

# Xtep (1368 HK)

## Core brand's recovery to drive re-rating

Combining better sales trend and sector re-rating, we find Xtep's risk reward attractive and upgrade to BUY with TP raised to HK\$3.63, based on a 13x FY21E P/E (from 10x for industry re-rating). Note that sportswear leader's valuation have been re-rated from 25x 2 yrs forward P/E in Dec 2019 to 32x P/E in Nov 2020.

- **So far so good in 4Q20E.** We now become more optimistic on Xtep's core brand, as its retail sales growth accelerated to double digit in Sep 2020 and even better in Oct 2020, comparing to MSD in 3Q20. We believe performance from both offline and online channels are encouraging. While the offline were driven by recovery in foot traffic, the online sales were boosted by better growth at Tmall and expansion to more platforms (VIPS and PDD). We attributed the drivers to: 1) the earlier and colder winter, and 2) more active use of wechat store and mini-program in 4Q20E.
- **Cash flow is still the priority.** Together with better sales, we expect both channel inventory and Xtep's receivable days to improve healthily in 4Q20E, while the retail discounts may stay the same at 30% to 35% off.
- **First multi-brand store "X-STREET" performed well.** Xtep opened its first multi-brand store in Xiamen on 8 Nov 2020, which has a store size of 1,500 sq m and sells Xtep (including top series like the Jeremy Lin's), Palladium, Saucony and Merrell products. Nicolas Tse, as brand ambassador, also joined grand opening and ~RMB 5mn sales was generated in just one day.
- **Focusing more on Saucony than on Merrell.** Management maintained target to open 30-50 stores in FY20E but most of those shall be under Saucony. Performance of ~20 stores opened YTD are in-line with management's expectation. However, breakeven may not be achieved until FY22E, and we forecast RMB 36mn and 65mn losses in FY20E and FY21E.
- **K-Swiss turnaround may lengthen while Palladium will open more self-owned store.** Due to second wave of COVID-19 in US and Europe, we now believe the breakeven period is likely to be longer than 3.5 years for K&P. Also, Xtep plans to open more self-owned stores for Palladium in China as E-land is closing down more under-performing stores. For K&P, we are forecasting a 22% sales drop and US\$ 15mn (~RMB 100mn) losses in FY20E.
- **Upgrade to BUY and raised TP to HK\$ 3.63.** We lifted our FY20E/ 21E/ 22E EPS estimates by 1%/ 6%/ 2, to factor in faster core brand growth and better opex control. Given attractive valuation of 10x FY21E P/E, we upgrade the stock to BUY and new TP is based on 13x FY21E P/E (up from 10x).

### Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	6,383	8,183	8,309	9,399	10,366
YoY growth (%)	24.8	28.2	1.5	13.1	10.3
Net income (RMB mn)	657	728	454	622	780
EPS (RMB)	0.295	0.302	0.182	0.250	0.313
YoY growth (%)	60.6	2.3	(39.7)	37.2	25.4
Consensus EPS (RMB)	n/a	n/a	0.204	0.285	0.341
P/E (x)	8.7	8.6	14.3	10.4	8.3
P/B (x)	1.1	0.9	0.9	0.9	0.8
Yield (%)	6.9	6.8	4.2	5.8	7.2
ROE (%)	12.3	10.5	6.4	8.4	10.1
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIS estimates

**BUY (Up)**

Target Price **HK\$3.63**  
 (Previous TP **HK\$2.73**)  
 Up/Downside **+24.8%**  
 Current Price **HK\$2.91**

### China Sportswear Sector

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#### Stock Data

Mkt Cap (HK\$ mn)	7,374
Avg 3 mths t/o (HK\$ mn)	15.86
52w High/Low (HK\$)	4.58/2.04
Total Issued Shares (mn)	2,534.0

Source: Bloomberg

#### Shareholding Structure

Mr Ding Shui Po & Family	53.89%
Templeton Investments	2.62%
Employee incentive scheme	4.01%
Free Float	39.48%

Source: HKEx

#### Share Performance

	Absolute	Relative
1-mth	17.5%	7.8%
3-mth	25.5%	16.3%
6-mth	-3.0%	-10.6%
12-mth	-35.7%	-32.4%

Source: Bloomberg

#### 12-mth Price Performance



Source: Bloomberg

#### Auditor: Ernst & Young

#### Related Reports

1. Xtep (1368 HK, BUY) - Better retail trend drags by lower margins - 31 Aug 2020
2. Xtep (1368 HK, HOLD) - Recovery may take longer than expected - 14 Jul 2020
3. Xtep (1368 HK, BUY) - Solid cash position to yield attractive dividend - 19 Mar 2020

## Earnings revision

Figure 1: Earnings revision

RMB mn	New			Old			Diff (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	8,309	9,399	10,366	8,309	9,299	10,131	0.0%	1.1%	2.3%
Gross profit	3,321	3,870	4,315	3,331	3,777	4,158	-0.3%	2.5%	3.8%
EBIT	894	1,095	1,274	887	1,042	1,254	0.8%	5.2%	1.6%
Net profit att.	454	622	780	449	586	766	1.0%	6.2%	1.9%
Diluted EPS (RMB)	0.182	0.250	0.313	0.180	0.235	0.307	1.0%	6.2%	1.9%
Gross margin	40.0%	41.2%	41.6%	40.1%	40.6%	41.0%	-0.1ppt	0.6ppt	0.6ppt
EBIT margin	10.8%	11.7%	12.3%	10.7%	11.2%	12.4%	0.1ppt	0.5ppt	-0.1ppt
Net profit att. margin	5.5%	6.6%	7.5%	5.4%	6.3%	7.6%	0.1ppt	0.3ppt	0ppt

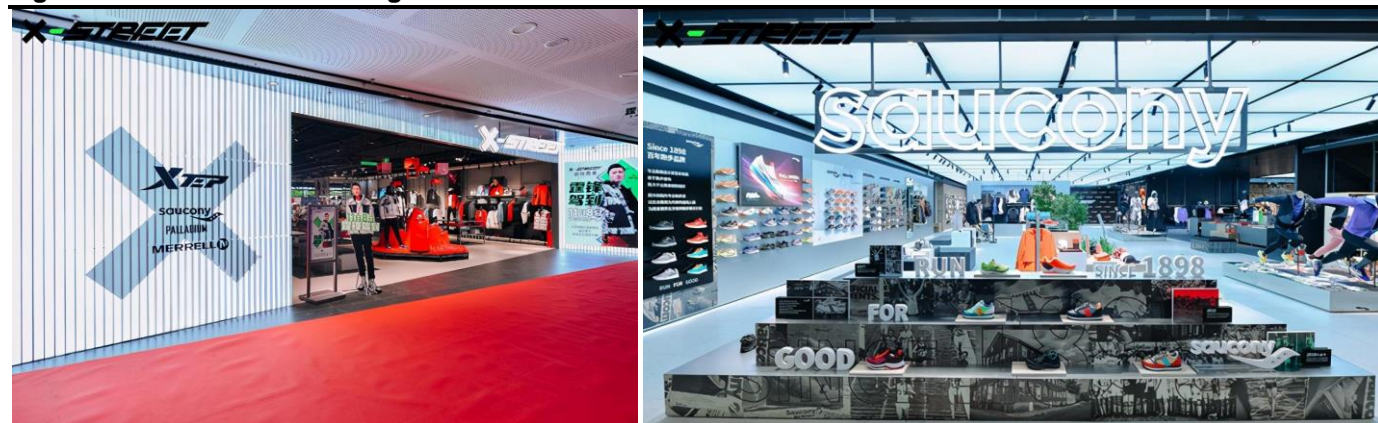
Source: Company data, CMBIS estimates

Figure 2: CMBIS estimates vs consensus

RMB mn	CMBIS			Consensus			Diff (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	8,309	9,399	10,366	8,055	9,275	10,357	3.2%	1.3%	0.1%
Gross profit	3,321	3,870	4,315	3,280	3,856	4,343	1.3%	0.4%	-0.6%
EBIT	894	1,095	1,274	839	1,109	1,306	6.5%	-1.2%	-2.5%
Net profit att.	454	622	780	483	685	822	-6.2%	-9.1%	-5.0%
Diluted EPS (RMB)	0.182	0.250	0.313	0.204	0.285	0.341	-10.7%	-12.3%	-8.2%
Gross margin	40.0%	41.2%	41.6%	40.7%	41.6%	41.9%	-0.7ppt	-0.4ppt	-0.3ppt
EBIT margin	10.8%	11.7%	12.3%	10.4%	12.0%	12.6%	0.3ppt	-0.3ppt	-0.3ppt
Net profit att. margin	5.5%	6.6%	7.5%	6.0%	7.4%	7.9%	-0.5ppt	-0.8ppt	-0.4ppt

Source: Company data, CMBIS estimates

Figure 3: X-STREET store image



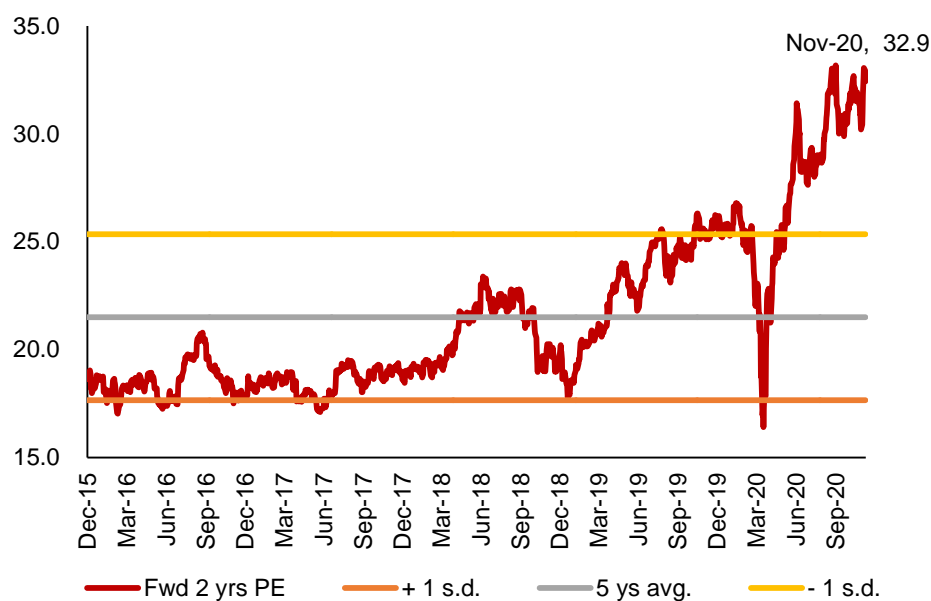
Source: Company, CMBIS estimates

## Valuation

Figure 4: Peers valuation table

			12m TP	Price	Up/ Down-	Mkt. Cap	Year	P/E (x)		P/B (x)		ROE (%)	3yrs PEG (x)	Yield (%)
Company	Ticker	Rating	(LC)	(LC)	side	(HK\$mn)	End	FY1E	FY2E	FY1E	FY2E	FY1E	FY1E	FY1E
H shares Sportswear														
Xtep Intl	1368 HK	BUY	3.63	2.91	24.8%	7,374	Dec-19	14.3	10.4	0.9	0.8	7.4	11.6	4.2
Anta Sports	2020 HK	BUY	101.84	96.65	5.4%	261,277	Dec-19	42.5	28.4	9.4	7.6	23.0	1.8	0.8
Li Ning	2331 HK	BUY	36.52	40.15	-9.0%	99,923	Dec-19	53.0	38.8	10.1	8.3	19.8	2.3	0.5
361 Degrees	1361 HK	NR	n/a	0.94	n/a	1,944	Dec-19	4.1	3.8	0.3	0.2	5.8	0.8	8.6
Topsports	6110 HK	NR	n/a	11.00	n/a	68,213	Feb-20	23.9	18.9	5.4	4.7	36.9	1.7	5.3
Pou Sheng	3813 HK	NR	n/a	1.87	n/a	10,017	Dec-19	20.2	7.7	1.1	0.9	5.6	1.0	0.6
China DX	3818 HK	NR	n/a	0.85	n/a	5,003	Mar-20	9.7	8.5	0.4	0.4	n/a	0.6	6.9
Avg.								24.0	16.7	3.9	3.3	16.4	2.8	3.8
Med.								20.2	10.4	1.1	0.9	13.6	1.7	4.2
International Sportswear														
Nike Inc	NKE US	NR	n/a	127.71	n/a	1,554,662	May-20	44.1	34.6	20.7	18.0	29.2	1.2	0.8
Adidas	ADS GY	NR	n/a	282.60	n/a	516,458	Dec-19	125.7	32.8	7.8	6.9	6.6	35.6	0.7
Puma	PUM GY	NR	n/a	80.98	n/a	111,373	Dec-19	158.8	41.6	6.2	5.6	3.8	9.7	0.2
Under Armour	UAA US	NR	n/a	15.06	n/a	49,643	Dec-19	n/a	119.5	4.5	4.3	(41.3)	0.0	0.0
Lululemon	LULU US	NR	n/a	322.19	n/a	325,582	Feb-20	76.5	50.3	17.8	15.0	30.8	4.8	0.0
Skechers	SKX US	NR	n/a	32.76	n/a	39,924	Dec-19	46.1	14.8	1.9	1.7	4.6	9.0	0.0
Vf Corp	VFC US	NR	n/a	77.53	n/a	234,476	Mar-21	58.5	26.7	11.4	11.0	(1.3)	2.4	2.5
Columbia	COLM US	NR	n/a	81.39	n/a	41,789	Dec-19	60.8	23.1	3.0	2.7	7.3	(17.5)	0.3
Wolverine	WWW US	NR	n/a	28.83	n/a	18,348	Dec-19	31.9	13.9	2.9	2.6	4.2	2.1	1.2
Mizuno Corp	8022 JP	NR	n/a	1905.00	n/a	3,721	Mar-20	n/a	14.6	0.5	0.5	1.9	0.0	2.6
Asics Corp	7936 JP	NR	n/a	1775.00	n/a	24,770	Dec-19	n/a	42.6	2.4	2.4	(2.2)	0.0	1.4
Avg.								75.3	37.7	7.2	6.4	4.0	4.3	0.9
Med.								59.7	32.8	4.5	4.3	4.2	2.1	0.7

Source: Bloomberg, CMBIS estimates

**Figure 5: Sportswear leaders' forward 2 years P/E band**

Source: Bloomberg, CMBIS estimates, leaders include Anta, Li Ning, Nike, Adidas and Lulu Lemon

**Figure 6: Xtep's forward 2 years P/E band**

Source: Bloomberg, CMBIS estimates

## Assumptions

Figure 7: Xtep's key assumptions

Major assumptions	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Sales by segment (RMB mn)</b>					
Shoes	3,925	4,653	4,856	5,609	6,238
Apparels	2,327	3,344	3,278	3,605	3,930
Accessories	131	185	176	185	198
Total	6,383	8,183	8,309	9,399	10,366
<b>Sales by segment growth (%)</b>					
Shoes	20.5%	18.6%	4.4%	15.5%	11.2%
Apparels	32.2%	43.7%	-2.0%	10.0%	9.0%
Accessories	36.6%	41.0%	-5.0%	5.0%	7.0%
Total	24.8%	28.2%	1.5%	13.1%	10.3%
<b>Sales by segment (RMB mn)</b>					
Mass market	6,383	7,707	7,380	8,183	8,917
Athleisure	0	466	881	999	1,148
Professional sports	0	10	48	217	301
Total	6,383	8,183	8,309	9,399	10,366
<b>Sales by segment growth (YoY)</b>					
Mass market	24.8%	20.7%	-4.2%	10.9%	9.0%
Athleisure	n/a	n/a	89.0%	13.5%	14.9%
Professional sports	n/a	n/a	379.0%	349.2%	38.4%
Total	24.8%	28.2%	1.5%	13.1%	10.3%
<b>Sales network</b>					
Xtep	5,580	5,279	5,015	5,065	5,167
Xtep kids	450	850	833	891	980
Oversea stores	200	250	250	250	300
Total	6,230	6,379	6,098	6,207	6,447
GP margins	44.3%	43.4%	40.0%	41.2%	41.6%
<b>Opex breakdown</b>					
A&P / sales	15.2%	14.4%	12.1%	12.0%	11.6%
Staff costs/ sales	11.6%	11.0%	12.7%	12.8%	13.6%
R&D / sales	2.6%	2.4%	2.8%	2.6%	2.4%
D&A / sales	1.4%	1.7%	2.2%	2.0%	1.9%
Provisions (write backs) / sales	-0.8%	-0.9%	-0.3%	0.0%	0.0%
Rental / sales	0.3%	0.1%	0.7%	0.9%	1.1%
Selling & distribution costs / sales	21.3%	21.0%	20.0%	20.2%	20.3%
Admin expenses / sales	9.8%	11.1%	12.8%	11.6%	11.2%
Total	31.0%	32.1%	32.7%	31.8%	31.5%
<b>OP margins</b>	<b>16.4%</b>	<b>15.1%</b>	<b>10.8%</b>	<b>11.7%</b>	<b>12.3%</b>
Effective tax rate	31.4%	34.8%	38.0%	33.0%	32.0%
<b>Net profit att. margins</b>	<b>10.3%</b>	<b>8.9%</b>	<b>5.5%</b>	<b>6.6%</b>	<b>7.5%</b>
<b>Net profit att. growth (%)</b>	<b>60.9%</b>	<b>10.8%</b>	<b>-37.7%</b>	<b>37.2%</b>	<b>25.4%</b>

Source: Company data, CMBIS estimates

## Financial Summary

### Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Revenue</b>	<b>6,383</b>	<b>8,183</b>	<b>8,309</b>	<b>9,399</b>	<b>10,366</b>
Footwear	3,925	4,653	4,856	5,609	6,238
Apparel	2,327	3,344	3,278	3,605	3,930
Accessories	131	185	176	185	198
<b>Cost of goods sold</b>	<b>(3,555)</b>	<b>(4,632)</b>	<b>(4,989)</b>	<b>(5,529)</b>	<b>(6,051)</b>
<b>Gross profit</b>	<b>2,828</b>	<b>3,550</b>	<b>3,321</b>	<b>3,870</b>	<b>4,315</b>
<b>Other income</b>	<b>196</b>	<b>308</b>	<b>291</b>	<b>216</b>	<b>223</b>
<b>Operating expenses</b>	<b>(1,980)</b>	<b>(2,625)</b>	<b>(2,718)</b>	<b>(2,991)</b>	<b>(3,264)</b>
S & D costs (ex-staff, D&A)	(1,357)	(1,718)	(1,658)	(1,899)	(2,102)
Admin exp. (ex-staff, D&A)	(456)	(711)	(827)	(847)	(913)
R & D	(166)	(195)	(233)	(244)	(249)
Other operating expenses	-	-	-	-	-
<b>EBIT</b>	<b>1,044</b>	<b>1,234</b>	<b>894</b>	<b>1,095</b>	<b>1,274</b>
Finance costs, net	(68)	(111)	(115)	(95)	(99)
JVs & associates	-	(2)	(36)	(65)	(15)
Exceptional	-	-	-	-	-
<b>Pre-tax profit</b>	<b>976</b>	<b>1,121</b>	<b>742</b>	<b>936</b>	<b>1,160</b>
Income tax	(306)	(390)	(282)	(309)	(371)
Less: Minority interests	13	4	7	5	8
<b>Net profit</b>	<b>657</b>	<b>728</b>	<b>454</b>	<b>622</b>	<b>780</b>

### Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>EBIT</b>	<b>1,044</b>	<b>1,234</b>	<b>894</b>	<b>1,095</b>	<b>1,274</b>
D & A	60	185	317	330	341
Change in working capital	(513)	36	286	(285)	(249)
Income tax paid	(309)	(334)	(282)	(309)	(371)
Others	(128)	(343)	(115)	(95)	(99)
<b>Net cash from operating</b>	<b>154</b>	<b>778</b>	<b>1,099</b>	<b>737</b>	<b>896</b>
Capex & investments	(72)	(97)	(208)	(141)	(155)
Associated companies	(1)	(35)	-	-	-
Interest received	-	-	-	-	-
Others	(208)	(1,913)	-	-	-
<b>Net cash from investing</b>	<b>(281)</b>	<b>(2,045)</b>	<b>(208)</b>	<b>(141)</b>	<b>(155)</b>
Equity raised	(31)	1,187	-	-	-
Net change in bank loans	(10)	386	-	-	-
Dividend paid	(459)	(436)	(334)	(336)	(433)
Others	(11)	(98)	-	-	-
<b>Net cash from financing</b>	<b>(511)</b>	<b>1,039</b>	<b>(334)</b>	<b>(336)</b>	<b>(433)</b>
<b>Net change in cash</b>	<b>(637)</b>	<b>(227)</b>	<b>558</b>	<b>261</b>	<b>308</b>
Beginning cash balance	3,832	3,196	2,970	3,527	3,788
Exchange difference	1	1	-	-	-
<b>Cash at the end of the year</b>	<b>3,196</b>	<b>2,970</b>	<b>3,527</b>	<b>3,788</b>	<b>4,096</b>

### Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Non-current assets</b>	<b>1,139</b>	<b>3,057</b>	<b>2,911</b>	<b>2,657</b>	<b>2,456</b>
Fixed asset	641	662	791	843	898
Intangible assets & goodwill	105	1,738	1,499	1,258	1,017
Prepaid lease payments	279	104	104	104	104
Interest in joint ventures	114	197	161	96	81
Other non-current assets	-	356	356	356	356
<b>Current assets</b>	<b>8,060</b>	<b>9,266</b>	<b>9,774</b>	<b>10,628</b>	<b>11,471</b>
Cash and cash equivalents	3,196	2,970	3,527	3,788	4,096
Inventories	836	1,046	1,162	1,288	1,409
Trade and other receivables	2,115	2,910	2,732	3,090	3,408
Prepayments	727	818	830	939	1,036
Other current assets	1,186	1,522	1,522	1,522	1,522
<b>Current liabilities</b>	<b>3,278</b>	<b>3,671</b>	<b>3,907</b>	<b>4,215</b>	<b>4,502</b>
Bank loans	1,483	1,086	1,086	1,086	1,086
Trade payables	879	1,420	1,640	1,818	1,989
Accruals & other payables	861	981	996	1,126	1,242
Tax payables	54	115	115	115	115
Others	1	69	69	69	69
<b>Non-current liabilities</b>	<b>590</b>	<b>1,691</b>	<b>1,691</b>	<b>1,691</b>	<b>1,691</b>
Bank loans	461	1,269	1,269	1,269	1,269
Deferred income	-	-	-	-	-
Deferred tax	107	280	280	280	280
Others	22	142	142	142	142
<b>Minority Interest</b>	<b>-</b>	<b>-</b>	<b>7</b>	<b>11</b>	<b>19</b>
<b>Total net assets</b>	<b>5,331</b>	<b>6,960</b>	<b>7,080</b>	<b>7,366</b>	<b>7,714</b>
<b>Shareholders' equity</b>	<b>5,331</b>	<b>6,960</b>	<b>7,080</b>	<b>7,366</b>	<b>7,714</b>

### Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Sales mix (%)</b>					
Footwear	61.5	56.9	58.4	59.7	60.2
Apparel	36.5	40.9	39.4	38.4	37.9
Accessories	2.1	2.3	2.1	2.0	1.9
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
<b>P&amp;L ratios (%)</b>					
Gross margin	44.3	43.4	40.0	41.2	41.6
Operating margin	16.4	15.1	10.8	11.7	12.3
Pre-tax margin	15.3	13.7	8.8	10.0	11.2
Net margin	10.3	8.9	5.4	6.3	7.6
Effective tax rate	31.4	34.7	36.2	30.7	31.6
<b>Balance sheet ratios</b>					
Current ratio (x)	2.5	2.5	2.5	2.5	2.5
Quick ratio (x)	2.2	2.2	2.2	2.2	2.2
Cash ratio (x)	1.0	0.8	0.9	0.9	0.9
Inventory turnover days	86	82	85	85	85
Trade receivables days	121	130	120	120	120
Trade payables days	90	112	120	120	120
Total debt / total equity ratio (%)	36	34	33	32	31
Net debt / equity ratio (%)	Net cash	Net cash	Net cash	Net cash	Net cash
<b>Returns (%)</b>					
ROE	12.3	10.5	6.4	8.4	10.1
ROA	7.1	5.9	3.6	4.7	5.6
<b>Per share</b>					
EPS (RMB)	0.30	0.30	0.18	0.25	0.31
DPS (RMB)	0.18	0.18	0.11	0.15	0.19
BVPS (RMB)	2.40	2.79	2.84	2.96	3.10

Source: Company data, CMBIS estimates



# Disclosures & Disclaimers

## Analyst Certification

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