



Rating
Hold

Asia
Hong Kong

Consumer
Retail / Wholesale Trade

Company
Li & Fung

Reuters 0494.HK Bloomberg 494 HK Exchange HSI Ticker 0494

Date
9 July 2018

Forecast Change

Price at 9 Jul 2018 (HKD)	2.62
Price target - 12mth (HKD)	2.89
52-week range (HKD)	4.43 - 2.61
HANG SENG INDEX	28,316

Continue to invest in digital; Hold

We expect Li & Fung (LF) to report a Core Operating Profit (COP) of USD115m on sales of USD6.1bn for 1H18. We estimate NP to reach USD43m during the same period. This is only for the company's continuing operations. For the discontinued operations, we expect a loss of USD85m including a NP of USD15m for the 5-month operation before disposal and a USD100m provision from the sale.

There is no like-for-like comparison as 1H17 was not restated to exclude the vertical business, which was sold in May 2018. But based on available information, **we work out a 1H17E P&L model for the continuing operation** (Figure 2) Our estimates are based on the following assumptions :

- **Sales declined 5% yoy in 1H18F, including a 7% decline in supply chain solutions** mainly due to store closures by its clients in the US and destocking. Shipment of back-to-school items continue to shift to 2H due to a shorter lead time. The Logistic business remains strong, with expected 15% growth. The remaining product business (onshore wholesale operation) is expected to decline by 2%.
- **Total margin is expected to improve from 9.9% to 10.6% for 1H18F. This is mainly due to mix shift.** On a like-for-like basis, we expect the total margin for supply chain solutions to report a 0.1ppt improvement to 6.7%, logistics to improve 0.4ppt to 34.3% and the product business to expand 0.7ppt.
- **We continue to expect the company to invest in digital** (USD150m investment in total during the 3-Year Plan period). However, we expect that a higher proportion (USD30m for full-year 2018 from previously USD15m) will be expensed instead of capitalized. Together with the top-line sales shortfall, we believe there will be operational deleveraging.
- **We estimate COP to decline 18% in 1H and to be down 11% in full-year 2018.** We estimate NP to decline 48% to USD43m in 1H vs. a 1% gain in full-year 2018F. We see NP improving in 2H18, mainly due to the absence of a USD35m restructuring cost which was booked in 2H17 and less op deleveraging in 2H with a higher sales mix.
- **1H trend might not be a good reflection of the full year trend.** Considering that sales will likely continue to shift towards 2H due to a

Valuation & Risks

Anne Ling

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Key changes

TP	3.37 to 2.89	↓	-14.2%
Sales (FYE)	13,248 to 13,107	↓	-1.1%
Op prof margin (FYE)	-	↓	-1.2%
Net profit (FYE)	99.4 to 86.7	↓	-12.8%

Source: Deutsche Bank

Price/price relative



Performance (%)	1m	3m	12m
Absolute	-15.2	-35.0	-8.1
HANG SENG INDEX	-8.5	-6.3	11.7

Source: Deutsche Bank

Key indicators (FY1)

ROE (%)	4.3
Net debt/equity (%)	25.1
Book value/share (USD)	0.22
Price/book (x)	1.5
Net interest cover (x)	6.3
Operating profit margin (%)	2.3

Source: Deutsche Bank



shorter lead time, 1H18 results are likely to be weaker when compared to previous 1Hs as most earnings are shifted to 2H18. In our model, we estimate 36% of full-year 2018 COP comes in 1H18 (vs. 39.4% of 1H17).

As announced during its investor day on 11 June 2017, **LF is reviewing its remaining product businesses**. We believe it will share further details on this in August, during the results meeting. For reference, the company announced its 1H17 results on 25 August 2017. As for its **new business model**, this is still ongoing. It is developing a platform with 3Q samples, showroom and product development. Currently, it offers such services for free. But should it mature as a business, it might start to charge a fee.

Based on the current trend, its **three-year plan target might be challenging** (COP to achieve low double-digit growth). That said, **management continues to look for new clients** which might offset such a shortfall.

Due to the **weaker-than-expected sales trend of its supply chain solution**, a result of continued store closures by clients and shorter lead time, we further lower **our sales forecast for FY18-20 by 1% p.a.** We also **raise our expense assumption** to reflect a higher proportion of investment to be expensed. These two factors, based on our estimates, will result in operational deleveraging, with **COP and EBIT revised down by 2-4% p.a.** in FY18-20F (figure 2). NP is lowered by 13%/6%/5% for 2018/19/20F which is higher than the EBIT revision as interest expense and perpetual bond interest payments remain unchanged. We lower our DCF-based TP from HK\$3.37 to HK\$ 2.89, a cut of 14%. This is because we lower our sales assumptions to a 0.75% CAGR from 1% and total margin by 30 pts for the period 2021-2029F, given its relatively weaker-than-expected sales trend over the past few years.

When compared to market forecasts, our forecasts are lower for 2019/20 as we are more conservative on the margin outlook. For 2018, we believe the NP forecast varies as market forecasts might exclude losses from non-core operations. Should this be excluded, core NP would be USD172m.

Our new TP of HK\$2.89 translates into core PE of 18x/16x FY18/19F with yields at 4-5%. We believe shares are fairly valued. Maintaining Hold. Upside risks include: 1) a recovery in the US market, especially in apparel which helps its sales growth, and 2) the signing of new accounts. Downside risks include: 1) the loss of existing clients, and 2) continued destocking pressure.



Forecasts and ratios

Year End Dec 31	2016A	2017A	2018E	2019E	2020E
Sales (USDm)	14,751.2	13,534.2	13,107.3	13,179.2	13,396.6
EBITDA (USDm)	371.3	405.2	367.7	383.2	416.2
Reported NPAT (USDm)	221.1	-374.6	86.7	201.1	234.6
Reported EPS FD(USD)	0.03	-0.05	0.01	0.02	0.03
DB EPS FD(USD)	0.03	-0.05	0.01	0.02	0.03
OLD DB EPS FD(USD)	0.03	-0.05	0.01	0.03	0.03
% Change	0.0%	-0.0%	-12.3%	-6.2%	-4.6%
DB EPS growth (%)	-36.5	-	-	126.8	16.4
PER (x)	20.1	-	31.7	14.0	12.0
EV/EBITDA (x)	13.4	9.8	8.6	8.2	7.4
DPS (net) (USD)	0.03	0.08	0.02	0.02	0.02
Yield (net) (%)	5.6	17.9	4.9	5.7	6.7

Source: Deutsche Bank estimates, company data



Figure 1: Forecast change

YE Dec USDm	2018F				2019F				2020F			
	Sales	COP	EBIT	NP	Sales	COP	EBIT	NP	Sales	COP	EBIT	NP
DB estimates (New)	13,107	316	296	87	13,179	331	316	201	13,397	364	354	235
DB estimates (Old)	13,248	323	303	99	13,319	344	326	215	13,537	376	360	246
Market forecast (Best 28 days)	13,000	-	313	209	13,078	-	355	231	13,402	-	397	277
Market forecast (Standard)	13,201	-	311	151	13,324	-	340	223	13,640	-	370	253
% chg												
DBe new vs. old	-1.1%	-2.1%	-2.3%	-12.8%	-1.0%	-3.5%	-2.8%	-6.3%	-1.0%	-3.3%	-1.8%	-4.6%
DBe new vs. market (Best 28 days)	0.8%	-	-5.3%	-58.4%	0.8%	-	-10.8%	-12.9%	0.0%	-	-10.8%	-15.3%
DBe new vs. market	-0.7%	-	-4.8%	-42.6%	-1.1%	-	-6.9%	-9.8%	-1.8%	-	-4.3%	-7.2%

Source: Deutsche Bank, Bloomberg Finance LP

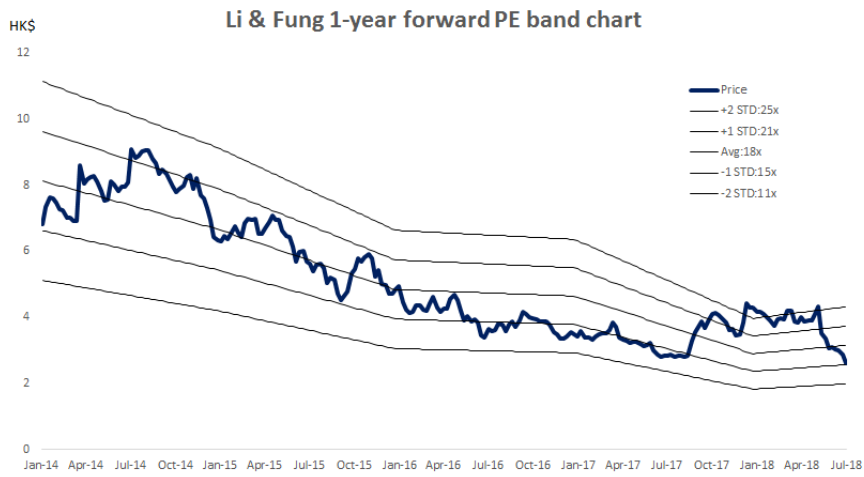
Figure 2: P&L

YE Dec US\$M	2017	2018F	2019F	2020F	ex				
					1H17	1H17E	2H17E	1H18F	2H18F
Sales	13,534	13,107	13,179	13,397	7,264	6,435	7,099	6,116	6,991
Services	12,013	11,617	11,688	11,889	5,813	5,813	6,200	5,513	6,104
Supply chain solution	10,989	10,440	10,335	10,335	5,326	5,326	5,664	4,953	5,487
Logistic services	1,028	1,182	1,360	1,564	490	490	538	563	619
Elimination	(4)	(6)	(7)	(9)	(2)	(2)	(2)	(3)	(2)
Products	1,552	1,521	1,521	1,536	1,474	645	907	626	895
LF Distribution (divested)	-	-	-	-	-	-	-	-	-
Elimination	(30)	(30)	(29)	(29)	(23)	(23)	(7)	(22)	(7)
Services	(20)	(20)	(20)	(19)	(15)	(15)	(6)	(15)	(5)
Products	(10)	(10)	(10)	(9)	(8)	(8)	(2)	(8)	(2)
External sales	13,534	13,107	13,179	13,397	7,264	6,435	7,099	6,116	6,991
Services	11,993	11,596	11,668	11,870	5,798	5,798	6,194	5,498	6,098
Supply chain solution	10,978	10,439	10,349	10,366	5,317	5,317	5,661	4,950	5,490
Logistic services	1,015	1,157	1,319	1,504	481	481	534	548	609
Products	1,542	1,511	1,511	1,526	1,466	637	905	618	893
P&L as reported									
Sales	13,534	13,107	13,179	13,397	7,264	6,435	7,099	6,116	6,991
COGS	(12,185)	(11,735)	(11,746)	(11,882)	(6,441)	(5,808)	(6,377)	(5,484)	(6,251)
GP	1,349	1,372	1,433	1,514	823	627	722	633	740
Other income	37	36	35	35	12	12	25	15	21
Total margin	1,386	1,408	1,468	1,549	835	639	747	648	761
Total expe	(1,030)	(1,092)	(1,136)	(1,185)	(665)	(499)	(531)	(533)	(559)
S&D expenses	(395)	(489)	(557)	(629)	(229)				
M&A expenses	(635)	(603)	(579)	(556)	(436)			0	0
COP	356	316	331	364	170	140	216	115	201
Gain on remeasurement of contingent consideration payable	31	-	-	-	30	30	2	-	-
Amortization of other intangible assets	(23)	(20)	(15)	(10)	(18)	(12)	(12)	(10)	(10)
Gain on disposal of business	-	-	-	-	0	-	-	-	-
One-off reorganization costs	(34)	-	-	-	0	-	(34)	-	-
Operating profit	330	296	316	354	182	158	172	105	191
Interest income	12	12	15	16	7	7	5	6	6
Interest expense	(70)	(59)	(59)	(59)	(37)	(36)	(34)	(30)	(29)
Associates	2	2	2	2	1	1	1	1	1
PBT	274	251	274	313	153	130	144	82	169
Tax	(41)	(37)	(40)	(46)	(21)	(16)	(25)	(12)	(25)
PAT	234	214	234	267	133	114	119	70	144
Remeasurement loss	-	-	-	-	-	-	0	0	0
PAT	234	214	234	267	133	114	119	70	144
Min	1	2	1	1	(1)	(1)	1	-	2
Perpetual	(64)	(44)	(34)	(34)	(32)	(32)	(32)	(27)	(17)
NP	170	172	201	235	100	82	89	43	129
Discontinued Operation	(545)	(85)	-	-	18	(563)	(85)	(85)	-
Profit for the year	(375)	87	201	235	100	(475)	(475)	(42)	129

Source: Company data, Deutsche Bank estimates



Figure 3: Li Fung one year forward PE band



Source: Bloomberg Finance LP, closing price as of 1 July 2018

The author of this report wishes to acknowledge the contribution made by Han Li, employee of Evalueserve, a third-party provider to Deutsche Bank of offshore research support services.



Model updated: 09 July 2018

Running the numbers

Asia

Hong Kong

Retail / Wholesale Trade

Li & Fung

Reuters: 0494.HK

Bloomberg: 494 HK

Hold

Price (9 Jul 18) HKD 2.62

Target Price HKD 2.89

52 Week range HKD 2.61 - 4.43

Market cap (m) HKDm 21,233
USDm 2,705.3

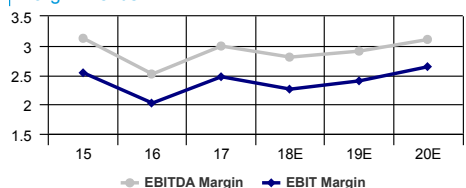
Company Profile

Li & Fung Limited, through its subsidiaries, operates an export trading business. The Company exports consumer products such as garments, fashion, accessories, toys, games, sporting goods, home furnishings, handicrafts, shoes, travel goods, and tableware. In addition, Li & Fung invests in properties.

Price Performance



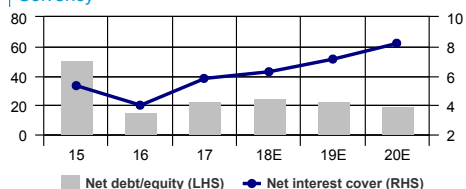
Margin Trends



Growth & Profitability



Solvency



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Fiscal year end 31-Dec

Financial Summary

	2015	2016	2017	2018E	2019E	2020E
DB EPS (USD)	0.04	0.03	-0.05	0.01	0.02	0.03
Reported EPS (USD)	0.05	0.03	-0.05	0.01	0.02	0.03
DPS (USD)	0.04	0.03	0.08	0.02	0.02	0.02
BVPS (USD)	0.3	0.4	0.3	0.2	0.2	0.2
Weighted average shares (m)	8,360	8,439	7,835	8,415	8,415	8,415
Average market cap (USDm)	6,996	4,448	3,445	2,705	2,705	2,705
Enterprise value (USDm)	8,413	4,974	3,984	3,161	3,126	3,078

Valuation Metrics

P/E (DB) (x)	20.3	20.1	nm	31.7	14.0	12.0
P/E (Reported) (x)	16.6	20.1	nm	31.7	14.0	12.0
P/BV (x)	2.03	1.11	1.96	1.55	1.51	1.48
FCF Yield (%)	7.2	6.3	11.8	4.0	7.6	8.9
Dividend Yield (%)	4.3	5.6	17.9	4.9	5.7	6.7
EV/Sales (x)	0.4	0.3	0.3	0.2	0.2	0.2
EV/EBITDA (x)	14.3	13.4	9.8	8.6	8.2	7.4
EV/EBIT (x)	17.6	16.7	11.9	10.7	9.9	8.7

Income Statement (USDm)

Sales revenue	18,831	14,751	13,534	13,107	13,179	13,397
Gross profit	2,189	1,474	1,349	1,372	1,433	1,514
EBITDA	589	371	405	368	383	416
Depreciation	111	73	71	71	67	62
Amortisation	0	0	0	0	0	0
EBIT	478	298	334	296	316	354
Net interest income/(expense)	-90	-75	-58	-47	-44	-43
Associates/affiliates	2	2	2	2	2	2
Exceptionals/extraordinary	117	63	-547	-85	0	0
Other pre-tax income/(expense)	0	0	0	0	0	0
Profit before tax	507	288	-269	166	274	313
Income tax expense	58	32	41	37	40	46
Minorities	-2	-1	1	-2	-1	-1
Other post-tax income/(expense)	-30	-36	-64	-44	-34	-34
Net profit	421	221	-375	87	201	235
DB adjustments (including dilution)	-76	0	0	3	3	3
DB Net profit	345	221	-375	90	205	238

Cash Flow (USDm)

Cash flow from operations	585	344	467	204	306	344
Net Capex	-85	-66	-61	-92	-92	-94
Free cash flow	500	278	406	112	214	250
Equity raised/(bought back)	0	0	0	-500	0	0
Dividends paid	-441	-282	-250	-580	-144	-168
Net inc/(dec) in borrowings	-193	-242	-635	0	0	0
Other investing/financing cash flows	-40	931	-104	1,094	0	0
Net cash flow	-173	685	-583	126	70	82
Change in working capital	87	18	160	-73	4	11

Balance Sheet (USDm)

Cash and other liquid assets	347	996	349	431	467	515
Tangible fixed assets	4,510	4,119	4,196	3,038	3,063	3,095
Goodwill/intangible assets	0	0	0	0	0	0
Associates/investments	40	43	45	48	50	52
Other assets	3,047	2,547	1,927	1,934	1,942	1,967
Total assets	7,944	7,705	6,518	5,451	5,522	5,628
Interest bearing debt	1,764	1,522	887	887	887	887
Other liabilities	3,356	2,854	3,258	2,743	2,775	2,836
Total liabilities	5,120	4,376	4,146	3,631	3,663	3,723
Shareholders' equity	2,820	3,330	2,365	1,814	1,855	1,902
Minorities	4	-1	7	6	5	3
Total shareholders' equity	2,824	3,329	2,372	1,820	1,859	1,905
Net debt	1,418	526	538	456	421	373

Key Company Metrics

Sales growth (%)	-2.4	-21.7	-8.3	-3.2	0.5	1.6
DB EPS growth (%)	-19.7	-36.5	na	na	126.8	16.4
EBITDA Margin (%)	3.1	2.5	3.0	2.8	2.9	3.1
EBIT Margin (%)	2.5	2.0	2.5	2.3	2.4	2.6
Payout ratio (%)	71.6	113.1	nm	158.4	80.0	80.0
ROE (%)	15.0	7.2	-13.2	4.3	11.1	12.7
Capex/sales (%)	0.5	0.5	0.5	0.7	0.7	0.7
Capex/depreciation (x)	0.8	0.9	0.9	1.3	1.4	1.5
Net debt/equity (%)	50.2	15.8	22.7	25.1	22.6	19.6
Net interest cover (x)	5.3	4.0	5.8	6.3	7.1	8.2

Source: Company data, Deutsche Bank estimates



Appendix 1

Important Disclosures

*Other information available upon request

Disclosure checklist			
Company	Ticker	Recent price*	Disclosure
Li & Fung	0494.HK	2.62 (HKD) 9 Jul 2018	NA

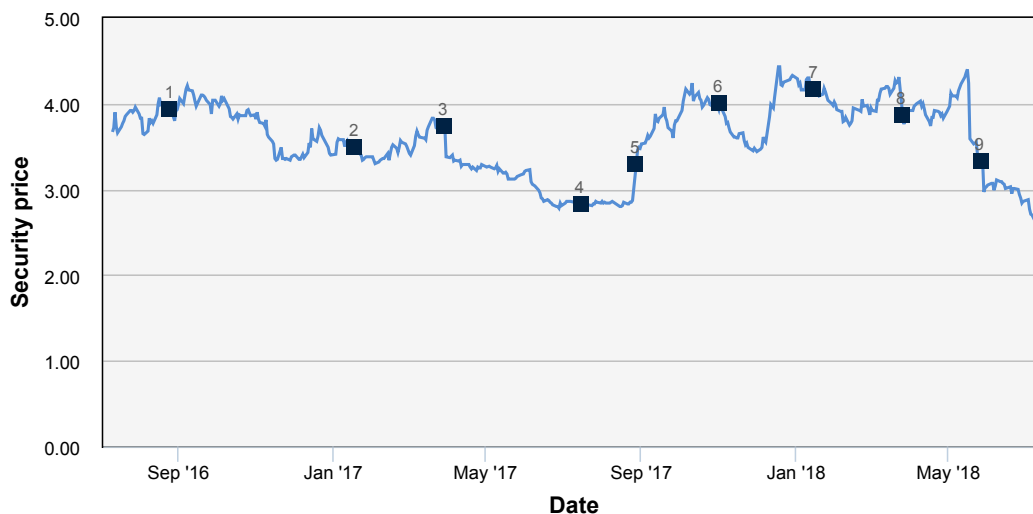
*Prices are current as of the end of the previous trading session unless otherwise indicated and are sourced from local exchanges via Reuters, Bloomberg and other vendors. Other information is sourced from Deutsche Bank, subject companies, and other sources. For disclosures pertaining to recommendations or estimates made on securities other than the primary subject of this research, please see the most recently published company report or visit our global disclosure look-up page on our website at <https://research.db.com/Research/Disclosures/CompanySearch>. Aside from within this report, important risk and conflict disclosures can also be found at <https://research.db.com/Research/Topics/Equities?topicId=RB0002>. Investors are strongly encouraged to review this information before investing.

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The views expressed in this report accurately reflect the personal views of the undersigned lead analyst(s) about the subject issuer and the securities of the issuer. In addition, the undersigned lead analyst(s) has not and will not receive any compensation for providing a specific recommendation or view in this report. Anne Ling

Historical recommendations and target price. Li & Fung (0494.HK)

(as of 07/09/2018)



Current Recommendations

- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

** Analyst is no longer at Deutsche Bank

1.	08/26/2016	Hold, Target Price Change HKD 4.07	Anne Ling
2.	01/18/2017	Hold, Target Price Change HKD 3.85	Anne Ling
3.	03/30/2017	Hold, Target Price Change HKD 3.71	Anne Ling
4.	07/16/2017	Hold, Target Price Change HKD 3.40	Anne Ling
5.	08/28/2017	Hold, Target Price Change HKD 3.64	Anne Ling
6.	11/02/2017	Hold, Target Price Change HKD 3.80	Anne Ling
7.	01/15/2018	Hold, Target Price Change HKD 3.60	Anne Ling
8.	03/26/2018	Hold, Target Price Change HKD 4.15	Anne Ling
9.	05/27/2018	Hold, Target Price Change HKD 3.37	Anne Ling



Equity Rating Key

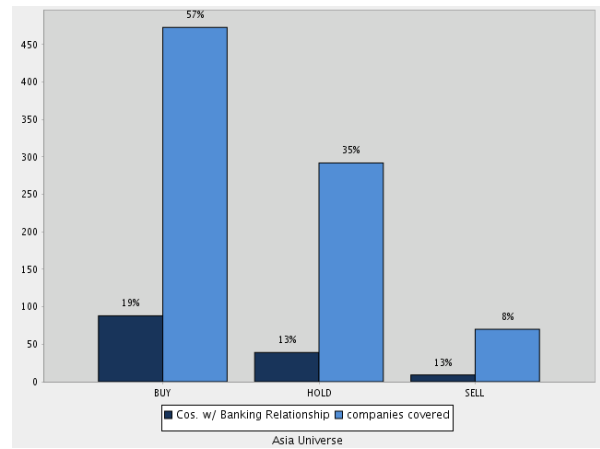
Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus pro-jected dividend yield) , we recommend that investors buy the stock.

Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock.

Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

Newly issued research recommendations and target prices supersede previously published research.

Equity rating dispersion and banking relationships





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