ORIENTAL PATRON

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Equity Research
Sportswear / China

Xtep Intl (1368 HK)

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Company Update

BUY

UNCHANGED

Close price:	**HK$2.82**
Target Price:	**HK$3.66 (+30%)**
Prior TP:	**HK$3.38**

Key Data

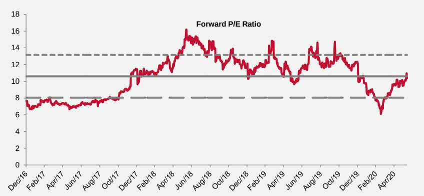
HKEx code		1368 HK
12 Months High	(HK$)	5.39
12 Month Low	(HK$)	2.04
3M Avg Dail Vol.	(mn)	5.25
Issue Share	(mn)	2,519.44
Market Cap	(HK$mn)	7,104.82
Fiscal Year		31/12/2019
Major shareholder (s)		Ding Shuibo (54.41%)

Source: Company data, Bloomberg, OP Research
Closing price are as of 16/10/2020

Price Chart

	1mth	3mth	6mth
Absolute %	17.5	24.4	9.3
Rel. MSCI CHINA %	14.7	16.1	-17.4

PE



Company Profile

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

Recovery speeded up

- **3Q20 retail sales growth for Xtep core brand recorded MSD yoy growth that beats expectations. Channel inventory level improves to ~5x.**
- **New shares issued to Nicholas Tse recaptures market attention.**
- **Reiterate BUY with TP lifted to HK$3.66 from HK$3.38 on higher 13x FY21E P/E for possible re-rating from solid operation momentum.**

3Q20 operations beat expectations. Xtep core brand retail sales recorded better than expected MSD yoy growth in 2Q20, a surprising acceleration in recovery given larger base in low tier cities (vs major peers) that are more economically weakened during the crisis. **With discount level remained 30-35% off (vs 20-25% in normal periods), the increase indicated MTS volume increase**, suggesting well resumed traffic come-back amid est. stable total store sizes. **We believe September growth had quickened** given still tepid recovery witnessed in Jul and Aug, representing **good momentum that continued into the Golden week that recorded stellar growth yoy. Channel inventory further improved to ~5x from 5-5.5x** in 2Q20, boding well for achieving full year inventory clearance target to bring back to 4x.

We see brand attractiveness growing among young people. We spotted a series of young-people-targeting campaigns, such as IP Cross with Jiangziya (No.1 hit movie during the holiday), Shaolin Temple themed ("丗") pop-up store in Shanghai CBD mall, street dance contests co-organizing in Xiamen. We think it rides well on the China Fashion tide, and actively links itself with young fashion, which lifts brand equity and paves way for possible higher front-tier city penetration given among the lowest 1st tier city exposure (~10% of total stores).

New shares issued to Nicholas Tse on Oct. 9th recaptures market attention. This is the 2nd time Xtep issued new shares to this 19-year-long spokesperson with the 1st back in 2016 that were sold by Mr. Tse at around 2019. Same as last time, the proceeds are used for launching Nicholas related products and his other promotion events (details in Ex.4). We believe tightened cooperation strengthens its flagship series Fenghuo Shoe (Nicholas series) and brand awareness.

Reiterate BUY with TP revised up to HK$3.66 on higher 18x/13x P/E (from 16x/12x) of same FY20E/21E adj. earnings, as we believe the accelerated momentum deserves valuation discount narrowing with Anta (still trading at 60% discount). We believe the operating loss of new brands is within control as K-Swiss and Palladium are mainly operated through wholesale while JV operations of Saucony and Merrel are still in small scale. We estimate -13%/-6% new brands drag on OP for FY20E/21E and expect positive contribution from FY22E when K-Swiss starts store opening. The overhangs on the counter may gradually ease off as retail resumption speeds up further in Q4.

Risks: (1) slow-down in retail resumption, (2) new brands less welcomed by consumers, (3) worse than expected overseas drag on new brands

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$)	0.324	0.317	0.206	0.282	0.384
EPS growth (%)	9.0	(2.4)	(35.0)	37.0	36.1
Change to previous EPS (%)			0.0	0.0	
Consensus EPS (HK$)			0.232	0.325	
ROE (%)	12.4	11.9	6.5	8.6	11.2
P/E (x)	8.7	8.9	13.7	10.0	7.4
P/B (x)	0.9	0.9	0.9	0.8	0.8
Yield (%)	7.1	7.1	4.4	6.0	8.2
DPS (HK$)	0.200	0.200	0.123	0.169	0.230

Source: Bloomberg, OP Research

Exhibit 2: Quarterly retail sales growth vs peers

Retail Sales Growth (yoy%)	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20
Xtep (online + offline)	**20%+**	**20%+**	**20%~**	**20%+**	-20%~ 25%	-LSD	+MSD
Anta Brand (online + offline)	**+low teens**	**+mid teens**	**+mid teens**	+ high teens	-20%~ 25%	-LSD	+LSD
361 Degrees core brands offline	+LSD	+LSD	+LSD	+LSD	-25%~ 30%	-low teens	-HSD

Source: Company, OP Research

Exhibit 3: (L) Shaolin Temple themed pop up store in Xintiandi SH in Oct; (R) IP Cross shoes with Jiangziya

Source: Company, OP Research

Exhibit 4: New shares issued to Nicholas Tse in 2016/2020

	2020-Oct-9th	2016-Jul-15th
No. of shares	5,000,000	5,000,000
Ex holdings	0	0
% of total	0.20%	0.23%
Subscription Price	HK$2.48	HK$4.50
+Premium/-discount	-1.20%	+13.07%
Lock-up	1 year	1 year
Total proceeds	HK$12.4 mn	HK$22.5 mn
Use of proceeds	development of the Group's products	development of the Group's products

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 cash	Net cash	Net cash	Net cash	Net cash
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

Company	Ticker	Price	Mkt cap (US$m)	3-mth avg t/o (US$m)	PER Hist (x)	PER FY1 (x)	PER FY2 (x)	EPS FY1 YoY%	EPS FY2 YoY%	3-Yr EPS Cagr (%)	PEG (x)	Div yld Hist (%)	Div yld FY1 (%)	P/B Hist (x)	P/B FY1 (x)	EV/ Ebitda Hist	EV/ Ebitda Cur Yr	Net gearing Hist (%)	Gross margin Hist (%)	Net margin Hist (%)	ROE Hist (%)	ROE FY1 (%)	Sh px 1-mth %	Sh px 3-mth %
Xtep Intl	**1368 HK**	**2.82**	**917**	**1.7**	**8.9**	**13.7**	**10.0**	**(35.0)**	**37.0**	**6.6**	**2.08**	**7.1**	**4.4**	**0.89**	**0.87**	**3.8**	**5.8**	**Net cash**	**43.4**	**8.5**	**11.9**	**6.5**	**17.5**	**22.6**
HSI		24,386.79			13.0	12.9	10.7	1.0	20.3	11.8	1.10	3.1	3.0	1.05	1.04						8.1	8.0	(1.4)	(2.3)
HSCEI		9,914.90			9.4	9.6	8.5	(1.7)	13.5	8.0	1.20	3.5	3.5	1.09	1.04						11.6	10.8	0.7	(2.2)
CSI300		4,791.68			18.8	16.4	14.0	14.1	17.7			1.8	1.9	2.2	2.0						11.5	12.1	2.9	6.1
Domestic peers																								
Adjusted sector avg*					**27.2**	**33.6**	**20.5**	**(13.3)**	**42.7**	**16.4**	**1.4**	**3.9**	**3.3**	**4.1**	**4.0**	**11.3**	**11.2**	**12.2**	**46.7**	**10.1**	**10.2**	**11.9**	**0.3**	**9.1**
361 Degrees	1361 HK	0.99	264	0.1	4.1	4.5	3.9	(8.6)	14.7	5.2	0.9	9.8	8.9	0.3	0.2	(1.7)	(1.9)	0.0	40.3	7.7	5.8	5.9	(2.0)	(18.9)
Anta Sports Prod	2020 HK	85.40	29,789	65.3	37.2	38.0	25.4	(2.2)	49.4	22.3	1.7	0.7	0.9	9.3	8.5	19.5	21.5	0.0	55.0	15.8	23.0	23.7	8.1	24.7
Li Ning Co Ltd	2331 HK	38.90	12,486	48.9	54.3	52.5	38.6	3.3	36.1	20.8	2.5	0.4	0.5	10.9	9.9	33.3	31.7	0.0	49.1	10.8	19.8	20.2	12.1	62.1
Pou Sheng Intl	3813 HK	1.87	1,293	1.0	10.2	21.0	7.9	(51.5)	166.2	17.6	1.2	N/A	0.6	1.1	1.1	4.2	6.0	73.3	34.1	3.1	5.6	5.4	1.1	3.9
China Dongxiang	3818 HK	1.00	759	6.4	13.8	11.5	10.2	20.0	13.3	17.0	0.7	4.9	5.8	0.5	0.5	(1.5)	(1.4)	0.0	60.2	19.9	N/A	4.1	(2.9)	24.6
Annil Co Ltd-A	002875 CH	10.72	273	7.0	43.6	73.9	37.0	(41.1)	100.0	15.6	4.7	N/A	N/A	2.1	N/A	29.9	N/A	0.0	52.6	3.2	(3.2)	N/A	(2.2)	(1.7)
Guirenniao Co-A	603555 CH	2.25	211	1.6	N/A	N/A	112.5	N/A	N/A	(129.1)	N/A	N/A	N/A	4.4	32.1	(5.0)	N/A	495.7	35.5	(64.4)	(116.8)	(962.0)	(0.4)	21.6
International peers																								
Adjusted sector avg*					**57.9**	**103.2**	**41.2**	**(22.2)**	**159.9**	**16.5**	**20.79**		**0.4**	**12.97**	**11.76**	**26.0**	**36.9**	**24.4**	**49.4**	**7.6**	**6.5**	**14.3**	**7.3**	**22.1**
Nike Inc -Cl B	NKE US	129.00	202,508	748.8	79.1	45.3	35.3	74.6	28.3	38.3	1.2	0.8	0.8	21.9	21.4	46.8	33.2	52.5	43.4	6.8	29.2	50.3	8.8	32.6
Under Armour-A	UAA US	12.92	5,459	80.9	64.6	N/A	115.4	N/A	N/A	12.1	N/A	N/A	0.0	4.1	3.9	11.5	(56.2)	23.8	46.9	1.7	(39.5)	(15.7)	5.6	24.7
Lululemon Ath	LULU US	353.61	46,080	607.5	71.4	84.1	54.8	(15.1)	53.4	16.2	5.2	N/A	0.0	23.2	19.5	37.8	50.2	0.0	55.9	16.2	30.8	25.5	14.1	12.9
Adidas Ag	ADS GR	283.80	66,684	117.7	28.4	119.0	32.8	(76.2)	263.4	1.8	65.2	N/A	0.8	8.9	7.8	15.5	33.4	26.6	52.0	8.4	8.5	7.7	0.9	19.0
Puma Se	PUM GR	80.44	14,224	19.4	45.7	164.5	41.7	(72.2)	294.7	14.1	11.6	N/A	0.2	6.8	6.2	18.5	31.0	19.2	48.8	4.8	3.3	3.8	7.1	21.0

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

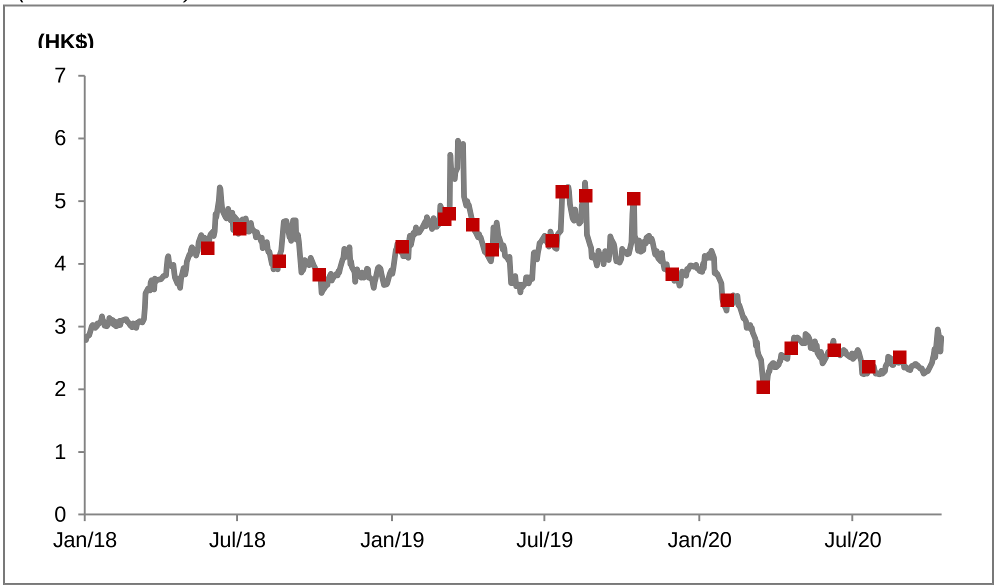
Source: Bloomberg, OP Research

Our recent reports

Date	Company / Sector	Ticker	Title	Rating	Analyst
16/10/2020	Anta Sports	2020	More visible outlook of full revival	HOLD	Megan Jin
16/10/2020	Kerry Logistics	636	Grabbing opportunities in spite of COVID headwind	NR	Kevin Tam
15/10/2020	Edvantage Group	382	Room of more earnings surprise	BUY	Megan Jin
08/10/2020	Innovent	1801	PD-1 front runner setting off	BUY	Kevin Tam
01/09/2020	Yeahka	9923	1H20 soft patch, but still encouraging growth in technology services	HOLD	Kevin Tam
31/08/2020	Xtep Intl	1368	More confident on new brands and 2H20E recovery	BUY	Megan Jin
28/08/2020	HKTV	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
22/07/2020	Xtep Intl	1368	Uncertainties on new brands remain but worst is seen	BUY	Megan Jin
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

Historical recommendations and target price: Xtep (1368 HK)

(as of 16/10/2020)



	Date	Rating	TP (HK$)	Close (HK$)	Date	Rating	TP (HK$)	Close (HK$)
1	24 Jul 2019	BUY	6.40	5.59	6. 20 Mar 2020	BUY	3.60	2.14
2	21 Aug 2019	BUY	6.50	5.52	7. 21 Apr 2020	BUY	3.60	2.73
3	18 Oct 2019	BUY	6.50	5.31	8. 11 Jun 2020	BUY	3.20	2.69
4	03 Dec 2019	BUY	5.90	4.04	9. 22 JuL 2020	BUY	3.17	2.42
5	05 Feb 2020	BUY	5.34	3.60	10. 31 Aug 2020	BUY	3.38	2.58

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