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HONG KONG RESEARCH
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Analyst: Kelvin Li

LI & FUNG LIMITED (利豐)

Sector	:	Conglomerates
HKSE Code	:	0494
Market Price	:	HK$24.95 (15/08/2007)
HSI	:	21,375.72 (15/08/2007)
Shares Issued	:	3,417.789 million
Market Cap.	:	HK$85,273.03 million
52-week Hi / Lo	:	HK$31.00 / HK$17.02

Chairman	:	Victor FUNG Kwok-king
Managing Director	:	William FUNG Kwok-lun

SUMMARY OF THE INTERIM RESULTS FOR THE SIX MONTHS ENDED 30TH JUNE 2007

Interim Results Highlights

	1H2007 HK$ million	1H2006 HK$ million	*Change*
• Turnover	37,772	27,970	*+35.0%*
• Core operating profit	1,179	836	*+41.0%*
• Amortization of intangible assets arising from business combinations	(4)	0	*N/A*
• Gain on disposal of properties	0	3	*-100.0%*
• Operating profit	1,175	839	*+40.0%*
• Net interest income	(46)	(20)	*+128.6%*
• Share of profit less losses of associated companies	8	12	*-27.4%*
• **Profit attributable to shareholders**	**1,051**	**764**	*+37.6%*
	HK$	HK$	
• EPS	0.308	0.236	*+30.5%*
• Interim DPS	0.210	0.160	*+31.3%*

- Li & Fung reported a 37.6% y-o-y rise in net profit to HK$1.051 billion for the six months ended 30th June 2007, beating consensus forecast of a 30% profit rise.
- Turnover grew 35.0% y-o-y to HK$37.8 billion in 1H07, accomplishing 48% of its full-year turnover target of US$10 billion (HK$78 billion) per financial year by 2007 under the current three-year (05-07) plan. The Group's total margin (gross profit plus other revenues) as a percentage of sales improved to 10.8% in 1H07 (1H06: 10.6%).
- EPS for the first half was HK$0.308, against HK$0.236 in 1H06. An interim dividend of HK$0.21 per share was proposed, which represented a payout ratio of 68%, little changed from a year earlier.
- **Segmental breakdown of core operating profits**:

	1H2007 HK$ million	1H2007 %	1H2006 HK$ million	1H2006 %	Change
Soft goods	1,002	85.0	720	86.2%	*+39.1%*
Hard goods	177	15.0	116	13.8%	*+52.7%*
Total	1,179	100.0	836	100.0	*+41.0%*

- Li & Fung saw strong volume and profit growth in both its soft- and hard-goods segments during the 1H2007. The higher-margin **soft-goods** business saw a solid 39.1% y-o-y rise in core operating profit in 1H07, accounting for 85.0% (1H06: 86.2%) of the total. It was driven by solid demand from its existing clients as well as contributions from the newly acquired outsourcing business of Tommy Hilfiger. **Hard goods** business reported an even stronger 52.7% y-o-y jump in core operating profit, accounting for 15.0% (1H06: 13.8%) of the Group's total. Both segments reported healthy margins for 1H2007, which helped lift the Group's core operating profit margin to 3.12% in 1H07 from 2.99% a year earlier.

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

	1H2007		1H2006		
	HK$ million	%	HK$ million	%	Change
US	806	68.3	566	67.7	*+42.2%*
Europe	242	20.5	175	20.9	*+38.3%*
Canada	50	4.2	41	4.9	*+21.2%*
Australasia	39	3.3	29	3.5	*+32.2%*
Central and Latin America	21	1.8	13	1.5	*+61.8%*
Rest of the world	22	1.9	11	1.3	*+94.2%*
Total	1,179	100.0	836	100.0	*+41.0%*

- The US market stayed as the top profit contributor during 1H2007, reporting a sharp 42.2% in core operating profit to HK$806 million, which accounted for 68.3% (1H06: 67.7%) of the Group's total. Acquisitions like Oxford Womenswear and the Rosetti handbag business were the key growth drivers. Growth in other regions was also strong as the global trend for outsourcing continued.

Outlook & Prospect

- ***Expanding into health, beauty and cosmetics business*** Li & Fung acquired CGroup in June 2007. With the purchase, the Group now extends its reach into health, beauty & cosmetics ("HBC") business, diversifying and enhancing its soft-goods segment.

- ***Buying spree continues*** After acquiring Tommy Hilfiger's sourcing operation and CGroup in 1H2007, the Group revealed two more new purchases along with its results announcement. The Group is acquiring Peter Black International, a company engaged in the design and development of footwear and beauty products, and New York-based Regatta, an apparel and brand management company. The acquisition should help strengthen Li & Fung's onshore business in both the US and Europe as well as speeding up the Group's expansion into the HBC market.

- ***A cautious US economic outlook materialized*** A slowdown in the housing market has been affecting different segments in the US, from subprime mortgage woes, triggering a global equities sell-off, to weakening economic sentiments. A possible slowdown in consumer sentiments would hurt both Li & Fung's hard and soft goods businesses. Latest figures showed that US consumer spending stayed solid in July 07. However, consumer sentiment is seen weakening substantially in August amid a sell-off in global equities, which may lead to a slowdown in orders next year.

- ***Further expansion to enhance earnings quality*** Li & Fung is on track to achieve its revenue target this year, as orders for 2H07 is more than 90% covered. As the current 3-year business plan will expire by end of 2007, the Group says it will reveal a new plan by early 2008. Developing HBC business and strengthening the European onshore business are seen being the key strategies in the next 3-yr plan. After recent stock market sell-off, valuation of Li & Fung has turned more reasonable at 29x FY2007E P/E. Nonetheless, we stay cautious that spill-over of the US subprime woes may hurt not only the US economy but also that of Europe. Accordingly, we recommend a "Hold" on the counter.

Recommendation: HOLD

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