

**BEA** securities

EAST ASIA SECURITIES COMPANY LIMITED

8/F, 10 Des Voeux Road Central, Hong Kong.

Dealing: 2842 3530 / 2842 3475 Research: 2842 3198 Facsimile: 2845 2937 / 2526 7992

HONG KONG RESEARCH**22nd February 2005**

Analyst: Kelvin Li

Main Board Listing – Research (Final)**I. T Limited [Stock Code: 0999]****Sole Sponsor** : CLSA Equity Capital Markets Limited**Coordinator, Bookrunner and Lead Manager** : CLSA Limited**Sector** : Consumer Discretionary**Business** : Apparel retailing**Total share offer:** 304,548,000 shares
(30.5% of the enlarged share capital)**Public Offer:** 30,456,000 shares (10%)**Placing:** 274,092,000 shares (90%)**Greenshoe:** 45,682,000 shares**Price:** HK\$1.75 – HK\$1.95 per share**Market Cap.:** HK\$1.75 billion – HK\$1.95 billion**Forecast FY2004/05 P/E:** 16.5x – 18.4x
(fully diluted)**Adjusted NTA per share:** HK\$0.63 – HK\$0.68**Staffing:** 1,067 (as of 14th February 2005)**HK Public Offer period:**
22nd February 2005 - 25th February 2005**Receiving bank:** Hang Seng Bank**Share registrar:** Computershare Hong Kong
Investor Service Limited**Listing date:** 4th March 2005**Business of I. T Limited**

Based in HK, the Group is a fast-growing apparel retailer. Founded in 1988, the company was initially engaged in selling *Dr. Martens* shoes under the name "GREEN PEACE". Since then, the company has developed into a multi-brand apparel retailer targeting the youth fashion market and was renamed "I. T". Via its multi-layer and multi-brand business model, the Group offers a wide range of apparel products, selling at varying prices to different customer groups.

The Group's brand portfolio could be divided into three main categories. (1) It distributes third-party international brands, via exclusive or non-exclusive distribution arrangements. (2) It distributes licensed international brands, in order to exert more control over pricing and the product range. (3) The Group develops in-house brands. These in-house brands are 100% owned by the company, which has full control over all design, sourcing, promotion and retail duties.

Since establishment, the Group has developed an extensive retail network in the Greater China, with 94 free-standing stores and 31 store-in-stores in HK. In the Mainland, it formed (HKEx: 0393) a 50-50 joint venture (GSIT) with Glorious Sun, which operates 23 concessions and sells apparel to 60 franchisee-owned free-standing stores and 2 franchisee-owned store-in-stores. In Taiwan, GSIT holds a 51% stake in a JV, operating 1 free-standing store and 8 concessions.

Major Shareholders after Listing (Assuming the over-allotment option is not exercised)

Sham family	67.2%
SCM Growth Fund	2.3%
	<u>30.5%</u>

This report has been prepared solely for information purposes and we are not soliciting any action based upon it. Neither this document nor its contents shall be construed as an offer, invitation, advertisement, inducement or representation of any kind or form whatsoever. The information is based upon information, which we consider reliable, but accuracy or completeness is not guaranteed. Opinions expressed herein are subject to change without notice. At time of this report, East Asia Securities Company Limited has no position in securities of the company or companies mentioned herein.

Use of Proceeds

Net proceeds from the offer are estimated to be HK\$432.5 million

(Assuming the over-allotment option is not exercised, and at an issue price of HK\$1.85 each, which is the mid-point of the indicative price range)

	HK\$ million
For funding the expansion of the Group's retail network in Hong Kong, including HK\$171 million for the opening of multi-brand stores, HK\$49 million for the opening of single brand stores and HK\$60 million for the renovation of the older stores in HK.	280
For funding the Group's retail network in the PRC and Taiwan, including HK\$40 million for the retail network expansion in the PRC and HK\$20 million for the retail network expansion in Taiwan.	60
For the repayment of a portion of the Group's existing long-term bank loans.	85
Remaining balance for general working capital.	7.5

Financial Highlights

	28 th February 2002 HK\$'000	Year ended 28 th February 2003 HK\$'000	29 th February 2004 HK\$'000	6 months ended 31 st August 2004 HK\$'000
Turnover	695,051	731,983	812,168	413,318
Gross profit/(loss)	384,247	415,703	485,597	253,118
Operating profit/(loss)	66,227	71,477	124,041	48,505
Net profit/(loss)	43,869	47,954	105,590	32,920

Breakdown of Turnover by Business Segments

	28 th February 2002 HK\$'000	%	Year ended 28 th February 2003 HK\$'000	%	29 th February 2004 HK\$'000	%	6 months ended 31 st August 2004 HK\$'000	%
Apparel from								
International brands	409,417	58.9	387,546	52.9	351,652	43.3	179,296	43.4
In-house brands	250,019	36.0	308,693	42.2	351,694	43.3	176,882	42.8
Licensed brands	0	0.0	6,885	0.9	69,234	8.5	39,169	9.5
Others*	35,615	5.1	28,859	4.0	39,588	4.9	17,971	4.3
Turnover	695,051	100.0	731,983	100.0	812,168	100.0	413,318	100.0

Remark (*): "Others" includes sales at a discontinued restaurant, sales revenue from off-season goods and discount outlets, royalties from the Malaysian franchisee, consultancy fees from a PRC franchisee and commissions on consignment sales.

Selected Financial Ratios

	28 th February 2002	Year ended 28 th February 2003	29 th February 2004	6 months ended 31 st August 2004
Gross margin	55.3%	56.8%	59.8%	61.2%
Net profit margin	6.3%	6.6%	13.0%	8.0%
Quick ratio	0.9	0.9	1.1	1.0
Inventory turnover days	61.5	62.4	66.7	95.2
Gearing ratio	28.8%	26.2%	17.1%	24.7%

Strengths/Opportunities

- ✓ According to government statistics, visitor arrivals in HK totalled more than 21 million in 2004, up 40% and 32% from 2003 and 2002, respectively. Influx of tourists should help boost the retail sector in HK. The Group, as a key local apparel retailer, should also benefit from the tourist boom.
- ✓ For the year ended 29th February 2004, when the local economy was suffering from SARS, the Group reported turnover of HK\$812 million and operating profit of HK\$124 million, up 10.95% and 73.5% y-o-y respectively from a year earlier. It demonstrated the management's capability to "keep the boat afloat" during tough times as well as the market acceptance of its product mix.
- ✓ The Group plans to maintain dividend payout ratio at 40%-50% in the future. However, dividend payout ratios are generally higher among retailing stocks. For instance, Giordano International (HKEx:0709) paid out more than 100% of its earnings as dividends in 2003.
- ✓ Shares of I. T Limited are priced at 16.5x – 18.4x FY2004/05E PE, which is in-line with sector peers when compared with Moisse International (HKEx: 0130)'s 18.7x FY2004/05E PE and Giordano International (HKEx: 0709)'s 18.3x FY2004E PE.

Weaknesses/Threats

- × For the six months ended 31st August 2004, sales revenue from international brands accounted for 43% of the Group's total turnover. The Group currently distributes apparel products from more than 400 international brands and usually carries only short-term or no contracts with these brands. Although each brand carries only a small portion of revenue contribution, discontinuation of a number of these brands may turn to have a significant impact on the company.
- × Outlets of the Group are located in major shopping malls in Hong Kong, while rental expenses accounted for a significant part of the total operating expenses. Operating lease rentals was about 17% of total turnover from 2002 to 2004, while the Group said it plans to keep the ratio below 20% in the coming years. According to property agencies, rent for prime retail locations in Hong Kong has risen more than 50% over 2004. Some major landlords, like Sun Hung Kai Properties (HKEx: 0016), said they will further raise rent in 2005. Rising rental expenses would push up the overall operating costs of the Group and accordingly would eat into its profit margins.
- × For the year ended 28th February 2004, 98% of the total revenue of the Group was from the Hong Kong market. Since establishment in 1996, the Group has already developed a pretty mature retail network in Hong Kong. Therefore, room for further organic growth and local market penetration is becoming quite saturated. The Group said they would look for expansion opportunities in the Mainland and expect the existing mainland business would turn profitable by February 2006. However, it remains uncertain as to whether its multi-layer and multi-brand business model would be successful in China.

Recommendation: Trading Buy