

Xtep Intl (1368 HK)

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Company Update

BUY
UNCHANGED

Close price: HK\$2.42

Target Price: HK\$3.17 (+31%)

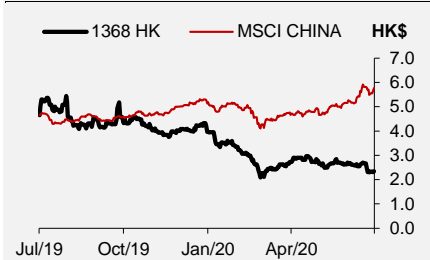
Prior TP: HK\$3.20

Key Data

HKEx code	1368 HK
12 Months High (HK\$)	5.99
12 Month Low (HK\$)	2.04
3M Avg Dail Vol. (mn)	6.54
Issue Share (mn)	2,519.44
Market Cap (HK\$mn)	6,097.05
Fiscal Year	31/12/2019
Major shareholder (s)	Ding Shuibo (54.48%)

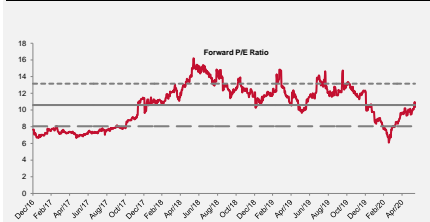
Source: Company data, Bloomberg, OP Research
 Closing price are as of 22/07/2020

Price Chart



	1mth	3mth	6mth
Absolute %	-10.4	-12.9	-38.7
Rel. MSCI CHINA %	-22.3	-35.6	-53.1

PE



Company Profile

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

Uncertainties on new brands remain but worst is seen

- 2Q20 Xtep core brand retail sales recovered to LSD yoy decrease, a satisfying recovery from 20-25% decline in 1Q20, up to expectations.
- 1H20E profit warning of 45%-55% net earnings decrease indicates larger-than-expected new brands loss.
- Maintain BUY with TP trimmed to HK\$3.17 on same 12x FY21E P/E. Though uncertainties on new brands remain, we believe the worst is seen and valuation is attractive.

2Q20 core brand retail sales recovered at the same pace with Anta. Xtep core brand retail sales recorded better than expected low-single-digit decline yoy in 2Q20, a satisfying recovery from 20-25% decline in 1Q20 and at the same pace with Anta. This demonstrates resilient brand competency amid discount pressure from top players. **Discount level maintained 30-35% off, same as last quarter**, worse than peers but indicates decent volume recovery. **Channel inventory improved to 5-5.5x** from 5.5x in 1Q20, targeted to 4x by year-end.

1H20E profit warning implies worse-than-expected new brands loss. The Company also issued 1H20E profit warning of 45%-55% attributable net earnings decline in which Xtep Brand would incur 25%-35% decrease, implying **larger-than-expected** ~RMB90mn loss from new brands in 1H20E. **K-Swiss is severely impacted** due to above 75% exposure to US&EU, and difficulties in trimming fixed distribution expenses. Its restructuring plan is also disrupted. **Palladium is also hit** with 40% revenue from US&EU. **Saucony JV in mainland China develops rapidly** with 15 stores opened in ~2 months in front tier cities. Merrell stores are expected to open during winter as planned.

We tweaked our FY20E/FY21E net earnings by -2.9%/-0.6% to assume higher new brands loss from RMB104 mn/RMB57 mn to RMB157 mn/RMB108 mn. We also tuned up Xtep core brand rev by 5%/3% for solid brand resilience.

Uncertainties remain but worst is seen. Looking ahead, though Xtep core brand still faces bumpy consumption recovery, we believe this 3rd largest domestic sports brand will ride on the speeding China's consumer activities resumption, esp. given proactive efforts in launching innovative campaigns on online channels. As for new brands, the pandemic testified how worst they will drag on earnings given barely any revenue during the period. Despite the uncertainties from overseas pandemic, we think the outlook Xtep's multi-brand strategy will gradually tune up from the current worst time. The recent trigger would be operation surprises of Saucony brand that demonstrates Xtep's direct operation capabilities. **Maintain Buy with TP trimmed to HK\$3.17 on 16x/12x FY20E/21E P/E, at 46%/54% discount to Anta/Li-Ning.**

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	8,216.3	9,744.2	11,074.0
Growth (%)	24.8	28.2	0.4	18.6	13.6
Adjusted net profit	656.5	727.7	434.0	579.6	780.7
Growth (%)	60.9	10.8	(40.4)	33.6	34.7
Adj. diluted EPS (HK\$)	0.324	0.317	0.198	0.264	0.356
EPS growth (%)	9.0	(2.4)	(37.6)	33.6	34.7
Change to previous EPS (%)			(2.9)	(0.6)	
Consensus EPS (HK\$)			0.230	0.325	
ROE (%)	12.4	11.9	6.2	8.1	10.5
P/E (x)	7.5	7.6	12.2	9.2	6.8
P/B (x)	0.8	0.8	0.8	0.7	0.7
Yield (%)	8.3	8.3	4.9	6.5	8.8
DPS (HK\$)	0.200	0.200	0.119	0.158	0.213

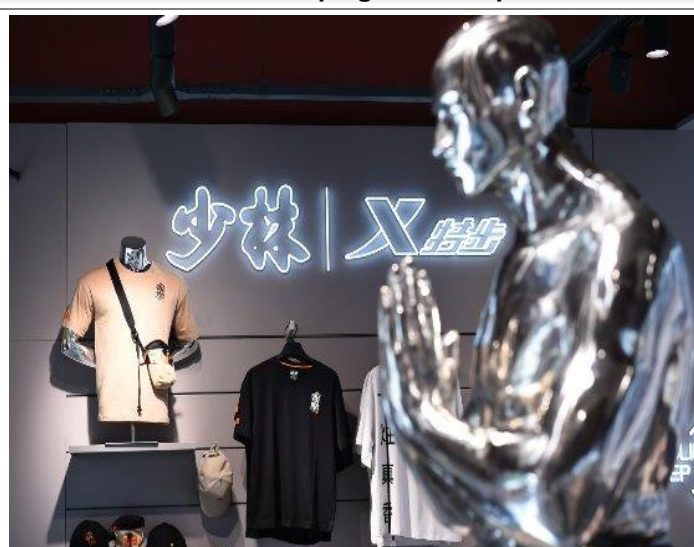
Source: Bloomberg, OP Research

Exhibit 2: Earnings Revision

(RMB mn)	FY20E			FY21E			OP Comments
	New	Old	% Chg	New	Old	% Chg	
Revenue	8,216	8,094	1.5	9,744	9,726	0.2	Nudge up Xtep core brand revenue on more resilient than expected brand competency
Gross profit	3,330	3,293	1.1	3,910	3,901	0.2	
Gross margin	40.5%	40.7%	(0.1)	40.1%	40.1%	0.0	Nudge down on stepped-up efforts in inventory clearance through outlets and online promotions
Opex	(2,703)	(2,647)	2.1	(3,079)	(3,065)	0.5	
EBIT	740	758	(2.4)	943	948	(0.5)	
Net Profit	434	447	(2.9)	580	583	(0.6)	Factor in worse than expected new brand loss, we now expect total RMB157mn/RMB108mn new brand loss versus previous -RMB104mn/RMB57mn
Diluted EPS (HK\$)	0.198	0.204	(2.9)	0.264	0.266	(0.6)	

Source: OP Research

Exhibit 4: Innovative campaigns for Xtep core brand



Launched Shaolin Temple crossover in Jun. 2020



Xtep launched online fashion show themed Shaolin Temple series in Jun. 2020



Source: Company, OP Research

Exhibit 3: 1H20E results preview

(RMB mn)	1H19	2H19	1H20E	2H20E	1H20E yoy%
Revenue	3,357	4,826	3,287	4,930	-2.1%
COGS	(1,860)	(2,773)	(1,946)	(2,940)	4.6%
Gross profit	1,497	2,053	1,341	1,989	-10.4%
Other income & gains	138	170	56	56	-59.4%
Selling exp	(637)	(1,082)	(723)	(1,040)	13.5%
Admin exp	(200)	(510)	(214)	(530)	6.6%
R&D	(81)	(115)	(82)	(113)	1.9%
Operating profit (EBIT)	717	517	378	362	-47.3%
Provisions or other items	0	0	0	0	n.a.
Interest income	27	2	15	15	-46.1%
Finance costs	(62)	(78)	(78)	(78)	0
Profit after financing costs	682	441	315	298	-53.8%
Associated cos	(1)	(1)	0	0	n.a.
Jointly controlled cos	0	0	0	0	n.a.
Pre-tax profit	681	440	315	298	-53.8%
Tax	(218)	(172)	(91)	(86)	-58.2%
Minority interests	0	(4.03)	(0.65)	(1)	-374.3%
Net profit	463	265	223	211	-51.9%
YoY%					
Revenue	23%	32%	-2%	2%	n.a.
Gross profit	25%	26%	-10%	-3%	n.a.
Net profit	23%	-6%	-52%	-20%	n.a.
Key ratios					in ppts
GPM	44.6%	42.5%	40.8%	40.4%	(3.80)
Selling exp	19.0%	22.4%	22.0%	21.1%	3.03
Admin exp	6.0%	10.6%	6.5%	10.8%	0.53
EIT	32.0%	39.0%	29.0%	29.0%	(3.04)
Net margin	13.8%	5.5%	6.8%	4.3%	(7.01)

Source: Company, OP Research

Financial Summary

Year to Dec	FY18	FY19	FY20E	FY21E	FY22E	Year to Dec	FY18	FY19	FY20E	FY21E	FY22E
Income Statement (RMB mn)						Ratios					
Xtep core brands	6,383	7,707	7,416	8,769	9,881	Gross margin (%)	44.3	43.4	40.5	40.1	40.3
Acquired brands	0	476	800	975	1,193	Operating margin (%)	16.4	15.1	9.0	9.7	11.1
						Net margin (%)	10.3	8.9	5.3	5.9	7.1
Turnover	6,383	8,183	8,216	9,744	11,074	Selling & dist'n exp/Sales (%)	21.3	21.0	21.5	21.0	20.5
YoY%	24.8	28.2	0.4	18.6	13.6	Admin exp/Sales (%)	7.1	8.7	9.1	8.4	7.6
COGS	(3,555)	(4,632)	(4,886)	(5,834)	(6,612)	Salaries/Sales (%)	11.5	10.9	11.5	10.0	9.1
Gross profit	2,828	3,550	3,330	3,910	4,462	A&P/Sales (%)	15.2	14.4	14.4	14.5	15.0
Gross margin	44.3%	43.4%	40.5%	40.1%	40.3%	R&D/Sales (%)	2.6	2.4	2.4	2.2	2.1
Other income	196	308	112	112	112	Payout ratio (%)	59.5	60.0	60.0	60.0	60.0
Selling & distribution	(1,357)	(1,718)	(1,763)	(2,046)	(2,274)	Effective tax (%)	31.4	34.7	29.0	29.0	29.0
Admin	(456)	(711)	(744)	(818)	(839)	Total debt/equity (%)	36.5	35.2	34.6	33.3	31.8
						Net	Net	Net	Net	Net	Net
R&D	(166)	(195)	(195)	(215)	(236)	Net debt/equity (%)	cash	cash	cash	cash	cash
Other opex	0	0	0	0	0	Current ratio (x)	2.5	2.5	2.5	2.4	2.3
Total opex	(1,980)	(2,625)	(2,703)	(3,079)	(3,350)	Quick ratio (x)	2.2	2.2	2.2	2.1	2.0
Operating profit (EBIT)	1,044	1,234	740	943	1,224	Inventory T/O (days)	86	82	82	82	82
Operating margin	16.4%	15.1%	9.0%	9.7%	11.1%	AR T/O (days)	121	130	150	115	115
Provisions	0	0	0	0	0	AP T/O (days)	90	112	112	112	112
Interest Income	72	29	29	31	34	Cash conversion cycle (days)	117	100	121	86	86
Finance costs	(141)	(140)	(156)	(156)	(156)	Asset turnover (x)	0.7	0.8	0.7	0.8	0.8
Profit after financing costs	976	1,123	613	819	1,103	Financial leverage (x)	1.7	1.8	1.8	1.8	1.9
Associated companies & JVs	0	(2)	0	0	0	EBIT margin (%)	16.4	15.1	9.0	9.7	11.1
Pre-tax profit	976	1,121	613	819	1,103	Interest burden (x)	0.9	0.9	0.8	0.9	0.9
Tax	(306)	(390)	(178)	(237)	(320)	Tax burden (x)	0.7	0.6	0.7	0.7	0.7
Minority interests	(13)	(4)	(1)	(2)	(2)	Return on equity (%)	12.4	11.9	6.2	8.1	10.5
Profit from discontinued operations	0	0	0	0	0	ROIC (%)	26.2	20.4	10.2	13.4	17.9
Net profit	657	728	434	580	781						
YoY%	61	11	(40)	34	35	Year to Dec	FY18	FY19	FY20E	FY21E	FY22E
Adjusted net profit*	577	695	434	580	781	Balance Sheet (RMB mn)					
YoY%	9	20	(38)	34	35	Fixed assets	677	696	719	752	797
Adjusted net margin	9.0%	8.5%	5.3%	5.9%	7.1%	Intangible assets & goodwill	8	1,644	1,642	1,640	1,638
EBITDA	1,126	1,322	816	1,028	1,313	Associated companies & JVs	0	39	39	39	39
EBITDA margin	17.6%	16.2%	9.9%	10.5%	11.9%	Long-term investments	339	520	520	520	520
EPS (RMB)	0.295	0.288	0.237	0.309	0.364	Other non-current assets	114	158	151	144	135
YoY%	9	(2)	(38)	34	35	Non-current assets	1,139	3,057	3,071	3,095	3,129
DPS (HK\$)	0.200	0.200	0.119	0.158	0.213	Inventories	836	1,046	1,046	1,104	1,318
						AR	2,115	2,910	3,377	3,070	3,489
Year to Dec	FY18	FY19	FY20E	FY21E	FY22E	Prepayments & deposits	727	818	821	974	1,107
Cash Flow (RMB mn)						Other current assets	1,186	1,522	1,522	1,522	1,522
EBITDA	1,126	1,322	816	1,028	1,313	Cash	3,196	2,970	2,742	3,618	3,662
Chg in working cap	(513)	36	(388)	570	(368)	Current assets	8,060	9,266	9,508	10,287	11,097
Others	(94)	(145)	0	0	0	AP	879	1,420	1,497	1,788	2,026
Operating cash	518	1,212	428	1,598	944	Tax	54	115	178	237	320
Interest received	(55)	(100)	29	31	34	Accruals & other payables	861	981	985	1,168	1,327
Tax	(309)	(334)	(115)	(178)	(237)	Bank loans & leases	1,483	1,155	1,155	1,155	1,155
Net cash from operations	154	778	342	1,451	741	CB & othe debts	0	0	0	0	0
Capex	(72)	(97)	(97)	(115)	(131)	Other current liabilities	1	1	1	1	1
Investments	(81)	(1,726)	7	8	9	Current liabilities	3,278	3,671	3,816	4,349	4,829
Change in short-term bank deposits	(234)	(332)	0	0	0	Bank loans & leases	461	1,376	1,376	1,376	1,376
Sales of assets	83	97	0	0	0	CB & othe debts	0	0	0	0	0
Interests received	0	0	0	0	0	Deferred tax & others	129	315	315	315	315
Others	24	14	0	0	0	MI	5	70	71	73	75
Investing cash	(281)	(2,045)	(91)	(108)	(122)	Non-current liabilities	595	1,761	1,762	1,764	1,766
FCF	(127)	(1,267)	251	1,344	619	Total net assets	5,326	6,890	7,001	7,269	7,631
Issue of shares	59	1,190	0	0	0	Shareholder's equity	5,326	6,890	7,001	7,269	7,631
Buy-back	(89)	(3)	0	0	0	Share capital	20	22	22	22	22
Minority interests	(4)	(73)	0	0	0	Reserves	5,306	6,868	6,979	7,247	7,609
Dividends paid	(459)	(436)	(323)	(312)	(419)	BVPS (HK\$)	2.97	3.17	3.22	3.34	3.51
Net change in bank loans	(10)	386	0	0	0	Total debts	1,944	2,424	2,424	2,424	2,424
Others	(7)	(25)	(156)	(156)	(156)	Net cash/(debts)	2,438	2,063	1,835	2,711	2,755
Financing cash	(511)	1,039	(479)	(468)	(575)						
Net change in cash	(637)	(227)	(228)	876	44						
Exchange rate or other Adj	1	1	0	0	0						
Opening cash	3,832	3,196	2,970	2,742	3,618						
Closing cash	3,196	2,970	2,742	3,618	3,662						
CFPS (HK\$)	0.087	0.354	0.156	0.661	0.338						

* 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)	PER		PER		3-Yr		Div yld		P/B		EV/		EV/		Gross	Net	ROE	Sh px	Sh px	
					Hist (x)	FY1 (x)	FY2 (x)	EPS FY1	EPS FY2	YoY%	YoY%	Cagr (%)	EPS	PEG (x)	Hist (%)	FY1 (%)	Hist (x)	P/B (x)	FY1 (x)	Hist	Cur Yr	Hist (%)	margin (%)	margin (%)
Xtep Intl	1368 HK	2.42	787	2.3	7.6	12.2	9.2	(37.6)	33.6	3.9	3.10	8.3	4.9	0.76	0.75	3.0	5.2	Net cash	43.4	0.3	11.9	6.2	(10.4)	(13.6)
HSI		25,057.94			10.9	11.6	9.8	(5.4)	18.0	7.6	1.52	3.7	3.5	1.01	0.98						9.2	8.5	2.2	4.9
HSCEI		10,243.51			8.5	8.9	7.9	(3.8)	12.6	6.4	1.38	3.9	3.8	1.08	1.00						12.6	11.3	3.7	5.9
CSI300		4,714.45			18.0	15.6	13.4	15.2	16.7			1.8	2.0	2.1	2.0						11.8	12.6	14.9	22.8
Domestic peers																								
Adjusted sector avg*					24.0	20.6	18.1	(9.0)	35.5	18.5	1.1	3.8	3.3	3.4	3.1	9.7	8.8	12.2	46.7	10.1	14.2	12.6	2.1	(5.7)
361 Degrees	1361 HK	1.17	312	0.2	5.1	5.4	4.5	(5.7)	19.3	7.8	0.7	9.2	8.5	0.3	0.3	(1.2)	(1.2)	0.0	40.3	7.7	7.2	6.5	17.0	2.2
Anta Sports Prod	2020 HK	71.60	24,968	81.8	32.6	31.9	22.2	2.1	43.6	22.3	1.4	0.9	1.1	8.7	7.2	17.0	18.3	0.0	55.0	15.8	29.8	24.7	(0.6)	12.6
Li Ning Co Ltd	2331 HK	24.30	7,757	47.2	35.5	34.8	25.8	1.9	34.7	19.7	1.8	0.7	0.8	7.1	6.5	20.9	20.9	0.0	49.1	10.8	23.2	19.9	(6.5)	2.1
Pou Sheng Intl	3813 HK	1.80	1,244	0.6	10.3	18.7	7.9	(45.2)	136.8	19.2	1.0	N/A	0.7	1.1	1.1	4.9	6.8	73.3	34.1	3.1	11.5	6.8	(1.6)	16.1
China Dongxiang	3818 HK	1.02	775	1.3	14.7	12.3	10.8	20.0	13.3	17.0	0.7	4.4	5.4	0.5	0.5	(0.6)	(0.6)	0.0	60.2	19.9	N/A	5.2	45.7	59.4
Annil Co Ltd-A	002875 CH	11.25	275	5.6	45.7	62.5	37.5	(26.9)	66.7	14.6	4.3	N/A	N/A	2.2	N/A	31.8	N/A	0.0	52.6	3.2	(0.6)	N/A	3.5	(21.8)
Guirenniao Co-A	603555 CH	1.77	159	1.6	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	3.8	N/A	(4.6)	N/A	495.7	35.5	(64.4)	(129.4)	N/A	0.6	(45.4)
International peers																								
Adjusted sector avg*					48.3	78.7	36.5	(26.3)	125.6	14.9	14.49	n.a.	0.5	11.54	10.58	20.5	32.5	24.4	49.4	7.6	24.2	14.7	3.7	15.9
Nike Inc -Cl B	NKE US	98.36	152,953	666.6	60.3	41.6	30.3	45.0	37.2	32.2	1.3	1.0	1.1	19.1	19.7	28.7	31.2	52.5	43.4	6.8	29.7	50.1	(1.2)	10.8
Under Armour-A	UAA US	10.50	4,505	82.8	52.5	N/A	97.2	N/A	N/A	12.4	N/A	N/A	0.0	3.1	3.0	10.0	769.7	23.8	46.9	1.7	(28.9)	(15.1)	10.4	9.5
Lululemon Ath	LULU US	325.39	42,368	593.4	65.7	75.6	51.8	(13.1)	45.9	15.4	4.9	N/A	0.0	23.1	18.1	34.5	46.2	0.0	55.9	16.2	36.1	25.9	6.8	53.4
Adidas Ag	ADS GR	246.00	56,782	173.0	24.6	86.9	28.2	(71.7)	207.8	2.0	42.8	N/A	1.1	7.2	6.8	13.5	27.0	26.6	52.0	8.4	20.2	8.2	3.9	18.1
Puma Se	PUM GR	67.74	11,767	22.0	38.5	110.7	35.5	(65.2)	211.6	12.3	9.0	N/A	0.3	5.2	5.2	15.6	25.6	19.2	48.8	4.8	10.8	4.6	(1.3)	25.1

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

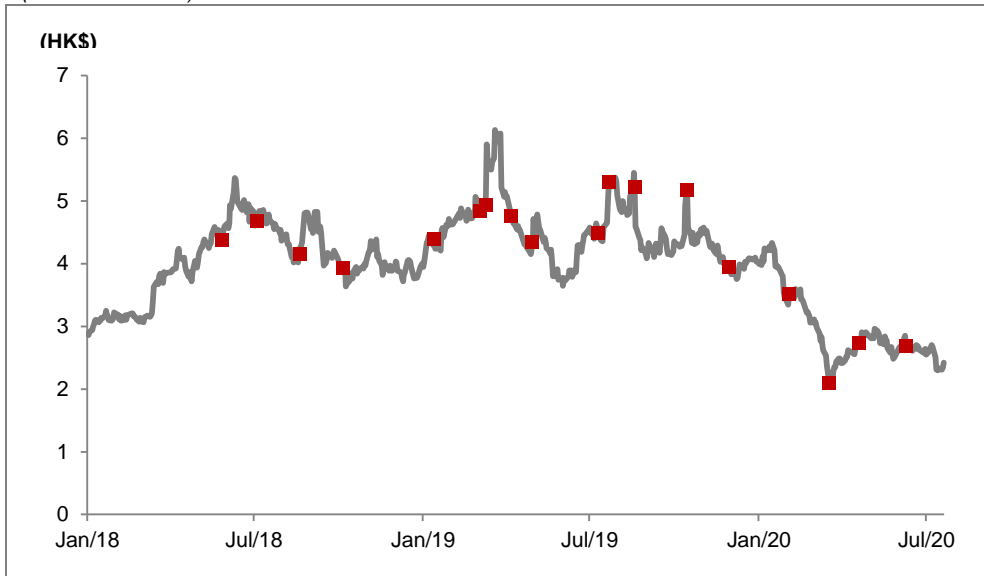
Source: Bloomberg, OP Research

Our recent reports

Date	Company / Sector	Stock Code	Title	Rating	Analyst
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	Ausuntria 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

Historical recommendations and target price: Xtep (1368 HK)

(as of 22/07/2020)



Date	Rating	TP (HK\$)	Close (HK\$)	Date	Rating	TP (HK\$)	Close (HK\$)
1 03 May 2019	BUY	5.70	4.67	6 03 Dec 2019	BUY	5.90	4.04
2 15 Jul 2019	BUY	5.60	4.74	7 05 Feb 2020	BUY	5.34	3.60
3 24 Jul 2019	BUY	6.40	5.59	8 20 Mar 2020	BUY	3.60	2.14
4 21 Aug 2019	BUY	6.50	5.52	9 21 Apr 2020	BUY	3.60	2.73
5 18 Oct 2019	BUY	6.50	5.31	10 11 Jun 2020	BUY	3.20	2.69

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