

# Can **Li Ning** become a sportswear **heavyweight?**



**Valuation Master Class**



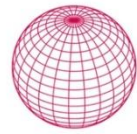


**What's interesting  
about Li Ning is that  
its net profit in 2021  
rose by 136%**



**Valuation Master Class**

# Can Li Ning become a sportswear heavyweight?



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Sector: Cons. Disc.



*Among China's leading and fastest-growing sports brands*

**Our estimate:**

**HKD60**

(Downside 10%)

**HOLD**



## 3 things to know about this company

- ★ Riding Chinese e-commerce wave to drive top-line growth
- ★ Efficient inventory management results in margin expansion
- ★ Strong cash flow is proof that investments are fruitful

## Key statistics

Analyst consensus (39)

**HKD89**

(Upside 34%)

**BUY**

PE ratio (21A)

**40x**

PB ratio (21A)

**7.6x**



## How Nationalism in China Has Dethroned Nike, Adidas

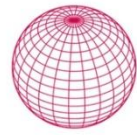
Data show sustained consumer pivot away from Western brands

By Jinshan Hong, Yasufumi Saito and Adrian Leung  
February 16, 2022

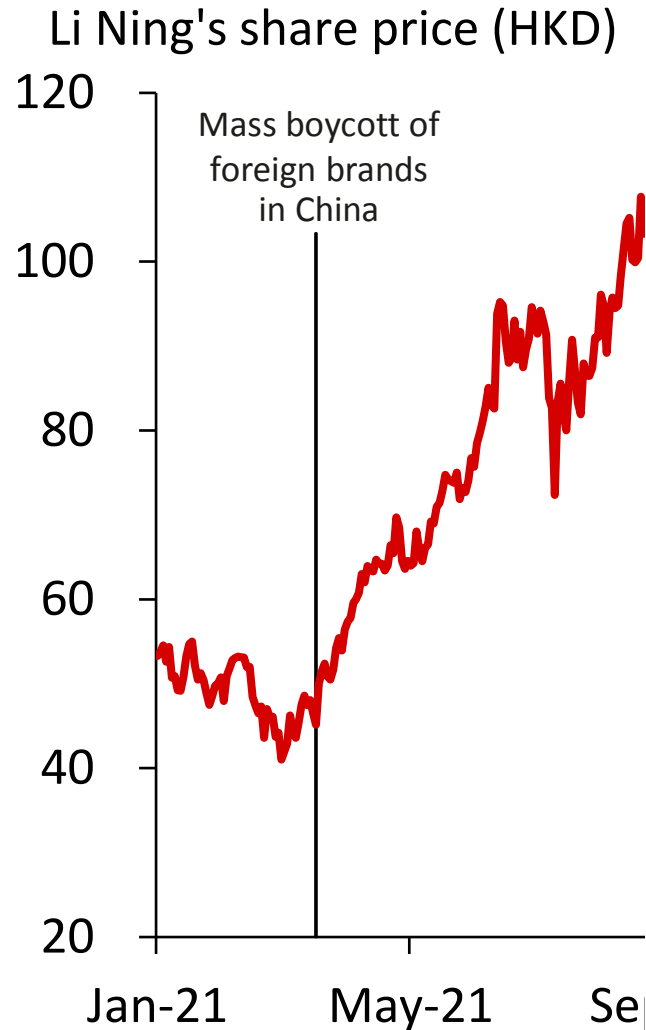
- ★ Public pressure has been mounting on Western brands to stop sourcing cotton from China's western region of Xinjiang due to concerns of forced labor
  - H&M, Nike, and Adidas bowed to this pressure and stopped buying cotton from the region
- ★ China fired back by removing Western brands from major e-commerce platforms and social media
  - Also, Chinese consumers started to boycott those brands



# Mass boycott of foreign brands constituted a catalyst for Li Ning

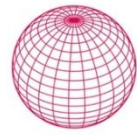


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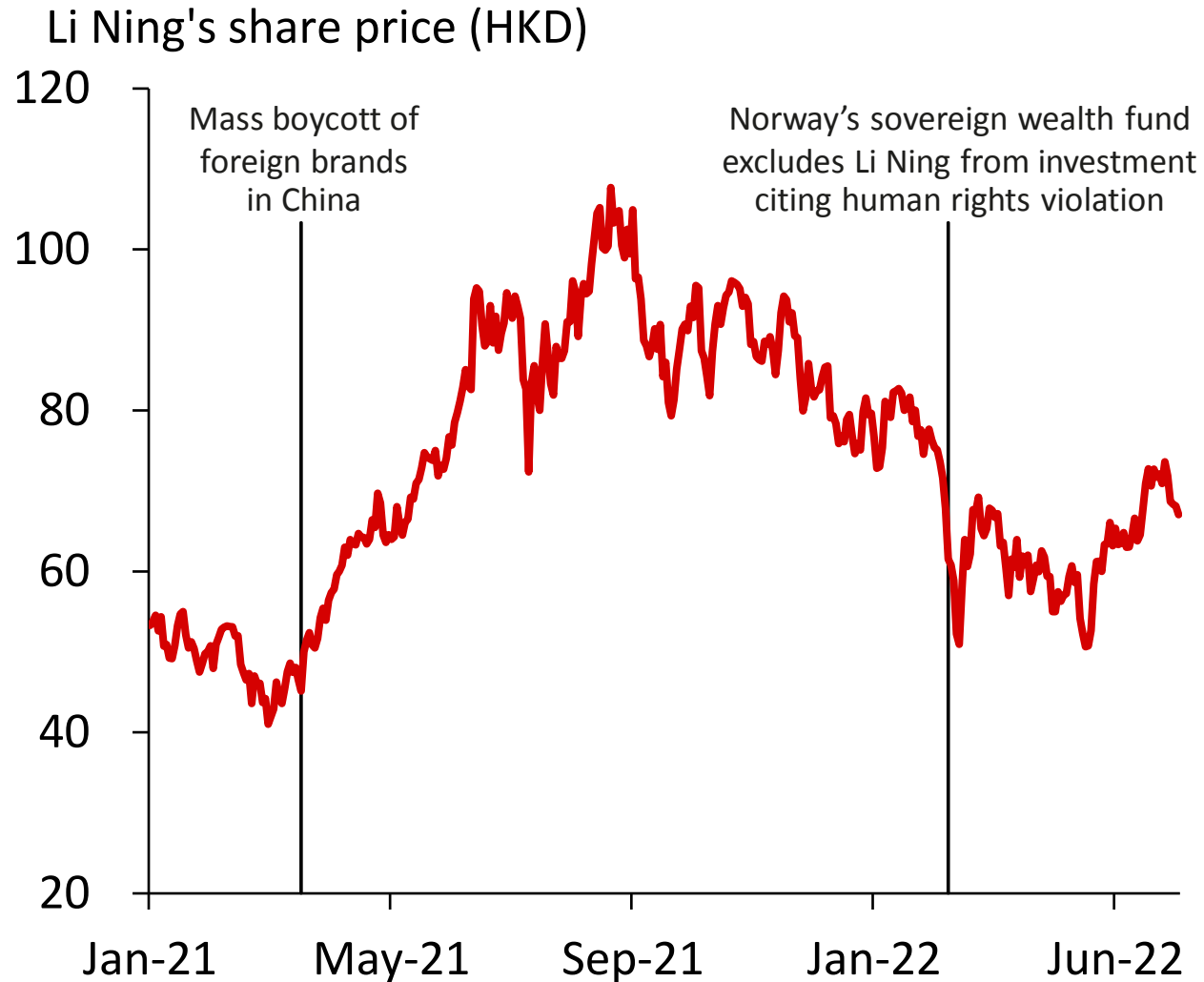


- ★ With the start of the boycott of Western brands, the share price of Li Ning almost doubled
- ★ Chinese people perceived the allegations as an offense
  - The hashtag "I support Xinjiang cotton" has more than 1.8bn views on Chinese platform Weibo

# The rise in share price was followed by a big drop

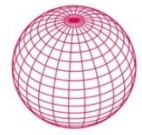


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★ Li Ning faced a couple of events that led to a quick drop in its share price

- **(1) Chinese Zero COVID policy**
- **(2) Supply chain issues due to the outbreak of the Russian war**
- **(3) Foreign funds start to divest shares due to concerns of violations of human rights**



Politicians decide which  
consumer electronics we buy

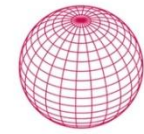


The social media platform  
we use



and now the brand of sports  
apparel we wear





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**Apparel 52%**

**Footwear  
42%**

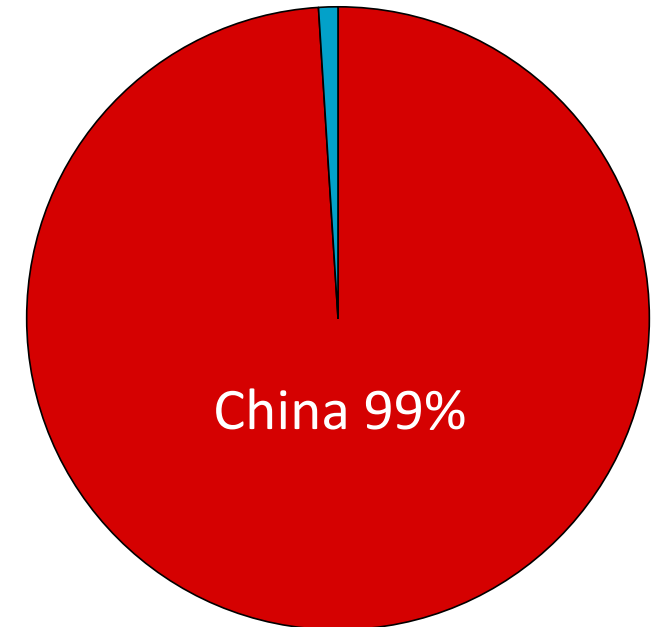


**Equipment &  
accessories 6%**



## Breakdown by region

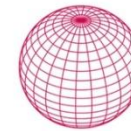
International 1%



China 99%



# 1 Riding Chinese e-commerce wave to drive top-line growth



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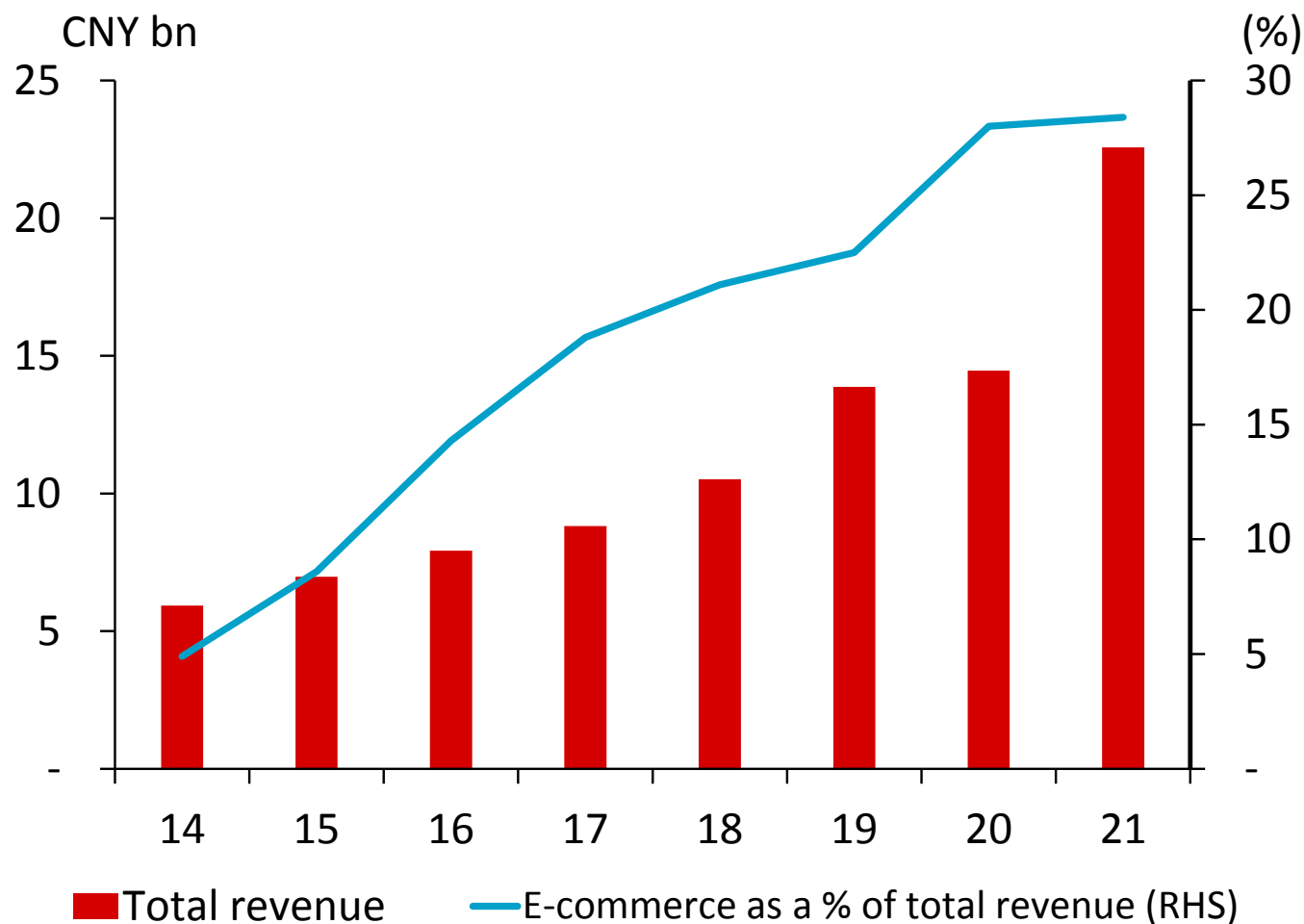
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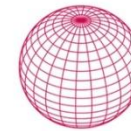
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Risks



- ★ Li Ning started selling their products online back in 2014 which at the time made up 5% of total revenue
- ★ As of 2021, the contribution of e-commerce has risen to almost 30%
  - **China is expected to be the first country that generates more sales from online than in physical stores in 2022**
  - **As a comparison, in the West, e-commerce accounts for only 10-20% of retail**

## 2 Efficient inventory management results in margin expansion



Sales

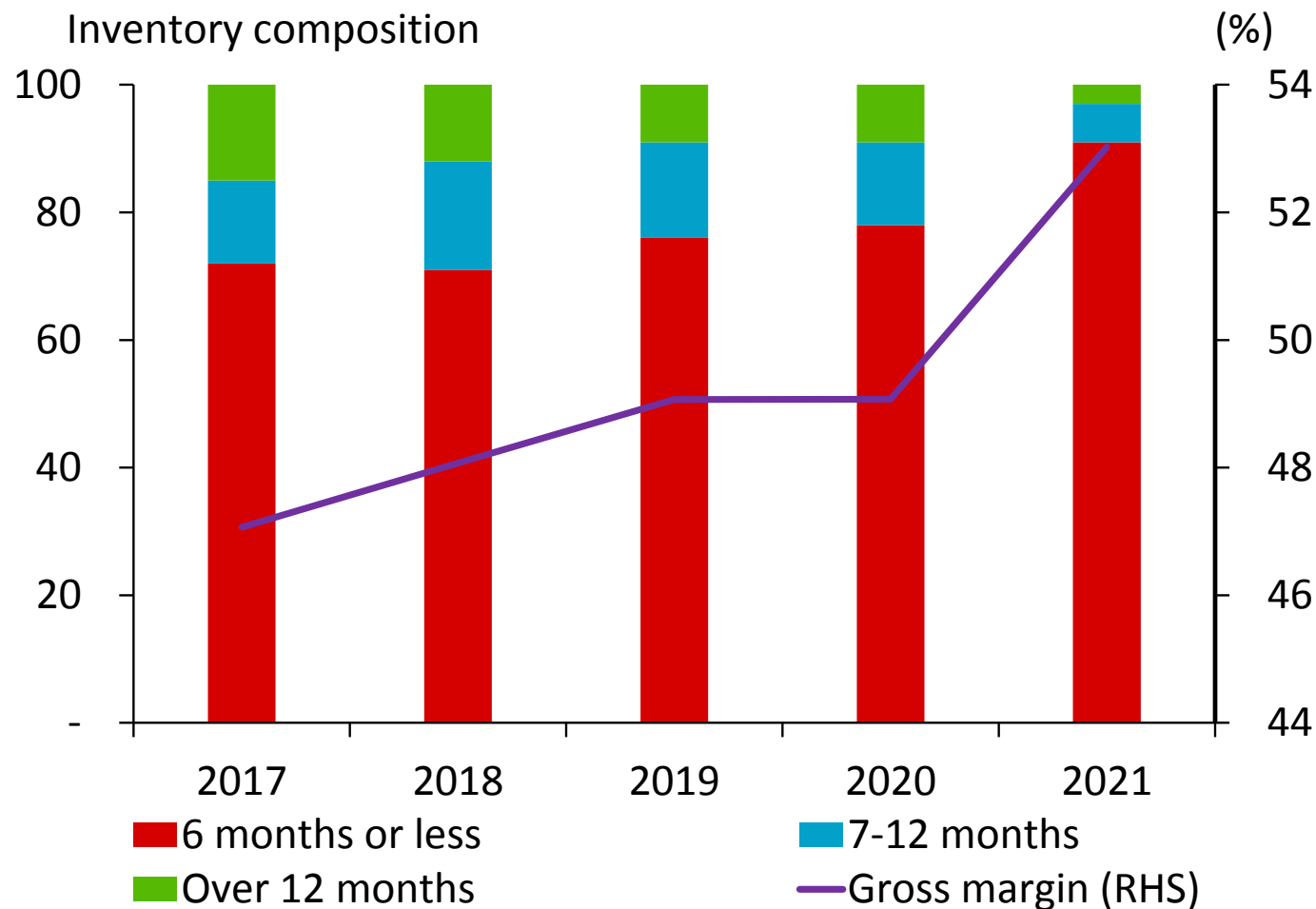
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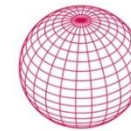
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Risks



- ★ Li Ning has consistently improved its inventory management
  - As a result, it has a higher turnover on its inventory with a lower share of older and outdated products
- ★ This has led to a massive margin expansion over time
  - Between 2017 and 2021, gross margin expanded by 6 percentage points

### 3 Strong cash flow is proof that investments are fruitful



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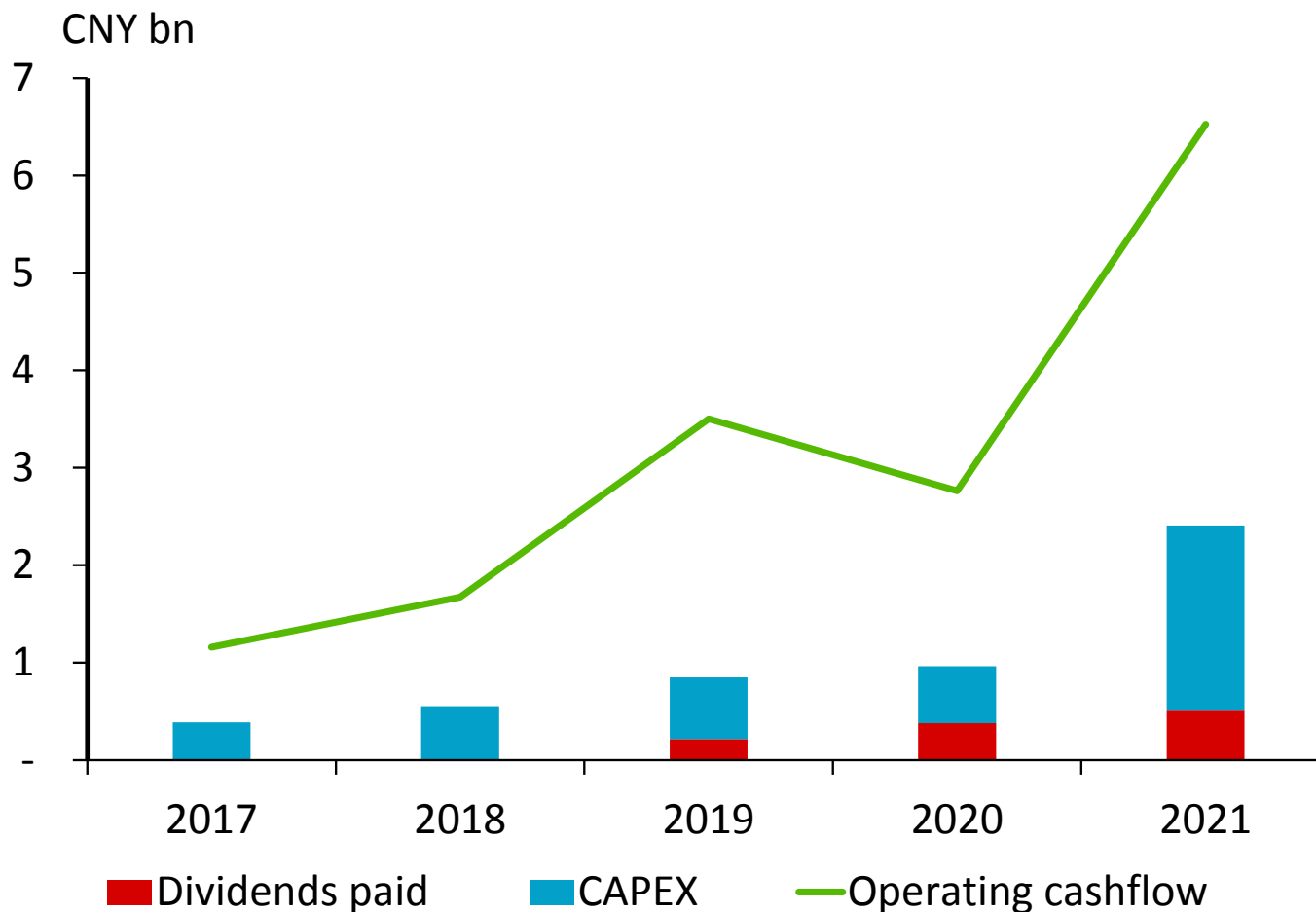
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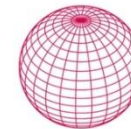
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Risks



- ★ To lay the foundation for future growth, CAPEX requirements are constantly rising
- ★ However, at the same time, Li Ning is generating strong cash flows, that can easily cover investments and also growing dividends





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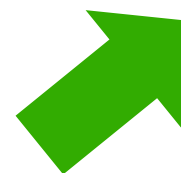
Risks

## Analyst consensus valuation

Recommendation	Apr-22	May-22	Jun-22	Current
Strong buy	18	19	20	20
Buy	17	18	18	18
Hold	1	-	-	-
Sell	-	-	-	-
Strong sell	1	1	1	1
<b>Average score</b>	<b>1.6</b>	<b>1.6</b>	<b>1.6</b>	<b>1.6</b>

Price target	Apr-22	May-22	Jun-22	Current
Median	97	89	88	89
Mean	95	90	89	89

**39**  
**analysts**



**Upside: 34%**

## Analyst consensus 3-year forecast

(%)	19	20	21	22E	23E	24E
Revenue growth	32.0	4.2	56.1	18.2	21.3	19.6
Gross margin	49.1	49.1	53.0	52.7	53.1	52.9
EBIT margin	10.6	15.2	22.8	22.0	22.9	23.4
Net margin	10.8	11.7	17.8	17.6	18.3	18.7

- ★ All analysts are very bullish except one courageous analyst issuing a **STRONG SELL**
- ★ Analysts predict revenue to continue seeing a strong rally and gross margin to stay high

# Profit & loss statement



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(YE Dec, RMB m)	2020A	2021A	2022E	2023E
Revenue	14,457	22,572	26,477	31,508
Cost of goods & services	(7,363)	(10,603)	(12,444)	(14,809)
<b>Gross profit</b>	<b>7,094</b>	<b>11,969</b>	<b>14,033</b>	<b>16,699</b>
SG&A	(5,230)	(7,249)	(8,473)	(10,083)
Other operating (exp)/inc	252	213	235	258
<b>EBIT</b>	<b>2,116</b>	<b>4,934</b>	<b>5,795</b>	<b>6,875</b>
Interest expense (net)	90	159	228	264
Other non-operating inc/(exp)	(81)	(111)	(89)	(71)
<b>Earnings before taxes (EBT)</b>	<b>2,125</b>	<b>4,981</b>	<b>5,935</b>	<b>7,068</b>
Income tax	(549)	(1,317)	(1,484)	(1,767)
<b>Earnings after taxes (EAT)</b>	<b>1,576</b>	<b>3,664</b>	<b>4,451</b>	<b>5,301</b>
Equity income/Minority interest	83	159	191	255
<b>Earnings from cont. operations</b>	<b>1,659</b>	<b>3,823</b>	<b>4,642</b>	<b>5,556</b>
Forex/Exceptionals before tax	39	188	-	-
<b>Net profit</b>	<b>1,698</b>	<b>4,011</b>	<b>4,642</b>	<b>5,556</b>

- ★ Gross profit growth is driven by strong revenue growth and efficient inventory management



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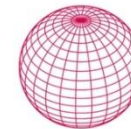
Risks

(YE Dec, RMB m)	2020A	2021A	2022E	2023E
Cash & short-term investments	7,187	15,146	17,115	19,975
Accounts receivable	724	982	1,177	1,400
Inventories	1,346	1,773	2,074	2,468
Other current assets	520	772	900	1,071
<b>Total current assets</b>	<b>9,777</b>	<b>18,672</b>	<b>21,266</b>	<b>24,915</b>
Long-term investments	1,356	4,772	5,096	5,486
<b>Net fixed assets</b>	<b>2,246</b>	<b>4,809</b>	<b>5,842</b>	<b>6,409</b>
Intangible assets	88	80	80	80
Goodwill	103	107	107	107
Other long-term assets	1,024	1,835	2,293	2,866
<b>Total assets</b>	<b>14,594</b>	<b>30,275</b>	<b>34,685</b>	<b>39,865</b>

- ★ To realize its growth potential, the company must continue allocating a high budget to CAPEX



# Balance sheet - liabilities



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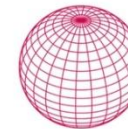
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(YE Dec, RMB m)	2020A	2021A	2022E	2023E
Overdrafts & short-term loans	361	367	417	438
Accounts payable	2,217	3,213	3,768	4,484
Other current liabilities	2,438	4,124	4,501	5,041
<b>Total current liabilities</b>	<b>5,015</b>	<b>7,704</b>	<b>8,686</b>	<b>9,963</b>
Long-term debt	689	956	973	1,021
Other long-term liabilities	201	510	766	842
<b>Total liabilities</b>	<b>5,904</b>	<b>9,171</b>	<b>10,424</b>	<b>11,826</b>
<b>Minority interest</b>	<b>3</b>	<b>3</b>	<b>3</b>	<b>3</b>
Paid-up capital - Common shares	4,420	12,955	12,955	12,955
Paid-up capital - Preferred shares	-	-	-	-
Retained earnings	4,433	8,205	11,362	15,139
Revaluation/Forex/Others	(167)	(59)	(59)	(59)
<b>Total equity</b>	<b>8,687</b>	<b>21,102</b>	<b>24,258</b>	<b>28,036</b>
<b>Total liab &amp; shareholders' equity</b>	<b>14,594</b>	<b>30,275</b>	<b>34,685</b>	<b>39,865</b>

★ Li Ning has a low level of leverage and is net cash



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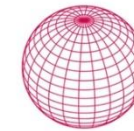
Risks

(YE Dec)	2020A	2021A	2022E	2023E
<b>Internal liquidity (x)</b>				
Current ratio	1.9	2.4	2.4	2.5
Quick, or acid test ratio	1.7	2.2	2.2	2.3
<b>Working cap. mgmt (Days)</b>				
Inventory conversion period	67	53	56	55
Receivables collection period	18	14	15	15
Days from raw mat to coll	85	67	70	70
Payables deferral period	106	92	101	100
Cash conversion cycle	(21)	(26)	(31)	(30)
<b>Profitability ratios (%)</b>				
Gross profit margin	49.1	53.0	53.0	53.0
EBIT margin	14.6	21.9	21.9	21.8
EBIT return on avg assets	15.6	22.0	17.8	18.4
Return on average assets	12.5	17.9	14.3	14.9
<b>Financial risk (x)</b>				
Liabilities-to-assets (%)	40.5	30.3	30.1	29.7
Debt-to-equity	0.1	0.1	0.1	0.1
Net debt-to-equity	(0.7)	(0.7)	(0.6)	(0.7)
Times-interest-earned	58.0	94.2	95.2	109.3
Effective interest rate (%)	5.6	5.4	5.5	5.5

- ★ The company has a negative cash conversion cycle as it has strong bargaining power over its suppliers

# Stock Picking Checklist

*Can this company be a ten bagger?*



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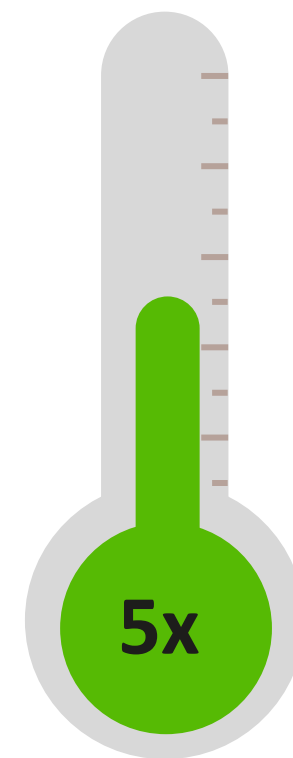
Ratios

Value

Risks

Checklist	Potential	Comment
1. <b>Management</b> is committed to growth	Good	Over the past 9 years, revenue grew at a CAGR of 16%
2. <b>Growth</b> can hit double-digits	Good	Given the rising support for domestic brands, double-digit growth is possible
3. Gross <b>Margin</b> can remain high	Good	Gross margin consistently increased over time
4. <b>Earnings</b> are predictable	Moderate	Fluctuating exceptional items
5. <b>Efficient</b> at deploying assets	Moderate	Asset turnover could fall as a result of rising investment requirements
6. <b>Cash Conversion</b> cycle is low	Good	Cash conversion cycle is negative
7. <b>Cash Flow</b> is consistently positive	Good	Li Ning's operating CF is strong and consistently rising
8. <b>Capital</b> is readily available	Good	The company is net cash
9. <b>Valuation</b> is reasonable	Weak	Trades high on both PE and PB

10x Bagger Potential







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(YE Dec, RMB m)	2020A	2021A	2022E	2023E
EBIT	2,116	4,934	5,795	6,875
Est tax rate (%)	25	25	25	25
<b>NOPAT</b>	<b>1,579</b>	<b>3,676</b>	<b>4,346</b>	<b>5,156</b>
Add: Depre & amort	1,013	1,140	1,306	1,688
Less: CAPEX	(586)	(1,892)	(2,339)	(2,256)
Chg in A/R	2	(258)	(195)	(224)
Chg in inventory	62	(427)	(301)	(394)
Chg in oth curr assets	(75)	(252)	(129)	(171)
Chg in A/P	83	997	555	716
Chg in oth curr liabs	191	1,686	378	540
<b>Less: Chg in working cap</b>	<b>263</b>	<b>1,746</b>	<b>307</b>	<b>467</b>
Less: Chg in invest cap				
<b>Free cash flow to firm</b>	<b>2,268</b>	<b>4,671</b>	<b>3,620</b>	<b>5,056</b>

- ★ Expect strong cash flow generation despite rising CAPEX requirements



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Forecast assumptions			
3-year average	Consensus	My assumptions	
Revenue growth (CAGR)	19.7	18.4	
Gross margin	52.9	53.0	
EBIT margin	22.8	21.8	
Net margin	18.2	17.6	

My valuation method			
Market: Hong Kong			
Market risk-free rate	1.7	Valuation Method: FCFF	
Market equity risk premium	5.0		
Market return	6.7		
Company beta (x)	1.3		
COE	8.0		
WACC	7.9		
Terminal growth rate	4.0		

- ★ Li Ning has strong revenue potential
  - However, I think that consensus might be slightly too optimistic with regards to margins
- ★ I value the company using FCFF with a terminal growth rate of 4%



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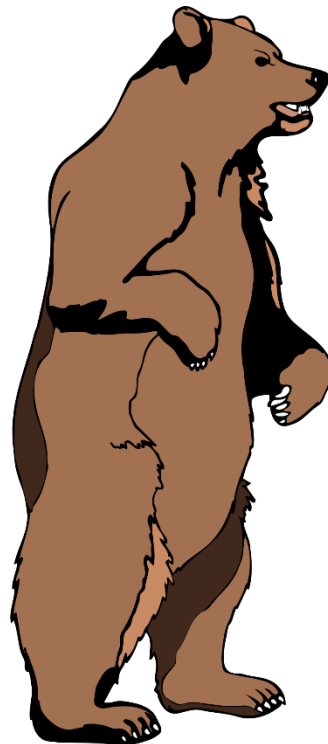
Value

Risks

**Bear**

**HKD55**

(Downside 16%)



**Base**

**HKD60**

(Downside 10%)



**Bull**

**HKD65**

(Downside 1%)







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Risks

- ★ Geopolitical situation may hinder the company's international expansions
- ★ Sanctions by Western governments could prevent investors from investing in the company
- ★ Failure to protect its own intellectual properties

# CONCLUSION

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- Chinese booming e-commerce to unlock double-digit growth
- Efficient inventory management drives margin expansion
- Strong cash generation supports a defensive balance sheet

