

Xtep Intl (1368 HK)

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Company Update

BUY

UNCHANGED

Close price: **HK\$2.69**

Target Price: **HK\$3.20 (+19%)**

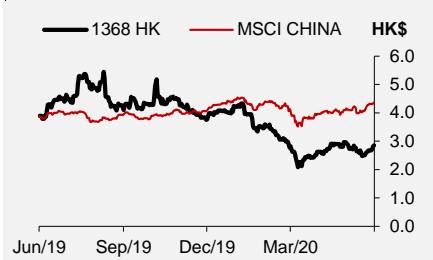
Prior TP: **HK\$3.60**

Key Data

HKEx code	1368 HK
12 Months High (HK\$)	5.99
12 Month Low (HK\$)	2.04
3M Avg Dail Vol. (mn)	7.76
Issue Share (mn)	2,512.45
Market Cap (HK\$m)	6,758.48
Fiscal Year	31/12/2019
Major shareholder (s)	Ding Shuibao (54.48%)

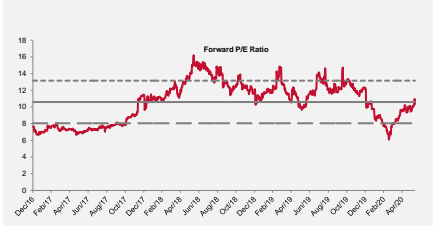
Source: Company data, Bloomberg, OP Research
Closing price are as of 11/06/2020

Price Chart



	1mth	3mth	6mth
Absolute %	-7.1	2.6	-32.5
Rel. MSCI CHINA %	-13.4	-9.4	-36.9

PE



Company Profile

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

More promising prospect from FY21E

- Core brand retail sales improved in April and May but 4Q20E trade fair order disappointed. We now estimate HSD decline in FY20E core brand revenue. Core brand GPM is est. to decrease as the company adjusts down markup rates. K-Swiss & Palladium are est. to be loss-making due to overseas pandemic.
- We cut our earnings forecast by 47%/42% for FY20E/FY21E respectively but forecast earnings rebound of 30%/25% in FY21E/22E.
- Maintain BUY with TP cut to HK\$3.20 on 12x FY21E P/E from HK\$3.60. We see more earnings visibility from FY21E and believe its multi-brand strategy of tapping into mid-to-high end market shall yield fruit in long term.

Core brand retail sales improved but 4Q20E trade fair order disappointed. Retail sales in April/ May recovered, registering teens decline/ single digit growth respectively, versus 20-25% decline in 1Q20. Discounts and inventory levels both improved slightly. However, 4Q20E trade fair order recorded LSD decrease, pointing to dimmer-than-expected outlook for 2H20E. **We therefore estimate HSD decline in FY20E core brand revenue** vs previous forecast of LTS increase. **Xtep plans to adjust down markup rates** for new core brand products, which we believe is a measure to cater for more price-sensitive consumer appetites. **This however will result in lower future core brand GPM from 43.8% in FY19 to est. 40%-41% in the future**, as gross costs and discount to distributors largely remain stable.

K-Swiss & Palladium are impacted by overseas pandemic due to considerable exposure to US and European market. Topline for the two brands are est. to decline to USD130-140mn, leading to a net loss for FY20E, versus previous expectation of breakeven. For Merrell and Saucony JV, we still expect 30-50 new stores this year.

We cut our earnings forecast by 47%/42% to RMB447 mn/RMB583 mn for FY20E/FY21E based on 1) 18%/12% cut in revenue for due to ASP cut and less expansionary distribution network; 2) 2.3 ppt/ 3.0 ppt cut in overall GPM; 3) ~RMB100/50 mn est. loss from new brands.

More earnings visibility from FY21E as new brands move closer to breakeven. We forecast 30%/25% earnings growth in FY21E/FY22E backed by 1) core brand to pace up recovering after channel inventory clearance in FY20E and competition easing; 2) loss from acquired brands to largely narrow as restructuring of K-Swiss to complete and Palladium distribution network to double from FY19 by end-FY21E.

Multi-brand strategy of tapping into mid-to-high end market shall yield fruit in long term. Given the booming middle class with relatively limited mid-to-high end sportswear choices in China, we continue to believe in positive outlook of these new brands that are with rich culture and professionalism. We expect K-Swiss to significantly expand China's footprint from FY22E. **Maintain Buy with TP cut to HK\$3.20 from HK\$3.60, representing 16x/12x FY20E/21E P/E (from 9x/8x), which is at its historical mean.**

Risks: (1) Channel inventory stack-up, (2) further deflated consumer confidence in low-tier cities due to weak economic growth, (3) pro-longed intensified competition

Exhibit 1: Forecast and Valuation

Year to Dec (RMB mn)	FY18	FY19	FY20E	FY21E	FY22E
Revenue	6,383.2	8,182.7	8,094.0	9,726.2	11,062.1
Growth (%)	24.8	28.2	(1.1)	20.2	13.7
Adjusted net profit	656.5	727.7	446.9	583.2	729.2
Growth (%)	60.9	10.8	(38.6)	30.5	25.0
Adj. diluted EPS (HK\$)	0.324	0.317	0.204	0.266	0.332
EPS growth (%)	9.0	(2.4)	(35.7)	30.5	25.0
Change to previous EPS (%)			(47.1)	(41.5)	
Consensus EPS (HK\$)			0.276	0.357	
ROE (%)	12.4	11.9	6.4	8.2	9.8
P/E (x)	8.3	8.5	13.2	10.1	8.1
P/B (x)	0.9	0.8	0.8	0.8	0.8
Yield (%)	7.4	7.4	4.5	5.9	7.4
DPS (HK\$)	0.200	0.200	0.122	0.159	0.199

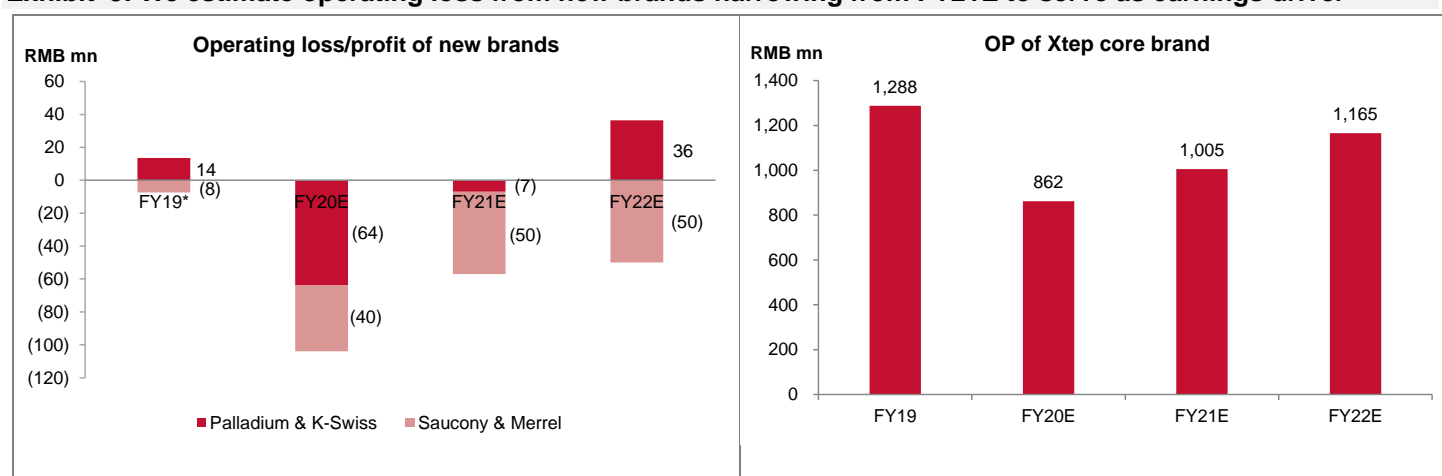
Source: Bloomberg, OP Research

Exhibit 2: Earnings Revision

(RMB mn)	FY20E			FY21E			OP Comments
	New	Old	% Chg	New	Old	% Chg	
Revenue	8,094	9,847	(17.8)	9,726	11,102	(12.4)	Cut on dimmer recovery outlook due to intensified competition and deflated consumer confidence
Gross profit	3,293	4,228	(22.1)	3,901	4,790	(18.6)	
Gross margin	40.7%	42.9%	(2.3)	40.1%	43.1%	(3.0)	Cut on markup rate decrease that resulted in lower GPM
Opex	(2,647)	(2,982)	(11.2)	(3,065)	(3,302)	(7.2)	
EBIT	758	1,358	(44.2)	948	1,600	(40.7)	Cut on pro-longed drag by new brands
Net Profit	447	844	(47.1)	583	997	(41.5)	
Diluted EPS (HK\$)	0.204	0.384	(47.1)	0.266	0.454	(41.5)	

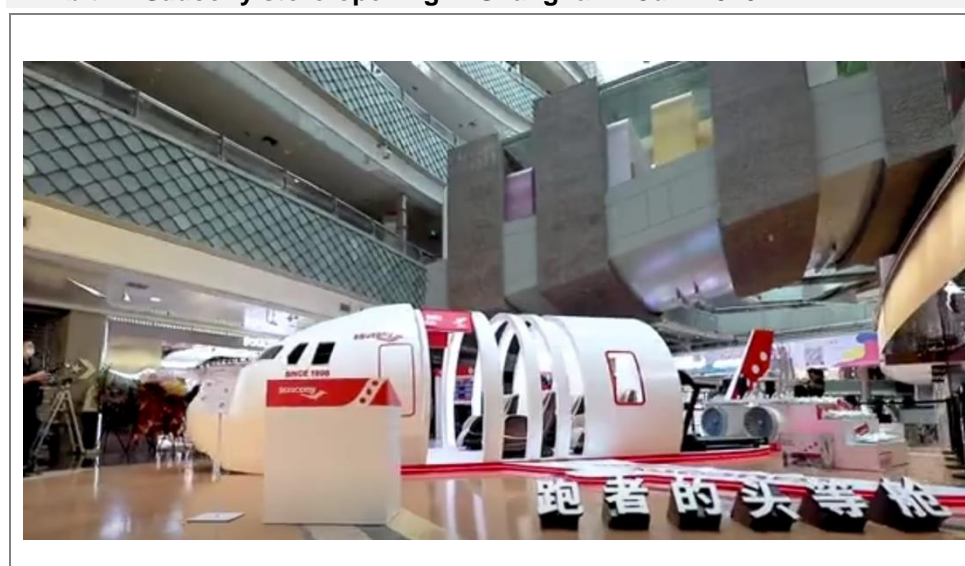
Source: OP Research

Exhibit 3: We estimate operating loss from new brands narrowing from FY21E to serve as earnings driver



* FY19 OP of Palladium & K-Swiss is after excluding one-off cost of RM60mn; FY19 OP of Palladium & K-Swiss consolidated 5 months of their full year results.
Source: Company, OP Estimates

Exhibit 4: Saucony store-opening in Shanghai in Jun. 2020



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	7,084	8,499	9,567
Acquired brands	0	476	1,010	1,227	1,495
Turnover	6,383	8,183	8,094	9,726	11,062
YoY%	24.8	28.2	(1.1)	20.2	13.7
COGS	(3,555)	(4,632)	(4,801)	(5,825)	(6,615)
Gross profit	2,828	3,550	3,293	3,901	4,447
Gross margin	44.3%	43.4%	40.7%	40.1%	40.2%
Other income	196	308	112	112	112
Selling & distribution	(1,357)	(1,718)	(1,700)	(2,019)	(2,287)
Admin	(456)	(711)	(752)	(831)	(884)
R&D	(166)	(195)	(195)	(215)	(236)
Other opex	0	0	0	0	0
Total opex	(1,980)	(2,625)	(2,647)	(3,065)	(3,408)
Operating profit (EBIT)	1,044	1,234	758	948	1,152
Operating margin	16.4%	15.1%	9.4%	9.7%	10.4%
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	631	824	1,030
Associated companies & JVs	0	(2)	0	0	0
Pre-tax profit	976	1,121	631	824	1,030
Tax	(306)	(390)	(183)	(239)	(299)
Minority interests	(13)	(4)	(1)	(2)	(2)
Profit from discontinued operations	0	0	0	0	0
Net profit	657	728	447	583	729
YoY%	61	11	(39)	30	25
Adjusted net profit*	577	695	447	583	729
YoY%	9	20	(36)	30	25
Adjusted net margin	9.0%	8.5%	5.5%	6.0%	6.6%
EBITDA	1,126	1,322	834	1,032	1,240
EBITDA margin	17.6%	16.2%	10.3%	10.6%	11.2%
EPS (RMB)	0.295	0.288	0.237	0.309	0.364
YoY%	9	(2)	(36)	30	25
DPS (HK\$)	0.200	0.200	0.122	0.159	0.199

Year to Dec	FY18	FY19	FY20E	FY21E	FY22E
Cash Flow (RMB mn)					
EBITDA	1,126	1,322	834	1,032	1,240
Chg in working cap	(513)	36	(366)	570	(384)
Others	(94)	(145)	0	0	0
Operating cash	518	1,212	468	1,603	856
Interest received	(55)	(100)	29	31	34
Tax	(309)	(334)	(115)	(183)	(239)
Net cash from operations	154	778	382	1,451	651
Capex	(72)	(97)	(96)	(115)	(131)
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)	(89)	(107)	(122)
FCF	(127)	(1,267)	292	1,343	529
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)	(328)	(316)	(401)
Net change in bank loans	(10)	386	0	0	0
Others	(7)	(25)	(156)	(156)	(156)
Financing cash	(511)	1,039	(484)	(472)	(556)
Net change in cash	(637)	(227)	(191)	872	(27)
Exchange rate or other Adj	1	1	0	0	0
Opening cash	3,832	3,196	2,970	2,778	3,650
Closing cash	3,196	2,970	2,778	3,650	3,622
CFPS (HK\$)	0.087	0.354	0.174	0.661	0.297

Year to Dec	FY18	FY19	FY20E	FY21E	FY22E
Ratios					
Gross margin (%)	44.3	43.4	40.7	40.1	40.2
Operating margin (%)	16.4	15.1	9.4	9.7	10.4
Net margin (%)	10.3	8.9	5.5	6.0	6.6
Selling & dist'n exp/Sales (%)	21.3	21.0	21.0	20.8	20.7
Admin exp/Sales (%)	7.1	8.7	9.3	8.5	8.0
Salaries/Sales (%)	11.5	10.9	11.7	10.0	9.1
A&P/Sales (%)	15.2	14.4	14.4	14.5	15.0
R&D/Sales (%)	2.6	2.4	2.4	2.2	2.1
Payout ratio (%)	59.5	60.0	60.0	60.0	60.0
Effective tax (%)	31.4	34.7	29.0	29.0	29.0
Total debt/equity (%)	36.5	35.2	34.6	33.3	31.9
Net debt/equity (%)	cash	cash	cash	cash	cash
Current ratio (x)	2.5	2.5	2.5	2.4	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	0.7	0.8
Financial leverage (x)	1.7	1.8	1.8	1.8	1.9
EBIT margin (%)	16.4	15.1	9.4	9.7	10.4
Interest burden (x)	0.9	0.9	0.8	0.9	0.9
Tax burden (x)	0.7	0.6	0.7	0.7	0.7
Return on equity (%)	12.4	11.9	6.4	8.2	9.8
ROIC (%)	26.2	20.4	10.5	13.5	16.9

Year to Dec	FY18	FY19	FY20E	FY21E	FY22E
Balance Sheet (RMB mn)					
Fixed assets	677	696	718	751	795
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	152	144	135
Non-current assets	1,139	3,057	3,070	3,093	3,127
Inventories	836	1,046	1,046	1,084	1,316
AR	2,115	2,910	3,326	3,064	3,485
Prepayments & deposits	727	818	809	972	1,105
Other current assets	1,186	1,522	1,522	1,522	1,522
Cash	3,196	2,970	2,778	3,650	3,622
Current assets	8,060	9,266	9,482	10,293	11,051
AP	879	1,420	1,471	1,785	2,027
Tax	54	115	183	239	299
Accruals & other payables	861	981	970	1,166	1,326
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	3,780	4,346	4,807
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	75
Non-current liabilities	595	1,761	1,762	1,764	1,766
Total net assets	5,326	6,890	7,010	7,277	7,605
Shareholder's equity	5,326	6,890	7,010	7,277	7,605
Share capital	20	22	22	22	22
Reserves	5,306	6,868	6,987	7,254	7,583
BVPS (HK\$)	2.97	3.17	3.22	3.35	3.50
Total debts	1,944	2,424	2,424	2,424	2,424
Net cash/(debts)	2,438	2,063	1,872	2,743	2,716

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

Source: Company, OP Research

Exhibit 2: Peer Group Comparison

Company	Ticker	Price	Mkt cap (US\$m)	3-mth avg t/o (US\$m)	3-Yr																	ROE (%)	Sh px 1-mth %	Sh px 3-mth %
					PER	PER	PER	EPS	EPS	EPS	Div yld	P/B	P/B	EV/	EV/	Gross	Net	ROE	Sh px	Sh px				
					Hist (x)	FY1 (x)	FY2 (x)	FY1 YoY%	FY2 YoY%	Cagr (%)	PEG (x)	Div yld Hist (%)	FY1 (%)	Hist (x)	FY1 (x)	Ebitda Hist	Ebitda Cur Yr	Net gearing Hist (%)	margin Hist (%)	margin Hist (%)	margin Hist (%)			
Xtep Intl	1368 HK	2.69	872	2.7	8.5	13.2	10.1	(35.7)	30.5	1.6	8.20	7.4	4.5	0.85	0.83	3.5	5.8	Net cash	43.4	0.3	11.9	6.4	(10.3)	(7.2)
HSI		24,480.15			10.6	11.4	9.7	(6.4)	17.5	7.1	1.60	3.9	3.5	0.99	0.96						9.3	8.4	(0.5)	(3.0)
HSCEI		9,944.60			8.3	8.7	7.7	(5.2)	12.6	6.0	1.45	3.9	3.9	1.04	0.98						12.6	11.3	(0.5)	(1.2)
CSI300		3,995.89			15.0	12.7	11.0		18.0	15.3		2.1	2.5	1.7	1.6						11.6	12.6	0.9	(0.8)
Domestic peers																								
Adjusted sector avg*					25.4	19.9	19.0	9.1	39.1	16.7	1.3	4.0	3.1	3.4	3.8	11.1	11.1	12.2	44.4	8.1	14.2	12.7	(0.1)	(1.3)
361 Degrees	1361 HK	1.01	269	0.2	4.4	4.6	3.8	(3.3)	18.8	8.6	0.5	10.7	9.8	0.3	0.3	(1.6)	(1.5)	0.0	40.3	7.7	7.2	6.8	(11.4)	(21.3)
Anta Sports Prod	2020 HK	71.25	24,840	91.2	32.7	30.5	22.1	7.3	38.2	21.9	1.4	0.9	1.1	8.7	7.1	17.1	17.1	0.0	55.0	15.8	29.8	25.0	5.6	11.0
Li Ning Co Ltd	2331 HK	25.10	8,011	60.8	37.0	36.1	26.6	2.5	35.6	19.5	1.8	0.4	0.8	7.4	6.7	21.8	21.7	0.0	49.1	10.8	23.2	20.0	(3.1)	15.7
Pou Sheng Intl	3813 HK	1.88	1,299	0.6	10.8	19.5	8.2	(44.5)	136.4	18.3	1.1	N/A	0.8	1.2	1.1	5.1	7.0	73.3	34.1	3.1	11.5	6.9	20.5	2.7
China Dongxiang	3818 HK	0.68	516	0.3	N/A	5.6	N/A	N/A	N/A	N/A	N/A	6.6	N/A	0.3	N/A	N/A	N/A	0.0	N/A	N/A	N/A	6.8	4.6	(9.3)
Annil Co Ltd-A	002875 CH	13.43	250	5.6	42.0	22.9	34.4	83.4	(33.6)	15.3	1.5	1.2	N/A	2.0	N/A	28.7	N/A	0.0	52.6	3.2	(0.6)	10.7	5.6	(6.7)
Guirenniao Co-A	603555 CH	1.85	164	3.6	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	4.0	N/A	(4.7)	N/A	495.7	35.5	(64.4)	(129.4)	N/A	(22.3)	(52.1)
International peers																								
Adjusted sector avg*					43.9	70.2	38.2	(36.4)	96.6	12.0	12.59	#DIV/0!	0.5	10.86	10.39	20.4	31.8	13.9	49.7	8.3	17.6	13.6	14.4	24.4
Nike Inc -Cl B	NKE US	102.12	158,800	810.1	40.0	44.2	38.4	(9.3)	15.0	9.3	4.8	0.9	0.9	17.6	19.8	29.6	33.2	0.0	44.7	10.3	48.0	41.4	12.3	21.6
Under Armour-A	UAA US	10.51	4,502	76.7	52.6	N/A	93.0	N/A	N/A	11.9	N/A	N/A	0.0	3.1	3.0	10.0	(288.7)	23.8	46.9	1.7	(28.9)	(15.1)	16.6	(7.6)
Lululemon Ath	LULU US	323.25	42,085	517.8	65.3	73.6	52.4	(11.3)	40.5	14.3	5.2	N/A	0.0	21.6	17.5	34.0	44.4	0.0	55.9	16.2	38.0	27.2	31.6	66.8
Adidas Ag	ADS GR	240.70	54,839	243.6	24.1	78.4	27.6	(69.3)	184.1	2.3	33.8	N/A	1.1	7.0	6.6	13.2	27.1	26.6	52.0	8.4	20.2	8.7	16.6	21.0
Puma Se	PUM GR	65.84	11,289	29.2	37.4	84.6	34.3	(55.8)	146.8	12.8	6.6	N/A	0.3	5.1	5.0	15.1	22.5	19.2	48.8	4.8	10.8	6.0	12.1	20.4

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

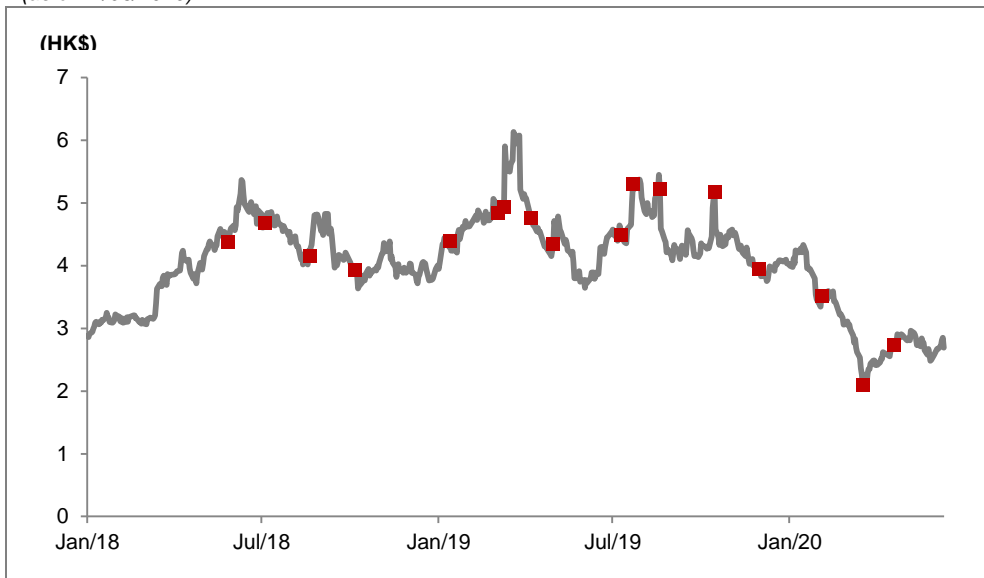
Source: Bloomberg, OP Research

Our recent reports

Date	Company / Sector	Stock Code	Title	Rating	Analyst
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
05/05/2020	HKTV	1137	HK based ecommerce on the rise	BUY	Kevin Tam/Megan Jin
23/04/2020	Edvantage Group	382	License fee saving may come earlier	BUY	Megan Jin/Dallas Cai
22/04/2020	361 Degrees Intl	1361	1Q20 retail sales in line	BUY	Megan Jin
21/04/2020	Xtep Intl	1368	1Q20 sales performance better than feared	BUY	Megan Jin/Dallas Cai
20/04/2020	Li-Ning	2331	1Q20 delivered satisfactory retail sales	BUY	Megan Jin/Dallas Cai
16/04/2020	Anta Sports	2020	Robust online FILA sales to drive 1Q20 sales beat	BUY	Dallas Cai/Megan Jin
15/04/2020	China Youzan	8083	FY19 GMV saw growth acceleration	BUY	Dallas Cai
02/04/2020	Greentown Services	2869	FY19 results largely in line	HOLD	Dallas Cai
31/03/2020	TCL Electronics	1070	FY19 results up to expectations	BUY	Dallas Cai
30/03/2020	Li-Ning	2331	A head start in FY20E with resilient operation	BUY	Dallas Cai/Megan Jin
27/03/2020	CH Display OPT	334	Lower order visibility ahead in FY20E	HOLD	Dallas Cai
27/03/2020	ChinaSoft Int'l	354	Cloud business ready to accelerate in FY20E	BUY	Dallas Cai
25/03/2020	Anta Sports	2020	FY20E strive for positive growth	BUY	Dallas Cai/Megan Jin
25/03/2020	China Overseas PPT	2669	FY19 results up to expectations	HOLD	Dallas Cai
23/03/2020	CG Services	6098	FY19 saw solid set of results	BUY	Dallas Cai
20/03/2020	Kingdee Int'l	268	Ambitious cloud target to weigh on FY20E earnings	HOLD	Dallas Cai
20/03/2020	Xtep Intl	1368	FY19 results in line with expectations	BUY	Dallas Cai/Megan Jin
19/03/2020	A-Living	3319	Unfolding a new 3-year plan	BUY	Dallas Cai
19/03/2020	Ausnutria Dairy	1717	Robust growth momentum to keep up in FY20E	BUY	Dallas Cai/Megan Jin

Historical recommendations and target price: Xtep (1368 HK)

(as of 11/06/2020)



Date	Rating	TP (HK\$)	Close (HK\$)	Date	Rating	TP (HK\$)	Close (HK\$)
1 09 Apr 2019	BUY	5.70	5.11	6. 18 Oct 2019	BUY	6.50	5.31
2 03 May 2019	BUY	5.70	4.67	7. 03 Dec 2019	BUY	5.90	4.04
3 15 Jul 2019	BUY	5.60	4.74	8. 05 Feb 2020	BUY	5.34	3.60
4 24 Jul 2019	BUY	6.40	5.59	9. 20 Mar 2020	BUY	3.60	2.14
5 21 Aug 2019	BUY	6.50	5.52	10. 21 Apr 2020	BUY	3.60	2.73

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