
THE GLOBAL CONTRARIAN

March 30, 2011

Lai Sun Garment (International) Limited

(BUY)

Price: HKD0.98

52-Week Range: HKD0.48– HKD1.27

FD Shares Outstanding: 1,617 million

Market Capitalization: HKD1,585 million (\$203 million)¹

Data as of March 23, 2011

¹One Hong Kong Dollar (HKD) is equivalent to \$0.1283, as of March 23, 2011.

²The common shares of Lai Sun Garment (International) Limited trade on the Hong Kong Stock Exchange.

Ticker²: 191 HK

Dividend: N/A

Yield: N/A



*Exclusive Marketers of
The Global Contrarian*

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THE GLOBAL CONTRARIAN

Investment Thesis

Lai Sun Garment (International) Limited (191 HK), originally founded in 1947 as a garment manufacturer, is a Hong Kong-based conglomerate whose businesses comprise property development in Hong Kong and Mainland China, hotel operations, and media and entertainment interests. For those able to invest in a company with Lai Sun Garment's limited market capitalization (approximately \$200 million) and free float, the upside is quite attractive, as Lai Sun Garment currently trades at a 20% discount to the value of its publicly traded equity interest in Lai Sun Development Company (488 HK) and its net cash position, attributable to the parent company (i.e. excluding minority interests), of HK\$237 million. Given this valuation discrepancy, shares of Lai Sun Garment are recommended for purchase.

The inefficient pricing of Lai Sun Garment's shares appears to be due, in part, to the reorganization of the ownership structure among its constituent companies that occurred in September 2010. Further, Lai Sun Garment, which reports its operating results semi-annually and operates on a July-ending fiscal year, has not yet issued financial statements that reflect this reorganization. Despite this, much of Lai Sun Garment's value is readily identifiable, and the discount to fair value is significant enough to render irrelevant this temporary lack of visibility.

Adjusting for the recent reorganization, Lai Sun Garment owns 47.97% of Lai Sun Development Company (488 HK). Lai Sun Development's current market capitalization is HK\$3.6 billion, which places the market value of Lai Sun Garment's stake at HK\$1.7 billion. This equity stake alone is worth more than Lai Sun Garment's current market capitalization of HK\$1.6 billion and seemingly ignores HK\$237 million in estimated net cash attributable to Lai Sun Garment, as well as its core operations.

It is also interesting to note that Lai Sun Development is valued at a significant discount to book value, with a market capitalization of HK\$3.6 billion relative to shareholder's equity, attributable to the company, of HK\$5.7 billion. Should Lai Sun Development trade at a valuation on par with book value, the upside to Lai Sun Garment's valuation would be substantial. Further, Lai Sun Development owns a 36.08% stake in eSun Holdings (571 HK), which in turn owns a 40.58% stake in Lai Fung Holdings (1125 HK), both of which trade at significant discounts to book value. The potential ripple effect if each of these entities were to trade at fair value would be an additional, and significant, driver of Lai Sun Garment's valuation.

THE GLOBAL CONTRARIAN

Company Description

Lai Sun Garment (“Garment”) is a Hong Kong-based conglomerate whose core business focuses on real estate development. The company has significant interests in associates and subsidiaries, including direct and indirect holdings in Lai Sun Development Company, eSun Holdings Limited, and Lai Fung Holdings Limited, all of which are publicly traded. These companies operate in the following industries.

Lai Sun Garment

Garment derives its revenues primarily from rental and related income from industrial properties held for investment and its newly opened Crocodile Center, a commercial development project in the Kowloon region of Hong Kong. Garment owns the retail portion of the Crocodile Center project, most of which it has leased to restaurants and retail brands. Garment also owns a 47.97% stake in Lai Sun Development.

Lai Sun Development

Lai Sun Development is engaged in property development and investment in Hong Kong. The company also operates hotels and restaurants in the region and earns the vast majority of the revenues from this segment from the Caravelle Hotel in Ho Chi Minh City, Vietnam. Lai Sun Development also currently holds a 36.08% equity interest in eSun Holdings.

eSun Holdings

eSun’s businesses operate within the media and entertainment industry. The company is also involved in the development of Macao Studio City, an integrated resort that plans to offer retail stores, concert venues, gaming facilities, and world-class hotels via its 40% interest in a jointly controlled entity. This development, however, has been embroiled in various regulatory and legal disputes and appears to be at a standstill. The company also holds a 40.58% equity interest in Lai Fung Holdings.

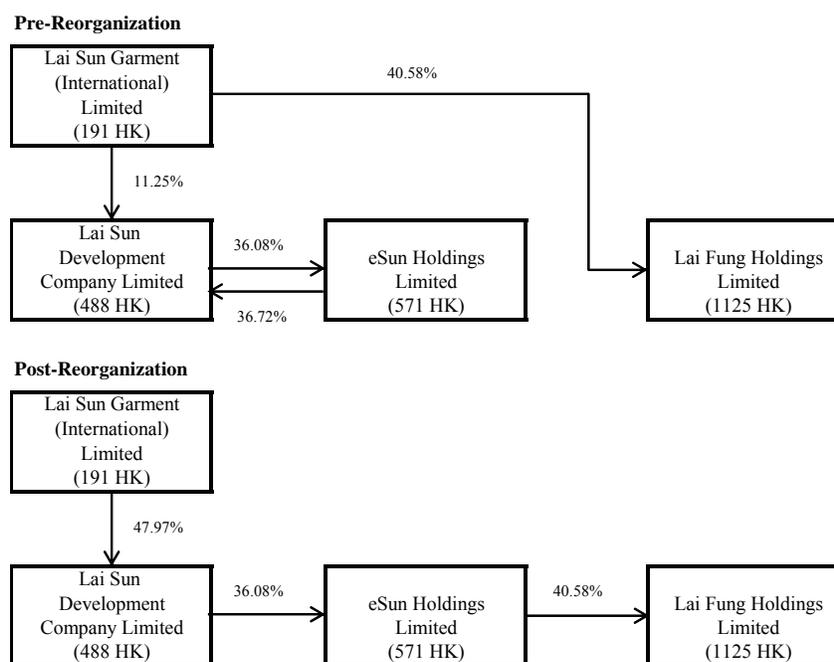
Lai Fung Holdings

This entity is principally engaged in property development and investment in Mainland China and currently has property projects in Shanghai, Guangzhou, and Zhongshan.

Prior to September 2010, these publicly traded entities were organized under a somewhat opaque cross-holding structure, which is shown in Exhibit 1 as the “Pre-Reorganization” structure. Following the September 2010 reorganization, the companies’ ownership was changed to the significantly simpler “Post-Reorganization” structure. Put simply, the reorganization involved transferring eSun Holdings’ 36.72% ownership in Lai Sun Development, along with HK\$178.4 million in cash, to Lai Sun Garment in exchange for its 40.58% stake in Lai Fung Holdings.

THE GLOBAL CONTRARIAN

Exhibit 1 Lai Sun Garment: Reorganization of Ownership Structure



Source: Company reports and Institutional Research Group estimates.

Although the September 2010 reorganization greatly simplified the group's structure, these companies have yet to report financials that reflect this change. Garment, Lai Sun Development, and Lai Fung Holdings operate on a fiscal year that ends July 31, which means their last annual reports (the most recent filing), as well as their next interim reports, will reflect the minority interests associated with the ownership structure that existed prior to the reorganization. Still, the appropriate adjustments can be made to each company's balance sheet, and, when one does so, one finds that all of these companies trade at significant discounts to the equity attributable to their shareholders. Further, in the case of both Garment and eSun, no value is given to these companies' core operations, as the market value of their equity holdings is equal to or greater than the enterprise value of the company.

In addition to any confusion related to this reorganization, shares of the companies are also likely trading at a discount to book value due to concerns about a bubble in the Hong Kong and Mainland China real estate markets. These concerns have been addressed in previous *Global Contrarian* reports, but a brief summary of the commercial real estate market in Hong Kong, which is the primary market for Garment and Lai Sun Development, is provided below.

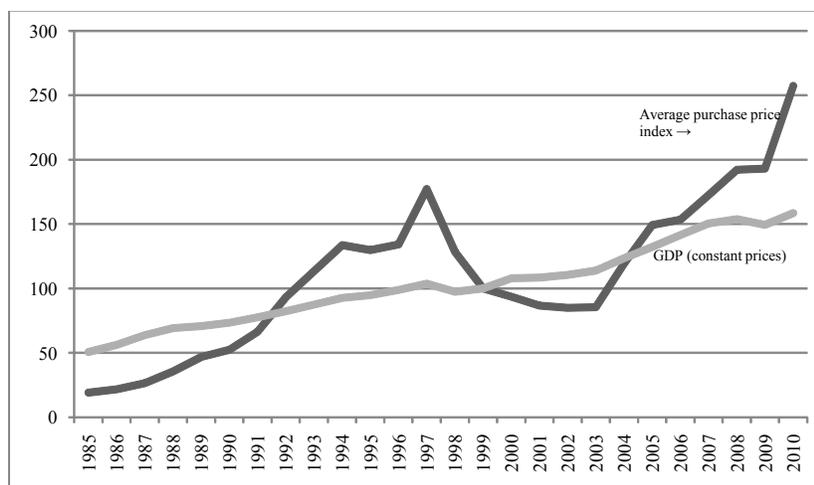
Hong Kong Real Estate Market

Valuations in Hong Kong's real estate market have fluctuated dramatically over the last twenty-five years, although observers seem to attach particular significance to the recent run-up that has occurred from 2002 to today. Over this time period, which begins with a trough in valuations that was the culmination of a multi-year decline in asset values, real estate prices have grown at a compound annual rate of nearly 15%. This growth, however, needs broader historical context.

THE GLOBAL CONTRARIAN

As shown in Exhibit 2, real estate values in 2002 were on par with the prices seen in 1992, with the intervening years representing the period during which Hong Kong gained its independence, an event that seems to have initially placed downward pressure on real estate prices. If one examines this market using 1992 as the base year, one finds that real estate values have grown at a compound annual rate of 5.8%. This is only modestly higher than GDP growth of 3.7% over this period.

Exhibit 2 Hong Kong Residential Market: Average Rental Price, Average Purchase Price, and Vacancy Rates



Source: International Monetary Fund and Hong Kong Rating and Valuation Department.

Depending on the period one chooses to examine, therefore, the appreciation in Hong Kong real estate values does not suggest that this market is dramatically inflated. Further, in the context of the current price-to-book value multiples for companies with exposure to Hong Kong real estate, these concerns are more than reflected in the equity of these companies. For example, shares of Lai Sun Development are trading at more than a 60% discount to book value, which would imply that real estate values could decline to levels seen in the early 1990's before the company would trade on par with book value. In this context, fears of a real estate bubble in Hong Kong are more than priced into the shares of companies such as Garment and Lai Sun Development.

Ownership Structure/Corporate Governance

It bears noting that Garment's Deputy Chairman, Peter Lam Kin Ngok, is the beneficial owner of 37.69% of Garment's shares, and is the son of Lai Sun Group's original founder, Lim Por-yen. The majority of this stake is held through Wisdoman Limited, which owns 484,991,750 shares of Garment (approximately 30%), and Mr. Lam Kin Ngok is listed as the beneficial owner of these shares via his 50% ownership in Wisdoman. The other 50% owner in Wisdoman, U Po Chu, was Lim Por-yen's second wife and is also listed as a beneficial owner of these shares.

Two of Lim Por-yen's other sons, Lam Kin-ming (Chairman of Lai Sun Garment and Deputy Chairman of Lai Fung Holdings) and Lam Kin-hong (Executive Deputy Chairman of Lai Fung Holdings), are directors of the Lai Sun Garment group of companies and have equity ownership stakes of less than 1%. Only three of Lai Sun Garment's eleven directors are independent.

THE GLOBAL CONTRARIAN

Lastly, it should be noted that, in 1999, Lim Por-yen was found guilty on charges of bribery and money laundering. He was in the process of appealing his conviction when he died in 2005.

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Valuation Analysis

Although confusion remains as to what Garment's financials will look like now that it has reorganized, it can be argued that an investment in this company can be justified based solely on the market value of its equity stake in Lai Sun Development and the net assets attributable only to the company (i.e., excluding minority interests). Although changes in the company's earnings and consolidated balance sheet can certainly be expected once Garment reports its next interim period, the company's current valuation insulates investors from these changes, as well as any potential deterioration in real estate values, and leaves significant upside to Garment's share price.

In fact, an investment in Garment appears to be justified based solely on the value of its stake in Lai Sun Development. As shown in Exhibit 3, Garment's 47.97% stake in Lai Sun Development has a current market value of HK\$1,732 million, compared to a market capitalization for Garment of HK\$1,585 million and an enterprise value of HK\$1,677 million when considering the consolidated company's net debt. This implies a slight negative valuation for Garment's core business, even though the company, excluding its investment in Lai Sun Development and adjusted for the reorganization outlined above, has shareholders' equity of HK\$632 million. It is also interesting to note that the majority of the consolidated company's debt is attributable to a subsidiary and that the company, as a stand-alone entity, has a net cash position of HK\$237 million.

Exhibit 3 Lai Sun Garment: Current Stub Valuation

(HK\$ in thousands, except per share amounts; shares in thousands)

Lai Sun Garment		Lai Sun Development	
Share Price (3/23/11)	0.98	Share Price (3/23/11)	0.255
Shares Outstanding	1,617,423	Shares Outstanding	14,162,042
Market Capitalization	1,585,075	Market Capitalization	3,611,321
Consolidated Net Debt (Cash)	91,896		
Enterprise Value	1,676,971	Value of 47.97% Stake Held by Garment	1,732,351
Value of interest in Lai Sun Development	1,732,351		
Stub Value of Lai Sun Garment	(55,380)		
Company Net Debt (Cash)	(237,425)		
Equity per Company's Statement of Financial Position, excluding Lai Sun Development and adjusted for reorganization	632,356		

Source: Company reports and Institutional Research Group estimates.

Even if one believed that Garment deserves a valuation equal to only 0.5x the equity attributable to the company, this value, when added to the market value of its stake in Lai Sun Development, implies share price appreciation of nearly 30% (Exhibit 4).

THE GLOBAL CONTRARIAN

Exhibit 4 Lai Sun Garment: Fair Value Estimate and Upside Potential

(HK\$ in thousands)

Shareholder's equity valued at 0.5x book value	316,178
Value of stake in Lai Sun Development	1,732,351
Equity value of Lai Sun Garment	2,048,529
Current market capitalization	1,585,075
Upside potential	29%

Source: Company reports and Institutional Research Group estimates.

This exercise assumes, of course, that the market price of the company's stake in Lai Sun Development is fair. It could be argued, however, that Lai Sun Development also currently trades at a significant discount to fair value.

As shown in Exhibit 5, Lai Sun Development has a current market capitalization of HK\$3,611 million, which represents less than 0.4x book value excluding non-controlling interests. This book value, however, includes the company's 36.08% share of net assets in eSun Holdings, which is also trading at a significant discount to book value. To be conservative, therefore, investors could look at the equity attributable only to the company, which does not include the net assets in eSun, and add the market value of its equity interest in eSun. Even when using this more conservative measure, Lai Sun Development trades at less than 0.6x book value.

Exhibit 5 Lai Sun Development: Valuation Relative to Book Value

(HK\$ in thousands, except per share amounts; shares in thousands)

Lai Sun Development	
Share Price (3/23/11)	0.255
Shares Outstanding	14,162,042
Market Capitalization	3,611,321
Shareholders' equity, excluding non-controlling interests	
P/BV	.38x
Equity per Company's Statement of Financial Position	5,698,500
Value of 36.08% stake in eSun Holdings	774,445
Total	6,472,945
P/BV	.56x

Source: Company reports and Institutional Research Group estimates.

If Lai Sun Development were to trade at parity to the company's book value plus the value of its eSun interest, it would realize share price appreciation of approximately 80%. The resulting increase in the value of Garment's holdings in Lai Sun Development would then warrant an increase in Garment's share price of over 100%.

By continuing this exercise, one would uncover even greater upside to Garment's share price. For example, it can be argued that eSun Holdings is significantly undervalued relative to its net assets, especially when considering the market value of its interest in Lai Fung Holdings. Any appreciation in eSun's equity would, in turn, increase the value of Lai Sun Development and, therefore, increase the value of Garment. Lastly, one may find Lai Fung Holdings to be significantly undervalued, as the company trades at only 0.3x book value.

THE GLOBAL CONTRARIAN

As mentioned earlier in this report, these discounts to book value likely reflect concerns about a real estate bubble in Hong Kong (in the case of Garment and Lai Sun Development) and Mainland China (in the case of Lai Fung Holdings), which would lead to significant asset impairments if this bubble were to burst. Garment has otherwise posted significant growth in book value per share in recent years, which should give investors an added degree of confidence in Garment's prospects if they believe these real estate concerns are already priced into the company's shares.

As shown in Exhibit 6, Garment has posted compounded annual growth in book value per share of nearly 12% since 2004 (years prior to 2004 use different accounting standards). However, it should be noted that Garment experienced significant declines in book value during the period 1998-2002, when shareholders' equity declined from HK\$9.1 billion to HK\$1.8 billion, largely due to Garment's share of losses in Lai Sun Development.

Exhibit 6 Lai Sun Garment: Book Value per Share Growth (HK\$ in thousands, shares in thousands)

Year-Ending July 31st,	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Equity Attributable to Shareholders	3,258,486	1,841,753	1,710,313	1,884,016	2,989,073	2,959,513	3,374,688	3,455,942	3,635,847	4,130,818
Shares Outstanding ('000s)	1,437,710	1,437,710	1,437,710	1,437,710	1,617,423	1,617,423	1,617,423	1,617,423	1,617,423	1,617,423
Book Value per Share	2.27	1.28	1.19	1.31	1.85	1.83	2.09	2.14	2.25	2.55
CAGR in Book Value per Share 2004-2010	11.8%									
CAGR in Book Value per Share 2001-2010	1.3%									

Source: Company reports and Institutional Research Group estimates.

Investors should note that if Lai Sun Development were to experience impairments of this magnitude again, the company would still trade at less than 1.2x book value once adjusted for its equity stake in eSun – a multiple that would not be unusual for a company of this type in a more normalized real estate environment. Because of this, the worst-case scenario for Garment has arguably been priced into its current valuation, while significant upside exists should the real estate market experience anything better than the extreme deterioration in values currently indicated by its share price. As such, shares of Garment are recommended for purchase.

THE GLOBAL CONTRARIAN

Conclusion

The entities within Lai Sun Garment's group of companies are undervalued relative to their net asset values and the market values of the publicly traded equity stakes they hold in each other. Lai Sun Garment's enterprise value, for example, represents a discount to just the market value of its equity stake in Lai Sun Development, so Garment is, therefore, getting no credit for its core development business. If any value were to be given to its core assets, Garment could easily realize share price appreciation of approximately 30%.

Significant share price appreciation is possible, moreover, if each of the companies within the group realizes valuations that are more reflective of its net assets and the market value of its publicly traded equity stakes. Under the new organizational structure, any increase in the market value of these companies should have a daisy-chain effect on the valuations of each company above it in the ownership hierarchy, ultimately ending with Garment. A more efficient pricing of the companies within the group could cause Garment's market value to more than double.

Given that there is significant downside protection for Garment via the market value of Lai Sun Development, and considering the substantial upside potential that would result from a more appropriate valuation of each of the companies within the group, shares of Garment are recommended for purchase.

THE GLOBAL CONTRARIAN

Exhibit 7 Lai Sun Garment: Consolidated Balance Sheet (HK\$ in thousands)

	2010	2009
Non-Current Assets		
Property, Plant and Equipment	316	667
Investment Properties	1,046,600	194,800
Properties Under Development	0	454,061
Interests in Associates	3,347,221	3,147,767
Available-for-Sale Equity Investments	243,709	210,522
Total Non-Current Assets	4,637,846	4,007,817
Current Assets		
Promissory Note Receivable	0	167,000
Debtors, Deposits Paid and Other Receivables	6,262	5,154
Tax Recoverable	682	0
Cash and Cash Equivalents	317,449	75,657
Total Current Assets	324,393	247,811
Current Liabilities		
Creditors, Deposits Received and Accruals	66,537	47,824
Tax Payable	0	204
Interest-Bearing Bank Borrowings	16,000	247,000
Total Current Liabilities	82,537	295,028
Total Assets Less Current Liabilities	4,879,702	3,960,600
Non-Current Liabilities		
Interest-Bearing Bank and Other Borrowings	376,745	31,745
Note Payable	195,000	195,000
Accrued Interest Payable	78,188	66,851
Deferred Tax Liabilities	86,041	31,157
Long Term Rental Deposits Received	12,910	0
Total Non-Current Liabilities	748,884	324,753
Equity Attributable to Shareholders of the Company	4,130,818	3,635,847

Source: Company reports.

THE GLOBAL CONTRARIAN

Exhibit 8 Lai Sun Garment: Balance Sheet

(HK\$ in thousands)

	2010	2009
Non-Current Assets		
Property, Plant and Equipment	218	667
Investment Properties	246,600	194,800
Interests in Subsidiaries	279,887	317,936
Interests in Associates	378,590	376,471
Available-for-Sale Equity Investments	219,367	190,692
Total Non-Current Assets	1,124,662	1,080,566
Current Assets		
Promissory Note Receivable	0	167,000
Debtors, Deposits Paid and Other Receivables	4,514	4,891
Tax Recoverable	682	0
Cash and Cash Equivalents	285,770	74,070
Total Current Assets	290,966	245,961
Current Liabilities		
Creditors, Deposits Received and Accruals	19,157	15,804
Tax Payable	0	204
Interest-Bearing Bank Borrowings	0	15,000
Total Current Liabilities	19,157	31,008
Total Assets Less Current Liabilities	1,396,471	1,295,519
Non-Current Liabilities		
Interest-Bearing Bank and Other Borrowings	31,745	31,745
Note Payable	195,000	195,000
Accrued Interest Payable	78,188	66,851
Deferred Tax Liabilities	39,625	31,157
Total Non-Current Liabilities	344,558	324,753
Equity	1,051,913	970,766

Source: Company reports.