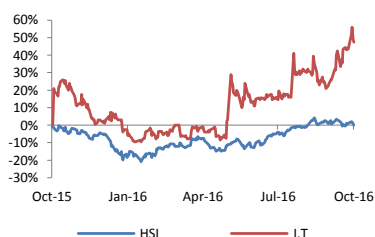
Significant expansion potential in China China will remain the key growth driver in the medium-term. The company's directly-operated stores (395 stores in 1HFY17) now cover 22 cities, with around 60%/40% of its store area in first-tier cities/the other 18 cities. Currently, its franchisees cover another 20+ cities (75 stores in 1HFY17) including certain affluent coastal cities such as Ningbo, Zhenjiang, Xiamen, Jiading etc. For example, the sales performance of franchised stores in Chengdu was stronger than management had expected, so the company ended the franchise co-operation when it expired this year and then opened directly-operated stores. Also, over the last two years, the company has observed that customers are focusing more on creating their own unique personal style. This trend should be positive for the company's trend-setting fashion business.

Good operating leverage in China The 5% segment profit growth YoY in 1HFY17 does not paint the whole picture. Excluding the HK\$23m write-back for onerous provisions in 1HFY16, segment profit would have increased by 47% YoY. This represents a 1.2pp increase in profit margin to 5.1% at a 5% SSSG despite GM narrowing by 0.6pp.

Why is the Japan subsidiary's growth so strong? The strong 28% revenue growth, in local currency, in 1HFY17 was driven by growth in inbound tourists and local consumption. A Bathing Ape stores are seen as a "must go" place to visit in Japan. The company developed a sub-brand "AAPE" two years ago and it has been well-received by HK consumers. The company therefore plans to open one AAPE store in Japan this year. In the US, the company will also open its second store in LA (the first was in New York) as A Bathing Ape has been gaining traction in the country. Sales at A Bathing Ape and AAPE stores outside of Japan are also an income source for the Japan subsidiary. Lastly, online sales have been performing well and contribute >10% of revenue.

HK market still challenging Opex ratio in the HK market increased by 4.6pp to 67.8% in 1HFY17 given 1) shop rental costs increased on renewal as most stores are located in shopping malls, 2) salary increases, and 3) operating deleverage. The 3% store area reduction YoY in 1HFY17 improved sales efficiency slightly as retail revenue only dropped 2%. Management believes it is difficult to say when the recovery will appear, but it will control retail discounts as well as operating costs and optimize its store network (2-4% YoY drop in store area in FY17).

Stock performance



Source: Bloomberg

Key data

| | |
|----------------------|----------------------|
| Oct 27 close (HK\$) | 2.95 |
| Shares in issue (m) | 1211.5 |
| Major shareholder | Sham Kar Wai (60.7%) |
| Market cap (HK\$ bn) | 3.6 |
| 3M avg. vol. (m) | 0.67 |
| 52W high/low (HK\$) | 3.15/1.80 |

Source: Bloomberg

Stock valuation

| YE Feb | Turnover (HK\$ m) | Net profit (HK\$ m) | Core net profit (HK\$ m) | Core EPS (HK\$) | EPS YoY (%) | P/E | Yield (%) | BPS (HK\$) | P/B | ROE (%) |
|--------|----------------------|------------------------|-----------------------------|--------------------|----------------|------|--------------|---------------|-----|------------|
| 2014 | 6,747 | 280 | 285 | 0.232 | -26 | 12.7 | 3.4 | 2.3 | 1.3 | 10.7 |
| 2015 | 7,181 | 312 | 300 | 0.244 | 4 | 12.2 | 4.1 | 2.3 | 1.3 | 10.6 |
| 2016 | 7,541 | 209 | 275 | 0.224 | -8 | 13.2 | 2.8 | 2.4 | 1.2 | 9.6 |
| 2017E | 8,133 | 341 | 341 | 0.281 | 26 | 10.5 | 4.3 | 2.6 | 1.1 | 11.3 |
| 2018E | 8,659 | 386 | 386 | 0.318 | 13 | 9.3 | 4.9 | 2.8 | 1.0 | 11.7 |

Sources: Company data, GF Securities (Hong Kong)

Figure 1: SSS trend breakdown by market in local currency

| Japan | 1Q | 2Q | 3Q | 4Q |
|-------|-------|----|--------|----|
| FY13 | 14.5% | na | -19.3% | na |
| FY14 | -6.1% | na | 18.6% | na |
| FY15 | 20.2% | na | 13.5% | na |
| FY16 | 23.2% | na | 37.4% | na |
| FY17 | 32.9% | na | | |

| China | 1Q | 2Q | 3Q | 4Q |
|-------|-------|-------|-------|-------|
| FY13 | 14.4% | 11.4% | 13.0% | na |
| FY14 | -5.6% | 1.8% | -6.0% | 10.5% |
| FY15 | 4.5% | 4.1% | -0.2% | 9.9% |
| FY16 | 3.5% | 8.3% | -2.2% | 8.0% |
| FY17 | 6.6% | 2.6% | | |

| HK | 1Q | 2Q | 3Q | 4Q |
|------|--------|-------|-------|-------|
| FY13 | 10.1% | 5.9% | 0.3% | na |
| FY14 | -10.3% | -8.7% | -3.4% | 6.2% |
| FY15 | 2.2% | 4.8% | -4.5% | 0.4% |
| FY16 | -0.5% | -1.3% | -2.0% | -4.1% |
| FY17 | 0.0% | -1.8% | | |

Sources: Company data, GF Securities (Hong Kong) estimates

Figure 2: GM trend breakdown by market

| Japan | 1Q | 1H | 9M | Full-year |
|-------|-------|-------|-------|-----------|
| FY13 | 66.8% | na | 62.3% | na |
| FY14 | 71.9% | 70.2% | 70.5% | 72.7% |
| FY15 | 75.3% | 73.9% | 76.0% | 76.4% |
| FY16 | 68.8% | 70.5% | 68.2% | 67.8% |
| FY17 | 71.5% | 71.6% | | |

| China | 1Q | 1H | 9M | Full-year |
|-------|-------|-------|-------|-----------|
| FY13 | 60.8% | 58.1% | 58.5% | 57.9% |
| FY14 | 56.5% | 55.8% | 56.8% | 57.3% |
| FY15 | 60.1% | 60.4% | 62.1% | 61.0% |
| FY16 | 62.7% | 59.0% | 61.3% | 61.4% |
| FY17 | 61.5% | 58.4% | | |

| HK | 1Q | 1H | 9M | Full-year |
|------|-------|-------|-------|-----------|
| FY13 | 62.2% | 59.1% | 58.8% | 58.0% |
| FY14 | 61.5% | 59.1% | 60.0% | 59.3% |
| FY15 | 61.4% | 60.6% | 61.1% | 60.7% |
| FY16 | 59.1% | 56.9% | 57.7% | 57.2% |
| FY17 | 60.4% | 58.9% | | |

Sources: Company data

Note: The company changed its calculation method for GM in Japan in FY16, so direct comparisons between FY16 GM with GMs of previous years do not reflect the real situation.

Figure 3: 1HFY17 revenue breakdown by market

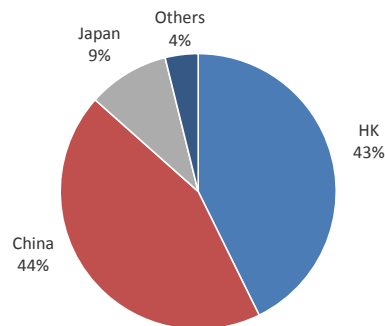
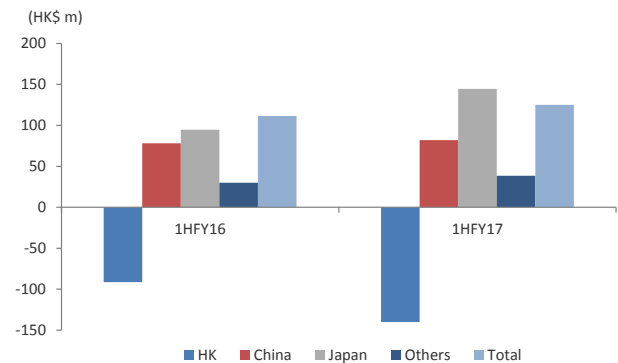
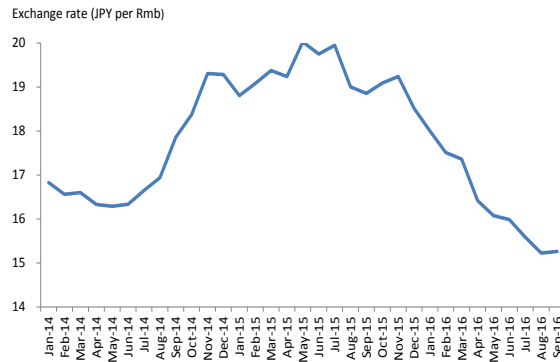


Figure 4: Segment profit breakdown by market



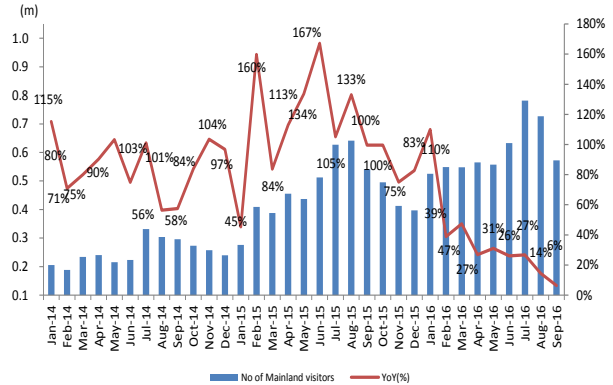
Sources: Company data, GF Securities (Hong Kong)

Figure 5: JPY vs Rmb



Sources: Bloomberg, GF Securities (Hong Kong)
Note: Month-end exchange rate used

Figure 6: Monthly mainland visitor arrivals to Japan



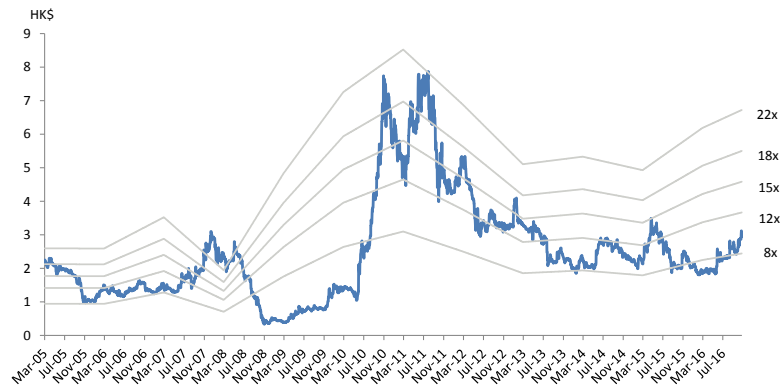
Sources: Japan National Tourism Organization, GF Securities (Hong Kong)

Figure 7: Key assumptions

| Year-end Feb (HK\$ m) | FY14 | FY15 | FY16 | FY17E | FY18E |
|--|---------|---------|-----------|-----------|-----------|
| Sales footage (sq ft) (Excludes JV and franchised stores) | | | | | |
| HK | 626,258 | 631,292 | 598,168 | 574,241 | 574,241 |
| growth (%) | 1% | 1% | -5% | -4% | 0% |
| China | 871,518 | 978,854 | 1,143,002 | 1,325,882 | 1,458,471 |
| growth (%) | 24% | 12% | 17% | 16% | 10% |
| Japan | 52,685 | 46,601 | 48,026 | 44,905 | 44,905 |
| growth (%) | -2% | -12% | 3% | -6% | 0% |
| Taiwan, Macau and others | 81,364 | 73,804 | 72,493 | 71,498 | 71,498 |
| growth (%) | 8% | -9% | -2% | -1% | 0% |
| SSSG | | | | | |
| HK | -4.0% | 0.7% | -2.0% | 0.0% | 0.0% |
| China | 0.0% | 4.5% | 3.9% | 5.0% | 4.0% |
| Revenue | | | | | |
| HK | 3,625 | 3,630 | 3,494 | 3,438 | 3,395 |
| growth (%) | -2% | 0% | -4% | -2% | -1% |
| China | 2,372 | 2,771 | 3,159 | 3,571 | 4,033 |
| growth (%) | 16% | 17% | 14% | 13% | 13% |
| Japan | 445 | 460 | 559 | 784 | 887 |
| growth (%) | -13% | 3% | 22% | 40% | 13% |
| Taiwan, Macau and others | 305 | 320 | 329 | 340 | 343 |
| growth (%) | 7% | 5% | 3% | 3% | 1% |
| GM (%) - Overall | | | | | |
| HK | 59.3% | 60.7% | 57.2% | 59.2% | 59.4% |
| China | 57.3% | 61.0% | 61.4% | 61.2% | 61.2% |
| Japan | 72.7% | 76.4% | 67.8% | 69.8% | 70.3% |
| Taiwan, Macau and others | 69.5% | 68.6% | 75.7% | 74.8% | 74.6% |
| SG&A expenses ratio (%) | | | | | |
| | 53.8% | 55.3% | 54.3% | 54.5% | 54.4% |
| Effective tax rate (%) | | | | | |
| | 18.9% | 28.3% | 41.1% | 35.3% | 36.3% |

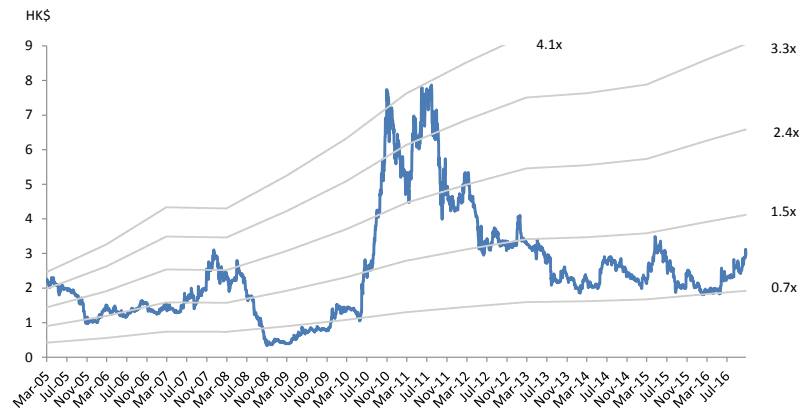
Sources: Company data, GF Securities (Hong Kong) estimates

Figure 8: P/E band



Sources: Bloomberg, GF Securities (Hong Kong) estimates

Figure 9: P/B band



Sources: Bloomberg, GF Securities (Hong Kong) estimates

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Sources: Company data, GF Securities (Hong Kong) estimates

Rating definitions

Benchmark: Hong Kong Hang Seng Index

Time horizon: 12 months

| Company ratings | |
|---------------------|--|
| Buy | Stock expected to outperform benchmark by more than 15% |
| Accumulate | Stock expected to outperform benchmark by more than 5% but not more than 15% |
| Hold | Expected stock relative performance ranges between -5% and 5% |
| Underperform | Stock expected to underperform benchmark by more than 5% |
| Sector ratings | |
| Positive | Sector expected to outperform benchmark by more than 10% |
| Neutral | Expected sector relative performance ranges between -10% and 10% |
| Cautious | Sector expected to underperform benchmark by more than 10% |

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