(TFS) Shenzhou International (2313 HK, BUY): Visible growth ahea d, TP lifted to HK$ 24

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FY12 missed on less hedging gains. Shenzhou's FY12 revenue edged down by 1.2%YoY to RMB 8.94bn, mainly due to capacity bottleneck, weak sales in Japan
(-13%YoY) and domestic market (-7.8%YoY) as well as downward ASPs. Sportswear accounted 55.9% of total sales despite a lower growth (+0.9%YoY). Net profit down by 4.9%YoY to RMB 1.62bn, missed our estimates mainly due to less hedging income (RMB 37mn in FY12 vs. RMB140mn in FY11) and higher operating expenses. As of FY12, Shenzhou is holding RMB 1.4bn net cash with gross gearing ratio at 9.7%. The company declared final dividend of HK$ 0.7/share, 40%YoY jump from that of FY11 and representing payout ratio of 47%.
Profit margins to remain stable. Gross margin down by 0.3ppt to 28.5% in FY12.
Excluding hedging gains, core gross margin up 0.6ppt to 28.2% from 27.7% in FY11, thanks to greater contribution from sportswear (~56%), which has relatively higher ASPs. SG&A to sales up by 1.4ppts to 8.3% mainly due to higher labor costs resulted from gradual capacity rolling out especially in 2H12. Total labor costs to sales ratio up by 2.1ppts to 21.4% in FY12 and we expect the uptrend to continue while operating margin to maintain stable as new plants reach full scale in the coming few years.
Capacity release well on track. Shenzhou commenced production in its new garment factory in Ningbo in 4Q12 and ~US$ 60mn revenue contribution is expected in FY13. Besides, for the Phase II of Cambodia plant and Anqing plant, total number of labors has increased to 7,000 and 6,200 as of FY12, and accounting for 9% and 13% of the group's total capacity. We expect a 10-15% capacity growth during
FY13-14 and the optimized production base will well relive pressure from rising labor costs and strengthen comprehensive competitiveness. Managements are also actively seeking for opportunities of building up new plants in Pan-Pacific Area.
Prudent control on retail business. Shenzhou has opened 17 self-owned stores mainly in Zhejiang, Shanghai and Jiangsu as end-FY12, with sales contribution less than 1% and ~RMB 40mn loss. The company targets 10-13 new openings in FY13 and breakeven for existing stores in FY14 with sales revenue reaching ~RMB 150mn.
Sound fundamentals, visible earnings rebound. Shenzhou is set to benefit from the capacity expansion in the next few years. We look for 15.8% 3-year earnings CAGR in FY12-15 supported by 10-15% capacity expansion and 3-5% ASP hike. The counter deserves premium justified by its unrivaled leadership with clear competitive strengths and sustainable profitability. We lift our target price to HK$ 24.00 from HK$19.80, represents 13.5x FY13P/E. Maintain Buy.

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