



Rating
Sell

Asia
China

Consumer
Textiles & Apparel

Company
Li Ning Co Ltd

Reuters 2331.HK	Bloomberg 2331 HK	Exchange HKG	Ticker 2331
ADR Ticker LNNGY	ISIN US52989T1025		

Date
20 March 2015

Forecast Change

Price at 19 Mar 2015 (HKD)	4.04
Price target - 12mth (HKD)	2.80
52-week range (HKD)	6.23 - 2.94
HANG SENG INDEX	24,120

Execution remains a major concern; maintaining Sell

Costly top-line growth

Li Ning (LN) recorded 24% sales growth in 2H14 and mid-teen to mid-twenties growth for 9M15 order book. However, the sales rebound was costly given expansion in core loss in 2H14 vs.1H14. In our view, LN should address how to sustain top line growth in a cost-effective way and lead to profitability from 2015. Management is confident of making profit in FY15. We see scope for long-term earnings and cash flow recovery but current valuations already more than price in this outlook, especially given the company's relatively high risk profile. Execution concern arises when LN resumes net store growth and re-taps into sports life segment to gain lost market share; maintaining Sell.

2015 – the beginning of a new development stage

Chairman Mr. Li Ning is appointed as interim CEO and confident that the company will turn profitable this year. While the operation is not yet optimized, good progress has been made which built up a solid foundation for growth since FY15. More improvements are required to resume profitability, i.e. cost structure optimization, working capital management and channel profitability. Platform cost to retail business is a key drag and takes time to be digested when scale grows. Cost saving will start from staffing and ad spending.

Regain mass market share and re-tap into sports life segment

LN added sports life as the other market positioning in addition to sports functionality, in order to tap broad customer base with more affordable pricing. Given a focus on sports functionality in the past two years, it lost market share in mass market where more local peers concentrate. Its collaboration with Mi Band and crossover with Marvel would be the first step. In addition, it plans 500 net store additions to regain its lost market share.

Maintaining target price at HKD2.8; risks

We lowered our FY15-16E EPS by 3.9-14.6% based on FY14 results. Our target price is maintained at HKD2.8 as we roll over 1-year forward valuation. It implies 22x FY15E PE. Upside risks: strong execution and a faster retail recovery; cost control.

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Price/price relative



Performance (%)	1m	3m	12m
Absolute	25.1	26.6	-31.9
HANG SENG INDEX	-2.9	4.3	11.8

Source: Deutsche Bank

Forecasts And Ratios

Year End Dec 31	2013A	2014A	2015E	2016E	2017E
Sales (CNYm)	5,824.1	6,727.6	8,238.2	9,683.9	11,272.7
Reported NPAT (CNYm)	-391.5	-781.5	165.0	457.4	807.3
Reported EPS FD(CNY)	-0.25	-0.49	0.10	0.26	0.45
DB EPS FD(CNY)	-0.63	-0.42	0.07	0.26	0.45
OLD DB EPS FD(CNY)	-0.54	-0.22	0.08	0.27	-
% Change	17.0%	91.4%	-14.3%	-5.6%	-
DB EPS growth (%)	-152.5	33.4	-	257.0	73.3
PER (x)	-	-	44.9	12.6	7.3

Source: Deutsche Bank estimates, company data

¹ DB EPS is fully diluted and excludes non-recurring items

² Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close

Deutsche Bank AG/Hong Kong

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Model updated: 19 March 2015

Running the numbers

Asia

China

Textiles & Apparel

Li Ning Co Ltd

Reuters: 2331.HK

Bloomberg: 2331 HK

Sell

Price (19 Mar 15) HKD 4.04

Target Price HKD 2.80

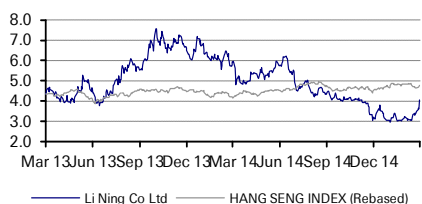
52 Week range HKD 2.94 - 6.23

Market Cap (m) HKDm 6,439
USDm 830

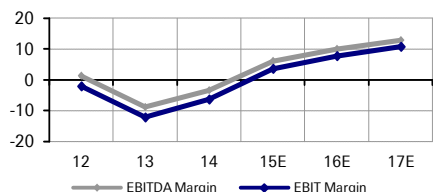
Company Profile

Li Ning is a leading PRC sports brand, specializing in the design and the distribution of footwear and accessories under the brand name Li Ning.

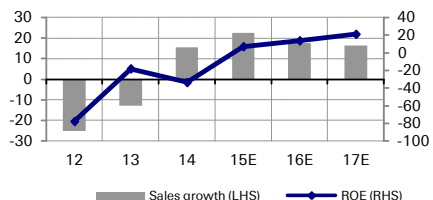
Price Performance



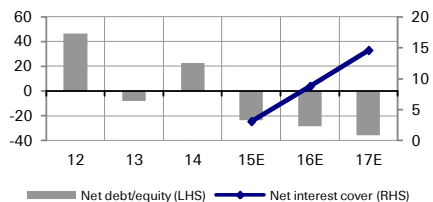
Margin Trends



Growth & Profitability



Solvency



Fiscal year end 31-Dec

Financial Summary

	2012	2013	2014	2015E	2016E	2017E
DB EPS (CNY)	-0.25	-0.63	-0.42	0.07	0.26	0.45
Reported EPS (CNY)	-1.24	-0.25	-0.49	0.10	0.26	0.45
DPS (CNY)	0.00	0.00	0.00	0.03	0.09	0.15
BVPS (CNY)	1.5	1.7	1.2	2.1	2.3	2.7
Weighted average shares (m)	1,599	1,594	1,594	1,594	1,594	1,594
Average market cap (CNYm)	7,611	6,774	6,391	5,143	5,143	5,143
Enterprise value (CNYm)	8,455	6,537	6,883	4,294	4,018	3,518

Valuation Metrics

P/E (DB) (x)	nm	nm	nm	44.6	12.5	7.2
P/E (Reported) (x)	nm	nm	nm	32.3	12.5	7.2
P/BV (x)	2.67	2.88	2.46	1.53	1.40	1.21
FCF Yield (%)	nm	nm	nm	0.2	7.1	13.3
Dividend Yield (%)	0.0	0.0	0.0	1.0	2.7	4.7
EV/Sales (x)	1.3	1.1	1.0	0.5	0.4	0.3
EV/EBITDA (x)	96.8	nm	nm	8.5	4.1	2.4
EV/EBIT (x)	nm	nm	nm	14.5	5.4	2.9

Income Statement (CNYm)

Sales revenue	6,676	5,824	6,728	8,238	9,684	11,273
Gross profit	2,913	2,390	2,886	3,625	4,275	4,994
EBITDA	87	-517	-230	503	970	1,449
Depreciation	227	193	198	206	221	236
Amortisation	0	0	0	0	0	0
EBIT	-139	-710	-429	296	749	1,213
Net interest income/(expense)	-202	-150	-143	-97	-86	-83
Associates/affiliates	-5	2	7	0	0	0
Exceptionals/extraordinaries	-1,460	541	-100	68	0	0
Other pre-tax income/(expense)	0	0	0	0	0	0
Profit before tax	-1,806	-317	-665	268	663	1,130
Income tax expense	149	42	79	67	166	282
Minorities	24	32	38	36	40	40
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	-1,979	-392	-781	165	457	807
DB adjustments (including dilution)	1,580	-613	112	-31	20	20
DB Net profit	-399	-1,005	-669	134	477	827

Cash Flow (CNYm)

Cash flow from operations	-1,083	-97	-394	256	656	1,023
Net Capex	-216	-286	-355	-247	-291	-338
Free cash flow	-1,299	-382	-749	9	365	685
Equity raised/(bought back)	746	1,480	0	1,285	0	0
Dividends paid	-23	-24	0	-22	-89	-184
Net inc/(dec) in borrowings	1,261	-1,053	480	-500	0	0
Other investing/financing cash flows	-639	7	41	0	0	0
Net cash flow	45	28	-228	772	276	501
Change in working capital	-832	566	58	-149	-162	-177

Balance Sheet (CNYm)

Cash and other liquid assets	1,255	1,283	1,034	1,874	2,150	2,651
Tangible fixed assets	1,464	1,344	1,500	1,541	1,611	1,713
Goodwill/intangible assets	0	0	0	0	0	0
Associates/investments	191	193	200	200	200	200
Other assets	3,109	3,197	3,305	3,932	4,551	5,231
Total assets	6,020	6,017	6,040	7,548	8,513	9,795
Interest bearing debt	2,099	1,046	1,525	1,025	1,025	1,025
Other liabilities	2,109	2,079	2,345	2,917	3,521	4,198
Total liabilities	4,207	3,125	3,870	3,942	4,547	5,224
Shareholders' equity	1,614	2,684	1,952	3,352	3,673	4,238
Minorities	199	208	218	254	294	334
Total shareholders' equity	1,812	2,892	2,169	3,606	3,966	4,571
Net debt	844	-237	491	-848	-1,125	-1,625

Key Company Metrics

Sales growth (%)	-25.2	-12.8	15.5	22.5	17.5	16.4
DB EPS growth (%)	na	-152.5	33.4	na	257.0	73.3
EBITDA Margin (%)	1.3	-8.9	-3.4	6.1	10.0	12.9
EBIT Margin (%)	-2.1	-12.2	-6.4	3.6	7.7	10.8
Payout ratio (%)	nm	nm	nm	30.0	30.0	30.0
ROE (%)	-77.8	-18.2	-33.7	7.0	13.6	20.9
Capex/sales (%)	3.2	4.9	5.3	3.0	3.0	3.0
Capex/depreciation (x)	1.0	1.5	1.8	1.2	1.3	1.4
Net debt/equity (%)	46.6	-8.2	22.7	-23.5	-28.4	-35.6
Net interest cover (x)	nm	nm	nm	3.1	8.7	14.6

Source: Company data, Deutsche Bank estimates



Company update

Maintaining target price at HKD2.8 and Sell rating. We lowered our FY15-16E EPS by 3.9-14.6% based on FY14 results. Our target price is maintained at HKD2.8 as we roll over 1-year forward valuation. It implies 22x FY15E PE. Our DCF-derived target price is based on a CoE of 9.5%, beta of 1.3 and TGR of 1%.

We see scope for long-term earnings and cash flow recovery but current valuations already more than price in this outlook, especially given the company's relatively high risk profile. As such, we maintain our Sell rating.

Upside risks to our view include:

- 1) Greater-than-anticipated improvements in efficiencies (regarding stores and sub-distributors); enhanced profitability and SSSG at both retail and distributor level.
- 2) Strong execution to successfully roll out channel revamp.
- 3) Strong replenishment orders and shorter lead time.

2015 – the beginning of a new development stage

The company believes the investment in the past three years has built a solid foundation and 2015 will mark a step up in its growth phase. Product, channel and retail capability are the three core pillars to build up its competitiveness.

Channel - Gaining share in mass market they lost

Net opening of 500 stores and renovation of 1000 stores. The company aims to regain market share it lost in the past few years, especially in Southern China. It standardized the store opening and operations to ensure that the new store can become profitable within 6-9 months. The majority of new openings is by distributors while the company will offer them some support. The total capex would be RMB400m.

Product R&D – focus on two platforms, sports functionality and sports life

Sports life. While functionality remains its key focus to position, the company plans to regain its market share in sports life where it was neglected in the past few years. Management thinks sports life enjoys the most potential in China's sportswear industry. Therefore, the company will also shift some focus to sports life to broaden its customer base, especially in the mass market with more affordable pricing. More meaningful change is expected in 2016.

Digitalized operation will be the driving force in the next three years. Besides price, consumers also care about experience. This includes collaboration with Marvel, Mi band, JD.com and Vdian.

- Mi band: in March, the company reached a strategic agreement with Mi band to jointly launch the "Smart" running shoes at an affordable price. The products will be launched in July.
- Marvel: the products associated with Marvel (to have cartoon characteristics on basketball shoes) will be launched in early April.



- Ecommerce – online sales grew by 48% in 2014 and contributed 5% of total sales. The profitability improved by 5ppt with better discount, distributor management and more in-season products. On Single Day, it recorded sales of RMB77m, ranking No.2 in sports/outdoor category which overtook Nike and Adidas and sold more than twice as much as its local peers.

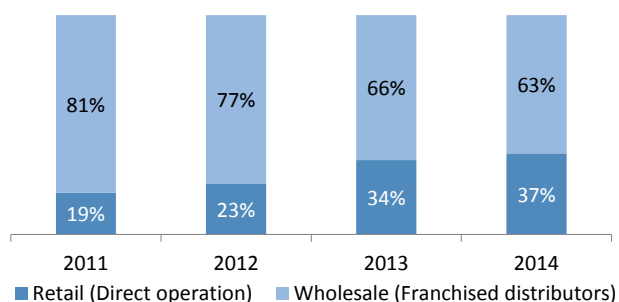
Retail capability – platform cost is a drag, continue to optimize cost structure

Retail business under Li Ning core brand recorded sales growth of 28.2% driven by both increase in stores count and SSSG. The store count for direct operation net grew by 30% to 1202 stores. Sales per sqm has increased by 12%. New product (current and last season) contributed 72% vs. 61% in 2013.

Excluding international market sales, sales from retail business accounted for 37% of Li Ning sales, vs. 34% in 2013. At the operating income level, it contributed low teens’ proportion excluding the platform cost.

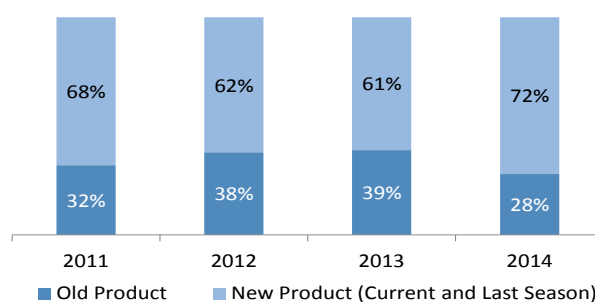
Platform cost accounted for 32% of sales in 2014, down from 39% in 2013. In management’s view, if the profit contribution exceeds 25%, it has sufficient scale to digest the platform cost. Currently, however, the new products portion for retail stores was 68%, lower than at distributors store due to the need to clear inventory.

Figure 1: Li Ning brand revenue mix (excl. international market sales)



Source: Deutsche Bank, company data

Figure 2: Product retail sell-through mix



Source: Deutsche Bank, company data

Chairman Mr. Li Ning is appointed as interim CEO

Mr. Li said while the company is still looking for a new CEO, he will take on the CEO responsibilities and lead the company to positive growth. While the operation is not yet optimized, good progress has been made for new development stage. He will be supported by the professional senior management team. He is confident the company can turn profitable this year and resume growth.

2014 results review

Li Ning recorded 16% sales growth to RMB6.7bn in FY15, but net loss nearly doubled to RMB781m due to AR provision and one-off restructuring expense. In 2H14, sales accelerated, up by 24% driven by new product and retail business. However, core loss expanded on high cost structure. No dividend was declared. It had a net debt of RMB494m as of end 2014 vs. net cash of RMB237m.



SSSG returned to positive in 2H14 and the trend continued ytd 2015. On a full year basis, SSSG recorded low-single-digit growth. For reference, in 4Q14, SSSG recorded mid-single-digit growth, with high single digits for direct operation and mid single digits for the franchised distributor.

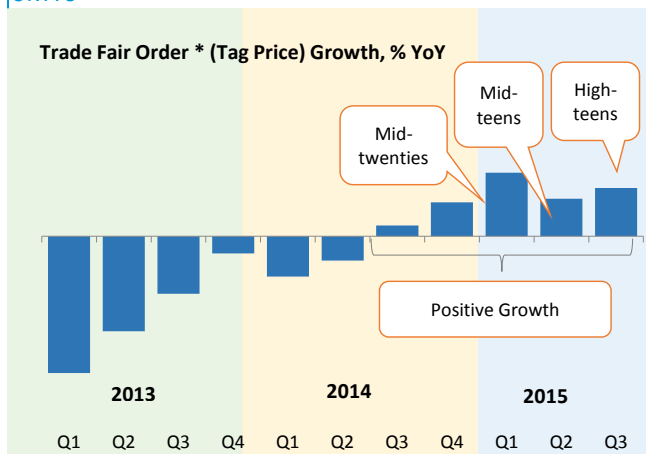
Figure 3: Li Ning brand SSSG – back to positive growth in 2H14 and trend continued in Jan/Feb 2015



Source: Deutsche Bank, company data

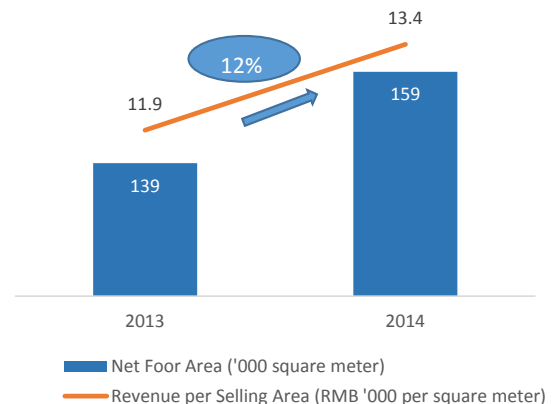
Positive order book growth for five consecutive quarters up to 3Q15 season. Specifically, in the mid twenties for 1Q15, mid teens for 2Q15 and high teens for 3Q15.

Figure 4: Li Ning brand order book – double digit in 9M15



Source: Deutsche Bank, company data

Figure 5: Li Ning brand retail business – 12% growth in sales per sqm

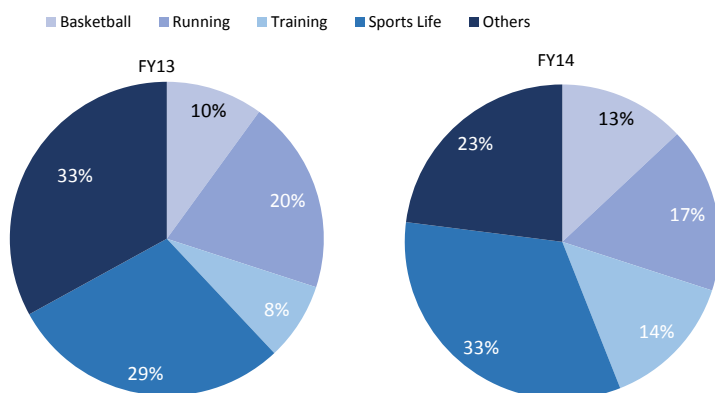


Source: Deutsche Bank, company data

The core categories (basketball, running, badminton, training and sports life) account for 77% of total, vs. 67% in 2013. Running performed relatively weak with -16% retail sell-through growth and -4% new product retail sell-through growth. While the high-end series of new products were welcomed by local consumers, they lost market in the mass end with pricing at RMB200-300.



Figure 6: Retail sell-through of five core categories



Source: Deutsche Bank, company data

By category,

Footwear sales grew by 11.9% and percentage to sales declined to 40.7% vs. 42% in 2013. However, management noted that footwear remains its core business to expand. Apparel sales grew by 23.9% and the proportion increased to 41.8%.

By geography,

Among three key regions, Southern China saw a slowdown, with only 4% sales growth due to fierce competition. In Eastern and Northern China, it recorded a recovery by 19.9% sales growth each.

Store network – in 2014, it net closed 289 Li Ning stores to a total of 5626 stores by year end. This included 4424 franchised stores and 1202 retail stores. During the year, the company added over 800 new stores.

GPM (excluding impact from inventory provision/write-back) improved by 1.9ppt to 42.9%, due to a rising proportion of new products. However, in 2H14, the GPM declined by 1.9ppt yoy to 40.9% due to an increase in procurement cost and inventory clearance. The company expects an improvement in 2015. While cost remains under pressure, this would be offset by more retail business and new products. Retail GPM has improved to 54% in 2014 vs. 49% in 2013 driven by new products. ASP will remain similar.

Ad spending declined by 7.8% and accounts for 19.3% of sales (vs. 24.2% in 2013) as the company reduced investments in non-core sports categories.

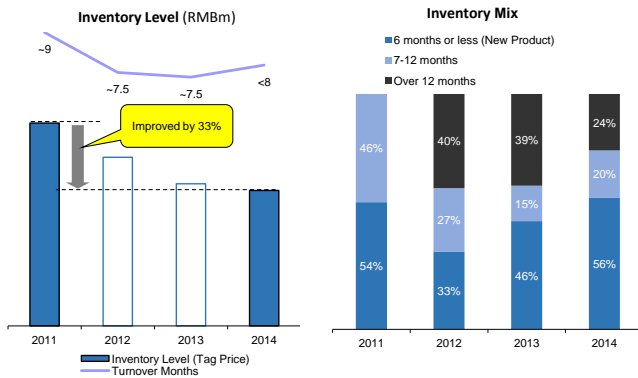
Staff cost increased by 22.3% due to investment in direct retail business and hiring of more experienced management executives. Rental expense rose by 28.1% as a result of an increase in direct-retail store count.

Channel inventory level was reduced by 33% vs. 2011, and inventory turnover days was below eight months. This is attributed to channel inventory reduction and a high mix of new products. The new products portion (six months or less) in inventory mix to 56% in 2014 vs. 2012/2013. At the group level, the inventory amount increased by 17% due to direct retail business expansion.



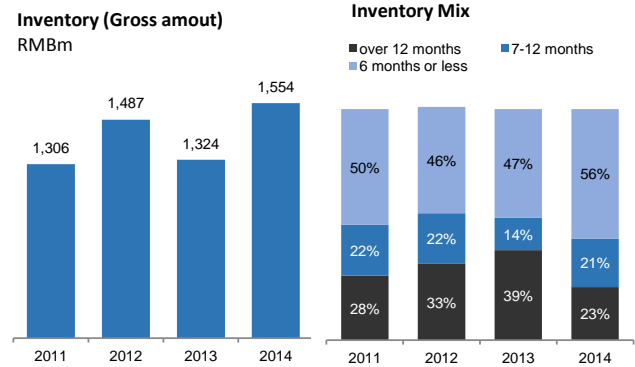
Inventory provision/writeback – in 2014, it had inventory write-back of RMB117.8m (1H: RMB18.4m provision; 2H: RMB136.2m write-back). The write-back in 2H14 was thanks to inventory clearance. To recap, the company made RMB203.9m inventory write-back in 2013.

Figure 7: Channel inventory mix



Source: Deutsche Bank, company data

Figure 8: Group inventory mix

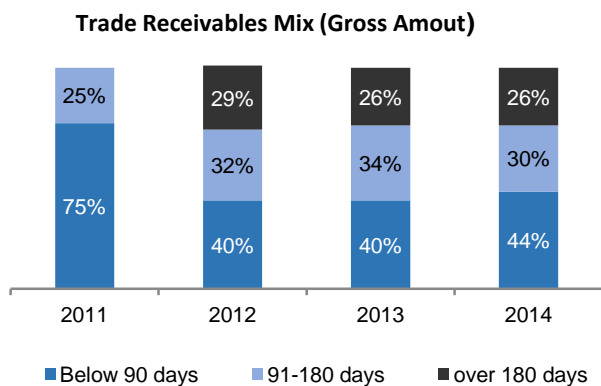


Source: Deutsche Bank, company data

Trade receivable level was down to RMB1.8bn vs. RMB1.9bn in 2013. The portion over 90 days still accounted for 56% in 2014.

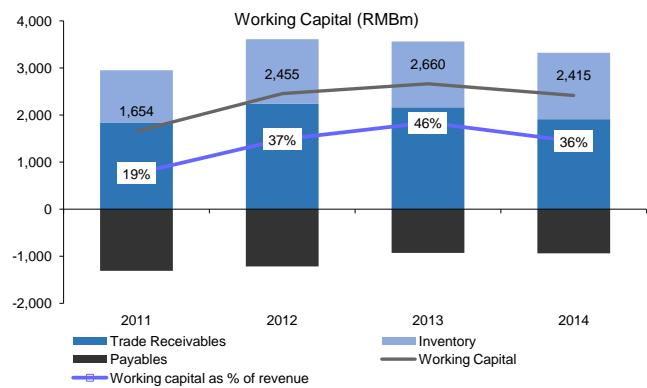
Bad debt provision/reversal – in 2014, it made additional RMB8.9m impairment of trade receivables (1H: RMB92.1m provision; 2H: RMB83.2m write-back). This compared to the RMB337.1m bad debt reversal made in 2013. The company explained that a majority of distributors recorded steady growth during the year, and provision for bad debt impairment therefore basically remained stable.

Figure 9: Trade receivable over 90 days still accounted for 56%



Source: Deutsche Bank

Figure 10: Working capital stabilized



Source: Deutsche Bank



Figure 11: What has improved in the past three years?

		FY12	FY13	FY14
Channel	Inventory Amount YoY% (Tag Price)	▪ ↓ 17%	▪ ↓ 15%	▪ ↓ 5%
	Inventory Mix	▪ New: Over 30% ▪ Over 12 months Approx. 40%	▪ New: Over 45% ▪ Over 12 months Approx. 40%	▪ New: Over 55% ▪ Over 12 months Approx. 25%
Product	New Product Retail Sales Growth, YoY%	▪ ↓ High-teens	▪ ↓ Low-twenties	▪ ↑ Mid-twenties
	New Product Retail Sell-through Mix, %	▪ 62%	▪ 61%	▪ 72%
Retail Capability	Overall Discount Rate (% of Tag Price)	▪ High-sixties	▪ Mid-sixties	▪ High-sixties
	Full Year New Product Weighted Average Sell Out Rate	▪ 3 months: 26% ▪ 6 months: 50%	▪ 3 months: 30% ▪ 6 months: 55%	▪ 3 months: 31% ▪ 6 months: 58%
	Full Year Overall SSSG	▪ ↓ High Single Digit	▪ ↓ Low-teens	▪ ↑ Low Single Digit
Financials	Platform Operating Cost (% of Revenue)	▪ 36%	▪ 39%	▪ 32%
	A&P Expenses (% of Revenue)	▪ 20%	▪ 24%	▪ 19%
	Reported Net Loss (RMB)	▪ RMB 1,979mn loss	▪ RMB 392mn loss	▪ RMB 781mn loss
	Adjusted EBITDA (RMB)	▪ RMB 445mn loss	▪ RMB 399mn loss	▪ RMB 206mn loss
	Net Cash / (Debt) Position (RMB)	▪ Net Debt RMB (206) mn	▪ Net Cash RMB 881 mn	▪ Net Cash RMB 34 mn

Source: Deutsche Bank, company data



Figure 12: P&L assumption

RMB millions, YE 31	2012	2013	2014	2015F	2016F	2016F	1H12	2H12	1H13	2H13	1H14	2H14
Total Revenue	6,676	5,824	6,728	8,238	9,684	11,273	3,855	2,821	2,906	2,918	3,137	3,591
Change y-o-y	-25%	-13%	16%	22%	18%	16%	-12%	-42%	-28%	5%	9%	24%
Gross Profit	2,913	2,390	2,886	3,625	4,275	4,994	1,701	1,211	1,141	1,249	1,418	1,468
Change y-o-y	-28%	-18%	21%	26%	18%	17%	-16%	-40%	-33%	3%	24%	18%
GP margin	44%	41%	43%	44%	44%	44%	44%	43%	39%	43%	45%	41%
SG&A (excl D&A)	(2,994)	(3,054)	(3,150)	(3,162)	(3,336)	(3,575)	(1,309)	(1,686)	(1,377)	(1,677)	(1,470)	(1,680)
Change y-o-y	13%	-9%	2%	3%	0%	5%	-14.7%	-4.1%	5.2%	-0.5%	6.8%	0.2%
As % of sales	-44.8%	-52.4%	-46.8%	-38.4%	-34.4%	-31.7%	-33.9%	-59.7%	-47.4%	-57.5%	-46.9%	-46.8%
EBITDA	87	(517)	(230)	503	970	1,449	518	(430)	(174)	(343)	(33)	(197)
Change y-o-y	-90%	-692%	-55%	-318%	93%	49%	-8.9%	-232.7%	-133.6%	-20.3%	-80.8%	-42.6%
EBITDA margin	1.3%	-8.9%	-3.4%	6.1%	10.0%	12.9%	13.4%	-15.3%	-6.0%	-11.8%	-1.1%	-5.5%
EBIT	(139)	(710)	(429)	296	749	1,213	393	(532)	(271)	(440)	(129)	(300)
Change y-o-y	-122.1%	409.7%	-39.6%	-169.1%	152.7%	62.0%	-11.2%	-382.1%	-168.9%	-17.4%	-52.5%	-31.8%
EBIT margin	-2.1%	-12.2%	-6.4%	3.6%	7.7%	10.8%	10.2%	-18.9%	-9.3%	-15.1%	-4.1%	-8.4%
Net earnings	(1,979)	(392)	(781)	165	457	807	(1)	(2,023)	(184)	(207)	(585)	(197)
Change y-o-y	-613%	-80%	100%	-121%	177%	76%	-84.9%	-2297.6%	-515.9%	-89.8%	217.4%	-5.1%
NP margin	-29.6%	-6.7%	-11.6%	2.0%	4.7%	7.2%	1.1%	-71.7%	-6.3%	-7.1%	-18.6%	-5.5%
Core net earnings	(520)	(933)	(681)	97	457	807	257	(777)	(416)	(516)	(265)	(416)

Source: Deutsche Bank estimate



Appendix 1

Important Disclosures

Additional information available upon request

Disclosure checklist

Company	Ticker	Recent price*	Disclosure
Li Ning Co Ltd	2331.HK	4.04 (HKD) 19 Mar 15	NA

*Prices are current as of the end of the previous trading session unless otherwise indicated and are sourced from local exchanges via Reuters, Bloomberg and other vendors. Data is sourced from Deutsche Bank and subject companies.

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Historical recommendations and target price: Li Ning Co Ltd (2331.HK)

(as of 3/19/2015)



Previous Recommendations

- Strong Buy
- Buy
- Market Perform
- Underperform
- Not Rated
- Suspended Rating

Current Recommendations

- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

*New Recommendation Structure as of September 9,2002

1.	28/03/2013:	Downgrade to Sell, Target Price Change HKD3.44	4.	15/08/2014:	Sell, Target Price Change HKD4.00
2.	12/08/2013:	Sell, Target Price Change HKD3.36	5.	17/12/2014:	Sell, Target Price Change HKD2.80
3.	24/03/2014:	Sell, Target Price Change HKD4.50			



Equity rating key

Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus projected dividend yield) , we recommend that investors buy the stock.

Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock

Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

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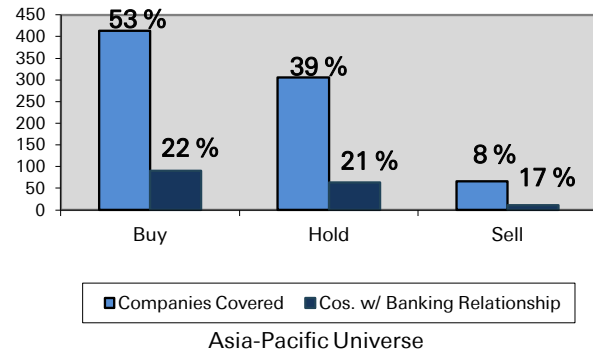
2. Ratings definitions prior to 27 January, 2007 were:

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Equity rating dispersion and banking relationships





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