

Xtep (1368 HK)

Recovery may take longer than expected

The COVID-19 outbreak, to some extent, is a stress test for consumer brands. Unlike Anta and Li Ning, Xtep is suffering more as a second tier brand. We believe more time is needed for its recovery, hence cutting EPS by 13-27% in FY20-22E. Given lack of near-term catalysts, we downgrade to HOLD and cut TP to HK\$2.70, based on a 9x FY21E P/E (equal to 5 years avg. and rolled over from 10x FY20E).

- **We forecast net profit to fall by 48% in 1H20E.** Sales in 1H20E will grow by 6% YoY, but that was only because of the consolidation of K-Swiss & other new businesses (core brand sales to fall by 8% in 1H20E). We forecast NP to plummet by 48% YoY in 1H20E, due to: 1) softer-than-peers online sales, 2) lower GP margin led by higher rebates to promote distributor's de-stocking, 3) operating deleverage as most of the opex are fixed and 4) higher inventory or receivable provisions. We also believe 1H20E cash flow to be under pressure, as credit period with distributors was likely to be lengthened.
- **2H20E outlook hindered by soft retail sales and excessive inventory.** According to our research, Xtep's retail sales could fall by 5% in 2Q20E, vs positive growth by all other peers (CMBIS est. of 16%/ 6%/ 1%/ 0% for FILA/ Anta/ Li Ning/ Pou Sheng). We are not surprised because it is much harder for second tier brand like Xtep to clear inventory effectively (neither offline and online), at the time that first tier brands like Adidas/ Nike/ Li Ning/ Anta are giving out more discounts. Xtep's channel inventory, in our view, would still be high at 5-5.5 months by 2Q20E, only at the same level as 1Q20E. We therefore expect inventory pressure to sustain into 3Q20E and will hinder future trade fair orders growth (4Q20E and perhaps onwards). All in All, we now expect 2H20E to remain stagnant with sales/ net profit decline of 8%/ 15% YoY. Moreover, rebates and other forms of subsidies for distributors could last longer into FY21E, which is adverse for margins.
- **More drags from K-Swiss & Palladium, as well as Saucony & Merrell.** Amid COVID-19 outbreak, K&P is suffering heavily because of its low e-commerce penetration and broad US & EU exposure. Therefore we now forecast a 22% sales decline and US\$ 15m (~RMB 100mn) loss for FY20E. For S&M JV, we now expect 35/ 10 new Saucony/ Merrell stores, and RMB 48m sales and RMB 36m losses in FY20E.
- **Downgrade to HOLD and cut TP to HK\$ 2.70.** We cut our FY20E/ 21E/ 22E EPS estimates by 27%/ 20%/ 13%, to factor in 1) weaker e-commerce sales, 2) lower GP margin, 3) higher operating deleverage and 4) greater drags from new businesses. Our TP is based on 9x FY21E P/E (rolled over from 10x FY20E) and we downgrade to HOLD due to lack of catalysts. Current valuation of 8x FY21E P/E and 5% FY20E dividend yield is not very attractive.

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	6,383	8,183	7,990	8,929	9,862
YoY growth (%)	24.8	28.2	(2.4)	11.8	10.5
Net income (RMB mn)	657	728	467	642	817
EPS (RMB)	0.295	0.302	0.187	0.258	0.328
YoY growth (%)	60.6	2.3	(37.9)	37.5	27.3
Consensus EPS (RMB)	n/a	n/a	0.206	0.289	0.345
P/E (x)	7.3	7.2	11.5	8.4	6.6
P/B (x)	0.9	0.8	0.8	0.7	0.7
Yield (%)	8.1	8.1	5.2	7.2	9.1
ROE (%)	12.3	10.5	6.6	8.7	10.5
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIS estimates

HOLD (Down)

Target Price **HK\$2.70**
 (Previous TP **HK\$2.90**)
 Up/Downside **+7.4%**
 Current Price **HK\$2.51**

China Sportswear Sector

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Stock Data

Mkt Cap (HK\$ mn)	6,324
Avg 3 mths t/o (HK\$ mn)	17.50
52w High/Low (HK\$)	5.99/2.04
Total Issued Shares (mn)	2,519.4

Source: Bloomberg

Shareholding Structure

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

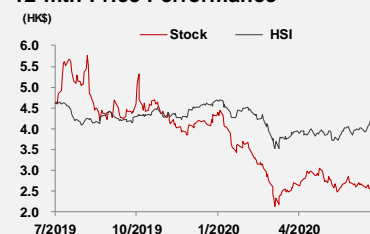
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-1.1%	-6.6%
3-mth	-0.7%	-6.2%
6-mth	-38.2%	-31.2%
12-mth	-43.7%	-37.7%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Ernst & Young

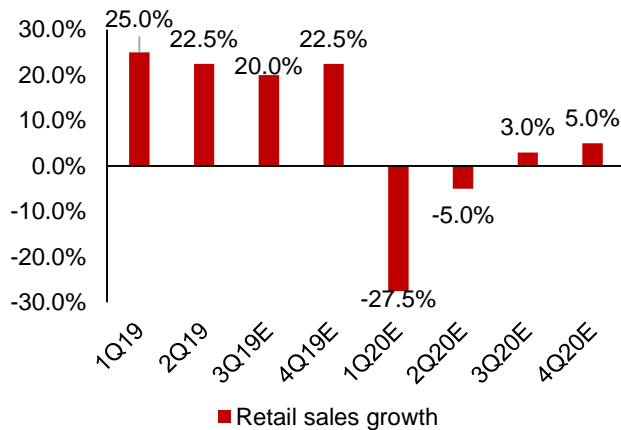
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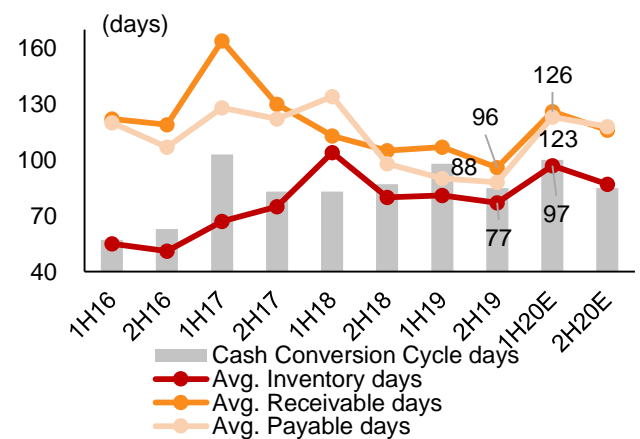
Focus Charts

Figure 1: Xtep's retail sales growth (CMBIS est.)



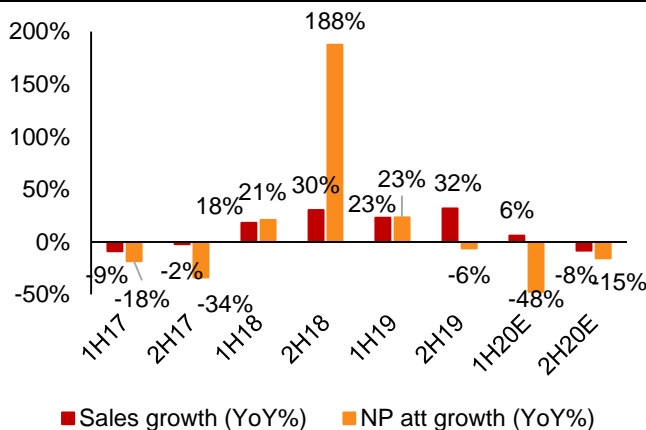
Source: Company data, CMBIS estimates

Figure 2: Xtep's cash conversion cycle



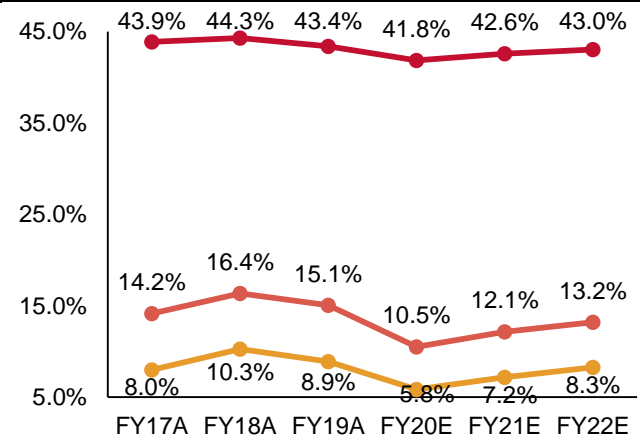
Source: Company data, CMBIS estimates

Figure 3: Sales/ net profit growth - half year



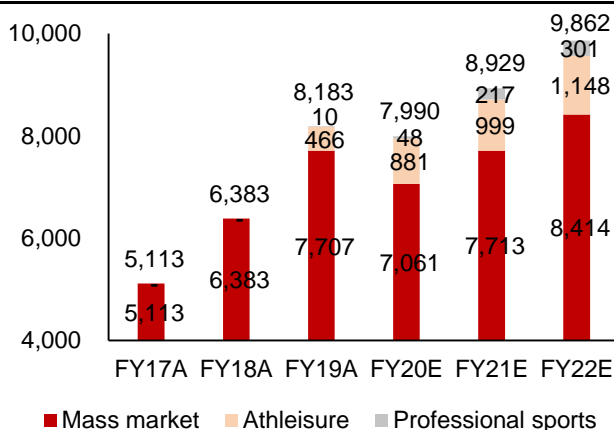
Source: Company data, CMBIS estimates

Figure 4: GP/ OP/ NP margin



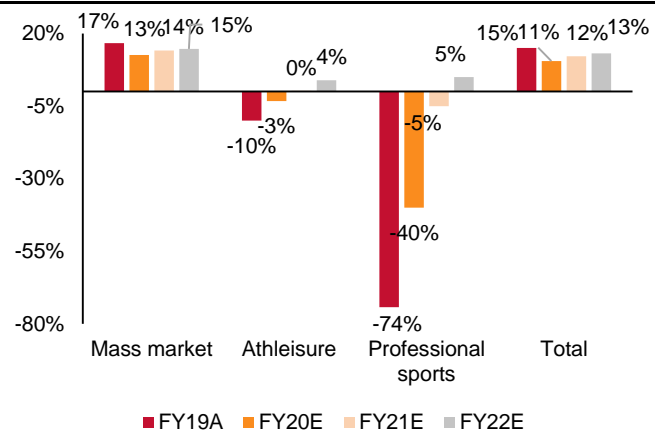
Source: Company data, CMBIS estimates

Figure 5: Sales breakdown, by segment



Source: Company data, CMBIS estimates

Figure 6: OP margin, by segment



Source: Company data, CMBIS estimates

Results Summary

Figure 7: Results preview – Half Year

Half yearly (RMB mn)	1H19	2H19	1H20E	2H20E	1H19 YoY	2H19 YoY	1H20E YoY	2H20E YoY
Revenue	3,357	4,826	3,564	4,426	23%	32%	6%	-8%
COGS	(1,860)	(2,773)	(2,096)	(2,551)				
Gross profit	1,497	2,053	1,468	1,875	25%	26%	-2%	-9%
GP margins	44.6%	42.5%	41.2%	42.4%				
Other income & gains	138	170	89	103				
S & D expenses	(637)	(1,082)	(791)	(1,001)	33%	23%	24%	-7%
S & D exp / sales	-19.0%	-22.4%	-22.2%	-22.6%				
Admin expenses	(281)	(625)	(317)	(586)	7%	74%	13%	-6%
Admin exp / sales	-8.4%	-13.0%	-8.9%	-13.2%				
Other opex	0	0	0	0				
Operating profit (EBIT)	717	517	449	392	21%	14%	-37%	-24%
OP margins	21.4%	10.7%	12.6%	8.9%				
Other items	0	0	0	0				
Net finance income	(36)	(75)	(32)	(16)				
Net finance income / sales	-1.1%	-1.5%	-0.9%	-0.4%				
Profit after financing costs	681	442	417	376				
Associated coms	0	(2)	(18)	(18)				
Jointly controlled coms	0	0	0	0				
Pre-tax profit	681	440	399	357	24%	3%	-41%	-19%
Tax	(218)	(172)	(156)	(132)				
Tax / sales	-6.5%	-3.6%	-4.4%	-3.0%				
Effective tax rate	-32.0%	-39.0%	-39.0%	-36.9%				
Minority interests	(0)	4	0	2				
Net profit att.	463	265	243	224	23%	-6%	-48%	-15%
NP margins	13.8%	5.5%	6.8%	5.1%				
Sales by segment								
Mass market	3,357	4,350	3,096	3,965	23%	19%	-8%	-9%
Athleisure	0	466	450	431				-8%
Professional sports	0	10	18	30				201%
Total	3,357	4,826	3,564	4,426	23%	32%	6%	-8%

Source: Company data, CMBIS estimates

Figure 8: Results preview - Full Year

Full yearly (RMB mn)	FY18	FY19	FY20E	FY21E	FY19 YoY	FY20E YoY	FY21E YoY
Revenue	6,383	8,183	7,990	8,929	28%	-2%	12%
COGS	(3,555)	(4,632)	(4,647)	(5,126)			
Gross profit	2,828	3,550	3,343	3,803	26%	-6%	14%
GP margins	44.3%	43.4%	41.8%	42.6%			
Other income & gains	196	308	192	202			
S & D expenses	(1,357)	(1,718)	(1,792)	(1,954)	27%	4%	9%
S & D exp / sales	-21.3%	-21.0%	-22.4%	-21.9%			
Admin expenses	(622)	(906)	(903)	(967)	46%	0%	7%
Admin exp / sales	-9.8%	-11.1%	-11.3%	-10.8%			
Other opex	0	0	0	0			
Operating profit (EBIT)	1,044	1,234	841	1,084	18%	-32%	29%
OP margins	16.4%	15.1%	10.5%	12.1%			
Other items	0	(2)	(36)	(65)			
Net finance income	(68)	(111)	(48)	(53)			
Net finance income / sales	-1.1%	-1.4%	-0.6%	-0.6%			
Profit after financing costs	976	1,121	757	965			
Associated coms	0	0	0	0			
Jointly controlled coms	0	0	0	0			
Pre-tax profit	976	1,121	757	965	15%	-33%	28%
Tax	(306)	(390)	(287)	(319)			
Tax / sales	-4.8%	-4.8%	-3.6%	-3.6%			
Effective tax rate	-31.4%	-34.8%	-38.0%	-33.0%			
Minority interests	13	4	2	5			
Net profit att.	657	728	467	642	11%	-36%	38%
NP margins	10.3%	8.9%	5.8%	7.2%			
Sales by segment							
Mass market	6,383	7,707	7,061	7,713	21%	-8%	9%
Athleisure	0	466	881	999		89%	13%
Professional sports	0	10	48	217		379%	349%
Total	6,383	8,183	7,990	8,929	28%	-2%	12%

Source: Company data, CMBIS estimates

Earnings revision

Figure 9: Earnings revision

RMB mn	New			Old			Diff (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	7,990	8,929	9,862	8,307	9,505	10,514	-3.8%	-6.1%	-6.2%
Gross profit	3,343	3,803	4,245	3,568	4,103	4,536	-6.3%	-7.3%	-6.4%
EBIT	841	1,084	1,302	1,079	1,346	1,521	-22.0%	-19.5%	-14.4%
Reported Net profit	455	642	792	620	798	910	-26.7%	-19.6%	-12.9%
Diluted EPS (RMB)	0.183	0.258	0.318	0.249	0.320	0.365	-26.7%	-19.6%	-12.9%
Gross margin	41.8%	42.6%	43.0%	43.0%	43.2%	43.1%	-1.1ppt	-0.6ppt	-0.1ppt
EBIT margin	10.5%	12.1%	13.2%	13.0%	14.2%	14.5%	-2.5ppt	-2ppt	-1.3ppt
Net profit att. margin	5.7%	7.2%	8.0%	7.5%	8.4%	8.7%	-1.8ppt	-1.2ppt	-0.6ppt

Source: Company data, CMBIS estimates

Figure 10: CMBIS estimates vs consensus

RMB mn	CMBIS			Consensus			Diff (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	7,990	8,929	9,862	8,123	9,447	10,624	-1.6%	-5.5%	-7.2%
Gross profit	3,343	3,803	4,245	3,333	3,951	4,472	0.3%	-3.7%	-5.1%
EBIT	841	1,084	1,302	858	1,141	1,331	-2.0%	-4.9%	-2.2%
Net profit att.	455	642	792	511	715	854	-11.0%	-10.3%	-7.3%
Diluted EPS (RMB)	0.183	0.258	0.318	0.206	0.289	0.345	-11.2%	-11.0%	-7.9%
Gross margin	41.8%	42.6%	43.0%	41.0%	41.8%	42.1%	0.8ppt	0.8ppt	1ppt
EBIT margin	10.5%	12.1%	13.2%	10.6%	12.1%	12.5%	0ppt	0.1ppt	0.7ppt
Net profit att. margin	5.7%	7.2%	8.0%	6.3%	7.6%	8.0%	-0.6ppt	-0.4ppt	0ppt

Source: Company data, CMBIS estimates

Valuation

Figure 11: 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\$m)	End	FY1E	FY2E	FY1E	FY2E	FY1E	FY1E	FY1E
H shares Sportswear														
Xtep Intl*	1368 HK	HOLD	2.70	2.51	7.6%	6,324	Dec-19	11.5	8.4	0.7	0.7	6.6	6.8	5.2
Anta Sports	2020 HK	BUY	95.55	71.60	33.4%	193,523	Dec-19	30.9	22.1	7.2	5.8	29.8	1.5	1.0
Li Ning	2331 HK	BUY	24.43	24.90	-1.9%	61,609	Dec-19	35.4	26.2	6.6	5.5	23.2	1.8	0.8
361 Degrees	1361 HK	NR	n/a	1.19	n/a	2,460	Dec-19	5.3	4.5	0.3	0.3	7.2	0.7	8.4
Topsports	6110 HK	NR	n/a	10.00	n/a	62,012	Feb-20	22.4	17.5	4.6	4.0	36.9	1.7	2.2
Pou Sheng	3813 HK	NR	n/a	1.86	n/a	9,964	Dec-19	19.3	8.2	1.1	1.0	11.5	1.1	0.7
China DX	3818 HK	NR	n/a	0.95	n/a	5,592	Mar-20	11.4	10.1	0.5	0.5	n/a	0.7	5.8
Avg.								19.5	13.8	3.0	2.5	20.1	2.0	3.4
Med.								19.3	10.1	1.1	1.0	17.5	1.5	2.2
International Sportswear														
Nike Inc	NKE US	NR	n/a	97.99	n/a	1,181,020	May-20	42.1	30.3	20.3	17.4	29.7	1.3	1.1
Adidas	ADS GY	NR	n/a	239.40	n/a	420,698	Dec-19	83.6	27.7	6.6	5.9	20.2	41.6	1.1
Puma	PUM GY	NR	n/a	68.40	n/a	90,457	Dec-19	107.0	35.8	5.2	4.7	10.8	8.7	0.3
Under Armour	UAA US	NR	n/a	9.52	n/a	31,792	Dec-19	n/a	85.8	2.8	2.7	(28.9)	0.0	0.0
Lululemon	LULU US	NR	n/a	314.39	n/a	317,277	Feb-20	73.1	50.1	17.5	15.2	36.1	4.9	0.0
Skechers	SKX US	NR	n/a	28.91	n/a	35,346	Dec-19	47.5	14.8	1.7	1.6	13.0	(12.9)	0.0
Vf Corp	VFC US	NR	n/a	60.74	n/a	183,393	Mar-20	56.3	24.4	7.5	7.6	17.7	2.9	3.2
Columbia	COLM US	NR	n/a	76.84	n/a	39,378	Dec-19	42.8	19.3	2.8	2.3	15.0	194.9	0.6
Wolverine	WWW US	NR	n/a	21.54	n/a	13,554	Dec-19	16.7	10.6	2.4	2.1	12.1	1.1	1.9
Mizuno Corp	8022 JP	NR	n/a	2020.00	n/a	3,887	Mar-20	7.9	7.2	0.5	0.5	4.7	0.0	2.5
Asics Corp	7936 JP	NR	n/a	1268.00	n/a	17,431	Dec-19	n/a	31.7	1.6	1.6	1.6	0.0	2.0
Avg.								53.0	30.7	6.3	5.6	12.0	22.0	1.2
Med.								47.5	27.7	2.8	2.7	13.0	1.3	1.1

Source: Bloomberg, CMBIS estimates

Assumptions

Figure 12: Xtep's key assumptions

Major assumptions	FY18A	FY19A	FY20E	FY21E	FY22E
Sales by segment (RMB mn)					
Shoes	3,925	4,653	4,497	5,028	5,538
Apparels	2,327	3,344	3,344	3,746	4,158
Accessories	131	185	148	156	166
Total	6,383	8,183	7,990	8,929	9,862
Sales by segment growth (%)					
Shoes	20.5%	18.6%	-3.3%	11.8%	10.1%
Apparels	32.2%	43.7%	0.0%	12.0%	11.0%
Accessories	36.6%	41.0%	-20.0%	5.0%	7.0%
Total	24.8%	28.2%	-2.4%	11.8%	10.5%
Sales by segment (RMB mn)					
Mass market	6,383	7,707	7,061	7,713	8,414
Athleisure	0	466	881	999	1,148
Professional sports	0	10	48	217	301
Total	6,383	8,183	7,990	8,929	9,862
Sales by segment growth (YoY)					
Mass market	24.8%	20.7%	-8.4%	9.2%	9.1%
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%	-2.4%	11.8%	10.5%
Sales network					
Xtep	5,580	5,279	5,173	5,329	5,488
Xtep kids	450	850	833	875	962
Oversea stores	200	250	250	250	300
Total	6,230	6,379	6,256	6,453	6,751
GP margins	44.3%	43.4%	41.8%	42.6%	43.0%
Opex breakdown					
A&P / sales	15.2%	14.4%	14.6%	14.2%	13.8%
Staff costs / sales	11.6%	11.0%	11.5%	10.9%	10.9%
R&D / sales	2.6%	2.4%	2.6%	2.6%	2.5%
D&A / sales	1.4%	1.7%	2.3%	2.1%	2.0%
Provisions (write backs) / sales	-0.8%	-0.9%	-0.3%	0.0%	0.0%
Rental / sales	0.3%	0.1%	1.0%	1.2%	1.4%
Selling & distribution costs / sales	21.3%	21.0%	22.4%	21.9%	21.5%
Admin expenses / sales	9.8%	11.1%	11.3%	10.8%	10.4%
Total	31.0%	32.1%	33.7%	32.7%	32.0%
OP margins	16.4%	15.1%	10.5%	12.1%	13.2%
Effective tax rate	31.4%	34.8%	38.0%	33.0%	32.0%
Net profit att. margins	10.3%	8.9%	5.8%	7.2%	8.3%
Net profit att. growth (%)	60.9%	10.8%	-35.9%	37.5%	27.3%

Source: Company data, CMBIS estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue	6,383	8,183	7,990	8,929	9,862
Footwear	3,925	4,653	4,497	5,028	5,538
Apparel	2,327	3,344	3,344	3,746	4,158
Accessories	131	185	148	156	166
Cost of goods sold	(3,555)	(4,632)	(4,647)	(5,126)	(5,617)
Gross profit	2,828	3,550	3,343	3,803	4,245
Other income	196	308	192	202	208
Operating expenses	(1,980)	(2,625)	(2,695)	(2,921)	(3,151)
D & A	(8)	(141)	(267)	(272)	(276)
Staff costs	(738)	(901)	(917)	(974)	(1,071)
S & D costs (ex-staff, D&A)	(623)	(823)	(881)	(987)	(1,057)
Admin exp. (ex-staff, D&A)	(611)	(760)	(630)	(689)	(748)
Other operating expenses	-	-	-	-	-
EBIT	1,044	1,234	841	1,084	1,302
Finance costs, net	(68)	(111)	(48)	(53)	(73)
JVs & associates	-	(2)	(36)	(65)	(15)
Exceptional	-	-	-	-	-
Pre-tax profit	976	1,121	757	965	1,214
Income tax	(306)	(390)	(287)	(319)	(388)
Less: Minority interests	13	4	2	5	8
Net profit	657	728	467	642	817

Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
EBIT	1,044	1,234	841	1,084	1,302
D & A	60	185	317	329	340
Change in working capital	(513)	36	421	(235)	(233)
Income tax paid	(309)	(334)	(287)	(319)	(388)
Others	(128)	(343)	(48)	(53)	(73)
Net cash from operating	154	778	1,243	806	948
Capex & investments	(72)	(97)	(200)	(134)	(148)
Associated companies	(1)	(35)	-	-	-
Interest received	-	-	-	-	-
Others	(208)	(1,913)	-	-	-
Net cash from investing	(281)	(2,045)	(200)	(134)	(148)
Equity raised	(31)	1,187	-	-	-
Net change in bank loans	(10)	386	-	-	-
Dividend paid	(459)	(436)	(339)	(346)	(451)
Others	(11)	(98)	-	-	-
Net cash from financing	(511)	1,039	(339)	(346)	(451)
Net change in cash	(637)	(227)	705	326	349
Beginning cash balance	3,832	3,196	2,970	3,674	4,000
Exchange difference	1	1	-	-	-
Cash at the end of the year	3,196	2,970	3,674	4,000	4,349

Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Non-current assets	1,139	3,057	2,903	2,643	2,436
Fixed asset	641	662	784	829	878
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
Current assets	8,060	9,266	9,531	10,352	11,195
Cash and cash equivalents	3,196	2,970	3,674	4,000	4,349
Inventories	836	1,046	1,018	1,123	1,231
Trade and other receivables	2,115	2,910	2,517	2,813	3,107
Prepayments	727	818	798	892	986
Other current assets	1,186	1,522	1,522	1,522	1,522
Current liabilities	3,278	3,671	3,652	3,912	4,174
Bank loans	1,483	1,086	1,086	1,086	1,086
Trade payables	879	1,420	1,424	1,571	1,721
Accruals & other payables	861	981	957	1,070	1,182
Tax payables	54	115	115	115	115
Others	1	69	69	69	69
Non-current liabilities	590	1,691	1,691	1,691	1,691
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
Minority Interest	-	-	2	7	16
Total net assets	5,331	6,960	7,088	7,384	7,750
Shareholders' equity	5,331	6,960	7,088	7,384	7,750

Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Sales mix (%)					
Footwear	61.5	56.9	56.3	56.3	56.2
Apparel	36.5	40.9	41.9	42.0	42.2
Accessories	2.1	2.3	1.9	1.7	1.7
Total	100.0	100.0	100.0	100.0	100.0
P&L ratios (%)					
Gross margin	44.3	43.4	41.8	42.6	43.0
Operating margin	16.4	15.1	10.5	12.1	13.2
Pre-tax margin	15.3	13.7	9.5	10.8	12.3
Net margin	10.3	8.9	5.9	7.2	8.4
Effective tax rate	31.4	34.7	37.2	30.9	32.2
Balance sheet ratios					
Current ratio (x)	2.5	2.5	2.6	2.7	2.7
Quick ratio (x)	2.2	2.2	2.4	2.4	2.4
Cash ratio (x)	1.0	0.8	1.0	1.0	1.0
Inventory turnover days	86	82	80	80	80
Trade receivables days	121	130	115	115	115
Trade payables days	90	112	112	112	112
Total debt / total equity ratio (%)	36	34	33	32	30
Net debt / equity ratio (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Returns (%)					
ROE	12.3	10.5	6.6	8.7	10.5
ROA	7.1	5.9	3.8	4.9	6.0
Per share					
EPS (RMB)	0.30	0.30	0.19	0.26	0.33
DPS (RMB)	0.18	0.18	0.11	0.15	0.20
BVPS (RMB)	2.40	2.79	2.84	2.96	3.11

Source: Company data, CMBIS estimates

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