

**Li Ning Co Ltd ----- Maintain UNDERPERFORM**

**FY14 results in line; future strategy sounds right, but execution and profitability remain key risks**

**EPS: ▼ TP: ◀▶**

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- Li Ning reported in-line results with retail revenue +28% YoY and wholesale +10% YoY; however, it still recorded Rmb781 mn of net losses or Rmb855 mn of recurring net losses in 2014.
- Pros and cons: Pros include (1) Mr Li as interim CEO, likely until turnaround; (2) new initiatives in e-commerce and future plan to adjust to young people's lifestyle changes; and (3) SSSG and trade fair data are encouraging. Cons include (1) margins and working capital distorted due to lack of details on retail vs wholesale; (2) limited cost savings; and (3) lack of transparency and visibility.
- Our simple score card (Figure 2) suggests that although the company seems to be following the right strategy and direction, execution and poor fundamentals remain overhangs. We don't believe the company will turn profitable in 2015 given the low sell-out ratio.
- We believe the market over-reacted to the company's incremental improvement. We fine-tune our estimates, but our target price of HK\$1.8 is unchanged. We believe the high valuation (2.2x 2015E P/B) for a loss-making company is not justified.

<b>Bbg/RIC</b>	2331 HK / 2331.HK	<b>Price (19 Mar 15, HK\$)</b>	4.04		
<b>Rating (prev. rating)</b>	U (U) [V]	<b>TP (prev. TP HK\$)</b>	1.80 (1.80)		
Shares outstanding (mn)	1,885.21	Est. pot. % chg. to TP	(55)		
Daily trad vol - 6m avg (mn)	5.4	52-wk range (HK\$)	5.65 - 2.78		
Daily trad val - 6m avg (US\$ mn)	2.3	Mkt cap (HK\$/US\$ mn)	7,616.2/ 981.8		
Free float (%)	77.2	<b>Performance</b>	<b>1M</b>	<b>3M</b>	<b>12M</b>
Major shareholders	Mr. Li Ning (22.8%)	Absolute (%)	26.6	39.5	(24.9)
		Relative (%)	25.5	30.6	(47.1)
<b>Year</b>	<b>12/13A</b>	<b>12/14A</b>	<b>12/15E</b>	<b>12/16E</b>	<b>12/17E</b>
Revenue (Rmb mn)	5,824	6,728	7,549	8,342	9,255
EBITDA (Rmb mn)	(517.2)	(404.4)	148.1	514.5	728.9
Net profit (Rmb mn)	(391.5)	(781.5)	(124.6)	226.6	314.2
EPS (Rmb)	(0.27)	(0.50)	(0.07)	0.09	0.13
- Change from prev. EPS (%)	n.a.	n.a.	n.m	(2)	
- Consensus EPS (Rmb)	n.a.	n.a.	0.01	0.19	
EPS growth (%)	n.m.	n.m.	n.m.	n.m.	38.6
P/E (x)	n.m.	n.m.	n.m.	34.7	25.0
Dividend yield (%)	0	0	0	0	0
EV/EBITDA (x)	(11.3)	(16.3)	36.3	9.9	6.3
P/B (x)	1.9	2.7	2.2	2.0	1.8
ROE (%)	(18.2)	(33.7)	(5.0)	7.2	9.1
Net debt(cash)/equity (%)	(7.7)	23.3	(21.6)	(29.0)	(38.7)

Note 1: ORD/ADR=25.00. Note 2: Li Ning engages in research and development, design, manufacturing, distribution and retailing of sports footwear, apparel and accessories for sport and leisure use mainly in China.

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**FY14 results in line with profit warning**

Li Ning reported FY14 results, with revenue up 15.5% and a net loss of Rmb781 mn, in line with the earlier profit warning. The full-year recurring loss was Rmb855 mn, which only slightly improved YoY. For 2H alone, Li Ning reported 23% YoY revenue growth, but still posted recurring losses of Rmb415 mn (or total losses of Rmb196 mn, including the writeback for inventories and receivables of Rmb219 mn).

**Scorecard suggests high valuation is not justified**

Our simple scorecard on the company's fundamentals suggests that although the company seems to be following the right strategy and direction, execution and poor fundamentals remain overhangs. We expect it to be loss-making in 2015E, and believe the stock is overvalued.

**Figure 1: Li Ning FY14 results review**

(Rmb mn)	2014	2013	YoY%	AvsE%	2H14	YoY%	HoH%
<b>Turnover</b>	<b>6,728</b>	<b>5,824</b>	<b>15.5</b>	<b>2.1</b>	<b>3,591</b>	<b>23.0</b>	<b>14.5</b>
- LI-NING retail	2,124	1,657	28.2	2.1	1,100	23.9	7.4
- LI-NING wholesale	3,630	3,289	10.4	11.1	2,037	23.5	27.8
- LI-NING export	178	137	29.7	-57.2	122	38.3	117.0
- Other brands	796	741	7.3	-3.9	332	13.1	-28.4
<b>Adj. gross profit *</b>	<b>2,886</b>	<b>2,390</b>	<b>20.7</b>	<b>-3.2</b>	<b>1,468</b>	<b>17.5</b>	<b>3.5</b>
Adj. gross margin (%)	42.9	41.0	1.9 pp	-2.4 pp	40.9	-1.9 pp	-4.3 pp
S&D/sales	42.6	45.9	-3.4 pp	-1.5 pp	41.5	-8.7 pp	-2.2 pp
Admin/sales **	9.8	9.8	0.0 pp	-2.0 pp	8.1	-2.4 pp	-3.6 pp
<b>Adj. operating profit</b>	<b>-603</b>	<b>-710</b>	<b>n.m.</b>	<b>n.m.</b>	<b>-300</b>	<b>n.m.</b>	<b>n.m.</b>
Adj. OPM (%)	-9.0	-12.2	3.2 pp	-0.1 pp	-8.4	6.7 pp	1.3 pp
<b>Reported net profit</b>	<b>-781</b>	<b>-392</b>	<b>n.m.</b>	<b>n.m.</b>	<b>-196</b>	<b>n.m.</b>	<b>n.m.</b>
Reported NPM (%)	-11.6	-6.7	-4.9 pp	0.8 pp	-5.5	1.7 pp	13.2 pp
Reported diluted EPS	-0.50	-0.27	n.m.	n.m.	-0.21	n.m.	n.m.
<b>Recur. net profit</b>	<b>-855</b>	<b>-933</b>	<b>n.m.</b>	<b>n.m.</b>	<b>-415</b>	<b>n.m.</b>	<b>n.m.</b>
Recur. EPS (Rmb)	-0.55	-0.64	n.m.	n.m.	-0.33	n.m.	n.m.

Note: \*COGS excluded inventory write back/provision. \*\*Admin expenses excluded AR write down/provisions. Source: Company data, Credit Suisse estimates

**Figure 2: Scorecard: right direction, but lots of execution risks**

	Pros	Cons	Score
<b>Strategy &amp; outlook</b>			<b>3</b>
Product focus:	Chairman said sportslife accounted for ~90% of market	Company has talked about mass market and sportslife for a few years. Will it be really different this time?	2
Channel development: ~500 new stores in 2015	New stores will be focused on Southern China, most by distributors, not retail for expense control	Are distributors willing to open stores in areas where Li Ning lost to Jinjiang brands?	2
Cost control and execution discipline	A&P expenses dropped from 24% of rev to 19% 22%YoY, +0.7pp to 12.2% of revenue	But labor cost increased	3
E-commerce and digitalisation	Co-operation with Mi-Band, new lifestyle change	Execution risk	5
Trade fair order	+high teens for 3Q15; +double digit for 9M15	In line with peers	5
CEO position	Chairman Li as interim CEO, likely until turnaround	Lack of track record	4
2015 profitable?	Chairman: confident (but no promise)	Low chance due to fixed operating expenses, such as committed sponsorship	1

**Fundamentals**

SSSG improvement in 4Q14	+hsd for direct retail, +msd for distributors' stores	In line with peers	4
Trade receivables days	Company: reduced with revenue growth	Distorted by increased direct retailing	1
Channel inventory <8mn at end 2014	Company: significant improvement	Deteriorated from 7m at Jun 2014	1
Company inventory	Company: due to direct retailing mainly	But still +37%YoY, vs. 28% retail revenue growth	1
Wholesale vs. retail	Revenue split available	No breakdown on GPM, OPM or working capital	1
New product sell out	3M 31%, 6M: 58%; target 6M 70%	Much lower than peers	1
Quarterly update	Company: yes, all major operational data available	But there is no regular release or announcement	1

Note: Score - 5 highest, 1 lowest. Source: Company data, Credit Suisse estimates

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**Li Ning Co Ltd** (2331.HK, HK\$4.04, UNDERPERFORM[V], TP HK\$1.8)

**Disclosure Appendix**

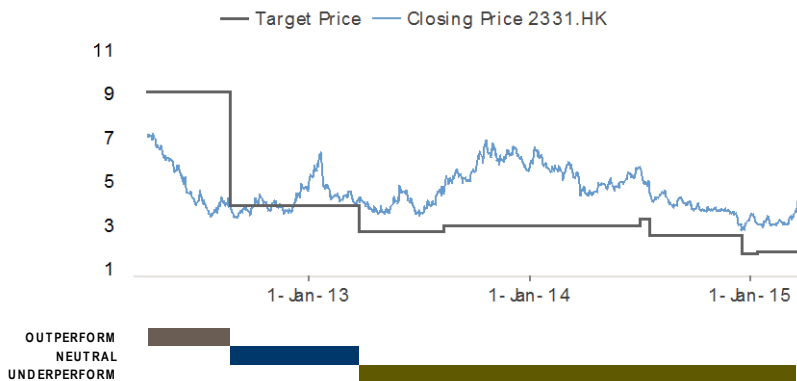
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2331.HK	Closing Price	Target Price	
Date	(HK\$)	(HK\$)	Rating
10-Apr-12	7.09	9.08	O
11-Apr-12	7.06		*
24-Aug-12	3.88	3.90	N
26-Mar-13	4.05	2.72	U
12-Aug-13	4.46	3.00	
03-Jul-14	5.55	3.27	
18-Jul-14	4.47	2.54	
18-Dec-14	2.80	1.70	
12-Jan-15	3.08	1.80	

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**Price Target: (12 months) for Li Ning Co Ltd (2331.HK)**

**Method:** Our target price of HK\$1.8 for Li Ning is based on a target price-to-book (P/B) multiple of 1.0x 2015E book value per share. We believe such a low target multiple is justified given its high execution risks and low profitability (or even loss making situation).

**Risk:** Risks to our target price of HK\$1.8 include: (1) the longer than expected transformation and execution risk in its retail focus new strategy; (2) prolonged inventory clean-up; (3) the worse than expected A&P spending and labor costs; (4) failure to improve SSSG and to grow trade fair orders; and (5) lack of working capital control and cash needs; (6) stability of management team. Upside risks include faster turnaround than expected and improvement in profitability.

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When you purchase non-listed Japanese fixed income securities (Japanese government bonds, Japanese municipal bonds, Japanese government guaranteed bonds, Japanese corporate bonds) from CS as a seller, you will be requested to pay the purchase price only.

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