Equity Research | Consumer Discretionary

Oct 28, 2016

I.T (999 HK)

Buy (maintained) Target price: HK\$3.60

Albert Yip, CFA SFC CE No. ADT599 albertyip@gfgroup.com.hk +852 3719 1010

GF Securities (Hong Kong) Brokerage Limited 29-30/F, Li Po Chun Chambers 189 Des Voeux Road Central Hong Kong

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

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, Jiaxing 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 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

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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

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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%		

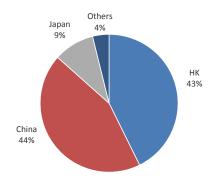
НК	1Q	1H	9M	Full-year
FY13	62.2%	59.1%	58.8%	58.0%
FY14	61.5%	59.1%	60.0%	59.3%
FY15	61.4%	60.6%	61.1%	60.7%
FY16	59.1%	56.9%	57.7%	57.2%
FY17	60.4%	58.9%		

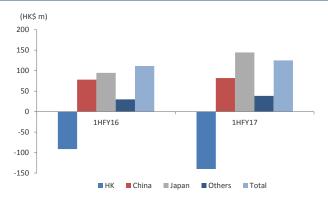
Sources: Company data

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

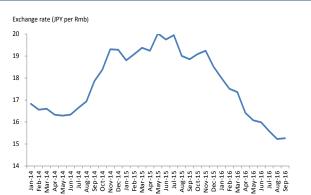
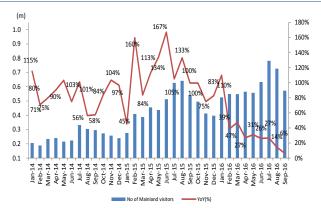


Figure 6: Monthly mainland visitor arrivals to Japan



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

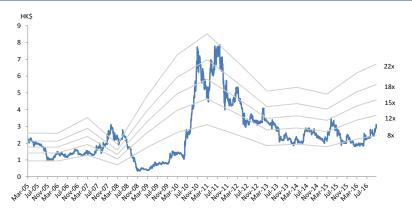
Sources: Bloomberg, GF Securities (Hong Kong) Note: Month-end exchange rate used

Figure 7: Key assumptions

gure 7. Key assumption.					
Year-end Feb (HK\$ m)	FY14	FY15	FY16	FY17E	FY18E
Sales footage (sq ft) (Excludes JV ar	nd franchised st	ores)			
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	59.9%	62.2%	60.6%	61.8%	62.0%
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%

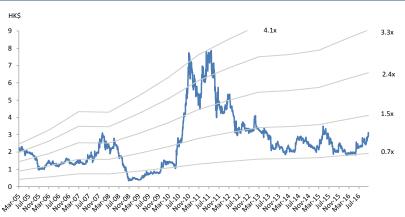
Sources: Company data, GF Securities (Hong Kong) estimates

Figure 8: P/E band



Sources: Bloomberg, GF Securities (Hong Kong) estimates

Figure 9: P/B band



Sources: Bloomberg, GF Securities (Hong Kong) estimates



Figure 10: Financial statements

	Income St	atement					Balance	Balance Sheet			
Year-end Feb (HK\$ m)	FY14	FY15	FY16	FY17E	FY18E	Year-end Feb (HK\$ m)	FY14	FY15	FY16	FY17E	FY18I
Turnover	6,747	7,181	7,541	8,133	8,659	Fixed assets					
HK	3,625	3,630	3,494	3,438	3,395	Furniture and equipment	913	836	857	882	922
China	2,372	2,771	3,159	3,571	4,033	Intangible assets	343	322	346	334	322
						Investments in and amounts due					
Japan	445	460	559	784	887	from JCEs	220	167	139	135	139
Others	305	320	329	340	343	Rental deposits	307	317	296	296	296
COGS	(2,703)	(2,716)	(2,975)	(3,111)	(3,294)	Deferred tax assets	136	132	130	130	130
Gross profit	4,044	4,464	4,423	5,022	5,365	Others	17	42	16	42	42
							1,937	1,817	1,783	1,819	1,851
Other income and gains	7	20	14	14	14						
SG&A expenses	(3,628)	(3,971)	(4,095)	(4,430)	(4,709)	Current assets					
Operating profit	424	513	402	606	670	Inventories	1,117	1,261	1,391	1,498	1,602
						A/C receivable	181	244	232	251	267
Net finance cost	(31)	(22)	(38)	(74)	(67)	Other prepayments	251	286	371	400	426
Other gains/losses	(6)	(19)	(64)	0	0	Others	36	72	54	54	54
Share of profit of JVs	(42)	(36)	(27)	(4)	4	Cash and cash equivalents	2,315	2,294	1,967	2,136	2,299
Profit before taxation	345	436	356	528	607		3,900	4,156	4,016	4,339	4,648
Taxation	(65)	(124)	(146)	(186)	(220)						
Non-controlling interests	(0)	(0)	(1)	(1)	(1)	Current liabilities					
Net Profit	280	312	209	341	386	A/C payables	358	385	433	453	480
Core net profit	285	298	275	341	386	Other payables	574	708	649	679	719
	Coch Flour	Chahamanh				Others	24	34	34	34	34
	Cash Flow S					ST borrowings	496	267	273	273	273
Year-end Feb (HK\$ m)	FY14	FY15	FY16	FY17E	FY18E	Income tax liabilities	32	101	68	112	132
Profit before tax	345	436	356	528	607		1,485	1,495	1,458	1,551	1,638
		308		286	272	Name and the little of					
Depreciation & amort	280		294			Non-current liabilities LT borrowings	1,495	1 460	1 262	1 262	1 262
Interest income Interest expenses	(44) 75	(64) 85	(41) 80	(13) 85	(14) 78	Others	1,495	1,469 134	1,262 141	1,262 141	1,262 142
Change of working capital	102	(92)	(198)	(105)	(79)	Deferred tax liabilities	45	34	41	41	41
Others	23	12	(198)	(57)	(59)	Deferred tax liabilities	1,556	1,6 37	1,444	1,444	1,445
Tax paid	(77)	(88)	(153)	(166)	(203)		1,550	1,037	1,444	1,444	1,443
Operating cash flow	705	598	319	557	603	Share capital	123	123	121	121	121
Operating cash now	703	330	313	337	003	Reserves	2,673	2,716	2,774	3,039	3,291
Capex	(259)	(275)	(322)	(300)	(300)	Equity	2,073 2,796	2,710 2,839	2,774	3,160	3,413
Interest received	40	63	45	13	14	Equity	2,750	2,039	2,655	3,100	3,413
Others	(57)	(26)	(25)	0	0	Non-controlling interests	1	1	2	3	4
Investing cash flow	(275)	(238)	(302)	(287)	(286)	Non-controlling interests	-	1	2	3	-
estg casi. note	(275)	(200)	(502)	(207)	(200)		Financial	Ratios			
Change of bank loans	964	(99)	(163)	0	0	Year-end Feb	FY14	FY15	FY16	FY17E	FY18I
Share issue/buyback	1	(3)	(32)	0	0						
Buyback of senior notes	0	(120)	0	0	0	Turnover growth	3.1%	6.4%	5.0%	7.8%	6.5%
Dividend paid	(37)	(135)	(135)	(102)	(153)	Core net profit growth	4.2%	4.1%	3.6%	4.2%	4.5%
Financing cash flow	928	(357)	(329)	(102)	(153)						
		,	(/	, - ,	,	Gross profit margin	59.9%	62.2%	60.6%	61.8%	62.0%
Net Cash Flow	4	182	147	(155)	336	Operating profit margin	6.3%	7.1%	6.4%	7.5%	7.7%
Effect of forex change	(4)	(25)	(14)	Ò	0	Core net profit margin	4.2%	4.1%	3.6%	4.2%	4.5%
5	. ,	. ,	. ,			. 5					
						Current ratio	2.6	2.8	2.8	2.8	2.8
						Quick ratio	1.9	1.9	1.8	1.8	1.9
						Inventory turnover days	157	160	163	170	172
						· · · · · · · · · · · · · · · · · · ·					
						Core ROE	10.7%	10.6%	9.6%	11.3%	11.7%
						Core ROA	5.5%	5.0%	4.7%	5.7%	6.1%

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

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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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