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ESPRIT HOLDINGS LIMITED (思捷環球)

Sector	:	Retail
HKSE Code	:	0330
Market Price	:	HK$104.7 (29/08/2007)
HSI	:	23,020.60 (29/08/2007)
Shares Issued	:	1,231.87 million
Mkt. Cap.	:	HK$128,977 million
52 weeks Hi / Lo	:	HK$111.0 / HK$62.15

Chairman & CEO	:	Heinz Jürgen KROGNER-KORNALIK
Deputy Chairman & CFO	:	John POON Cho Ming

SUMMARY OF THE FINAL RESULTS FOR THE YEAR ENDED 30TH JUNE 2007

Final Results Highlights

	FY06/07 HK$ million	FY05/06 HK$ million	*Change*
• Turnover	29,640	23,349	26.9%
• Operating profit	6,259	4,765	31.4%
• Share of results of associates	130	84	54.8%
• **Net profit**	**5,180**	**3,737**	**38.6%**
	HK$	HK$	
• EPS – Basic	4.22	3.09	36.6%
• DPS – Final	1.00	0.73	37.0%
• DPS – Special	1.48	1.08	37.0%
• DPS – Total	3.18	2.31	37.7%

- Esprit Holdings reported a 38.6% y-o-y rise in net profit to HK$5.18 billion for the year ended 30/06/2007. The results beat consensus forecasts of HK$4.8 billion. Excluding a HK$178 million of reversal of tax provision in prior years, the bottom-line still improved some 34% y-o-y.
- Turnover grew 26.9% y-o-y in HK dollar term to HK$29.64 billion (or 18.5% y-o-y in local currency), lifted by 25.1% growth in Germany, 33.5% growth in rest of Europe, 16.6% growth in Asia Pacific and 16.3% growth in North America. Europe remained the dominant source of revenue, accounting for 86.3% of sales.
- Gross margin improved marginally from 52.7% in FY06 to 53.6%. Overall EBIT margin improved from 20.4% in FY06 to 21.1%, of which retail EBIT margin went up 2.8 percentage points to 15.1% offsetting the 1.7 percentage points drop in wholesale EBIT margin to 26.4%. Total operating expenses to sales increased slightly from 32.3% in FY06 to 32.5%. Net margin improved to 17.5% from last year's 16.0%, attributable to lower effective tax rate of 20.8% (FY06: 23.5%).
- EPS increased 36.6% to HK$4.22. The Group declared final dividend of HK$1.00 (up 37.0% y-o-y) and special dividend of HK$1.48 (up 37.0% y-o-y). Total dividend amounted to HK$3.18 (up 37.7% y-o-y). Dividend payout ratio was 75.4% (FY06: 74.8%).

- As of 30/06/2007, the Group's financial position remained strong with no long-term bank borrowings and a cash position of HK$5.2 billion (FY06: HK$2.7 billion).

Business Highlights

- Breakdown of turnover by markets

	FY06/07		FY05/06		
	HK$ million	%	HK$ million	%	*Change*
Germany	13,935	47.0%	10,964	47.0%	27.1%
Rest of Europe	11,638	39.3%	8,898	38.1%	30.8%
Asia Pacific	3,367	11.4%	2,887.0	12.4%	16.6%
North America and others	700	2.4%	602.0	2.6%	16.3%
Total	**29,640**	100.0%	**23,350**	100.0%	26.9%

- Breakdown of turnover by activities

	FY06/07		FY05/06		
	HK$ million	%	HK$ million	%	*Change*
Wholesale	16,601	56.0%	13,450	57.6%	23.4%
Retail	12,828	43.3%	9,701	41.5%	32.2%
Licensing and others	211	0.7%	198	0.8%	6.6%
Total	**29,640**	100.0%	**23,349**	100.0%	26.9%

- Breakdown of distribution channels

		FY06/07	FY05/06	Change y-o-y
Wholesale	Total point of sales	13,095	11,459	1,636
	Sq. m.	Over 629,000	Over 525,000	Over 104,000
Direct retail	Total point of sales	604	668	-64
	Sq. m.	237,719	Over 224,000	Over 13,719

Wholesale

- Turnover from the wholesale business grew 23.4% to HK$16.601 billion. Contributing to the turnover growth was the net addition of 823 new controlled-space wholesale point-of-sales since the beginning of the financial year. The Group controls 1,176 partnership stores, 4,090 shop-in-stores and 7,829 identity corners as at the end of 30/06/2007.
- Europe delivered 14.5% turnover growth, accounting for 92.8% of the wholesale turnover. Germany remained the biggest contributor and achieved a growth of 21.2% while the rest of Europe grew 24%. Italy and Spain recorded impressive wholesale turnover growth at 49.3% and 72.0% y-o-y respectively.
- Asia Pacific recorded a turnover growth of 35.9%, driven by solid performance in China and the Middle East.

Retail

- Turnover from the retail business surged 32.2% to HK$12.828 billion thanks to an impressive 19.8% overall comp-store sales growth.
- Retail turnover from Europe rose 35.0% y-o-y mainly driven by the strong comp-store sales growth of 23.4%. Benelux recorded 48.7% y-o-y increase in turnover. Total retail selling space in Europe grew 11.6% y-o-y.
- Asia Pacific and North America recorded a turnover growth of 10% and 18% respectively while comp-store sales growth rates were 3% and 11% respectively.

Licensing

- Licensing turnover grew 6.6% to HK$211 million, accounting for 0.7% of the Group's total turnover. The Group works with over 30 licenses and offered more than 30 categories of Esprit licensed products.

Outlook & Prospects

- ***Wholesale initiatives*** Wholesale orders booked to December 2007 showed a mid-teen percentage y-o-y growth with the previous concerns on VAT hike effective 1/1/2007 seemed to have largely passed. Meanwhile, over 2,000 new controlled-space wholesale point-of-sales are expected to be added with over half of those being partnership stores, which are relatively bigger in size and more instrumental in brand building. Key focus will be put in Spain, Italy, India and the Middle East.
- **Rapid retail expansion** CAPEX of over HK$1 billion will be spent on opening new stores and renovating existing stores with a planned net addition of over 100 new directly managed retail stores or 31,000 sq.m retail selling space. In Europe, the Group will continue focusing on developing high growth potential markets such as France and the UK. The Group will double its investment in the US to US$40 million this year, adding 10 new stores.
- **More branding revamps** edc successfully spun-off from Esprit and became a free-standing brand. There are now 13 standalone edc stores located in Germany, Benelux and Switzerland and new edc standalone stores are planned in France, Austria, Hong Kong and India in FY08. A new product line under the Esprit family, "de. corp ESPRIT URBAN CASUAL" will be launched in Spring 2008. This new line targets the youngsters at the 20's age group.
- ***Exploring M&A opportunities on the back of strong financial position***
  Management maintained the view that M&A is a quick way to grow and tap into new markets but thought the current valuations of potential M&A targets are too expensive. Management think it is of the best interest to distribute the earnings as dividends (75% payout ratio) rather than buying M&A targets at hefty valuations that may not be earnings accretive.

- ***Lower effective tax rate*** The German government has decided to reduce the average corporate tax rate from 38.7% to about 29.8% beginning on 1/1/2008. With about 50% of total turnover generated from Germany, Management expects the effective tax charge to be 2%-3% lower from next year.

- ***Fair valuation*** The counter is currently trading at a FY08 PER of 20X. Such valuation is not demanding on the back of its estimated growth rates of 20+% in the next 2-3 years. Management are confident in delivering consistent performance (y-o-y total turnover growth of 18%+, operating margin widening about 1-2 percentage points y-o-y). International retailers trade at an average 2008 PER of 23X. Esprit can be valued conservatively at par to its peers. Its current valuation is reasonable when compared with other European retailers like Sweden's Hennes & Mauritz (23.8X) and Spain's Inditex Group (22.4X). Hence, we see any share-price weakness as an entry opportunity.

Recommendation: Buy on weakness

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