Company Report

China Merchants Securities (HK) Co., Ltd.
Hong Kong Equity Research

Li Ning (2331 HK)

1H beat on GPM; FY top-line grow LSD% on guided

- **Disciplined promotion fuelled higher GPM that beat consensus**
- **2H expectation settling on a refreshed LSD% FY top-line growth**
- **BUY-rated; TP based on 15.0x end-24E P/E**

A reassuring 1H bodes well for a promising risk/reward

Li Ning's stringent retail discount control brought to a fruitful 1.0-1.5pp gross margins beat and hence a narrowed -8% yoy net profit decline in 1H that compared to an expected -18% yoy. During the analyst call this morning, management refreshed the market with a more realistic LSD% top-line growth guidance for 2024, in view of a HSD% decline in offline traffic seen in 3Q-to-date. That said, a relatively steady 2H outlook that matches with our/market expectation is bolstered by, in our view, management's cautious and proactive risk control along with its business acumen in terms of : 1) a healthy inventory level at <4 months, 2) a happening channel optimisation with a higher online contribution that offers improving margins (+0.9pp yoy in 1H), 3) an eye-catching growth generation stemming from the rising share in the running segment (retail sell-through +25% yoy in 1H). Considering also shares now trading at 10-year low, we are BUY-rated as risk-reward turns more promising in our view.

Key analyst call takeaway

- 3Q-TD offline traffic down HSD% yoy albeit August momentum saw m-m improvement.
- Li Ning revised down the full-year sales growth to LSD% from MSD% but maintained a low-teens % for net profit margin in 2024.
- Pressure in 2H GPM due to expense kitchen-sink and intensifying promotions. A&P will likely inflate on Olympic ads.

Key 1H results data

- 1H24 revenue grew 2.3% yoy, while retail sell-through (both online and offline) declined by LSD%. Offline sell-through declined by MSD%. Net profit down 8% yoy; NPM dropped 1.5 pp to 13.6%.
- Retail sell-through from Running/Basketball/Fitness/Sports Casual grew by 25%/-20%/7%/-7%, respectively. The cumulative sales volume of the big 3 running shoes surpassed 5mn.

Earnings change

- We trim our 2024-26E revenue by 2-8% in view of the refreshed guidance, which lead to 3-6% cut in our net profits assumptions.

Valuation and risks

Our new TP of HKD20.0 (from previously HKD25.6) is now based on 15.0x (from previously 16.9x) end-24 P/E, which still represents -1SD below long term average since 2016. **Key risks:** irrational destocking.

Financials

Year ended 31 Dec (RMB mn)	2022	2023	2024E	2025E	2026E
Revenue	25,803	27,598	28,408	29,949	32,975
yoy growth	*14.3%*	*7.0%*	*2.9%*	*5.4%*	*10.1%*
Attributable net profit	4,064	3,187	3,285	3,768	4,287
Adj. EPS (RMB), diluted	1.54	1.23	1.27	1.45	1.65
yoy growth	*-2.4%*	*-20.4%*	*3.4%*	*14.4%*	*13.8%*
P/E (x)	8.3x	10.5x	10.1x	8.8x	7.8x
ROE %	17.9%	13.1%	13.0%	13.8%	14.5%

Sources: Company data, CMS (HK) estimates; share price as of Aug 15, 2024

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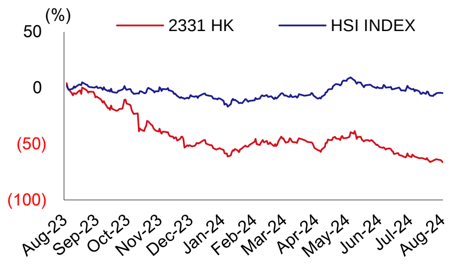
WHAT'S NEW

Li Ning's stringent retail discount control brought to a fruitful 1.0-1.5pp gross margins beat and hence a narrowed -8% yoy net profit decline that compared to an expected -18% yoy. Management refreshed the market with a more realistic LSD% topline growth guidance for 2024.

BUY

Previous	BUY
Price	HKD 13.2
12-month Target Price (Potential up/downside)	HKD20.0(+51.5%)
Previous	HKD25.60

Price Performance



Source: Bloomberg; share price as of Aug 15, 2024

%	1m	6m	12m
2331 HK	(14.4)	(34.8)	(67.8)
HSI	(5.0)	7.3	(7.9)

Sector: Consumer Discretionary	
Hang Seng Index (Aug 15, 2024)	17,109
HSCEI (Aug 15, 2024)	6,035
Key Data	
52-week range (HKD)	12.88 - 41.46
Market cap (HKD mn)	34,115
Avg. daily volume (mn)	32.37
BVPS (RMB)	9.3
Shareholding Structure	
Viva China Holdings Ltd	10.5%
Others	6.0%
No. of shares outstanding (mn)	2,584
Free float	83.5%

Source: Bloomberg

Company Report

Key conference call takeaway

- **2H24 overview**: Foot traffic 3Q-TD decelerated from 2Q24, continuing the declining trend since 1Q24. Management plans to control the shipment volume in the 2H, as offline sales are likely to fall short of expectation, so that to avoid the inventory clearing in the future.
- **2024 Guidance:** Li Ning revised down the full-year sales growth to low-single digit from mid-single digit disclosed previously post-1Q results, after factoring-in the weak performance in July and August. The Company maintained the guidance of a low-teens % for net profit margin in 2024.
- **Margin:** GPM is likely to face challenging situation in 2H due to 1) the overall expenditures for the FY are more likely to occur in 2H and 2) lower-than-expected offline sales in 2H may lead to potential discounting pressure. A&P expense will increase due to leveraging the marketing from the Olympics Game.
- **Impairment:** The Company has recorded a total impairment of around RMB69mn generated from the stores and decorations in 1H24, and at the same time it expects the sum of full-year impairment will be less than the c.RMB334mn last year.
- **Outlook for 2025:** The Company holds a cautious view on 2025 and does not believe there would be much performance improvement, based on the unsatisfied results in July and August.

Key 1H24 results data points

Li Ning 1H24 revenue grew by 2.3% yoy to RMB14.345bn, while retail sell-through (both online and offline) declined by low-single-digit. Offline sell-through in 1H24 declined by mid-single-digit, where the benefit from low-single-digit improvement in ASP offset by the mid-single-digit decrease in sales volume. The ticket price was flat yoy. Net profit declined by 8% yoy, with NPM dropping by 1.5 pp to 13.6% in 1H24.

By category, retail sell-through from Running/Basketball/Fitness/Sports Casual sector grew by 25%/-20%/7%/-7%, respectively, and accounted for 30%/22%/14%/33% of the total retail sell-through. For Running shoes, the cumulative sales volume of the big 3 products, Super Light + Rough Rabbit + Feidian series, surpassed 5mn pairs in 1H24.

Inventory level

- Overall: 3.9x
- DTC: 3.9x
- E-commerce: a bit over 3x
- Distributor: 4x in average

Margin by channel:

- **DTC**
  - GPM: mid-60s %, grew by low-single digit %
  - OPM: low-teens %, improved slightly
- **Wholesales**
  - GPM: mid-40s %, flat yoy
  - OPM: mid- to high-30s %, flat yoy
- **E-commerce**
  - GPM: mid-50s %, lifted by mid-single digit
  - OPM: mid20s %, improved by low-single digit

Offline retail operations challenges:

- Offline retail sell-through down by mid-single-digit
- Foot traffic declined by mid-single-digit
- Discount rate and ASP improved by low-single-digit

Online operation relatively outperformed:

- Online direct retail sell-through grew by mid-teens
- Discount rate improved by low-single-digit pp
- Online traffic surged by mid-teens

Figure 1: Earnings revision summary

RMB mn	New FY24E	New FY25E	New FY26E	Old FY24E	Old FY25E	Old FY26E	Diff (%) FY24E	Diff (%) FY25E	Diff (%) FY26E
Revenue	28,408	29,949	32,975	29,131	32,041	35,880	-2.5%	-6.5%	-8.1%
Gross Profit	14,221	14,982	16,446	14,201	15,641	17,479	0.1%	-4.2%	-5.9%
Operating Profit	3,817	4,183	4,775	3,842	4,662	5,121	-0.7%	-10.3%	-6.8%
Net profit	3,285	3,768	4,287	3,502	4,189	4,621	-6.2%	-10.0%	-7.2%
Gross Margin	50.1%	50.0%	49.9%	48.7%	48.8%	48.7%	1.3ppt	1.2ppt	1.2ppt
OPM	13.4%	14.0%	14.5%	13.2%	14.5%	14.3%	0.2ppt	-0.6ppt	0.2ppt
NPM	11.6%	12.6%	13.0%	12.0%	13.1%	12.9%	-0.5ppt	-0.5ppt	0.1ppt

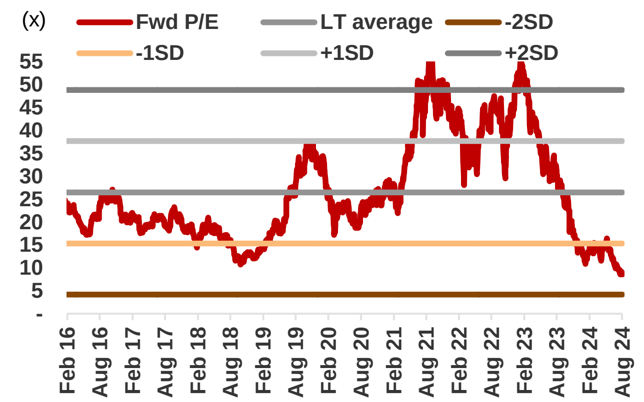
Sources: Company data, CMS (HK) estimates

Figure 2: CMS estimates vs. consensus

RMB mn	CMS FY24E	CMS FY25E	CMS FY26E	Consensus FY24E	Consensus FY25E	Consensus FY26E	Diff (%) FY24E	Diff (%) FY25E	Diff (%) FY26E
Revenue	28,408	29,949	32,975	28,997	31,707	34,511	-2.0%	-5.5%	-4.5%
Gross Profit	14,221	14,982	16,446	13,995	15,442	16,947	1.6%	-3.0%	-3.0%
Operating Profit	3,817	4,183	4,775	3,726	4,327	4,876	2.4%	-3.3%	-2.1%
Net profit	3,285	3,768	4,287	3,286	3,753	4,306	0.0%	0.4%	-0.4%
Gross Margin	50.1%	50.0%	49.9%	48.3%	48.7%	49.1%	1.8ppt	1.3ppt	0.8ppt
OPM	13.4%	14.0%	14.5%	12.8%	13.6%	14.1%	0.6ppt	0.3ppt	0.4ppt
NPM	11.6%	12.6%	13.0%	11.3%	11.8%	12.5%	0.2ppt	0.7ppt	0.5ppt

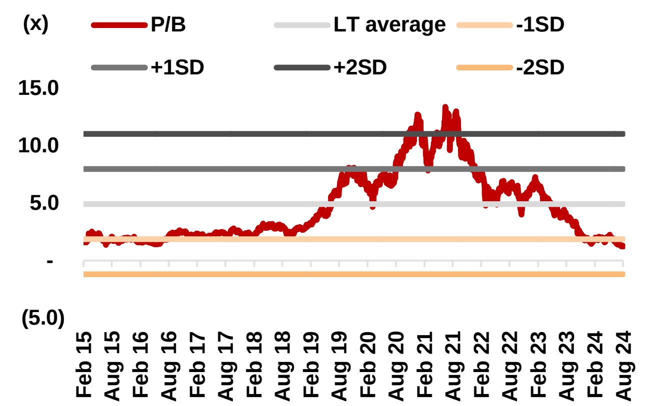
Sources: Company data, Bloomberg, CMS (HK) estimates

Figure 3: Forward P/E



Sources: Bloomberg, CMS (HK)

Figure 4: Historical P/B



Sources: Bloomberg, CMS (HK)

Financial statement

Balance Sheet

RMB mn	2022	2023	2024E	2025E	2026E
Current assets	**12,395**	**13,653**	**14,793**	**16,558**	**18,828**
Cash & equivalents	7,382	5,444	6,220	7,763	9,591
Trading investments	832	838	838	838	838
ST bank deposits	644	3,494	3,494	3,494	3,494
Trade receivables	1,020	1,206	1,578	1,664	1,832
Other receivables	88	178	178	178	178
Inventories	2,428	2,493	2,484	2,621	2,895
Other current assets	0	0	0	0	0
Non-current assets	**21,252**	**20,555**	**21,137**	**21,545**	**21,829**
Investment & deposits	1961	1715	1715	1715	1715
Property, plant & eqt.	3,235	4,124	4,829	5,313	5,645
Intangible assets	217	221	221	221	221
LT bank deposits	11023	9037	9037	9037	9037
Other non-current assets	4,816	5,458	5,335	5,259	5,211
Total assets	**33,647**	**34,208**	**35,930**	**38,103**	**40,657**
Current liabilities	**7,241**	**7,268**	**7,182**	**7,276**	**7,463**
Borrowings	0	0	0	0	0
Trade payables	1,584	1,790	1,703	1,797	1,985
Other liquid liabilities	5,656	5,479	5,479	5,479	5,479
Long term liabilities	**2,074**	**2,533**	**2,533**	**2,533**	**2,533**
Deferred tax liabilities	519	627	627	627	627
Borrowings	0	0	0	0	0
Others	1,555	1,905	1,905	1,905	1,905
Total liabilities	**9,315**	**9,801**	**9,715**	**9,808**	**9,996**
Total equity	**24,332**	**24,407**	**26,215**	**28,295**	**30,661**
Issued capital	240	240	240	240	240
Reserves	24,089	24,167	25,976	28,055	30,421
Minority interests	2	0	0	0	0
Total equity and liabilities	**33,647**	**34,208**	**35,930**	**38,103**	**40,657**

Cashflow Statement

RMB mn	2022	2023	2024E	2025E	2026E
Operating cash flow	**3,914**	**4,688**	**4,952**	**5,933**	**6,449**
Pretax profit	5,415	4,256	4,575	5,025	5,716
Deprec & amort.	1393	1833	2117	2293	2416
Finance costs	327	319	343	343	343
Working capital change	(978)	(315)	(450)	(128)	(254)
CF from investing activities	**(9,481)**	**(2,449)**	**(2,700)**	**(2,700)**	**(2,700)**
Capital expenditure	(1,757)	(1,727)	(2,000)	(2,000)	(2,000)
Other investments	(7,725)	(722)	(700)	(700)	(700)
CF from financing activities	**(1,887)**	**(4,217)**	**(1,476)**	**(1,689)**	**(1,921)**
Borrowings	0	0	0	0	0
Dividends	(1,195)	(2,175)	(1,476)	(1,689)	(1,921)
Others	(693)	(2,042)	0	0	0
Net cash flow	**(7,455)**	**(1,978)**	**776**	**1,544**	**1,827**
Forex effect	93	40	0	0	0
Ending cash	**7,382**	**5,444**	**6,220**	**7,763**	**9,591**

Profit & Loss

RMB mn	2022	2023	2024E	2025E	2026E
Revenue	**25,803**	**27,598**	**28,408**	**29,949**	**32,975**
Cost of sales	(13,319)	(14,246)	(14,187)	(14,966)	(16,529)
Gross profit	**12,485**	**13,352**	**14,221**	**14,982**	**16,446**
Other income	829	543	580	580	580
Selling expenses	(7,314)	(9,080)	(9,600)	(9,980)	(10,711)
Admin expenses	(1,113)	(1,256)	(1,383)	(1,399)	(1,540)
Adj. operating profit	**4,887**	**3,559**	**3,817**	**4,183**	**4,775**
Net finance costs	327	319	343	343	343
Share of results of JV	201	378	416	499	599
Non-recurring gain/(loss)	0	0	0	0	0
Profit before tax	**5,415**	**4,256**	**4,575**	**5,025**	**5,716**
Income tax expense	(1,351)	(1,069)	(1,144)	(1,256)	(1,429)
Profit after tax	**4,064**	**3,187**	**3,432**	**3,768**	**4,287**
Minority interests	0	0	0	0	0
Reported net profit	**4,064**	**3,187**	**3,285**	**3,768**	**4,287**
Recurring net profit	**4,064**	**3,187**	**3,285**	**3,768**	**4,287**
EPS (RMB) – recurring, diluted	**1.54**	**1.23**	**1.27**	**1.45**	**1.65**

Financial

	2022	2023	2024E	2025E	2026E
yoy growth rate					
Revenue	14.3%	7.0%	2.9%	5.4%	10.1%
Operating profit	-4.6%	-27.2%	7.2%	9.6%	14.2%
Recurring net profit	1.7%	-21.6%	3.1%	14.7%	13.8%
Profitability					
Gross margin	48.4%	48.4%	50.1%	50.0%	49.9%
OPM	18.9%	12.9%	13.4%	14.0%	14.5%
Recurring NP margin	15.7%	11.5%	11.6%	12.6%	13.0%
Liquidity					
AR days	7.4	27.4	20.0	20.0	20.0
Inventory days	57.6	63.0	63.0	63.0	63.0
AP days	43.6	43.2	43.2	43.2	43.2
Cash conversion cycle	21.3	47.2	39.8	39.8	39.8
Cash flow & leverage					
Free cash low	2,157	2,961	2,952	3,933	4,449
Net debt to equity	-33.0%	-36.6%	-37.1%	-39.8%	-42.7%
Dividend payout ratio	29.8%	15.0%	45.0%	45.0%	45.0%
Dividend yield	3.4%	1.4%	4.2%	4.8%	5.5%
Return analysis					
ROE	17.9%	13.1%	13.0%	13.8%	14.5%
Asset turnover	0.8	0.8	0.8	0.8	0.8
Net margin	15.7%	11.5%	11.6%	12.6%	13.0%
Financial leverage	1.4	1.4	1.4	1.4	1.3
ROA	12.7%	9.4%	9.4%	10.2%	10.9%
Valuation					
P/E	8.3x	10.5x	10.1x	8.8x	7.8x
P/B	1.4x	1.4x	1.3x	1.2x	1.1x

Sources: Company data, CMS (HK) estimates

Investment Ratings

Industry Rating	Definition
OVERWEIGHT	Expect sector to outperform the market over the next 12 months
NEUTRAL	Expect sector to perform in-line with the market over the next 12 months
UNDERWEIGHT	Expect sector to underperform the market over the next 12 months

Company Rating	Definition
BUY	Expect stock to generate 10%+ return over the next 12 months
HOLD	Expect stock to generate +10% to -10% over the next 12 months
SELL	Expect stock to generate loss of 10%+ over the next 12 months

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