

Stella (1836 HK)

A dividend play riding on the athleisure trend

We think the risk-reward currently for Stella is excellent, because of: 1) a turnaround of the clothing and sportswear sector in the US, 2) the company's specific strengths like its high-end positioning (e.g. producing Jordan series for Nike) and ramp-up of footwear business by luxury brands (acquired 17-18 new clients, like Moncler, Lacoste and Kenzo (under LVMH) in the past two years) and 3) undemanding valuation of 8x FY23E P/E and 9% FY23E yield.

■ **Company-wise, we expect Stella's growth to accelerate and outperform its peers.** We are impressed that Stella not only managed to resume positive sales growth of 13% in 4Q23, but also outperformed peers like Feng Tay (-3%), Eclat (+10%) and Makalot (+9%). Referring to our NDR call recently, management is still confident on accelerated growth in FY24E (low-teen net profit growth, with 0% to MSD volume and flattish ASP growth), even after a beat in FY23E results. In our view, the general picture in FY24E and FY25E is: 1) sportswear companies to shift from de-stocking to re-stocking, 2) luxury brand sales growth to be soft but price hikes shall continue, and 3) high-end fashion and causal names' growth to slowly pick up but with healthy discounts and inventory levels. **And we think Stella can further differentiate itself and deliver an outstanding result, thanks to:**

1) Stella's high-end positioning (it is the maker of Jordan athleisure series, as well as many other limited or cross-over collections) and its strategic partnership with Nike. Therefore, it should be able to recover faster during the Nike's turnaround (from de-stocking in FY23E to re-stocking in FY24E), and the U-rate of sports segment factory should increase gradually (80%+ in FY24E and 90%+ in FY25E (close to pre-Covid level). During FY19-23, Jordan brand sales growth was always faster than Nike group's. Moreover, the construction of a new factory (with designed capacity of 10mn pairs of shoes) in Indonesia for Nike (to be opened in early FY26E) is still on track.

2) The popular trend of category expansion by the luxury and high-end fashion brands. Many brands are looking for new growth drivers and category expansion is one of that. In fact, we can tell from the sales mix of the Prada and Gucci brands that their footwear sales were all climbing from FY19 to 9M23. Therefore, as one of the best high-end athleisure shoes maker in town, we are confident that Stella can ramp this up further. In the past two years, it has acquired about 17 to 18 clients (e.g. Moncler, Lacoste, Kenzo (under the LVMH group)), and these could provide a boost in orders in FY25E (as the product testing usually last for around 1-2 years for a new client). For example, one of Moncler's lately strategy is to generate around 10% of sales from its footwear business in the mid-term.

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20A	FY21A	FY22A
Revenue (RMB mn)	1,589	1,545	1,136	1,541	1,631
YoY growth (%)	0.7	-2.8	-26.5	35.6	5.9
Net income (RMB mn)	62	96	1	91	117
EPS (RMB)	0.08	0.12	0.00	0.11	0.15
YoY growth (%)		54.1	-98.9	8,446.0	29.0
Consensus EPS (RMB)	N/A	N/A	N/A	N/A	N/A
P/E (x)	14.3	13.6	553.4	10.7	6.3
P/B (x)	1.0	1.3	1.0	1.0	0.8
Yield (%)	6.5	6.8	5.0	2.2	13.3
ROE (%)	6.8	10.0	0.2	9.3	11.8
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIGM estimates

NOT - RATED

Current Price

HK\$10.46

China Textile Sector

Walter Woo

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Stock Data

Mkt Cap (HK\$ mn)	8,318
Avg 3 mths t/o (HK\$ mn)	5.25
52w High/Low (HK\$)	10.76/7.10
Total Issued Shares (mn)	795.2

Source: Bloomberg

Shareholding Structure

Cordwalner Bonaventure Inc.	21.85%
Mr. Chiang Jeh-Chung	6.43%
Mr. Chen Li-Ming	3.62%
Free Float	68.10%

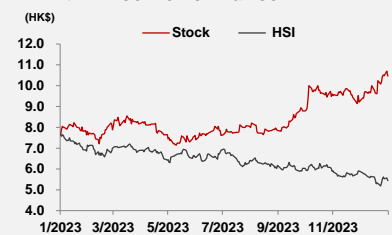
Source: HKEx, Bloomberg

Share Performance

	Absolute	Relative
1-mth	16.2%	23.2%
3-mth	21.7%	31.7%
6-mth	40.6%	74.2%
12-mth	35.3%	90.9%

Source: Bloomberg

12-mth Price Performance



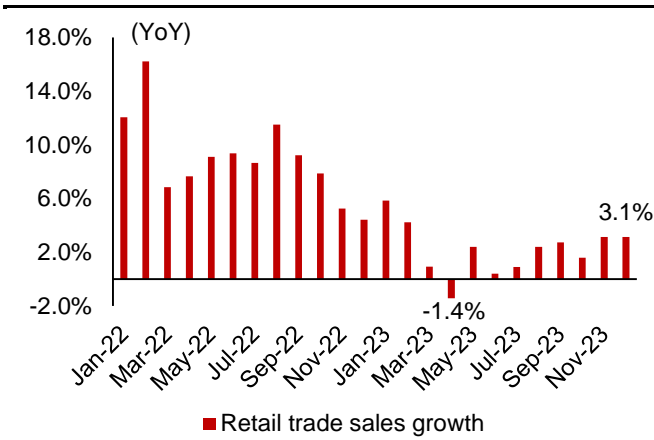
Source: Bloomberg

Auditor: Ernst & Young

- **We tend to believe the US retail sales growth (so as the subsectors like clothing and sportswear) has started to turnaround, despite various uncertainties.** Firstly, US retail trade sales growth already accelerated to 3.1% in both Nov and Dec 2023, from 1.6% in Oct and 2.0% in 3Q23. The pattern is similar to the clothing and sportswear sub-sectors (picked up from -1.4%/ -2.4% in Oct 2023 to 2.8%/ 0.3% in Nov-Dec 2023). Secondly, the inventory level peaked out as well, and sales to inventory ratio for the clothing sector dropped from 2.4x in Dec 2022, to 2.37x in Sep 2023 and 2.34x in Dec 2023. Thirdly, the outlook for 2024 should be at least better than that in 2023. According to a survey done by BoF-Mckinsey State of Fashion, about 26% and 37% of the fashion industry executives found 2024 better or the same vs 2023, improving from 16% and 28% back in the 2023 survey. And this background has echoed with Stella's outperformance in Dec 2023, where some of its luxury and high-end fashion clients experienced strong sell-through and ordered early shipments for the items planned for Jan 2024.
- **We are confident on its 3-year target and even beyond.** Currently, Stella has three new factories in the pipeline, where the designed capacity are 10mn pairs in Indonesia (started in FY23E), 5mn pairs in Bangladesh (will start in FY24E) and another 10mn pairs in Indonesia (will start in FY26E). Therefore by FY27E, the total designed capacity can be as high as 85mn pairs a year, implying a MSD to HSD volume CAGR during FY23E-27E. Supported by Stella's leadership in R&D and product quality, we are optimistic about the ramp-up and shift of segment mix (where the optimistic level should be 40%-45% for luxury and high-end fashion, 45% for sports and 10%-15% for casual). Together with various measures to lift efficiency (e.g. merging the R&D centres for luxury, high-end fashion and casual) and shift of casual segment orders from Vietnam to Indonesia and Bangladesh), we do find the 3-year target (10% OP margin and low-teen net profit growth during FY23E-25E) totally achievable.
- **Stella is a world-class athleisure shoes maker.** Stella is a leading developer and manufacturer of high-end footwear and leather goods. It has over 50 clients while the major ones are Nike, Deckers, Cole Haan, Balenciaga, Michael Kors, Timberland, Tory Burch, etc. It is also an exporter with over 75% sales going into the US and EU in FY22 while its production bases are spread across China (~25%), Vietnam (~50%) and the rest of Asia. While Huali and Feng Tay are also focusing on footwear manufacturing for similar clients, Stella is mainly making and selling athleisure shoes (such Nike's Jordan's retro series, Balenciaga's Triple S series) and lady shoes (e.g. UGG's classic), which are different from those more functional and performance-based sneakers.
- **The risk-reward is still attractive.** Thanks to the highly attractive dividend yield of 9% FY23E and 11% FY24E yield, we see the downside protected. And with undemanding P/E of 8x FY23E and 7x FY24E, plus the low-teens NP growth, we think the upside is huge.

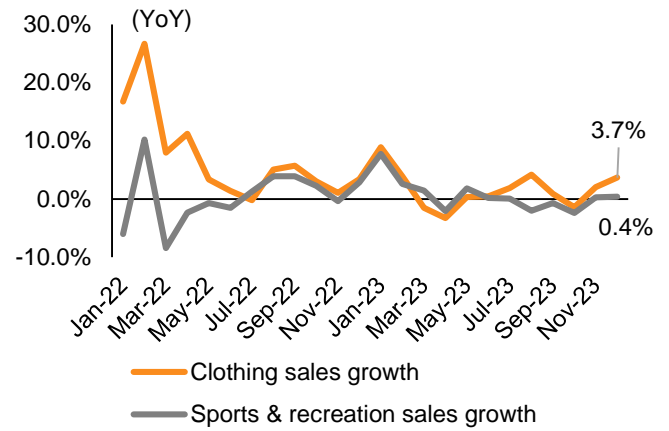
Focus charts

Figure 1: US retail trade sales growth (YoY)



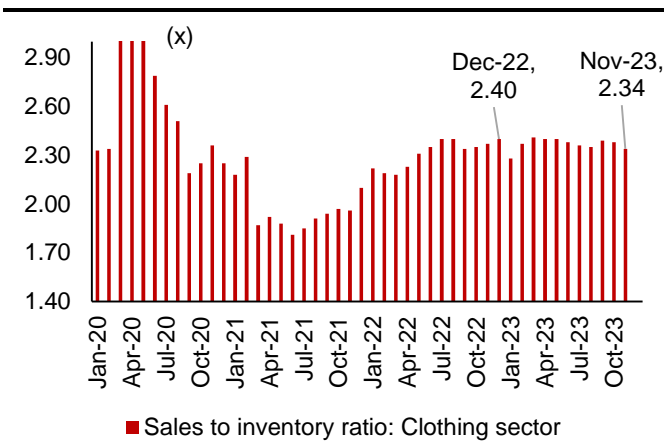
Source: US Census Bureau, CMBIGM estimates

Figure 2: US clothing and sports related retail sales growth (YoY)



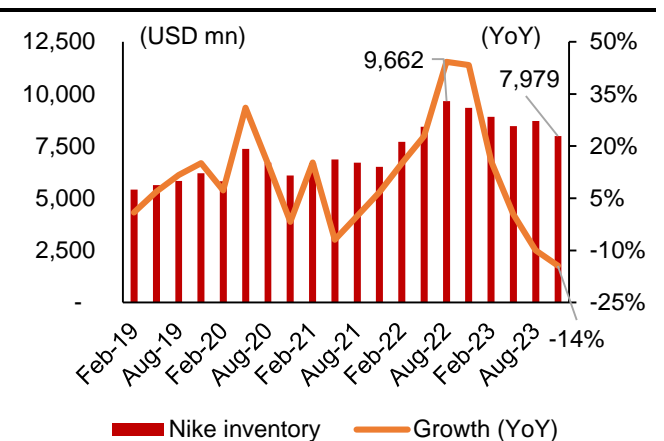
Source: US Census Bureau, CMBIGM estimates

Figure 3: US clothing sector's sales to inventory ratio



Source: US Census Bureau, CMBIGM estimates

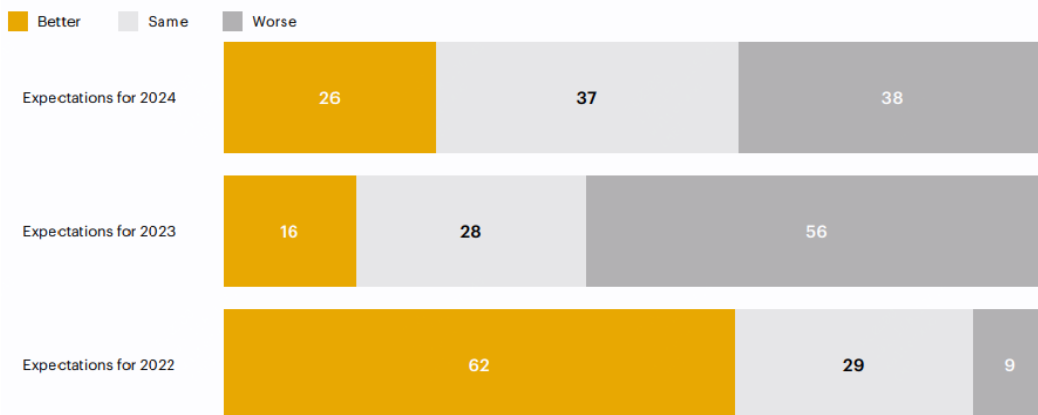
Figure 4: Nike's inventory and growth (YoY)



Source: Company data, CMBIGM estimates

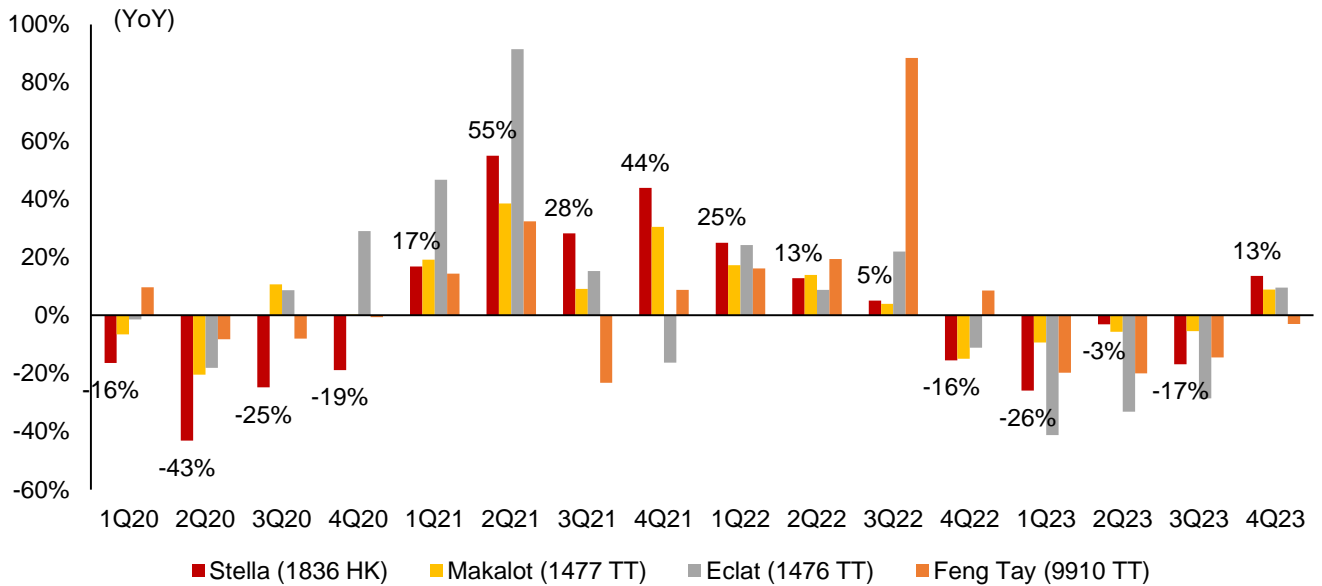
Figure 5: Expectations for 2024, by fashion industry executives

Expectations for how fashion industry conditions will evolve in the year ahead compared to prior year, % of respondents



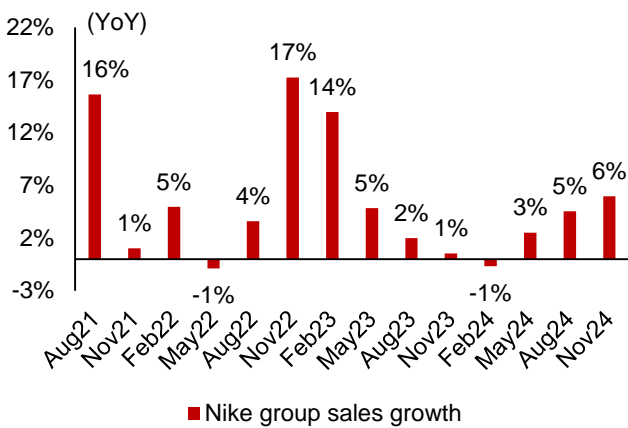
Source: BoF-McKinsey State of Fashion 2024 Executive Survey, CMBIGM

Figure 6: Quarterly sales growth (YoY), by Stella and its peers



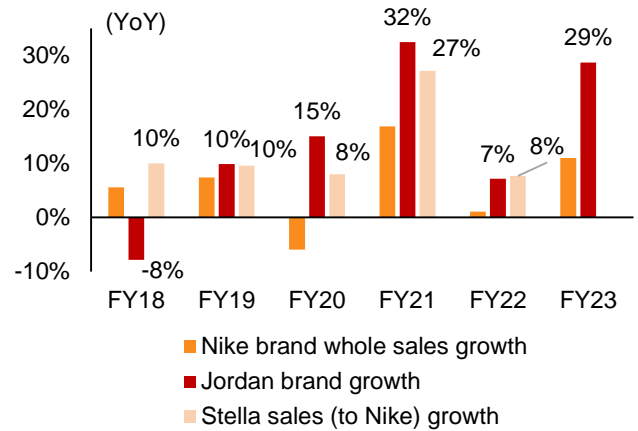
Source: Company data, CMBIGM estimates

Figure 7: Nike sales growth (YoY)



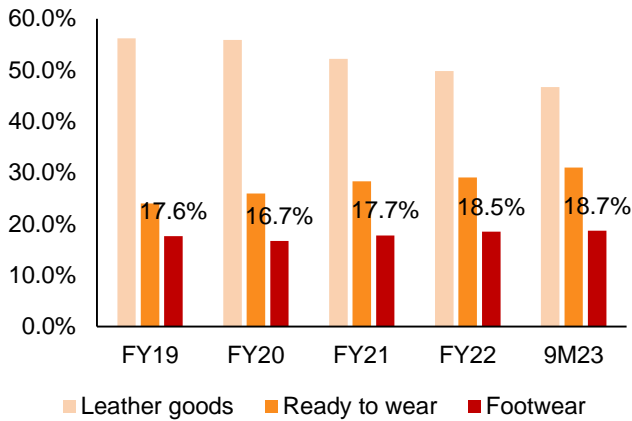
Source: Company data, CMBIGM estimates

Figure 8: Sales growth (YoY) of Nike brand, Jordan brand and Stella's sales (to Nike)



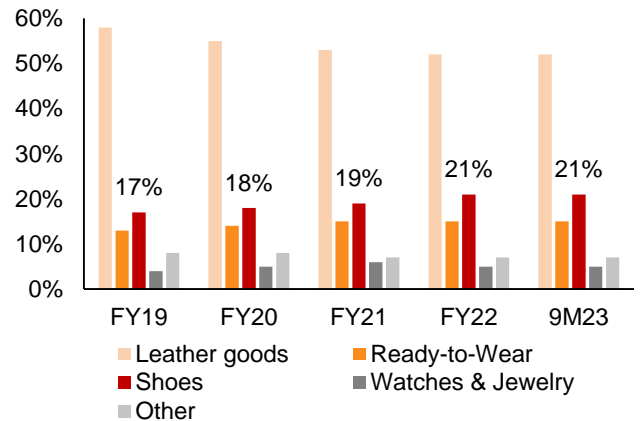
Source: Company data, CMBIGM estimates

Figure 9: Prada’s sales mix, by product segment



Source: Company data, CMBIGM estimates

Figure 10: Gucci’s sales mix, by product segment



Source: Company data, CMBIGM estimates

Figure 11: Moncler’s footwear segment’s mid-term target (10% of total sales)

...Supported by a new FOOTWEAR offer from outdoor to city luxury

Out Lux
Luxury Outdoor Redefined

DNA inspired, Functional and Innovative Outdoor Footwear. Quality & Durability

Street Lux
Utilitarian take on athletic sneakers

A beautiful clash between traditional aesthetics, Footwear and Moncler's DNA

Hybrid Lux
The future of footwear, now

Moncler's hub for endless design explorations, new technologies, sustainable materials, modern shapes and colour applications

City Lux
Where Style meets Tech

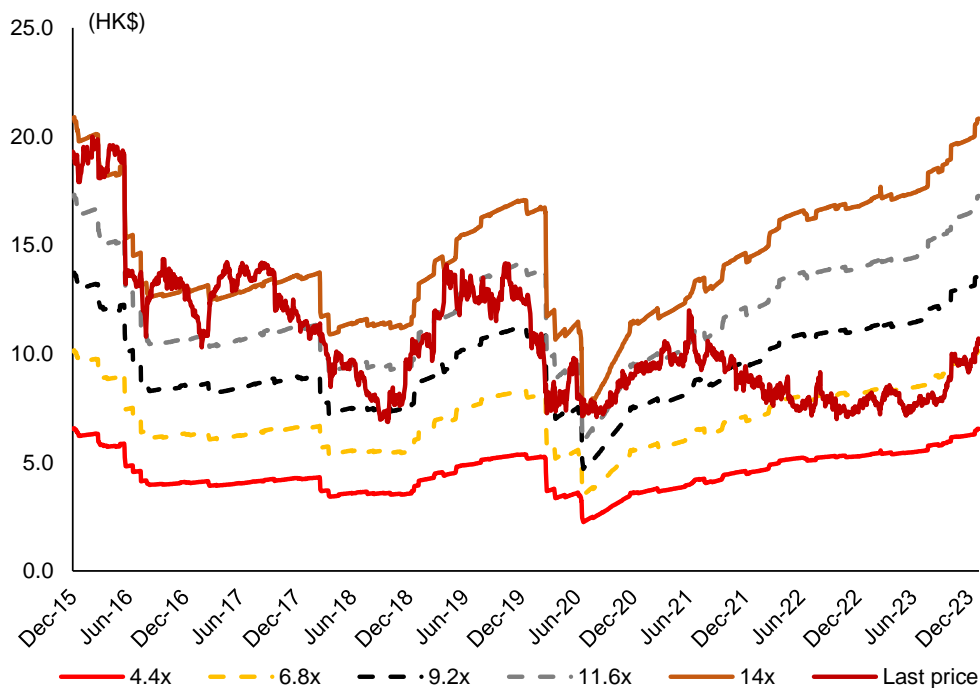
High-end Italian craftsmanship combined with Moncler outdoor's DNA

FOOTWEAR EXPECTED TO REACH 10% OF REVENUES

Source: Company data, CMBIGM

Valuation

Figure 12: Forward 12M P/E valuation band



Source: Bloomberg, CMBIGM estimates

Valuation

Figure 13: Peers valuation table

Company	Ticker	Rating	12m TP (LC)	Price (LC)	Up/Down-side	Mkt. Cap (HK\$mn)	Year End	P/E (x)		P/B (x)	ROE (%)	3yrs PEG (x)	Yield (%)	YTD perf.	
								FY1E	FY2E	FY2E	FY0	FY1E	FY1E	FY1E	
H shares Sportswear															
Stella	1836 HK	NR	n/a	10.46	n/a	8,318	Dec-22	8.0	7.1	0.4	11.3	0.6	9.2	13.6	
Shenzhen	2313 HK	NR	n/a	67.95	n/a	102,144	Dec-22	20.4	16.6	2.6	14.0	1.8	2.8	(15.5)	
Crystal	2232 HK	NR	n/a	2.97	n/a	8,473	Dec-22	6.4	5.8	0.7	12.8	0.9	5.0	2.4	
Huali	300979 CH	NR	n/a	53.00	n/a	67,350	Dec-22	19.6	16.6	3.5	22.7	2.5	2.1	0.7	
Yue Yuen	551 HK	NR	n/a	7.62	n/a	12,285	Dec-22	8.3	5.7	0.4	5.0	4.6	8.5	(11.8)	
Regina Miracle	2199 HK	NR	n/a	2.01	n/a	2,461	Mar-23	8.0	6.2	0.6	5.3	0.7	3.7	(6.5)	
Pacific Textiles	1382 HK	NR	n/a	1.24	n/a	1,735	Mar-23	6.5	5.9	0.6	4.7	0.7	13.7	(8.1)	
Nameson	1982 HK	NR	n/a	0.50	n/a	1,140	Mar-23	n/a	n/a	n/a	7.5	n/a	n/a	0.0	
Best Pacific	2111 HK	NR	n/a	1.09	n/a	1,133	Dec-22	4.0	3.0	0.3	8.7	0.3	10.1	(1.8)	
Feng Tay	9910 TT	NR	n/a	161.50	n/a	40,030	Dec-23	21.4	18.2	5.2	22.7	n/a	3.2	(7.7)	
Eclat	1476 TT	NR	n/a	547.00	n/a	37,671	Dec-22	28.5	23.4	5.3	18.6	30.0	2.6	(2.7)	
Makalot	1477 TT	NR	n/a	357.50	n/a	21,703	Dec-22	21.8	19.3	5.1	25.8	2.3	4.0	0.8	
								Avg.	13.9	11.6	2.2	13.3	4.5	5.9	(3.1)
								Med.	8.3	7.1	0.7	12.1	1.4	4.0	(2.2)

Source: Bloomberg, CMBIGM estimates

Note: Data as of 30 Jan 2024.

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