

**Analyst: Kelvin Li**
**LI & FUNG LIMITED (利豐)**

Sector	: Conglomerates	Non-executive Chairman	: Victor FUNG Kwok-king
HKSE Code	: 0494	Managing Director	: William FUNG Kwok-lun
Market Price	: HK\$31.85 (27/03/2008)		
HSI	: 22,664.22 (27/03/2008)		
Shares Issued	: 3,452.906 million		
Market Cap.	: HK\$109,975.0 million		
52-week Hi / Lo	: HK\$39.50 / HK\$22.40		

**SUMMARY OF THE FINAL RESULTS FOR THE YEAR ENDED 31<sup>ST</sup> DECEMBER 2007**
**Final Results Highlights**

	FY2007 <u>HK\$ million</u>	FY2006 <u>HK\$ million</u>	<u>Change</u>
• Turnover	92,460	68,010	+36.0%
• Core operating profit	3,187	2,344	+35.9%
• Gain on disposal of properties	457	72	+536.0%
• Amortization of intangible assets arising from business combinations	(19)	-	N/A
• Operating profit	3,600	2,412	+49.2%
• Net interest income/ (expense)	(291)	(50)	+487.9%
• Share of profit less losses of associated companies	5	11	-53.3%
• <b>Profit attributable to shareholders</b>	<b>3,060</b>	<b>2,202</b>	<b>+39.0%</b>
	<u>HK\$</u>	<u>HK\$</u>	
• EPS	0.895	0.671	+33.4%
• DPS – interim	0.210	0.160	+31.3%
• DPS – final	0.500	0.390	+28.2%
• DPS – total	0.710	0.550	+29.1%

- Li & Fung reported a solid 39.0% y-o-y rise in net profit to HK\$3.06 billion for the year ended 31<sup>st</sup> Dec 2007. However, the results were below market expectations of HK\$3.34 billion, mainly due to rising sales cost pressure, higher goodwill amortization following acquisition over the past year and a jump in interest expense.
- Turnover grew 36.0% y-o-y to HK\$92.5 billion (US\$11.9 billion) in FY07, completing its full-year turnover target of US\$10 billion per financial year set out in the 2005-2007 three-year plan. The Group's total margin (gross profit plus other revenues) as a % of sales dipped to 11.12% in FY07 from 11.24% a year earlier, mainly diluted by *KarstadtQuelle's* lower margin business.
- EPS for FY07 was HK\$0.895, against HK\$0.671 a year earlier. A final dividend of HK\$0.50 (FY06: HK\$0.39) per share was proposed, bringing the full-year dividend payout to HK\$0.71 (FY06: HK\$0.55), which represented a payout ratio of 79%, slightly down from 82% a year earlier.

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• **Segmental breakdown of core operating profits:**

	FY2007		FY2006		Change
	HK\$ million	%	HK\$ million	%	
Soft goods	2,364	74.2%	1,799	76.7%	+31.4%
Hard goods	823	25.8%	545	23.3%	+50.9%
<b>Total</b>	<b>3,187</b>	<b>100.0%</b>	<b>2,344</b>	<b>100.0%</b>	<b>+35.9%</b>

Li & Fung's **soft-goods** business saw a solid 31.4% y-o-y rise in core operating profit in FY07 on a 38.2% y-o-y turnover growth, accounting for 74.2% (FY06: 76.7%) of the Group's total. It was driven by solid organic growth as well as contributions from the newly acquired sourcing business of *Tommy Hilfiger* and *Regatta*. **Hard goods** business reported an even stronger 50.9% y-o-y jump in core operating profit on a 31.2% rise in turnover, accounting for 25.8% (FY06: 23.3%) of the Group's total. Both segments reported healthy margins for FY07, which helped maintain the Group's core operating profit margin at 3.45% in FY07.

• **Geographical breakdown of core operating profits:**

	FY2007		FY2006		Change
	HK\$ million	%	HK\$ million	%	
US	2,067	64.9%	1,639	69.9%	+26.1%
Europe	767	24.1%	435	18.5%	+76.5%
Canada	130	4.1%	109	4.6%	+19.1%
Australasia	97	3.1%	67	2.9%	+45.4%
Central and Latin America	57	1.8%	40	1.7%	+44.0%
Rest of the world	68	2.1%	55	2.3%	+24.4%
<b>Total</b>	<b>3,187</b>	<b>100.0%</b>	<b>2,344</b>	<b>100.0%</b>	<b>+35.9%</b>

The US market stayed as the top profit contributor in FY07, reporting a 26.1% rise in core operating profit to HK\$2.1 billion, which accounted for 64.9% (FY06: 69.9%) of the Group's total, thanks to the Group's establishment of US onshore business since 2004. The European segment registered the strongest profit growth, largely driven by the contribution from *KarstadtQuelle*.

**Outlook & Prospect**

- **Expanding into health, beauty and cosmetics business** Li & Fung is extending its foothold in health, beauty & cosmetics ("HBC") business via the acquisition of *C Group* and *Peter Black* last year. In 2008, the Group further enhance its HBC portfolio by buying the full control of C.D.P. Asia – an integrated manufacturer of point-of-purchase systems and solutions provider for global HBC brands. HBC expansion should help diversify and complement its soft-goods segment.
- **Setting another three-year plan** Li & Fung has revealed a new three-year plan for 2008-2010. Annual turnover is expected to reach US\$20 billion by 2010, representing an expected CAGR of 19% during the 2008-2010 period. Core annual operating profit is targeted to reach US\$1 billion by 2010, up by more than 1.4x from FY07, representing a CAGR of nearly 35% in 2008-2010.
- **Next strategic move – onshore business expansion in Europe & China** Since establishment in 2004, Li & Fung's US onshore business has been proceeding well and made a good contribution. The Group is now planning to expand its onshore business into Europe and China, leveraging on its existing onshore business platform and expertise in the US. Meanwhile, Li & Fung said it would set aside US\$100 million for small acquisitions this year, and it may come to financial markets for additional capital on large potential deals.
- **Further expansion to enhance earnings quality** Despite a possible recession in the US, Li & Fung said its order book stays strong so far in 2008. Trading at 26x FY08E P/E, we recommend a "HOLD" on the counter, as we should see the Group's sourcing business further strengthen and earnings quality further improve in the next three years.

**Recommendation: HOLD**



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