

China / Hong Kong Company Update

Shenzhou International

Bloomberg: 2313 HK EQUITY | Reuters: 2313.HK

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DBS Group Research . Equity

31 Mar 2022

BUY (Upgrade from HOLD)

Last Traded Price (30 Mar 2022): HK\$113.10 (HSI : 22,232)

Price Target 12-mth: HK\$133 (18% upside) (Prev HK\$177)

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What's New

- Shenzhou's FY21 earnings results in line with its profit warning expectation of a 33.7% drop y-o-y
- Vietnam's abandonment of zero-COVID strategy and higher vaccination rate lift key concerns on further operation disruption
- Revised down FY22F earnings by 28% to reflect slower than expected margin recovery due to cost inflation and COVID disruption in Ningbo during 1Q22
- Trading 45%+ below its 2021 peak, negatives have been more than priced in, Upgrade to BUY with new TP of HK\$133

Expect restoration of stability in FY22

Investment Thesis

Vietnam's abandoning of the zero-COVID strategy and higher vaccination rate lift key concerns. Whilst the suspension of operations due to COVID was well telegraphed to the market, the delay of production coupled with rises in raw material and energy costs caused a larger-than-expected drop in the margins in 2H21. Going into FY22, the abandonment of the zero-COVID strategy in Vietnam and the higher vaccination rate of 76% should help Shenzhou avoid the suspension of its operation and extra costs due to delayed orders.

Attractive valuation for the industry bellwether. As Shenzhou's previous strong share price has been due to its consistency, a break in this due to COVID and inflation has hit its massive premium. As Vietnam's lockdown measures are unlikely to occur in FY22, we think the worst is over for the company, especially at the current attractive valuation, where the stock is trading at -1SD of its five-year mean PE.

Diversified manufacturing bases with strong flexibility and vertical integration are experts in securing clients. Shenzhou's diversified manufacturing bases in China, Vietnam, and Cambodia provide clients with unmatched sourcing flexibility, which has ensured stability. A unique ability to provide vertically integrated fabric and garment production, faster response time, and better development capabilities help in securing its all-star client base comprising Nike, Uniqlo, Adidas, and Puma.

Price Relative



Forecasts and Valuation

| FY Dec (RMBm) | 2020A | 2021A | 2022F | 2023F |
|-----------------------------|--------|--------|--------|--------|
| Turnover | 23,031 | 23,845 | 27,461 | 31,514 |
| EBITDA | 6,461 | 4,736 | 6,337 | 7,804 |
| Pre-tax Profit | 5,512 | 3,823 | 5,140 | 6,557 |
| Net Profit | 5,107 | 3,372 | 4,532 | 5,782 |
| Net Profit Gth (Pre-ex) (%) | 0.2 | (34.0) | 34.4 | 27.6 |
| EPS (RMB) | 3.40 | 2.24 | 3.02 | 3.85 |
| EPS (HK\$) | 4.19 | 2.77 | 3.72 | 4.74 |
| EPS Gth (%) | 0.2 | (34.0) | 34.4 | 27.6 |
| Diluted EPS (HK\$) | 4.19 | 2.77 | 3.72 | 4.74 |
| DPS (HK\$) | 2.16 | 1.66 | 2.42 | 3.08 |
| BV Per Share (HK\$) | 22.37 | 22.78 | 24.54 | 26.79 |
| PE (X) | 27.0 | 40.9 | 30.4 | 23.8 |
| P/Cash Flow (X) | 24.0 | 348.0 | 32.6 | 23.4 |
| P/Free CF (X) | 37.1 | nm | 66.6 | 40.5 |
| EV/EBITDA (X) | 20.3 | 28.8 | 21.6 | 17.5 |
| Net Div Yield (%) | 1.9 | 1.5 | 2.1 | 2.7 |
| P/Book Value (X) | 5.1 | 5.0 | 4.6 | 4.2 |
| Net Debt/Equity (X) | CASH | CASH | CASH | CASH |
| ROAE (%) | 18.7 | 12.1 | 15.2 | 17.7 |
| Earnings Rev (%) | | | (28) | New |
| Consensus EPS (RMB) | | | 3.93 | 4.82 |
| Other Broker Recs: | | B:35 | S:0 | H:3 |

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

Valuation:

We upgrade Shenzhou to BUY with a new TP of HK\$133. It is based on a 35.8x FY22F PE, equivalent to its five-year average forward PE.

Where we differ:

We are more conservative on Shenzhou's GP margin and earnings in FY2022, compared to the consensus. However, we are optimistic to FY2023 where the GP margin and profit normalized.

Key Risks to Our View:

Slower-than-expected order demand and Vietnam's COVID-19 outbreak persistently leading to stricter lockdown measures.

At A Glance

| | |
|--|------------------|
| Issued Capital (m shrs) | 1,503 |
| Mkt Cap (HK\$m/US\$m) | 169,989 / 21,718 |
| Major Shareholders (%) | |
| Keep Glory Limited | 44.8 |
| Fairco Group Limited | 5.0 |
| Free Float (%) | 50.2 |
| 3m Avg. Daily Val. (US\$m) | 77.13 |
| GIICS Industry: Consumer Discretionary / Consumer Durables & Apparel | |



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Shenzhou International

WHAT'S NEW

Shenzhou's FY21 earnings results in line with its profit warning expectation of a 33.7% drop y-o-y

Shenzhou's FY21 earnings results in line with its profit warning expectation. Shenzhou's earnings significantly dropped 31% y-o-y to RMB3.37bn. Revenue increased 3.5% y-o-y thanks to the 10.5% increase in sales of sportswear products. The earnings decline largely stemmed from the impact of the COVID-19 pandemic, with unfavorable factors such as the production lines in Cambodia and Vietnam partially suspending operations, the increase in production costs, such as material and labour cost, and the exchange rate of the Renminbi having been strengthened. Whilst the suspension was well telegraphed to the market, the delay in production coupled with rises in raw material and energy costs caused a larger-than-expected drop in the margins. The GP margin stood at 24.3% in FY21, representing a decrease of 6.9ppt from last year. The board proposed a total dividend of HK\$1.63 per share, with a higher dividend payout ratio of 60.3% (2020: 51.1%).

Vietnam's disruption is unlikely to happen in 2022, as the zero-COVID strategy was abandoned by the government.

In June 2021, the Delta variant caused an increase in cases leading to the Vietnamese Government imposing strict city and province-wide lockdowns. By October, the government decided to abandon its zero-COVID strategy due to its steep economic cost. The government instituted vaccine mandates to encourage vaccination, requiring proof of vaccination for entry into grocery stores, shopping malls, and office buildings. By Feb 2022, 76% of people in Vietnam were fully vaccinated. The abandoning of the zero-COVID strategy has led to Vietnam experiencing a large uptick in Omicron cases. Nevertheless, in 2022, the country is unlikely to impose strict lockdown measures similar to that of 2021, meaning that the factory lockdowns, production disruption, and order delays Shenzhou experienced in 2021 are unlikely to reoccur moving forward. As the COVID-19 cases in Vietnam were a key overhang of the company, we think this acts as a re-rate catalyst to Shenzhou.

1Q22F sales volume has recovered to previous level and expect 2H22F volume to grow 20% yoy.

In 1Q2022, the sales volume has recovered to the similar like as of same period of 2021. This was despite the disruption in Ningbo in Jan 2022. Due to the lower base in 2021, the management expects 2Q's sales volume to improve while 2H2022 to have a 20% growth on sales volume. The sales volume will be mainly contributed by Nike and Puma, as

well as Chinese customers. New customer Lululemon is also expected to post significant increase in orders.

Revised down FY22F earnings by 28% to reflect the lower-than-expected margin in FY21. The GP margin in 2HFY21 dropped significantly to 19.6%, due to the inflationary environment, logistics costs, raw material costs, and labour costs. We expect these factors will linger to FY22F, but the impact will be less severe than 2HFY21. We think Shenzhou can pass on these costs, but it will take some time. We expect the GP margin to gradually improve to 26%-28% in FY22/23F, respectively. Moreover, Shenzhou has stopped hiring new labour in Ningbo and has been slowing down its recruitment plans in Vietnam. The management stresses that they are taking a more conservative approach to its recruitment progress amid the current challenging environment. That said, we have revised down revenue by 8% in FY22F to RMB27bn. Moving into FY23F, we expect revenue and earnings to grow 15% and 28%, respectively.

Attractive valuation for industry bellwether. Shenzhou's share price has dropped 43% since the suspension of Vietnam's production line and is currently trading at below -1SD of its five-year mean PE. In the past, Shenzhou share price has been strong due to its consistency and stability, we saw a break in this due to COVID and inflation, which have hit its massive premium. However, as the biggest concern, i.e., Vietnam's COVID-19 situation and lockdown measures, is unlikely to reoccur this year, paired up with its attractive valuation, we should revisit this "best in class" company in the textile industry.

We upgrade Shenzhou to BUY with a lower TP of HK\$133.

It is based on a 35.8x FY22F PE, equivalent to its five-year average forward PE. We like Shenzhou's (1) diversified manufacturing bases in China, Vietnam, and Cambodia, which provide clients with unmatched sourcing flexibility hence ensuring stability and (2) its unique ability to provide vertically integrated fabric and garment production, faster response times, and better development capabilities, which help in securing its all-star client base of Nike, Uniqlo, Adidas, and Puma.

Shenzhou International

Company Background

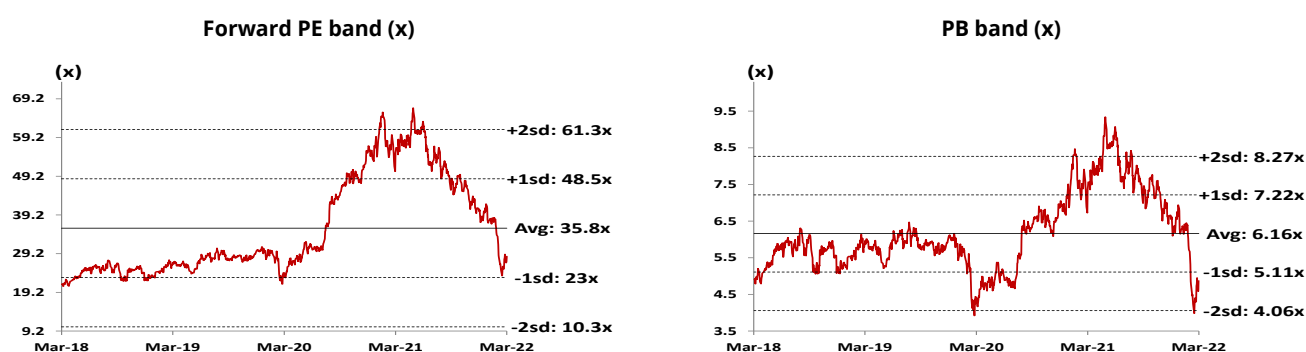
Shenzhou International is China's largest vertically integrated knitwear manufacturer. The company is primarily engaged in the production of premium knitwear (sportswear, casual wear, and lingerie) on an Original Equipment Manufacturer (OEM) basis with production facilities located in China, Vietnam, and Cambodia (total capacity of c.400m pieces/year of various knitwear). The company boasts of renowned clients such as Nike, Adidas, and Puma.

Income Statement (RMB m)

| FY Dec | 2019A | 2020A | % cha v-o-v |
|----------------------------|--------------|--------------|--------------|
| Revenue | 22,665 | 23,031 | 1.6 |
| Cost of Goods Sold | (15,789) | (15,836) | 0.3 |
| Gross Profit | 6,876 | 7,195 | 4.6 |
| Other Opng (Exp)/Inc | (1,930) | (1,787) | (7.4) |
| Operating Profit | 4,946 | 5,407 | 9.3 |
| Other Non Opng (Exp)/Inc | 427 | (125) | nm |
| Associates & JV Inc | 6 | 6 | 7.8 |
| Net Interest (Exp)/Inc | 194 | 224 | 15.7 |
| Exceptional Gain/(Loss) | 0 | 0 | nm |
| Pre-tax Profit | 5,572 | 5,512 | (1.1) |
| Tax | (613) | (430) | (29.9) |
| Minority Interest | 137 | 24 | (82.4) |
| Net Profit | 5,095 | 5,107 | 0.2 |
| Net Profit before Except. | 5,095 | 5,107 | 0.2 |
| EBITDA | 5,976 | 6,461 | 8.1 |
| Margins & Ratio | | | |
| Gross Margins (%) | 30.3 | 31.2 | |
| Opg Profit Margin (%) | 21.8 | 23.5 | |
| Net Profit Margin (%) | 22.5 | 22.2 | |

Source: Company, DBS HK

Historical PE and PB band



Source: Thomson Reuters, DBS HK

Shenzhou International

Segmental Breakdown (RMB m)

| FY Dec | 2019A | 2020A | 2021A | 2022F | 2023F |
|-------------------------|---------------|---------------|---------------|---------------|---------------|
| Revenues (RMB m) | | | | | |
| Sports wear | 16,322 | 15,941 | 17,612 | 20,501 | 23,658 |
| Casual wear | 5,388 | 4,481 | 4,721 | 5,429 | 6,189 |
| Lingerie wear | 803 | 1,033 | 1,040 | 1,248 | 1,498 |
| Other knitwear | 153 | 1,576 | 472 | 283 | 170 |
| Total | 22,665 | 23,031 | 23,845 | 27,461 | 31,514 |

Source: Company, DBS HK

Income Statement (RMB m)

| FY Dec | 2019A | 2020A | 2021A | 2022F | 2023F |
|----------------------------|--------------|--------------|--------------|--------------|--------------|
| Revenue | 22,665 | 23,031 | 23,845 | 27,461 | 31,514 |
| Cost of Goods Sold | (15,789) | (15,836) | (18,055) | (20,321) | (22,690) |
| Gross Profit | 6,876 | 7,195 | 5,790 | 7,140 | 8,824 |
| Other Opng (Exp)/Inc | (1,930) | (1,787) | (2,210) | (2,142) | (2,458) |
| Operating Profit | 4,946 | 5,407 | 3,579 | 4,998 | 6,366 |
| Other Non Opg (Exp)/Inc | 427 | (125) | 124 | 155 | 190 |
| Associates & JV Inc | 6 | 6 | 7 | 7 | 7 |
| Net Interest (Exp)/Inc | 194 | 224 | 113 | (21) | (6) |
| Dividend Income | 0 | 0 | 0 | 0 | 0 |
| Exceptional Gain/(Loss) | 0 | 0 | 0 | 0 | 0 |
| Pre-tax Profit | 5,572 | 5,512 | 3,823 | 5,140 | 6,557 |
| Tax | (613) | (430) | (452) | (607) | (775) |
| Minority Interest | 137 | 24 | 0 | 0 | 0 |
| Preference Dividend | 0 | 0 | 0 | 0 | 0 |
| Net Profit | 5,095 | 5,107 | 3,372 | 4,532 | 5,782 |
| Net Profit before Except. | 5,095 | 5,107 | 3,372 | 4,532 | 5,782 |
| EBITDA | 5,976 | 6,461 | 4,736 | 6,337 | 7,804 |
| Growth | | | | | |
| Revenue Gth (%) | 8.2 | 1.6 | 3.5 | 15.2 | 14.8 |
| EBITDA Gth (%) | 12.0 | 8.1 | (26.7) | 33.8 | 23.2 |
| Opg Profit Gth (%) | 11.0 | 9.3 | (33.8) | 39.6 | 27.4 |
| Net Profit Gth (%) | 12.2 | 0.2 | (34.0) | 34.4 | 27.6 |
| Margins & Ratio | | | | | |
| Gross Margins (%) | 30.3 | 31.2 | 24.3 | 26.0 | 28.0 |
| Opg Profit Margin (%) | 21.8 | 23.5 | 15.0 | 18.2 | 20.2 |
| Net Profit Margin (%) | 22.5 | 22.2 | 14.1 | 16.5 | 18.3 |
| ROAE (%) | 20.2 | 18.7 | 12.1 | 15.2 | 17.7 |
| ROA (%) | 16.0 | 13.9 | 8.0 | 9.7 | 11.1 |
| ROCE (%) | 18.0 | 15.6 | 9.0 | 10.4 | 11.8 |
| Div Payout Ratio (%) | 50.3 | 51.4 | 60.1 | 65.0 | 65.0 |
| Net Interest Cover (x) | NM | NM | NM | 240.3 | 1,071.8 |

Source: Company, DBS HK

Shenzhou International

Interim Income Statement (RMB m)

| FY Dec | 2H2019 | 1H2020 | 2H2020 | 1H2021 | 2H2021 |
|-------------------------|--------------|--------------|--------------|--------------|--------------|
| Revenue | 12,386 | 10,234 | 12,797 | 11,369 | 12,476 |
| Cost of Goods Sold | (8,684) | (7,075) | (8,761) | (7,996) | (10,059) |
| Gross Profit | 3,701 | 3,159 | 4,036 | 3,372 | 2,417 |
| Other Oper. (Exp)/Inc | (908) | (893) | (895) | (1,027) | (1,183) |
| Operating Profit | 2,793 | 2,266 | 3,141 | 2,345 | 1,235 |
| Other Non Opg (Exp)/Inc | 74 | 409 | (534) | 128 | (4) |
| Associates & JV Inc | 3 | 3 | 3 | 5 | 2 |
| Net Interest (Exp)/Inc | 88 | 100 | 124 | 53 | 60 |
| Exceptional Gain/(Loss) | 0 | 0 | 0 | 0 | 0 |
| Pre-tax Profit | 2,958 | 2,778 | 2,734 | 2,530 | 1,293 |
| Tax | (336) | (289) | (141) | (304) | (147) |
| Minority Interest | 57 | 23 | 1 | 0 | 0 |
| Net Profit | 2,679 | 2,512 | 2,594 | 2,226 | 1,145 |
| Net profit bef Except. | 2,679 | 2,512 | 2,594 | 2,226 | 1,145 |
| Growth | | | | | |
| Revenue Gth (%) | 5.0 | (0.4) | 3.3 | 11.1 | (2.5) |
| Opg Profit Gth (%) | 14.6 | 5.3 | 12.5 | 3.5 | (60.7) |
| Net Profit Gth (%) | 13.4 | 4.0 | (3.2) | (11.4) | (55.8) |
| Margins | | | | | |
| Gross Margins (%) | 29.9 | 30.9 | 31.5 | 29.7 | 19.4 |
| Opg Profit Margins (%) | 22.5 | 22.1 | 24.5 | 20.6 | 9.9 |
| Net Profit Margins (%) | 21.6 | 24.6 | 20.3 | 19.6 | 9.2 |

Source: Company, DBS HK

Shenzhou International

Balance Sheet (RMB m)

| FY Dec | 2019A | 2020A | 2021A | 2022F | 2023F |
|-------------------------------|---------------|---------------|---------------|---------------|---------------|
| Net Fixed Assets | 9,592 | 10,167 | 11,130 | 12,010 | 13,108 |
| Invt in Associates & JVs | 18 | 14 | 601 | 601 | 601 |
| Other LT Assets | 1,750 | 3,117 | 3,892 | 3,833 | 3,776 |
| Cash & ST Invt | 11,025 | 13,615 | 12,215 | 14,433 | 17,325 |
| Inventory | 5,282 | 4,811 | 6,636 | 7,424 | 8,289 |
| Debtors | 3,649 | 4,168 | 3,502 | 4,119 | 4,727 |
| Other Current Assets | 538 | 960 | 4,158 | 4,158 | 4,158 |
| Total Assets | 31,855 | 36,852 | 42,132 | 46,577 | 51,983 |
| ST Debt | 3,192 | 6,210 | 10,212 | 10,212 | 10,212 |
| Creditors | 881 | 1,060 | 1,387 | 1,152 | 1,286 |
| Other Current Liab | 1,512 | 1,582 | 1,934 | 1,934 | 1,934 |
| LT Debt | 900 | 502 | 483 | 3,017 | 5,551 |
| Other LT Liabilities | 179 | 227 | 333 | 333 | 333 |
| Shareholder's Equity | 25,172 | 27,276 | 27,771 | 29,917 | 32,655 |
| Minority Interests | 19 | (5) | 12 | 12 | 12 |
| Total Cap. & Liab. | 31,855 | 36,852 | 42,132 | 46,577 | 51,983 |
| Non-Cash Wkg. Capital | 7,077 | 7,297 | 10,975 | 12,615 | 13,954 |
| Net Cash/(Debt) | 6,933 | 6,902 | 1,519 | 1,204 | 1,562 |
| Debtors Turn (avg days) | 58.8 | 66.1 | 53.6 | 54.8 | 54.8 |
| Creditors Turn (avg days) | 21.8 | 26.2 | 29.9 | 22.2 | 22.1 |
| Inventory Turn (avg days) | 130.6 | 118.8 | 143.3 | 142.8 | 142.4 |
| Asset Turnover (x) | 0.7 | 0.6 | 0.6 | 0.6 | 0.6 |
| Current Ratio (x) | 3.7 | 2.7 | 2.0 | 2.3 | 2.6 |
| Quick Ratio (x) | 2.6 | 2.0 | 1.2 | 1.4 | 1.6 |
| Net Debt/Equity (X) | CASH | CASH | CASH | CASH | CASH |
| Net Debt/Equity ex MI (X) | CASH | CASH | CASH | CASH | CASH |
| Capex to Debt (%) | 58.2 | 30.4 | 17.5 | 16.3 | 15.7 |
| Z-Score (X) | NA | NA | NA | NA | NA |

Source: Company, DBS HK

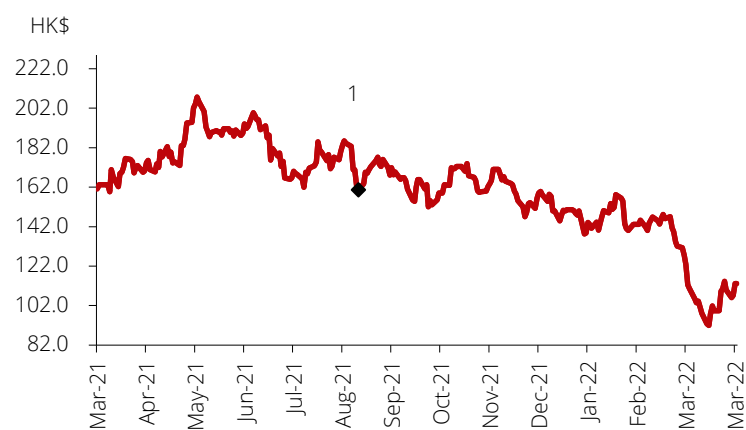
Cash Flow Statement (RMB m)

| FY Dec | 2019A | 2020A | 2021A | 2022F | 2023F |
|-------------------------------|----------------|----------------|----------------|----------------|----------------|
| Pre-Tax Profit | 5,572 | 5,512 | 3,823 | 5,140 | 6,557 |
| Dep. & Amort. | 1,031 | 1,054 | 1,156 | 1,339 | 1,438 |
| Tax Paid | (721) | (484) | (452) | (607) | (775) |
| Assoc. & JV Inc/(loss) | 0 | 0 | 0 | 0 | 0 |
| (Pft)/Loss on disposal of FAs | 9 | 43 | 2 | 0 | 0 |
| Chg in Wkg. Cap. | (61) | 131 | (831) | (1,640) | (1,339) |
| Other Operating CF | (225) | (502) | (3,302) | 0 | 0 |
| Net Operating CF | 5,604 | 5,755 | 396 | 4,231 | 5,881 |
| Capital Exp. (net) | (2,380) | (2,038) | (1,876) | (2,160) | (2,479) |
| Other Invt. (net) | (1,181) | 439 | 0 | 0 | 0 |
| Invt in Assoc. & JV | 0 | 10 | 0 | 0 | 0 |
| Div from Assoc & JV | 0 | 0 | 0 | 0 | 0 |
| Other Investing CF | 409 | (968) | (609) | 0 | 0 |
| Net Investing CF | (3,152) | (2,557) | (2,485) | (2,160) | (2,479) |
| Div Paid | (2,403) | (2,582) | (1,985) | (2,386) | (3,044) |
| Chg in Gross Debt | 1,452 | 2,640 | 2,534 | 2,534 | 2,534 |
| Capital Issues | 0 | 0 | 0 | 0 | 0 |
| Other Financing CF | (37) | (24) | 0 | 0 | 0 |
| Net Financing CF | (988) | 34 | 549 | 147 | (511) |
| Currency Adjustments | 0 | 0 | 0 | 0 | 0 |
| Chg in Cash | 1,464 | 3,231 | (1,539) | 2,218 | 2,892 |
| Opg CFPS (RMB) | 3.77 | 3.74 | 0.82 | 3.91 | 4.80 |
| Free CFPS (RMB) | 2.14 | 2.47 | (0.98) | 1.38 | 2.26 |

Source: Company, DBS HK

Shenzhou International

Target Price & Ratings History



| S.No. | Date | Closing Price | 12-mth Target Price | Rating |
|-------|-----------|---------------|---------------------|--------|
| 1: | 27-Aug-21 | HK\$162.20 | HK\$177.00 | Hold |

Source: DBS HK

Analyst: *Dennis Lam*
Byron Lam

Shenzhou International

DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*Share price appreciation + dividends

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Sources for all charts and tables are DBS HK unless otherwise specified.

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