

Xtep Intl (1368 HK)

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Company Update

BUY

UNCHANGED

Close price: HK\$2.58

Target Price: HK\$3.38 (+31%)

Prior TP: HK\$3.17

Key Data

HKEx code	1368 HK
12 Months High (HK\$)	5.39
12 Month Low (HK\$)	2.04
3M Avg Dail Vol. (mn)	5.34
Issue Share (mn)	2,519.44
Market Cap (HK\$mn)	6,500.16
Fiscal Year	31/12/2019
Major shareholder (s)	Ding Shuibao (54.48%)

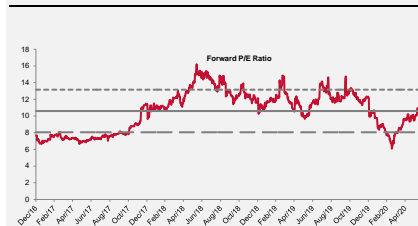
Source: Company data, Bloomberg, OP Research
Closing price as of 28/08/2020

Price Chart



	1mth	3mth	6mth
Absolute %	9.3	3.2	-17.8
Rel. MSCI CHINA %	3.0	-22.7	-41.1

PE



Company Profile

Xtep International Holdings Ltd. designs, manufactures, and markets sportswear. The Company produces footwear, apparel, and accessories.

More confident on new brands and 2H20E recovery

- Xtep delivered satisfactory 1H20 results of 10%/-46% growth/decline in rev/net earnings and maintained high payout ratio of 60%.
- New brands outlook are more upbeat with GPM expected to lift significantly since FY21E. Breakeven in FY22E target unchanged.
- Reiterate BUY with TP modified up to HK\$3.38 on same 12x FY21E P/E with adj. earnings tuned up by 7%.

Satisfactory 1H20 results. Xtep registered overall 10%/-46% growth/decline to RMB 3,679 mn/RMB 248 mn in 1H20 rev/net earnings, with core brand declined by -5%/-23% in rev/operating profit and new brands contributing/losing RMB 478 mn/-52mn respectively, slightly better than consensus and profit warning. **Good working capital control** of 89 turnover days (down 9 days yoy) benefiting from AP credit utilization. **The company maintained high payout ratio of 60%** on the back of healthy OCF and solid cash position of RMB 3 bn. **Core brand is guided up** with FY20E rev growth flat yoy (vs previous LSD slide), on decent retail sales recovery in July to Aug and better distributor profitability in second half. **Target better retail discount in 2H20E** of 30-25% retail discount for core brand (from 35-40%) as 60-70% of the bought-back Q1 inventories have been cleared. **No. of stores largely remain stable by end-FY20E** as guided to reduce by only 200-300 from FY19.

New brands outlook more upbeat. We see more exciting new brands development with pandemic impact in control. **Overall new brand loss for 2H20E is expected to be similar in 1H20**, as K-Swiss benefits from wholesale model in overseas business that suffers from less fixed costs during lockdown. **Store opening plan for Palladium is faster than expected** targeting 50 new stores in China in FY20E (vs existing 180 by FY19). Saucony/Merrell opened 12/2 in top tier cities in 1H20, with very positive consumer response. **GPM for new brands are expected to lift significantly since FY21E** from current ~40% level backed by 1) Saucony and Merrell production will gradually transfer from overseas to PRC, 2) DTC mix for Palladium/K-Swiss will increase from FY20E/FY22E. **Management roughly maintained new brands breakeven timeline** of FY22E. Upon this confidence, we lowered new brands loss forecasts for FY20E/21E to RMB -120 mn/RMB -63 mn by 24%/41%.

Solid multi-brand sportswear frontrunner trading at attractive valuation. We believe the current trading discount of 60% to Anta suggests good entry points given forward dividend yield high at 6.6%. As Xtep has very cautious strategy on direct stores opening, and that middle class demand is in high growth stage amid still rare quality brand in China, we think the market over-worried about the company's new DTC operations and K-Swiss development. **Reiterate BUY with TP revised up to HK\$3.38** on same 16x/12x P/E of (4%/7% higher) FY20E/21E adj. earnings.

Risks: (1) Channel inventory stack-up, (2) new brands less welcomed by consumers

Exhibit 1: Forecast and Valuation

Year to Dec (RMB mn)	FY18	FY19	FY20E	FY21E	FY22E
Revenue	6,383.2	8,182.7	8,531.2	10,100.1	11,465.4
Growth (%)	24.8	28.2	4.3	18.4	13.5
Adjusted net profit	656.5	727.7	451.6	618.4	841.8
Growth (%)	60.9	10.8	(37.9)	37.0	36.1
Adj. diluted EPS (HK\$)	0.324	0.317	0.206	0.282	0.384
EPS growth (%)	9.0	(2.4)	(35.0)	37.0	36.1
Change to previous EPS (%)			4.1	6.7	
Consensus EPS (HK\$)			0.232	0.325	
ROE (%)	12.4	11.9	6.5	8.6	11.2
P/E (x)	8.0	8.1	12.5	9.2	6.7
P/B (x)	0.9	0.8	0.8	0.8	0.7
Yield (%)	7.8	7.8	4.8	6.6	8.9
DPS (HK\$)	0.200	0.200	0.123	0.169	0.230

Source: Bloomberg, OP Research

Exhibit 2: Earnings Revision

(RMB mn)	FY20E			FY21E			OP Comments
	New	Old	% Chg	New	Old	% Chg	
Revenue	8,531	8,216	3.8	10,100	9,744	3.7	Revised up on better outlook of Xtep core brand rev growth in 2H20E
Gross profit	3,499	3,330	5.1	4,101	3,910	4.9	
Gross margin	41.0%	40.5%	0.5	40.6%	40.1%	0.5	Lifted on better than expected new brands margin
Opex	(2,858)	(2,703)	5.7	(3,162)	(3,079)	2.7	Revised up on higher AR provisions offset by lower A&P expenses
EBIT	824	740	11.3	1,050	943	11.3	
Adj. net Profit	452	434	4.1	618	580	6.7	Revised up effective tax rate to account in AR provision impact.
Diluted EPS (HK\$)	0.206	0.198	4.1	0.282	0.264	6.7	

Source: OP Research

Exhibit 3: 1H20E results review

(RMB mn)	1H19	2H19	1H20	1H20E	yoy%	OP Comments	FY20E
Revenue	3,357	4,826	3,679	3,287	11.9%		8,531
COGS	(1,860)	(2,773)	(2,190)	(1,946)	12.6%		(5,032)
Gross profit	1,497	2,053	1,489	1,341	11.1%		3,499
Other income & gains	138	170	210	56	274.4%	More than expected government subsidies of RMB 139 mn vs RMB 88 mn in 1H19	182
Selling exp	(637)	(1,082)	(685)	(723)	-5.2%	Lower than expected A&P expenses	(1,744)
new brands impact		(147)	(165)		n.a.		
Admin exp excl R&D	(199)	(511)	(412)	(214)	92.7%		(908)
new brands impact		(106)	(93)		n.a.		
R&D	(82)	(114)	(101)	(82)	23.4%		(205)
Operating profit (EBIT)	717	517	501	378	32.4%		824
Provisions or other items	0	0	0	0	n.a.		0
Interest income	27	2	3	15	-82.5%		29
Finance costs	(62)	(78)	(80)	(78)	0		(156)
Profit after financing costs	682	441	423	315	34.5%		697
Associated cos	(1)	(1)	(5)	0	n.a.		0
Jointly controlled cos	0	0	0	0	n.a.		0
Pre-tax profit	681	440	418	315	32.8%		697
Tax	(218)	(172)	(166)	(91)	81.4%	Due to AR provision increases that can't be deducted	(244)
Minority interests	0	(4.03)	(4)	(0.65)	584.4%		(1)
Net profit	463	265	248	223	11.2%		452
YoY%							
Revenue	23%	32%	10%	-2%	n.a.		4.3%
Gross profit	25%	26%	-1%	-10%	n.a.		-1.4%
Net profit	23%	-6%	-46%	-52%	n.a.		-37.9%
Key ratios							
					in ppts		
GPM	44.6%	42.5%	40.5%	40.8%	(0.32)		41.0%
Selling exp	19.0%	22.4%	18.6%	22.0%	(3.38)		20.4%
*excl. new brands impact		19.4%	14.1%		n.a.		
Admin exp	5.9%	10.6%	11.2%	6.5%	4.69		10.6%
*excl. new brands impact		8.4%	8.7%		n.a.		
EIT	32.0%	39.0%	39.6%	29.0%	10.62		35.0%
Net margin	13.8%	5.5%	6.7%	6.8%	(0.04)		5.3%

Source: Company, OP Research

Financial Summary

Year to Dec	FY18	FY19	FY20E	FY21E	FY22E
Income Statement (RMB mn)					
Xtep core brands	6,383	7,707	7,731	9,125	10,273
Acquired brands	0	476	800	975	1,193
Turnover	6,383	8,183	8,531	10,100	11,465
YoY%	24.8	28.2	4.3	18.4	13.5
COGS	(3,555)	(4,632)	(5,032)	(5,999)	(6,778)
Gross profit	2,828	3,550	3,499	4,101	4,688
Gross margin	44.3%	43.4%	41.0%	40.6%	40.9%
Other income	196	308	182	112	112
Selling & distribution	(1,357)	(1,718)	(1,744)	(2,109)	(2,374)
Admin	(456)	(711)	(908)	(828)	(850)
R&D	(166)	(195)	(205)	(226)	(248)
Other opex	0	0	0	0	0
Total opex	(1,980)	(2,625)	(2,858)	(3,162)	(3,472)
Operating profit (EBIT)	1,044	1,234	824	1,050	1,328
Operating margin	16.4%	15.1%	9.7%	10.4%	11.6%
Provisions	0	0	0	0	0
Interest Income	72	29	29	31	34
Finance costs	(141)	(140)	(156)	(156)	(156)
Profit after financing costs	976	1,123	697	926	1,206
Associated companies & JVs	0	(2)	0	0	0
Pre-tax profit	976	1,121	697	926	1,206
Tax	(306)	(390)	(244)	(306)	(362)
Minority interests	(13)	(4)	(1)	(2)	(3)
Profit from discontinued operations	0	0	0	0	0
Net profit	657	728	452	618	842
YoY%	61	11	(38)	37	36
Adjusted net profit*	577	695	452	618	842
YoY%	9	20	(35)	37	36
Adjusted net margin	9.0%	8.5%	5.3%	6.1%	7.3%
EBITDA	1,126	1,322	900	1,135	1,417
EBITDA margin	17.6%	16.2%	10.5%	11.2%	12.4%
EPS (RMB)	0.295	0.288	0.179	0.245	0.333
YoY%	9	(2)	(35)	37	36
DPS (HK\$)	0.200	0.200	0.123	0.169	0.230
Year to Dec	FY18	FY19	FY20E	FY21E	FY22E
Cash Flow (RMB mn)					
EBITDA	1,126	1,322	900	1,135	1,417
Chg in working cap	(513)	36	(467)	561	(383)
Others	(94)	(145)	0	0	0
Operating cash	518	1,212	433	1,697	1,034
Interest received	(55)	(100)	29	31	34
Tax	(309)	(334)	(115)	(244)	(306)
Net cash from operations	154	778	347	1,484	762
Capex	(72)	(97)	(101)	(120)	(136)
Investments	(81)	(1,726)	7	8	9
Change in short-term bank deposits	(234)	(332)	0	0	0
Sales of assets	83	97	0	0	0
Interests received	0	0	0	0	0
Others	24	14	0	0	0
Investing cash	(281)	(2,045)	(94)	(112)	(127)
FCF	(127)	(1,267)	253	1,372	636
Issue of shares	59	1,190	0	0	0
Buy-back	(89)	(3)	0	0	0
Minority interests	(4)	(73)	0	0	0
Dividends paid	(459)	(436)	(330)	(330)	(450)
Net change in bank loans	(10)	386	0	0	0
Others	(7)	(25)	(156)	(156)	(156)
Financing cash	(511)	1,039	(485)	(486)	(606)
Net change in cash	(637)	(227)	(232)	886	30
Exchange rate or other Adj	1	1	0	0	0
Opening cash	3,832	3,196	2,970	2,737	3,623
Closing cash	3,196	2,970	2,737	3,623	3,653
CFPS (HK\$)	0.087	0.354	0.158	0.676	0.347

Year to Dec	FY18	FY19	FY20E	FY21E	FY22E
Ratios					
Gross margin (%)	44.3	43.4	41.0	40.6	40.9
Operating margin (%)	16.4	15.1	9.7	10.4	11.6
Net margin (%)	10.3	8.9	5.3	6.1	7.3
Selling & dist'n exp/Sales (%)	21.3	21.0	20.4	20.9	20.7
Admin exp/Sales (%)	7.1	8.7	10.6	8.2	7.4
Salaries/Sales (%)	11.5	10.9	11.1	9.7	8.8
A&P/Sales (%)	15.2	14.4	12.0	14.5	15.0
R&D/Sales (%)	2.6	2.4	2.4	2.2	2.2
Payout ratio (%)	59.5	60.0	60.0	60.0	60.0
Effective tax (%)	31.4	34.7	35.0	33.0	30.0
Total debt/equity (%)	36.5	35.2	34.6	33.2	31.5
Net debt/equity (%)	Net	Net	Net	Net	Net
Current ratio (x)	2.5	2.5	2.4	2.3	2.3
Quick ratio (x)	2.2	2.2	2.2	2.1	2.0
Inventory T/O (days)	86	82	82	82	82
AR T/O (days)	121	130	150	115	115
AP T/O (days)	90	112	112	112	112
Cash conversion cycle (days)	117	100	121	86	86
Asset turnover (x)	0.7	0.8	0.7	0.8	0.8
Financial leverage (x)	1.7	1.8	1.8	1.8	1.9
EBIT margin (%)	16.4	15.1	9.7	10.4	11.6
Interest burden (x)	0.9	0.9	0.8	0.9	0.9
Tax burden (x)	0.7	0.6	0.6	0.7	0.7
Return on equity (%)	12.4	11.9	6.5	8.6	11.2
ROIC (%)	26.2	20.4	10.3	14.0	19.0
Year to Dec	FY18	FY19	FY20E	FY21E	FY22E
Balance Sheet (RMB mn)					
Fixed assets	677	696	723	759	808
Intangible assets & goodwill	8	1,644	1,642	1,640	1,638
Associated companies & JVs	0	39	39	39	39
Long-term investments	339	520	520	520	520
Other non-current assets	114	158	151	143	134
Non-current assets	1,139	3,057	3,075	3,101	3,139
Inventories	836	1,046	1,046	1,137	1,355
AR	2,115	2,910	3,506	3,182	3,612
Prepayments & deposits	727	818	853	1,009	1,146
Other current assets	1,186	1,522	1,522	1,522	1,522
Cash	3,196	2,970	2,737	3,623	3,653
Current assets	8,060	9,266	9,664	10,474	11,289
AP	879	1,420	1,542	1,839	2,077
Tax	54	115	244	306	362
Accruals & other payables	861	981	1,022	1,210	1,374
Bank loans & leases	1,483	1,155	1,155	1,155	1,155
CB & othe debts	0	0	0	0	0
Other current liabilities	1	1	1	1	1
Current liabilities	3,278	3,671	3,964	4,510	4,969
Bank loans & leases	461	1,376	1,376	1,376	1,376
CB & othe debts	0	0	0	0	0
Deferred tax & others	129	315	315	315	315
MI	5	70	71	73	76
Non-current liabilities	595	1,761	1,762	1,764	1,767
Total net assets	5,326	6,890	7,012	7,301	7,692
Shareholder's equity	5,326	6,890	7,012	7,301	7,692
Share capital	20	22	22	22	22
Reserves	5,306	6,868	6,990	7,279	7,670
BVPS (HK\$)	2.97	3.17	3.23	3.36	3.54
Total debts	1,944	2,424	2,424	2,424	2,424
Net cash/(debts)	2,438	2,063	1,831	2,717	2,746

* Adjusted for one-off gain from land sale, one-off cost from acquisition, and inventory write-back.

Source: Company, OP Research

Exhibit 4: Peer Group Comparison

				PER		PER		3-Yr		Div yld		Div yld		P/B		P/B		EV/		EV/		Gross		Net		ROE		Sh px	
			Mkt cap	3-mth avg	Hist	PER	FY2	EPS FY1	EPS FY2	EPS	PEG	Hist	FY1	Hist	FY1	Ebitda	Ebitda	Net gearing				margin	margin	ROE	FY1	1-mth	3-mth		
Company	Ticker	Price	(US\$m)	t/o (US\$m)	(x)	FY1 (x)	(x)	YoY%	YoY%	Cagr (%)	(x)	(%)	(%)	(x)	(x)	Hist	Cur Yr	Hist (%)				Hist (%)	Hist (%)	Hist (%)	(%)	%	%		
Xtep Intl	1368 HK	2.58	839	1.8	8.1	12.5	9.2	(35.0)	37.0	6.6	1.90	7.8	4.8	0.81	0.80	3.3	5.1	Net cash				43.4	8.5	11.9	6.5	6.2	4.0		
HSI		25,422.06			12.7	12.0	10.1	6.0	18.5	12.5	0.96	3.7	3.3	1.05	0.99									8.2	8.2	2.6	9.9		
HSCEI		10,182.83			8.9	8.8	7.8	0.9	12.4	8.2	1.07	4.0	3.9	1.00	0.99									11.3	11.2	0.3	6.6		
CSI300		4,844.27			18.3	16.0	13.7	14.0	16.9			1.8	1.9	2.2	2.0									11.9	12.6	6.0	25.6		
Domestic peers																													
Adjusted sector avg*					27.3	31.4	20.5	(10.6)	35.3	18.7	1.3	4.0	3.1	4.3	3.8	11.5	10.6	12.2				46.7	10.1	11.9	12.1	4.7	16.7		
361 Degrees	1361 HK	1.11	296	0.2	4.7	5.1	4.5	(8.6)	14.7	5.2	1.0	9.7	7.7	N/A	0.3	(1.4)	(1.5)	0.0				40.3	7.7	N/A	5.9	3.7	7.8		
Anta Sports Prod	2020 HK	82.05	28,617	81.4	36.6	37.0	25.4	(1.2)	46.1	22.2	1.7	0.8	0.9	9.2	8.3	19.2	21.4	0.0				55.0	15.8	23.0	23.7	11.3	20.6		
Li Ning Co Ltd	2331 HK	34.45	11,040	53.1	49.3	47.6	35.1	3.5	35.7	20.9	2.3	0.5	0.6	9.1	9.0	30.0	28.5	0.0				49.1	10.8	19.8	20.2	33.5	34.3		
Pou Sheng Intl	3813 HK	1.81	1,251	0.5	10.1	20.3	7.6	(50.2)	167.1	19.1	1.1	N/A	0.9	1.1	1.1	4.2	5.5	73.3				34.1	3.1	5.6	5.4	5.2	24.0		
China Dongxiang	3818 HK	1.02	775	5.3	14.5	12.1	10.6	20.0	13.3	17.0	0.7	4.8	5.5	0.5	0.5	(0.9)	(0.8)	0.0				60.2	19.9	N/A	5.2	1.2	70.9		
Annil Co Ltd-A	002875 CH	11.92	296	5.1	48.4	66.2	39.7	(26.9)	66.7	14.6	4.6	N/A	N/A	2.3	N/A	33.9	N/A	0.0				52.6	3.2	(0.6)	N/A	2.8	15.0		
Guirenniao Co-A	603555 CH	1.78	163	1.4	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	3.9	N/A	(4.6)	N/A	495.7				35.5	(64.4)	(129.4)	N/A	4.1	(1.1)		
International peers																													
Adjusted sector avg*					51.6	99.1	50.1	(29.7)	168.1	15.1	15.05		0.4	12.98	11.63	23.9	35.7	24.4				49.4	7.6	7.6	13.5	6.0	9.4		
Nike Inc -CI B	NKE US	110.84	172,898	656.4	68.0	47.2	33.6	43.9	40.6	32.9	1.4	0.9	0.9	21.4	21.7	40.2	34.8	52.5				43.4	6.8	29.7	47.7	15.1	12.6		
Under Armour-A	UAA US	9.92	4,270	80.4	49.6	N/A	91.9	N/A	N/A	12.4	N/A	N/A	0.0	3.2	3.1	9.5	(41.5)	23.8				46.9	1.7	(39.5)	(19.1)	(12.2)	9.6		
Lululemon Ath	LULU US	374.84	48,807	613.8	75.7	86.6	59.3	(12.6)	46.1	15.4	5.6	N/A	0.0	26.6	20.8	39.7	52.9	0.0				55.9	16.2	36.1	27.3	16.2	31.8		
Adidas Ag	ADS GR	251.90	60,097	145.5	25.2	97.0	28.7	(74.0)	237.3	2.4	39.8	N/A	1.0	7.9	6.9	13.9	27.3	26.6				52.0	8.4	8.5	8.5	6.2	6.5		
Puma Se	PUM GR	69.46	12,471	17.6	39.5	165.8	37.0	(76.2)	348.4	12.5	13.3	N/A	0.3	5.9	5.6	16.1	28.0	19.2				48.8	4.8	3.3	3.2	4.6	8.9		

* Outliners and "N/A" entries are in red and excl. from the calculation of averages

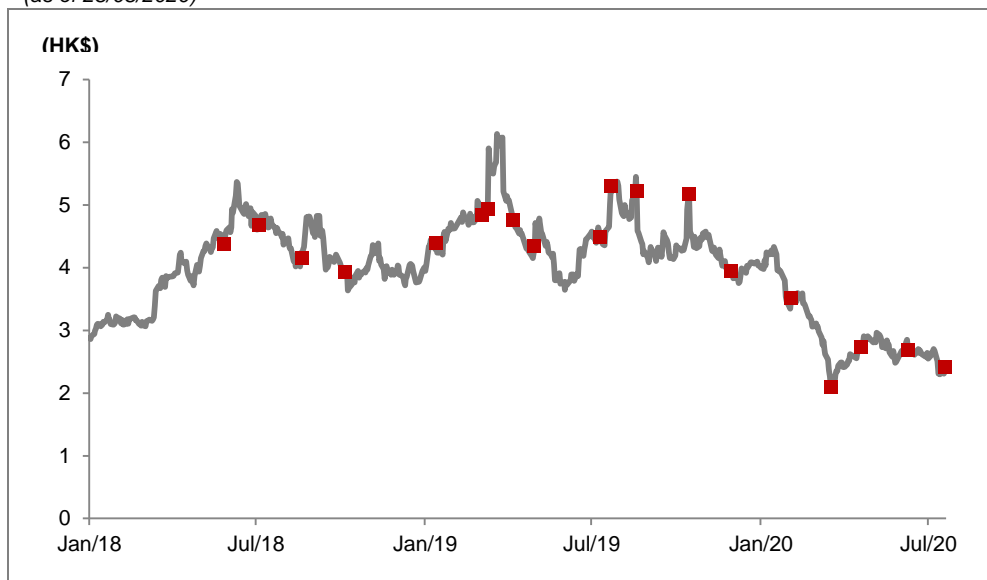
Source: Bloomberg, OP Research

Our recent reports

Date	Company / Sector	Ticker	Title	Rating	Analyst
28/08/2020	HKT	1137	Management vision beyond domestic e commerce	BUY	Kevin Tam
27/08/2020	CG Services	6098	Leader aims higher	BUY	Megan Jin
26/08/2020	Anta Sports	2020	Less foreseeable catalysts	HOLD	Megan Jin
24/08/2020	GT Services	2869	1H20 steady on track	HOLD	Megan Jin
21/08/2020	A-Living	3319	Undervalued acquisition synergies	BUY	Megan Jin
20/08/2020	Sunny Optical	2382	Less convincing earnings outlook	HOLD	Kevin Tam
17/08/2020	Ausnutria Dairy	1717	2Q20 fluctuations to be under control by 4Q20	BUY	Megan Jin
17/08/2020	Li-Ning	2331	Well positioned to capture consumption recovery	BUY	Megan Jin
12/08/2020	China Youzan	8083	Robust momentum kept up	BUY	Megan Jin
14/08/2020	S-Enjoy Service	1755	3rd party expansion speeding up	BUY	Megan Jin
30/07/2020	Viva Biotech	1873	Biotech PE model to reap more long term return	NR	Kevin Tam
21/07/2020	361 Degrees Intl	1361	Slow recovery in 2Q20 retail sales	BUY	Megan Jin
16/07/2020	Anta Sports	2020	More visible outlook of full revival	BUY	Megan Jin
10/07/2020	Digital China	861	Thrive on data servicing capabilities	NR	Kevin Tam
02/07/2020	S-Enjoy Service	1755	New share incentives with strong commitment	BUY	Megan Jin
02/07/2020	TCL Electronics	1070	Inject smartphone business at start of 5G replacement cycle	BUY	Dallas Cai
30/06/2020	Yeahka	9923	From payment to Fintech	BUY	Kevin Tam
19/06/2020	Powerlong CM	9909	Moving into the fast lane	NR	Dallas Cai
11/06/2020	Xtep Intl	1368	More promising prospect from FY21E	BUY	Megan Jin
08/06/2020	Edvantage Group	382	Campus capacity enlarged further	BUY	Megan Jin
04/06/2020	S-Enjoy Service	1755	Robust expansion continues	BUY	Megan Jin
04/06/2020	Greentown Services	2869	Placing for new growth initiatives - city services most likely	HOLD	Dallas Cai
28/05/2020	A-Living	3319	Positive read-across from April property sales	BUY	Dallas Cai
25/05/2020	HKBN	1310	Challenging to becoming BN leader	NR	Kevin Tam
18/05/2020	Skyworth	751	The sky getting clear	NR	Kevin Tam
14/05/2020	Ausnutria Dairy	1717	Premium products brought up GPM in 1Q20	BUY	Megan Jin/Dallas Cai
14/05/2020	China Youzan	8083	1Q loss narrowed as economies of scale kicking in	BUY	Dallas Cai

Historical recommendations and target price: Xtep (1368 HK)

(as of 28/08/2020)



Date	Rating	TP (HK\$)	Close (HK\$)	Date	Rating	TP (HK\$)	Close (HK\$)
1 15 Jul 2019	BUY	5.60	4.74	6 05 Feb 2020	BUY	5.34	3.60
2 24 Jul 2019	BUY	6.40	5.59	7 20 Mar 2020	BUY	3.60	2.14
3 21 Aug 2019	BUY	6.50	5.52	8 21 Apr 2020	BUY	3.60	2.73
4 18 Oct 2019	BUY	6.50	5.31	9 11 Jun 2020	BUY	3.20	2.69
5 03 Dec 2019	BUY	5.90	4.04	10 22 Jul 2020	BUY	3.17	2.42

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