

# Topsports (6110 HK)

## Business to normalize from July 2020

We are amazed by Topsport's strong cash flow management in FY2/20 and believed its efficient digital transformation will lead to effective recovery in 2H21E. Despite a relatively high valuation at 18x FY2/22E P/E (44% premium over int'l peers' avg. of 12x, but JD sports (JD LN) is at 19x), we still expect further re-rating aided by better sentiment, as double digit growth is likely to return in 2H21E.

- **FY2/20 net profit inline while sales missed by 5%.** Topsports's NP rose by 5% YoY to RMB 2.3bn, inline with BBG est. while sales only increased by 3% YoY to RMB 33.7bn, 5% below cons. We attributed this to: 1) slightly weaker direct retail sales (8% decline vs 35% growth for wholesales in 2H20) but 2) better GP margin even with COVID-19 (only 0.4ppt YoY drop to 40.5% in 2H20). **Remarkable momentum prior COVID-19.** According to mgmt., sales/ operating income growth were 13%/+ 20%+ YoY during Mar 2019 - Jan 2020 (excluding Feb), better than 12%/ 18% YoY in 1H19.
- **Inevitable pressure on cash flow, but we are confident due to: 1) excellent working capital. 2) support by principal brands and 3) its digital edge.** Sales was terrible in Feb 2020 and inventory days was rising (from 104 in FY2/19 to 120 in FY2/20), but operating cash flow can still grow by 105% YoY in FY2/20, helped by better payables (from 10 to 16 days) and receivable (from 29 to 22 days) conditions because of its unmatched relationship with landlords. **Moreover, principal brands are highly supportive by: 1) allowing order cancellation (mostly in 1Q and 3Q, in our view), 2) providing a more flexible return policy, 3) giving out higher rebates for inventory clearances, even with deep retail discounts and 4) wider use of digital tools for procurement, e-commerce, etc. Digital sales contribution climbed to 10-20% (of total direct retail sales) during Mar-May 2020,** much higher than the mid- to high-single digit % before COVID-19 crisis thanks to different digital initiatives, such as mini-programs, mobile payment at physical stores and more inventory sharing.
- **Positive growth in May 2020 and business will be normalized from Jul 2020.** According to management, positive growth was recorded in May 2020, while both sales and retail discounts can be normalized from Jul 2020.
- **Target stable store numbers in FY2/21E but area growth and store revamps will continue.** Overall store count may not change much in FY2/21E, but there will be more: 1) renovation (more stores being upgraded and filling with trendier products) and 2) larger sized stores (to replace smaller ones). Note that gross selling area went up by 10.6% YoY (vs FY2/19's 9.3%) while store count was only up by 0.6% (+52 to 8,395) in FY2/20.
- **Recovery trend to drive sentiment improvement despite valuation premium.** In general, we are optimistic and expect future sales recovery to boost sentiment, even though we see potential cut in consensus sales after a 5% miss. Based on BBG's est. Topsports is trading at 18x FY2/22E P/E (44% over int'l distributors avg. of 12x), relatively high but still justifiable.

### Earnings Summary

(YE 28 Feb)	FY18A	FY19A	FY20A
Revenue (RMB mn)	26,550	32,564	33,690
YoY growth (%)	22.4	22.7	3.5
Net income (RMB mn)	1,436	2,200	2,303
EPS (RMB)	n/a	0.4173	0.4088
YoY growth (%)	n/a	n/a	(2.0)
P/E (x)	n/a	21.9	22.7
P/B (x)	n/a	28.6	5.5
Yield (%)	n/a	1.2	2.0
ROE (%)	33.1	76.8	36.9
Net gearing (%)	64.0	202.7	32.6

Source: Company data, CMBIS estimates

**NOT RATED**

Current Price

HK\$10.40

### China Sportswear Sector

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#### Stock Data

Mkt Cap (HK\$ mn)	64,493
Avg 3 mths t/o (HK\$ mn)	95.05
52w High/Low (HK\$)	11.28/6.31
Total Issued Shares (mn)	6,201.2

Source: Bloomberg

#### Shareholding Structure

Hillhouse Capital	82.91%
Free Float	17.09%

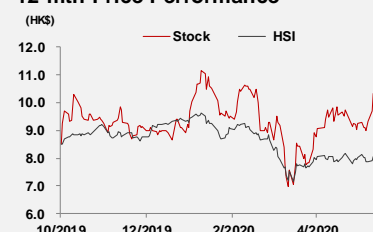
Source: HKEx

#### Share Performance

	Absolute	Relative
1-mth	2.4%	6.3%
3-mth	-6.7%	9.3%
6-mth	5.8%	24.5%
12-mth	n/a	n/a

Source: Bloomberg

#### 12-mth Price Performance

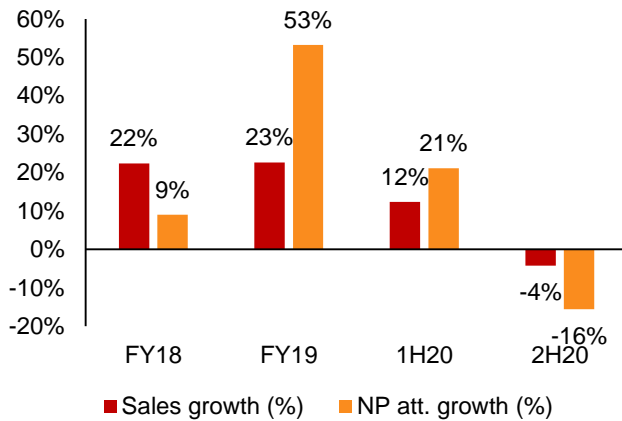


Source: Bloomberg

**Auditor: PricewaterhouseCoopers**

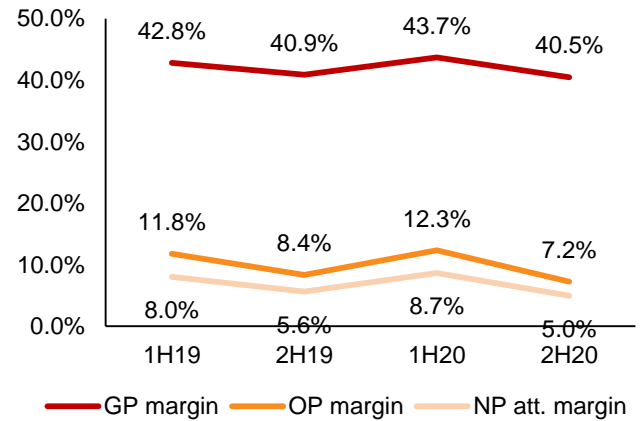
## Focus Charts

**Figure 1: Sales/ net profit att. growth**



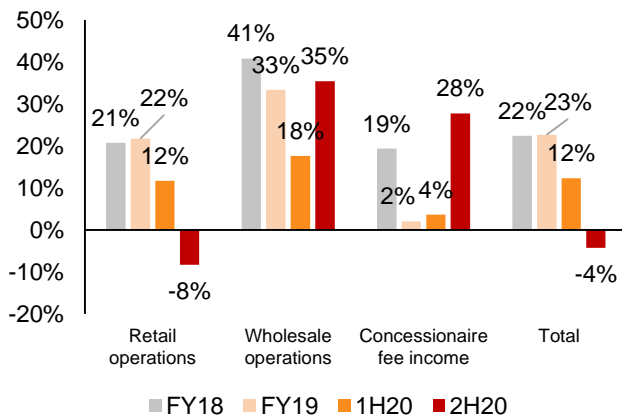
Source: Company data, CMBIS estimates

**Figure 2: GP/ OP / NP margin**



Source: Company data, CMBIS estimates

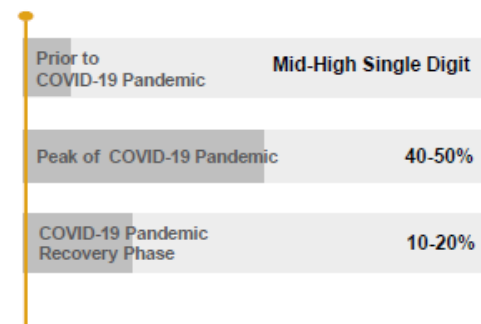
**Figure 3: Sales growth by channel**



Source: Company data, CMBIS estimates

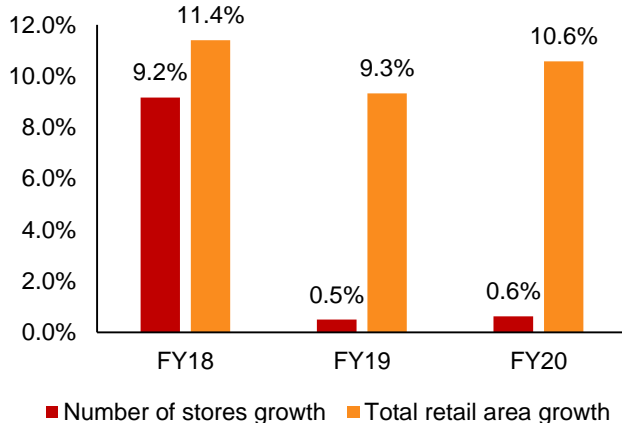
**Figure 4: Retail sales mix thru digital connections**

### Directly-Operated Retail Sales Value (incl. VAT) Contributed by Digital Connections



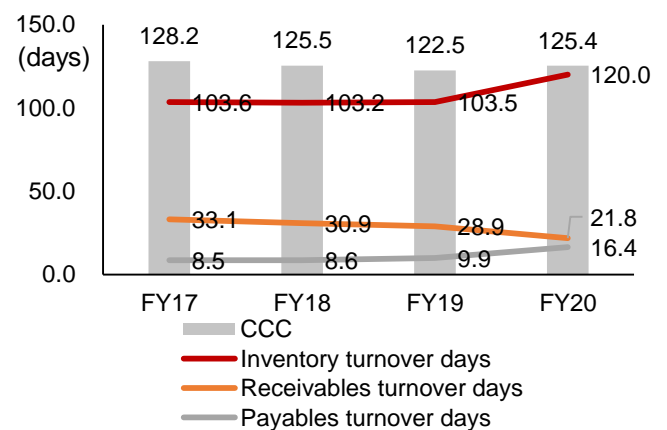
Source: Company data, CMBIS estimates

**Figure 5: Number of stores and retail area growth**



Source: Company data, CMBIS estimates

**Figure 6: Working capital conditions**



Source: Company data, CMBIS estimates

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