

17 August 2018

Hong Kong

EQUITIES

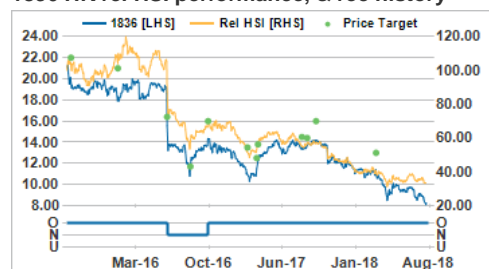
1836 HK Outperform
Price (at 13:00, 16 Aug 2018 GMT) HK\$8.27

Valuation	HK\$	13.00
- PER		
12-month target	HK\$	13.00
Upside/Downside	%	+57.2
12-month TSR	%	+62.6
Volatility Index		Low/Medium
GICS sector		
Consumer Durables & Apparel		
Market cap	HK\$m	6,570
Market cap	US\$m	837
Free float	%	56
30-day avg turnover	US\$m	0.3
Number shares on issue	m	794.4

Investment fundamentals

Year end 31 Dec		2017A	2018E	2019E	2020E
Revenue	m	1,577.3	1,569.0	1,648.6	1,763.9
EBIT	m	63.5	60.0	90.3	103.9
EBIT growth	%	-27.3	-5.5	50.4	15.1
Reported profit	m	62.6	56.0	87.5	100.7
Adjusted profit	m	62.6	56.0	87.5	100.7
EPS rep	¢	7.9	7.1	11.0	12.7
EPS rep growth	%	-23.3	-10.4	56.1	15.2
EPS adj	¢	7.9	7.1	11.0	12.7
EPS adj growth	%	-23.3	-10.4	56.1	15.2
PER rep	x	13.3	14.9	9.5	8.3
PER adj	x	13.3	14.9	9.5	8.3
Total DPS	¢	7.7	4.7	7.7	0.0
Total div yield	%	7.3	4.5	7.3	0.0
ROA	%	5.3	5.0	7.6	8.7
ROE	%	6.4	5.8	9.1	10.5
EV/EBITDA	x	7.5	7.6	5.6	5.1
Net debt/equity	%	-7.4	-6.8	-6.8	-6.8
P/BV	x	0.9	0.9	0.9	0.9

1836 HK rel HSI performance, & rec history



Note: Recommendation timeline - if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.

Source: FactSet, Macquarie Research, August 2018

(all figures in USD unless noted, TP in HKD)

Macquarie Governance and Risk Score (MGRS)

On our proprietary [Governance and Risk Score](#) Stella International Holdings scores in the third quartile of our current universe coverage.

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Stella International Holdings

Adjusted OPM picking up

Key points

- ▶ Shipment volume growth maintained while ASP continued to drop.
- ▶ Redundancy cost to reach ~US\$20m for FY18 and FY19; potential idle asset disposal.
- ▶ Financial position capable to support dividend policy.

Event

- Stella released 1H18 results after market close. Revenue declined 3% YoY to US\$739m, while net profit dropped 19.6% YoY to US\$23m due to one-off redundancy expense and FX impact. Excluding the one-off items and impact from RMB appreciation, adjusted net profit would have grown 14.2% YoY. We lower our net profit by 11.4% and 1.1% for FY18E/19E. Maintain Outperform with an unchanged TP of HK\$13/sh based on 15x FY19E PER, factoring in Macquarie Macro Strategy's FX projection of US\$ appreciation.

Impact

- **Shipment volume growth maintained while ASP continued to drop.** Total shipment volume rose 7.4% YoY to 29m pairs in 1H18. The company maintained its guidance of 60mn pairs for full-year shipments. Meanwhile, ASP for footwear products fell 6.4% to US\$24.9 per pair, which was mainly due to style changes, according to management. The company believes that the ASP drop will continue but with limited impact on their margin recovery. They still expect OPM to reach 6% for FY18 and target 8% for the long term. During 1H18, the adjusted OPM improved 0.9ppt YoY to 5.7%.
- **Redundancy cost to reach ~US\$20m for FY18 and FY19; potential idle asset disposal.** Redundancy cost amounted to US\$7.5m in 1H18. The company expects another one-off charge of ~US\$15m from planned factory closure in Guangxi in 2H18 and estimates redundancy cost to be US\$20m in FY19. We believe the redundancy cost can be offset by potential land asset disposals next year (Dongguang idle land market value at US\$29m, with US\$8.5m book value). Stella is shifting capacity out of China and expects a 40:60 capacity split between China and overseas in 2019.
- **Financial position capable to support dividend policy.** Management is comfortable with the debt level, as most of their debt is short-term working capital borrowing. Regarding the client bankruptcy impact, the entire amount due from Rockport has been fully settled. As for Nine West, total outstanding receivables were ~US\$7m, with Stella's net exposure ~US\$4.5m deducting insurance coverage. As of 31 June 2018, Stella's total provision against receivables was US\$8.1m, which would be sufficient to cover the impairment loss. The company declared an interim dividend of HK\$30 cents/sh. Management expects operating cash flow to turn to a positive level at the end of the year, which could be capable of supporting their dividend policy.

Earnings and target price revision

- We lower our net profit by 11.4% and 1.1% for FY18E/19E. TP remains unchanged at HK\$13/sh.

Price catalyst

- 12-month price target: HK\$13.00 based on a PER methodology.
- Catalyst: 3Q18 operation result

Action and recommendation

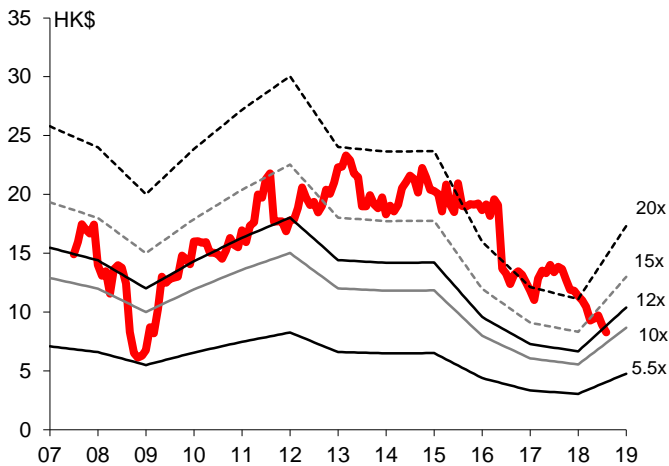
- Maintain Outperform.

Investment thesis: Maintain Outperform, TP remains at HK\$13/sh

We maintain our Outperform rating on Stella International Holdings with an unchanged target price of HK\$13. We lower our NP estimates for FY18E/19E by 11.4% and 1.1% respectively, factoring in 1H18 results and management guidance.

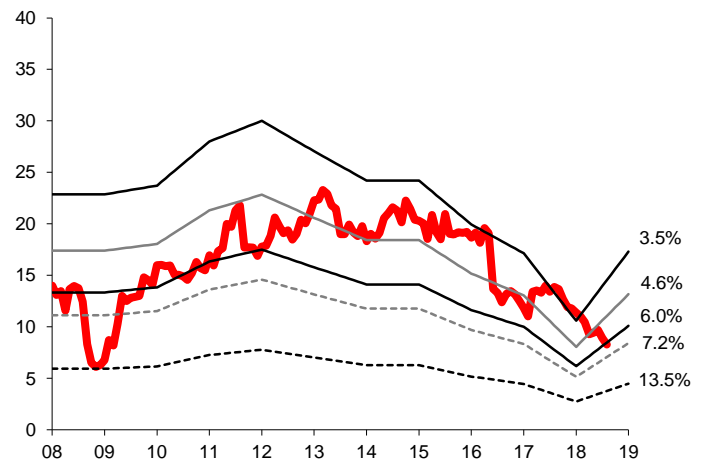
Despite the ASP drop, we believe OPM will gradually recover, backed by efficiency improvements. We believe redundancy cost can be offset by potential land asset disposals next year.

Fig 1 PER band



Source: Bloomberg, Macquarie Research, August 2018

Fig 2 Dividend yield band



Source: Bloomberg, Macquarie Research, August 2018

Earnings revision

We lower our NP forecast for FY18E and FY19E by 11.4% and 1.1%, respectively, as we factor in 1H18 results and management guidance.

- **OP margin.** We raise our OP margin assumption by 1.3ppt for FY18 and 1.1ppt for FY19.
- **Net margin.** We lower our Net margin assumption by 0.4ppt for FY18 to factor in one-off cost.

Fig 3 Earnings revision summary

(US\$ mn)	Old FY18	Old FY19	New FY18	New FY19	% chg. FY18	% chg. FY19
Assumptions						
SSSg	4.0%	3.0%	-1.0%	3.0%	-5.0%	0.0%
OEM volume growth (%)	7.0%	5.0%	7.2%	5.0%	0.2%	0.0%
OEM ASP change (%)	-2.0%	5.0%	-5.6%	0.3%	-3.6%	-4.7%
Revenue	1,601	1,764	1,569	1,649	-2.0%	-6.6%
Gross Profit	282	327	271	292	-3.8%	-10.7%
Operating Profit	56	78	62	76	12.4%	-2.5%
Pre-Tax	65	90	60	90	-7.0%	-0.2%
Net Income	63	88	56	87	-11.4%	-1.1%
EPS (US\$)	7.98	11.15	7.07	11.03	-11.3%	-1.0%
Margin (%)						
Gross Margin	17.1%	17.6%	17.3%	17.7%	0.2ppt	0.1ppt
OP Margin	2.7%	3.5%	4.0%	4.6%	1.3ppt	1.1ppt
Net Margin	3.9%	4.4%	3.6%	5.3%	-0.4ppt	0.9ppt

Source: Macquarie Research, August 2018

Macquarie Quant View

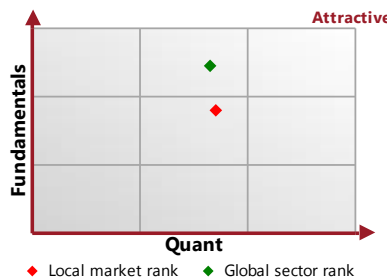
The Quant View page below has been derived from models that are developed and maintained by Sales and Trading personnel at Macquarie. The models are not a product of the Macquarie Research Department.

The quant model currently holds a marginally positive view on Stella International Holdings. The strongest style exposure is Quality, indicating this stock is likely to have a superior and more stable underlying earnings stream. The weakest style exposure is Profitability, indicating this stock is not efficiently converting investments to earnings; proxied by ratios like ROE or ROA.

296/656

Global rank in
Consumer Durables & Apparel

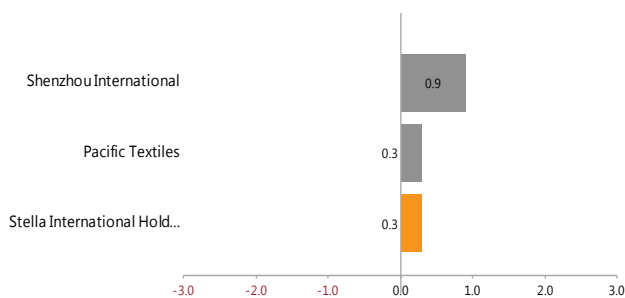
% of BUY recommendations 20% (1/5)
Number of Price Target downgrades 1
Number of Price Target upgrades 0



Displays where the company's ranked based on the fundamental consensus Price Target and Macquarie's Quantitative Alpha model.
Two rankings: Local market (Hong Kong) and Global sector (Consumer Durables & Apparel)

Macquarie Alpha Model ranking

A list of comparable companies and their Macquarie Alpha model score (higher is better).



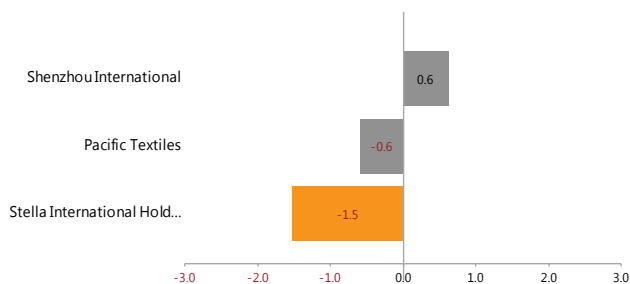
Factors driving the Alpha Model

For the comparable firms this chart shows the key underlying styles and their contribution to the current overall Alpha score.



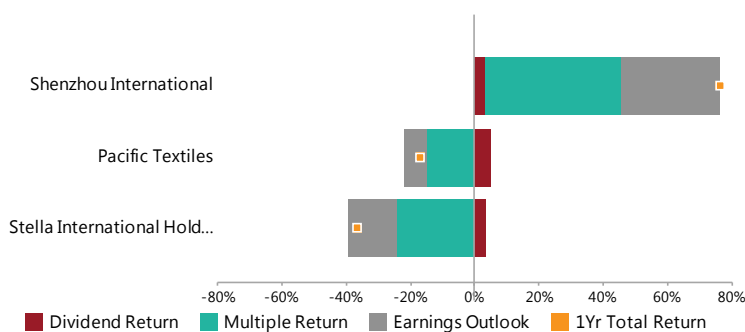
Macquarie Earnings Sentiment Indicator

The Macquarie Sentiment Indicator is an enhanced earnings revisions signal that favours analysts who have more timely and higher conviction revisions. Current score shown below.



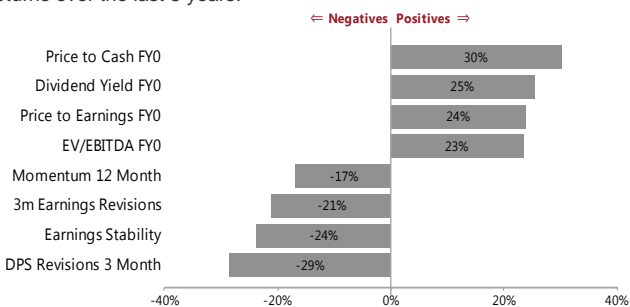
Drivers of Stock Return

Breakdown of 1 year total return (local currency) into returns from dividends, changes in forward earnings estimates and the resulting change in earnings multiple.



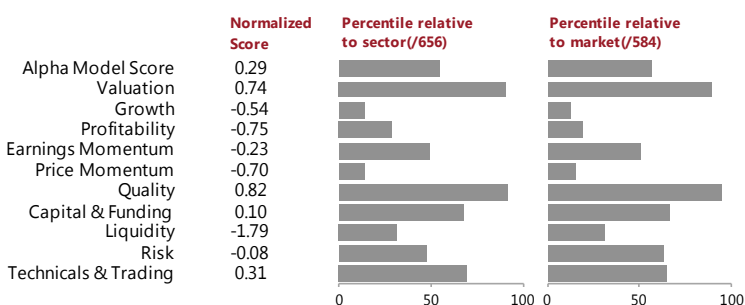
What drove this Company in the last 5 years

Which factor score has had the greatest correlation with the company's returns over the last 5 years.



How it looks on the Alpha model

A more granular view of the underlying style scores that drive the alpha (higher is better) and the percentile rank relative to the sector and market.



Source (all charts): FactSet, Thomson Reuters, and Macquarie Quant. For more details on the Macquarie Alpha model or for more customised analysis and screens, please contact the Macquarie Global Quantitative/Custom Products Group (cpg@macquarie.com).

Stella International Holdings (1836 HK, Outperform, Target Price: HK\$13.00)

Interim Results		1H/18A	2H/18E	1H/19E	2H/19E	Profit & Loss		2017A	2018E	2019E	2020E
Revenue	m	739	830	778	871	Revenue	m	1,577	1,569	1,649	1,764
Gross Profit	m	122	150	133	159	Gross Profit	m	270	271	292	317
Cost of Goods Sold	m	617	680	645	712	Cost of Goods Sold	m	1,307	1,298	1,356	1,447
EBITDA	m	47	53	59	78	EBITDA	m	101	99	136	152
Depreciation	m	20	20	23	23	Depreciation	m	37	39	46	48
Amortisation of Goodwill	m	0	0	0	0	Amortisation of Goodwill	m	0	0	0	0
Other Amortisation	m	0	0	0	0	Other Amortisation	m	0	0	0	0
EBIT	m	27	33	36	54	EBIT	m	63	60	90	104
Net Interest Income	m	-1	-1	0	0	Net Interest Income	m	-1	-3	0	0
Associates	m	3	0	0	0	Associates	m	1	3	0	0
Exceptionals	m	0	0	0	0	Exceptionals	m	0	0	0	0
Forex Gains / Losses	m	0	0	0	0	Forex Gains / Losses	m	0	0	0	0
Other Pre-Tax Income	m	0	0	0	0	Other Pre-Tax Income	m	0	0	0	0
Pre-Tax Profit	m	28	32	36	54	Pre-Tax Profit	m	64	60	90	104
Tax Expense	m	-5	-2	-4	-4	Tax Expense	m	-4	-7	-7	-8
Net Profit	m	24	29	32	51	Net Profit	m	60	53	83	95
Minority Interests	m	1	2	1	3	Minority Interests	m	2	3	5	5
Reported Earnings	m	25	31	34	54	Reported Earnings	m	63	56	87	101
Adjusted Earnings	m	25	31	34	54	Adjusted Earnings	m	63	56	87	101
EPS (rep)	¢	3.1	3.9	4.2	6.8	EPS (rep)	¢	7.9	7.1	11.0	12.7
EPS (adj)	¢	3.1	3.9	4.2	6.8	EPS (adj)	¢	7.9	7.1	11.0	12.7
EPS Growth yoy (adj)	%	-12.9	-8.4	35.5	72.5	EPS Growth (adj)	%	-23.3	-10.4	56.1	15.2
						PE (rep)	x	13.3	14.9	9.5	8.3
						PE (adj)	x	13.3	14.9	9.5	8.3
EBITDA Margin	%	6.3	6.3	7.6	8.9	Total DPS	¢	7.7	4.7	7.7	0.0
EBIT Margin	%	3.7	4.0	4.6	6.3	Total Div Yield	%	7.3	4.5	7.3	0.0
Earnings Split	%	44.2	55.8	38.4	61.6	Basic Shares Outstanding	m	793	793	793	793
Revenue Growth	%	-3.0	1.8	5.2	4.9	Diluted Shares Outstanding	m	793	793	793	793
EBIT Growth	%	-12.1	0.9	31.8	65.7						
Profit and Loss Ratios		2017A	2018E	2019E	2020E	Cashflow Analysis		2017A	2018E	2019E	2020E
Revenue Growth	%	1.7	-0.5	5.1	7.0	EBITDA	m	101	99	136	152
EBITDA Growth	%	-22.2	-1.4	37.2	11.7	Tax Paid	m	-4	-7	-7	-8
EBIT Growth	%	-27.3	-5.5	50.4	15.1	Chgs in Working Cap	m	20	-2	-2	-2
Gross Profit Margin	%	17.1	17.3	17.7	18.0	Net Interest Paid	m	-1	-3	0	0
EBITDA Margin	%	6.4	6.3	8.3	8.6	Other	m	1	28	-11	-25
EBIT Margin	%	4.0	3.8	5.5	5.9	Operating Cashflow	m	118	116	116	116
Net Profit Margin	%	4.0	3.6	5.3	5.7	Acquisitions	m	0	0	0	0
Payout Ratio	%	98.0	66.8	69.9	0.0	Capex	m	-50	-45	-45	-45
EV/EBITDA	x	7.5	7.6	5.6	5.1	Asset Sales	m	0	0	0	0
EV/EBIT	x	11.9	12.3	8.5	7.4	Other	m	0	1	1	1
Balance Sheet Ratios						Investing Cashflow	m	-50	-44	-44	-44
ROE	%	6.4	5.8	9.1	10.5	Dividend (Ordinary)	m	-71	-61	-61	-61
ROA	%	5.3	5.0	7.6	8.7	Equity Raised	m	0	0	0	0
ROIC	%	6.7	5.9	9.3	10.7	Debt Movements	m	0	0	0	0
Net Debt/Equity	%	-7.4	-6.8	-6.8	-6.8	Other	m	-1	0	0	0
Interest Cover	x	64.7	23.5	nmf	nmf	Financing Cashflow	m	-72	-61	-61	-61
Price/Book	x	0.9	0.9	0.9	0.9	Net Chg in Cash/Debt	m	-4	12	12	12
Book Value per Share		1.2	1.2	1.2	1.2	Free Cashflow	m	68	71	71	71
						Balance Sheet		2017A	2018E	2019E	2020E
						Cash	m	75	65	65	65
						Receivables	m	429	342	342	342
						Inventories	m	172	205	205	205
						Investments	m	12	24	24	24
						Fixed Assets	m	0	0	0	0
						Intangibles	m	0	0	0	0
						Other Assets	m	540	552	552	552
						Total Assets	m	1,228	1,188	1,188	1,188
						Payables	m	146	182	182	182
						Short Term Debt	m	0	0	0	0
						Long Term Debt	m	3	0	0	0
						Provisions	m	0	0	0	0
						Other Liabilities	m	111	51	51	51
						Total Liabilities	m	260	233	233	233
						Shareholders' Funds	m	972	961	961	961
						Minority Interests	m	-4	-6	-6	-6
						Other	m	0	0	0	0
						Total S/H Equity	m	968	954	954	954
						Total Liab & S/H Funds	m	1,228	1,188	1,188	1,188

All figures in USD unless noted.

Source: Company data, Macquarie Research, 八月 2018

Important disclosures:

Recommendation definitions

Macquarie - Australia/New Zealand

Outperform – return >3% in excess of benchmark return
 Neutral – return within 3% of benchmark return
 Underperform – return >3% below benchmark return

Benchmark return is determined by long term nominal GDP growth plus 12 month forward market dividend yield, which is currently around 9%.

Macquarie – Asia/Europe

Outperform – expected return >+10%
 Neutral – expected return from -10% to +10%
 Underperform – expected return <-10%

Mazi Macquarie – South Africa

Outperform – expected return >+10%
 Neutral – expected return from -10% to +10%
 Underperform – expected return <-10%

Macquarie - Canada

Outperform – return >5% in excess of benchmark return
 Neutral – return within 5% of benchmark return
 Underperform – return >5% below benchmark return

Macquarie - USA

Outperform (Buy) – return >5% in excess of Russell 3000 index return
 Neutral (Hold) – return within 5% of Russell 3000 index return
 Underperform (Sell) – return >5% below Russell 3000 index return

Volatility index definition*

This is calculated from the volatility of historical price movements.

Very high-highest risk – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

High – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

Medium – stock should be expected to move up or down at least 30–40% in a year.

Low-medium – stock should be expected to move up or down at least 25–30% in a year.

Low – stock should be expected to move up or down at least 15–25% in a year.

* Applicable to Asia/Australian/NZ/Canada stocks only

Recommendations – 12 months

Note: Quant recommendations may differ from Fundamental Analyst recommendations

Financial definitions

All "Adjusted" data items have had the following adjustments made:

Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense
 Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

EPS = adjusted net profit / epowa*

ROA = adjusted ebit / average total assets

ROA Banks/Insurance = adjusted net profit / average total assets

ROE = adjusted net profit / average shareholders funds

Gross cashflow = adjusted net profit + depreciation

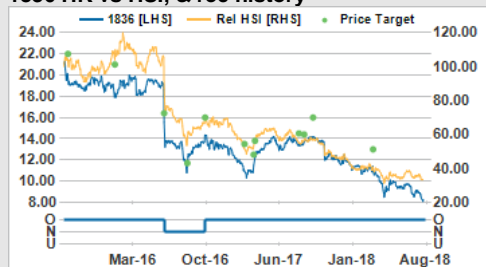
*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

Recommendation proportions – For quarter ending 30 June 2018

	AU/NZ	Asia	RSA	USA	CA	EUR	
Outperform	52.87%	61.26%	48.86%	47.54%	69.86%	46.61%	(for global coverage by Macquarie, 3.51% of stocks followed are investment banking clients)
Neutral	34.10%	27.25%	36.36%	46.72%	21.92%	43.22%	(for global coverage by Macquarie, 2.10% of stocks followed are investment banking clients)
Underperform	13.03%	11.49%	14.77%	5.74%	8.22%	10.17%	(for global coverage by Macquarie, 0.00% of stocks followed are investment banking clients)

1836 HK vs HSI, & rec history



(all figures in HKD currency unless noted)

Note: Recommendation timeline – if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.
 Source: FactSet, Macquarie Research, August 2018

12-month target price methodology

1836 HK: HK\$13.00 based on a PER methodology

Company-specific disclosures:

Important disclosure information regarding the subject companies covered in this report is available at www.macquarie.com/research/disclosures.

Date	Stock Code (BVG code)	Recommendation	Target Price
16-Mar-2018	1836 HK	Outperform	HK\$13.00
14-Sep-2017	1836 HK	Outperform	HK\$16.00
18-Aug-2017	1836 HK	Outperform	HK\$14.40
02-Aug-2017	1836 HK	Outperform	HK\$14.50
21-Mar-2017	1836 HK	Outperform	HK\$13.80
17-Mar-2017	1836 HK	Outperform	HK\$12.50
17-Feb-2017	1836 HK	Outperform	HK\$13.50
20-Oct-2016	1836 HK	Outperform	HK\$16.00
27-Aug-2016	1836 HK	Neutral	HK\$11.70
17-Jun-2016	1836 HK	Neutral	HK\$16.40
19-Jan-2016	1836 HK	Outperform	HK\$21.00
29-Aug-2015	1836 HK	Outperform	HK\$22.00

Target price risk disclosures:

1836 HK: Any inability to compete successfully in their markets may harm the business. This could be a result of many factors which may include geographic mix and introduction of improved products or service offerings by competitors. The results of operations may be materially affected by global economic conditions generally, including conditions in financial markets. The company is exposed to market risks, such as changes in interest rates, foreign exchange rates and input prices. From time to time, the company will enter into transactions, including transactions in derivative instruments, to manage certain of these exposures.

Analyst certification:

We hereby certify that all of the views expressed in this report accurately reflect our personal views about the subject company or companies and its or their securities. We also certify that no part of our compensation was, is or will be, directly or indirectly, related to the specific recommendations or views

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