

# China Dongxiang

## Major business to go through adjustment period

### Results Review

#### 2017 results miss expectations

**China Dongxiang announced 2017 results:** Revenue fell 9.9% to Rmb1,353mn; net profit fell 7.5% to Rmb805mn or Rmb0.14/share. The results missed expectations. The apparel business posted a net loss of around Rmb17mn (vs. a profit of around Rmb196mn in 2016). **The firm proposed to pay a total 2017 DPS of Rmb0.27 (including interim, final and special payments) for a payout ratio of 189%.**

**Sales in China fell 8.3% to Rmb1,037mn**, as retail sales value (RSV) and same store sales fell by mid and low single-digit percentages, respectively, though retail performance improved in 2H17. Online RSV fell by a low single-digit percentage, while kidswear sales jumped 32.6% to Rmb114mn. As of end-2017, the number of Kappa retail and kids stores totaled 1,137 and 350 (down 12.6% and up 33.6%, respectively). **Sales in Japan fell 15% to Rmb316mn.**

**Financial overview:** Gross margin slipped 1.2ppt to 55.7%, net investment income jumped 23.9% to Rmb876mn, and SG&A expense ratio rose 7.6ppt to 50.7% on a 26.5% increase in A&P costs.

#### Trends to watch

In the apparel business, management expects mid to high single-digit growth in same-store efficiency and low double-digit RSV growth in 2018. It intends to attach more importance to footwear products and said store renovations and relocations are planned.

#### Earnings forecast

**We lower our 2018 EPS forecast by 6% to Rmb0.16 (implying growth of 13.2%) and introduce a 2019 EPS estimate of Rmb0.17 (5.5%).**

#### Valuation and recommendation

The stock is trading at 7.4x 2018e and 7.0x 2019e P/E. **We maintain BUY but lower our target price by 15% to HK\$1.85 (23.2% upside)** to reflect adjustments in our SOTP valuation. We assign a 10% multi-business discount to the sum of the firm's segments and value the apparel business at 14x 2019e P/E. The apparel business targets niche sportswear segments and should turn around in the next few years. We expect robust growth from the investment business.

#### Risks

Consumption could slow further; apparel trends could disappoint.

#### Haiyan GUO

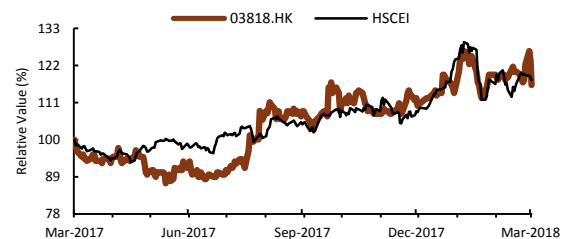
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### Maintain BUY

Ticker	03818.HK
CICC investment rating	BUY
Last close	HK\$1.50
CICC target	HK\$1.85
52wk price range	HK\$1.69~1.12
Market cap (bn)	HK\$9
Daily value (mn)	HK\$12.62
Shares outstanding (mn)	5,675
Free float (%)	100
Daily volume (mn sh)	8.14
Business sector	Apparel



(Rmb mn)	2016A	2017A	2018E	2019E
Revenue	1,501	1,353	1,525	1,691
(+/-)	2.2%	-9.9%	12.8%	10.9%
Net profit	870	805	911	961
(+/-)	8.4%	-7.5%	13.2%	5.5%
EPS	0.15	0.14	0.16	0.17
BPS	1.70	1.69	1.58	1.66
DPS	0.09	0.27	0.10	0.10
CPS	0.02	0.00	0.14	0.16
P/E	8.8	8.8	7.4	7.0
P/B	0.8	0.7	0.8	0.7
EV/EBITDA	6.0	5.8	5.9	5.3
Dividend yield	6.9%	21.5%	8.1%	8.5%
ROAA	8.0%	7.3%	8.6%	9.2%
ROAE	9.1%	8.3%	9.8%	10.5%

Source: Wind, Bloomberg, Corporate filings, CICC Research



## Financial summary

Financial statement (Rmb mn)	2016A	2017A	2018E	2019E	Financial ratios	2016A	2017A	2018E	2019E
<b>Income statement</b>					<b>Growth ability</b>				
Revenue	1,501	1,353	1,525	1,691	Revenue	2.2%	-9.9%	12.8%	10.9%
COGS	-647	-599	-664	-731	Operating profit	1.1%	1.1%	6.2%	5.5%
Selling expenses	-488	-566	-534	-558	EBITDA	1.2%	1.1%	4.8%	5.4%
Administrative expenses	-159	-120	-137	-152	Net profit	8.4%	-7.5%	13.2%	5.5%
Other ops income (expense)	0	0	0	0	<b>Profitability</b>				
Operating profit	1,016	1,027	1,090	1,150	Gross margin	56.9%	55.7%	56.5%	56.8%
Finance costs	28	-79	-34	-36	Operating margin	67.6%	75.9%	71.5%	68.0%
Other income (expense)	0	0	0	0	EBITDA margin	68.4%	76.8%	71.3%	67.8%
Profit before income tax	1,048	930	1,056	1,114	Net margin	58.0%	59.5%	59.7%	56.8%
Income tax	-178	-129	-147	-155	<b>Liquidity</b>				
Minority interest	1	4	1	1	Current ratio	4.24	5.35	4.81	5.37
Net profit	870	805	911	961	Quick ratio	4.05	4.97	4.43	4.90
EBITDA	1,027	1,038	1,088	1,147	Cash ratio	1.64	1.79	1.00	1.41
Recurrent net income	196	-17	93	143	Liabilities / assets	13.2%	11.9%	12.5%	12.2%
<b>Balance sheet</b>					Net debt / equity	net cash	net cash	net cash	net cash
Cash and bank balances	2,218	1,544	820	1,148	<b>Return</b>				
Trade and bill receivables	244	234	305	293	RoA	8.0%	7.3%	8.6%	9.2%
Inventories	255	321	318	385	RoE	9.1%	8.3%	9.8%	10.5%
Other current assets	3,014	2,512	2,520	2,545	<b>Per-share data</b>				
Total current assets	5,730	4,611	3,962	4,371	EPS (Rmb)	0.15	0.14	0.16	0.17
Fixed assets and CIP	69	97	130	164	BPS (Rmb)	1.70	1.69	1.58	1.66
Intangible assets and others	5,347	6,191	6,179	6,168	DPS (Rmb)	0.09	0.27	0.10	0.10
Total non-current assets	5,415	6,288	6,309	6,332	Cash flow per share (Rmb)	0.02	0.00	0.14	0.16
Total assets	11,145	10,899	10,272	10,704	<b>Valuation</b>				
Short-term borrowings	751	229	229	229	P/E	8.8	8.8	7.4	7.0
Trade and bill payables	164	152	198	187	P/B	0.8	0.7	0.8	0.7
Other current liabilities	438	482	397	398	EV/EBITDA	6.0	5.8	5.9	5.3
Total current liabilities	1,352	862	823	814	Dividend yield	6.9%	21.5%	8.1%	8.5%
Long-term borrowings	0	274	274	274					
Total non-current liabilities	119	438	462	490					
Total liabilities	1,471	1,300	1,285	1,304					
Share capital	54	55	55	55					
Retained profit	9,604	9,531	8,919	9,333					
Equity	9,675	9,599	8,986	9,399					
Total liabilities & equity	11,145	10,899	10,272	10,704					
<b>Cash flow statement</b>									
Pretax profit	1,048	930	1,056	1,114					
Depreciation & amortization	11	11	-2	-3					
Change in working capital	62	65	-29	-92					
Others	-1,016	-985	-207	-125					
Cash flow from operations	106	21	819	894					
Capital expenditure	-5	-46	-20	-20					
Others	1,245	1,201	0	0					
Cash flow from investing	1,241	1,155	-20	-20					
Equity financing	0	0	0	0					
Bank borrowings	280	-251	0	0					
Others	-895	-1,503	-1,522	-546					
Cash flow from financing	-615	-1,754	-1,522	-546					
Foreign exchange gain (loss)	73	-84	0	0					
Net changes in cash	804	-662	-723	328					

Source: Corporate filings, CICC Research

## Company description

China Dongxiang Group is a leading international sportswear brand enterprise based in China. The company is primarily engaged in the design, development, marketing and wholesale of branded sportswear in China. Since 2006, it has owned the exclusive rights to the internationally-recognized, decades-old Italian Kappa brand in China and Macau. According to ZOU Marketing, Kappa is one of the top three international sportswear brands in China by sales.



Figure 1: 2017 results review

(Rmb mn)	2016A	2017E	2017A	2017A YoY	vs CICC estimate	2018E	2018E YoY
Revenue	1,501	1,640	1,353	-9.9%	-17.5%	1,525	12.8%
Gross profit	854	941	753	-11.8%	-20.0%	861	14.3%
Operating profit	1,016	1,064	1,027	1.1%	-3.5%	1,090	6.2%
Net profit	870	917	805	-7.5%	-12.3%	911	13.2%
<b>Fully-diluted EPS (Rmb)</b>	<b>0.15</b>	<b>0.17</b>	<b>0.14</b>	<b>-7.5%</b>	<b>-14.4%</b>	<b>0.16</b>	<b>13.2%</b>
Gross margin	56.9%	57.4%	55.7%	-1.2ppt	-1.7ppt	56.5%	0.8ppt
Operating margin	67.6%	64.9%	75.9%	8.3ppt	11ppt	71.5%	-4.5ppt
Net margin	58.0%	55.9%	59.5%	1.5ppt	3.6ppt	59.7%	0.2ppt

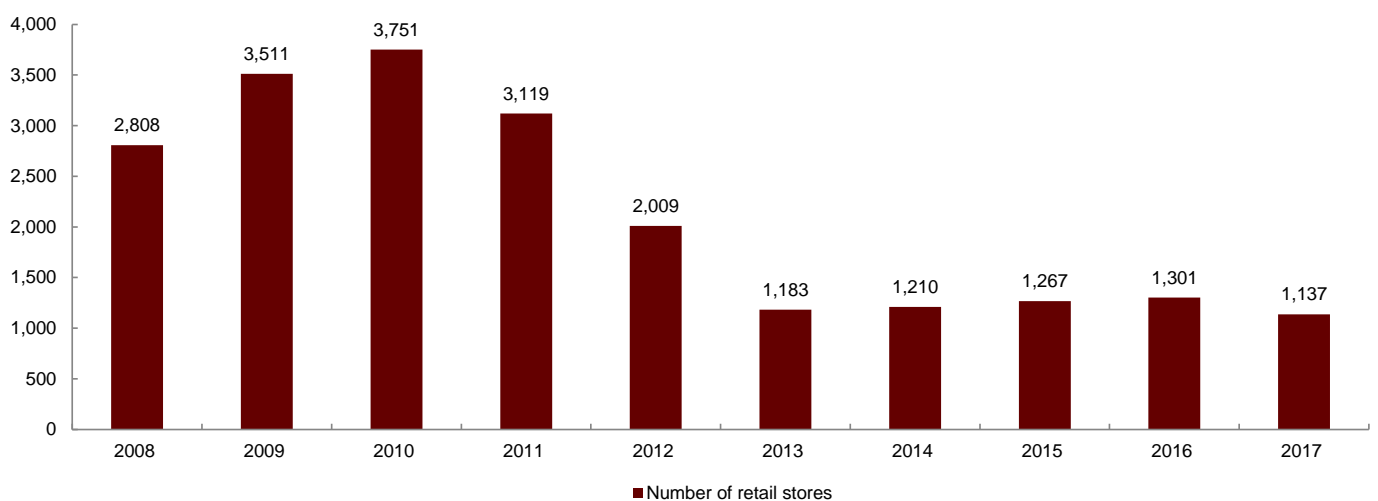
Source: Company annual results, CICC Research

Figure 2: Historical interim results breakdown

(Rmb mn)	1H16	2H16	2016	1H17	2H17	2017	1H17(+/-%)	2H17(+/-%)	2017(+/-%)
<b>Turnover</b>	<b>650</b>	<b>851</b>	<b>1,501</b>	<b>626</b>	<b>726</b>	<b>1,353</b>	<b>-3.7%</b>	<b>-14.7%</b>	<b>-9.9%</b>
COGS	-278	-373	-651	-262	-331	-593	-5.8%	-11.1%	-8.9%
Reversal of impairment losses of inventories	-19	22	3	-23	17	-6	23.2%	-23.5%	-296.2%
<b>Gross Profit</b>	<b>354</b>	<b>500</b>	<b>854</b>	<b>342</b>	<b>412</b>	<b>753</b>	<b>-3.4%</b>	<b>-17.7%</b>	<b>-11.8%</b>
Other gains (net)	485	324	809	557	403	960	14.8%	24.4%	18.7%
Selling and Distribution Costs	-241	-248	-488	-217	-349	-566	-9.7%	40.9%	16.0%
General and Administrative Expenses	-47	-112	-159	-55	-66	-120	17.0%	-41.6%	-24.5%
<b>Operating Profit</b>	<b>552</b>	<b>464</b>	<b>1,016</b>	<b>627</b>	<b>400</b>	<b>1,027</b>	<b>13.6%</b>	<b>-13.8%</b>	<b>1.1%</b>
Finance Income (net)	9	19	28	-30	-50	-79	-426.6%	-365.5%	-385.3%
Share of Results of Associates	2	2	4	-1	-16	-17	-	-	-
<b>Profit before taxation</b>	<b>563</b>	<b>485</b>	<b>1,048</b>	<b>597</b>	<b>333</b>	<b>930</b>	<b>6.0%</b>	<b>-31.2%</b>	<b>-11.3%</b>
Taxation	-87	-91	-178	-64	-65	-129	-26.4%	-28.7%	-27.6%
<b>Profit for the year</b>	<b>476</b>	<b>393</b>	<b>870</b>	<b>533</b>	<b>268</b>	<b>801</b>	<b>11.8%</b>	<b>-31.8%</b>	<b>-7.9%</b>
Minority interests	-2	2	-1	-3	-0	-4	-	-	-
<b>Net profit</b>	<b>479</b>	<b>392</b>	<b>870</b>	<b>536</b>	<b>269</b>	<b>805</b>	<b>12.0%</b>	<b>-31.4%</b>	<b>-7.5%</b>
<b>Key Ratios</b>									
Gross margin (before reversal of impairment losses of inventories)	57.3%	56.2%	56.7%	58.2%	54.4%	56.2%	0.9%	-1.8%	-0.5%
Gross margin (after reversal of impairment losses of inventories)	54.4%	58.8%	56.9%	54.5%	56.7%	55.7%	0.1%	-2.1%	-1.2%
Other gains/Revenue	74.6%	38.0%	53.9%	89.0%	55.4%	71.0%	14.3%	17.4%	17.1%
Distribution Costs/Revenue	37.0%	29.1%	32.5%	34.7%	48.1%	41.9%	-2.3%	19.0%	9.3%
Administrative Costs/Revenue	7.2%	13.2%	10.6%	8.7%	9.0%	8.9%	1.5%	-4.2%	-1.7%
Operating Margin	84.9%	54.5%	67.6%	100.1%	55.0%	75.9%	15.2%	0.6%	8.3%
Net Margin	73.6%	46.0%	58.0%	85.6%	37.0%	59.5%	12.0%	-9.0%	1.5%
Effective Tax Rate	15.4%	18.8%	17.0%	10.7%	19.5%	13.9%	-4.7%	0.7%	-3.1%

Source: Company annual results, CICC Research

Figure 3: Number of Kappa retail stores



Source: Company annual results, CICC Research



Figure 4: 2017 results breakdown by business segment

(Rmb mn)		2016A						2017A					
		Total	Sportswear- China	Sportswear- Japan	Disposal (mainly Alibaba)	Other investments	Unallocated	Total	Sportswear- China	Sportswear- Japan	Disposal (mainly Alibaba)	Other investments	Unallocated
Revenue		1,501	1,130	372	0	0	0	1,353	1,037	316	0	0	0
	YoY	2%	7%	-11%	-	-	-	-10%	-8.3%	-15%	-	-	-
Cost of goods sold		-647	-404	-244	0	0	0	-599	-390	-209	0	0	0
Gross profit		854	726	128	0	0	0	753	647	107	0	0	0
	Gross margin	57%	64%	34%	-	-	-	56%	62%	34%	-	-	-
Other gains		809	15	7	968	-180	0	960	14	4	671	271	0
Operating profit (loss)		1,016	288	-6	956	-183	-40	1,027	188	-40	657	257	-36
	Operating margin	68%	25%	-2%	-	-	-	76%	18%	-13%	-	-	-
Financial income		28	21	1	0	0	6	-79	-54	-2	0	0	-23
	% of revenue	2%	2%	0%	-	-	-	-6%	-5%	-1%	-	-	-
Share of profits of a joint venture		4	5	0	0	-1	0	-17	-10	-1	0	-7	0
Profit (loss) before tax		1,048	315	-5	956	-184	-34	930	124	-43	657	251	-58
	PBT margin	70%	28%	-1%	-	-	-	69%	12%	-14%	-	-	-
Income tax		-178	-113	-1	-64	0	0	-129	-97	-1	-31	0	0
	Effective tax rate	17%	36%	-21%	7%	-	0%	14%	78%	-2%	5%	-	0%
Profit (loss) for the year		870	202	-6	891	-184	-34	801	27	-44	625	251	-58
	Net profit margin	58%	18%	-2%	-	-	-	59%	3%	-14%	-	-	-

Source: Company annual results, CICC Research

Figure 5: SOTP valuation

(Rmb mn)	2016	2017	Comments
Cash	1,713	1,052	Unrestricted cash
Total value of investments	7,420	7,769	
Available for sale securities (listed)	1,986	2,160	Alibaba shares transferred from Yunfeng E-Commerce Funds in 1H15; measured by market valued
Available for sale securities (unlisted)	2,719	2,904	
Tebon Innovation Capital Co., Ltd.	155	0	
Citic Mezzanine Fund I	248	132	
Yunfeng Fund II	325	163	
Yuanxin Dongchao	275	273	
Tibet Ruixintong	300	300	
Herun Piloting Jiashi	200	198	
Others	1,216	1,837	
Other financial assets (liabilities)	2,714	2,706	Including investment in treasury products issued by commercial banks
Treasury products issued by commercial banks	1,002	1,090	
Loans and receivables	1,487	1,439	
Others	225	177	
Debt	751	503	
Total net profit (2019)		961	
Profit of sportswear business		100	
Total value of sportswear business		1,400	Business valued at 14x 2019e P/E
Total value of the company		9,704	Cash+Investment-Debt+Value of sportswear business-NCI
Total number of shares (mn)		5,675	
Multi-business discount		10%	
Per share value of the company (Rmb)		1.54	Total value / total number of shares
Per share value of the company (HK\$)		1.85	
Current price (HK\$)		1.50	

Source: Company annual results, CICC Research

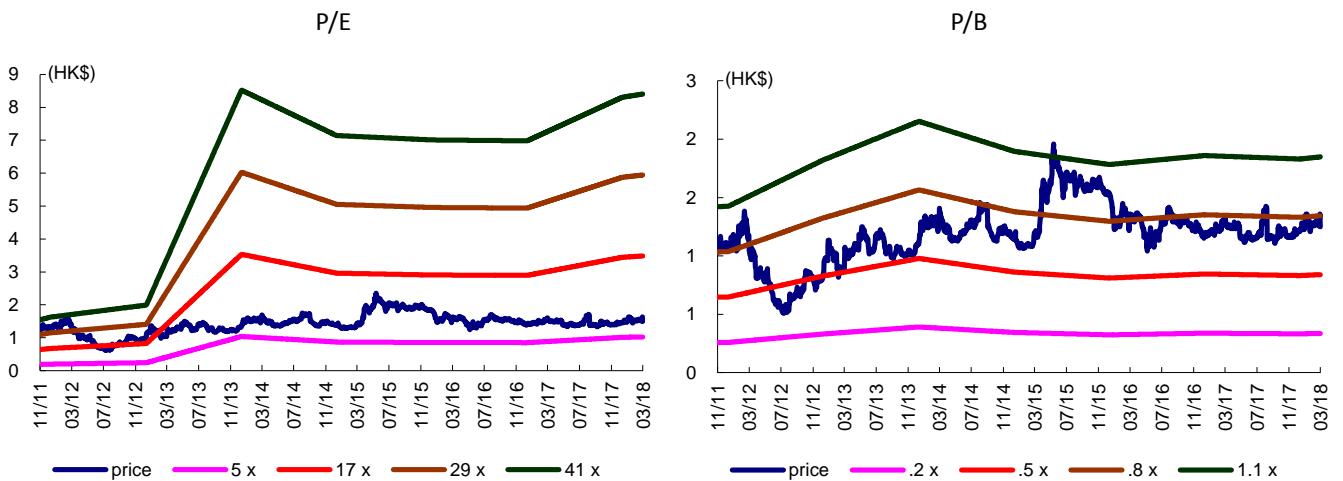


Figure 6: Earnings forecast revisions

(Rmb mn)	2017A	2018E			2019E
		Old	New	+/-	
<b>Revenue</b>	<b>1,353</b>	<b>1,784</b>	<b>1,525</b>	<b>-14.5%</b>	<b>1,691</b>
<b>Gross profit</b>	<b>753</b>	<b>1,030</b>	<b>861</b>	<b>-16.4%</b>	<b>960</b>
Other gains	960	800	900	12.5%	900
Selling and distribution costs	-566	-548	-534	-2.5%	-558
Administrative expenses	-120	-168	-137	-18.1%	-152
<b>Operating profit</b>	<b>1,027</b>	<b>1,115</b>	<b>1,090</b>	<b>-2.2%</b>	<b>1,150</b>
<b>Profit before tax</b>	<b>930</b>	<b>1,166</b>	<b>1,056</b>	<b>-9.4%</b>	<b>1,114</b>
Taxation	-129	-198	-147	-26.1%	-155
<b>Profit for the year</b>	<b>801</b>	<b>968</b>	<b>910</b>	<b>-6.0%</b>	<b>960</b>
<b>Net profit</b>	<b>805</b>	<b>969</b>	<b>911</b>	<b>-6.0%</b>	<b>961</b>

Source: Company annual results, CICC Research

Figure 7: Historical P/E and P/B bands



Source: Bloomberg, company annual results, CICC Research



Figure 8: Valuations of comparable companies

Ticker	Company	Price (Local)	Mkt cap (mn)	Net Profit (mn, report currency)						EPS (local currency)			P/E			2016-2018 Net Profit CAGR	PEG	
				2016A	YoY	2017A/E	YoY	2018E	YoY	2016A	2017A/E	2018E	2016A	2017A/E	2018E			
<b>Apparel &amp; Textiles (A shares)</b>																		
Casual wear	002269.SZ	Metersbonwe	2.98	7,487	36	NM	47	29%	68	46%	0.01	0.02	0.03	207.1	160.2	110.0	37.2%	5.6
Casual wear	002563.SZ	Semir	10.37	27,935	1,427	6%	1,593	12%	1,810	14%	0.53	0.59	0.67	19.6	17.5	15.4	12.6%	1.5
	002503.SZ	SYT	5.02	15,683	362	86%	784	117%	1,025	31%	0.12	0.25	0.33	43.4	20.0	15.3	68.4%	0.6
Menswear	002029.SZ	Septwolves	9.23	6,975	267	-2%	299	12%	343	15%	0.35	0.40	0.45	26.1	23.3	20.3	13.3%	2.0
	600398.SH	Heilan Home	11.74	52,745	3,123	6%	3,444	10%	3,882	13%	0.70	0.77	0.86	16.9	15.3	13.6	11.5%	1.5
	600177.SH	Youngor	8.76	31,373	3,685	-16%	3,992	8%	4,208	5%	1.03	1.11	1.18	8.5	7.9	7.5	6.9%	1.2
	002154.SZ	Baoxiniao	3.11	3,929	(387)	-487%	(30)	NM	28	NM	-0.31	-0.02	0.02	NM	NM	138.4	NM	NM
Home textiles	002293.SZ	Luolai	15.10	11,237	317	-23%	385	21%	440	14%	0.43	0.52	0.59	35.4	29.2	25.5	17.8%	2.0
	002327.SZ	Fuanna	11.53	10,044	439	9%	481	10%	523	9%	0.50	0.55	0.60	22.9	20.9	19.2	9.2%	2.5
	002397.SZ	Mendale	6.35	4,847	97	-37%	124	28%	154	24%	0.13	0.16	0.20	49.8	39.0	31.5	25.8%	1.9
Outdoor	300005.SZ	Toread	5.02	4,474	166	-37%	141	-15%	163	15%	0.19	0.16	0.18	27.0	31.8	27.5	-0.9%	NM
Footwear	603001.SH	Aokang	13.51	5,417	305	-22%	299	-2%	322	7%	0.76	0.75	0.80	17.7	18.1	16.8	2.7%	6.6
Textiles	000726.SZ	Luthai A	10.65	8,855	805	13%	905	12%	1,004	11%	0.87	0.98	1.09	12.2	10.9	9.8	11.7%	1.0
	200726.SZ	Luthai B	8.70	8,855	805	13%	905	12%	1,004	11%	0.97	1.18	1.37	8.9	7.4	6.3	11.7%	0.8
<b>Apparel &amp; Textiles (H shares)</b>																		
Intimate wear	2298.HK	Cosmo Lady	4.10	8,800	242	-55%	274	13%	320	17%	0.13	0.15	0.19	32.6	26.8	21.8	15.0%	2.2
	2199.HK	Regina Miracle	6.80	8,325	98	-78%	239	144%	300	26%	0.08	0.19	0.24	85.3	34.9	27.8	75.2%	1.1
Menswear	1234.HK	China Lilang	8.70	10,414	540	-14%	611	13%	717	17%	0.50	0.61	0.76	17.3	14.2	11.5	15.2%	1.1
Womenswear	6116.HK	La Chapelle	8.68	4,754	532	-14%	538	1%	559	4%	1.08	1.18	1.29	8.0	7.4	6.7	2.5%	3.2
Sportswear	2331.HK	Li Ning	7.79	16,974	643	4395%	496	-23%	636	28%	0.33	0.27	0.37	23.7	22.7	21.1	-0.5%	NM
	3818.HK	China Dongxiang	1.50	8,512	870	8%	805	-8%	911	13%	0.17	0.17	0.20	8.8	8.8	7.4	2.3%	3.8
	2020.HK	Anta sports	39.40	105,772	2,386	17%	3,088	29%	3,859	25%	0.99	1.38	1.81	39.8	28.5	21.7	27.2%	1.5
	1368.HK	Xtep International	4.16	9,241	528	-15%	408	-23%	544	33%	0.26	0.22	0.31	15.7	18.9	13.5	1.5%	NM
Textiles	2313.HK	Shenzhou International	82.65	124,241	2,948	25%	3,598	22%	4,281	19%	2.19	2.87	3.59	37.8	23.6	19.8	20.5%	1.8
	1382.HK	Pacific Textile	7.77	11,239	976	-13%	1,002	3%	1,070	7%	0.67	0.69	0.74	11.5	11.2	10.5	4.7%	2.4
	2678.HK	Texhong Textile	10.82	9,900	1,188	101%	1,152	-3%	1,370	19%	1.45	1.51	1.89	7.5	7.2	5.7	7.4%	1.0
<b>Luxury &amp; Jewelry (A shares)</b>																		
	600612.SH	Lao Feng Xiang	42.90	18,519	1,057	-5%	1,221	15%	1,331	9%	2.02	2.33	2.54	21.2	18.4	16.9	12.2%	1.7
	900905.SH	Lao Feng Xiang B	3.67	18,519	1,057	-5%	1,221	15%	1,331	9%	0.29	0.34	0.36	12.6	10.7	10.1	12.2%	1.0
	002345.SZ	CHJ	10.75	9,733	234	-8%	264	13%	291	10%	0.26	0.29	0.32	41.7	36.9	33.5	11.5%	3.6
	000026.SZ	Fiyta	10.24	4,062	111	-9%	154	39%	198	29%	0.25	0.35	0.45	40.6	29.2	22.7	33.6%	1.2
	200026.SZ	Fiyta B	5.93	4,062	111	-9%	154	39%	198	29%	0.28	0.42	0.57	21.1	14.1	10.4	33.6%	0.5
<b>Luxury &amp; Jewelry (H shares)</b>																		
	1929.HK	Chow Tai Fook	9.22	92,200	3,055	4%	3,956	29%	4,358	10%	0.31	0.40	0.44	30.2	23.3	21.2	19.4%	1.6
	0590.HK	Luk Fook	28.10	16,498	1,017	6%	1,148	13%	1,303	13%	1.73	1.96	2.22	16.2	14.4	12.7	13.2%	1.2
	0116.HK	Chow Sang Sang	17.92	12,139	742	-34%	834	12%	900	8%	1.10	1.23	1.33	16.4	14.5	13.5	10.1%	1.6

Note: Highlighted companies are covered by CICC; other estimates are based on market consensus  
 Source: Bloomberg, Wind Info, company annual results, CICC Research



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V160908

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