

Company Report

China Merchants Securities (HK) Co., Ltd.
Hong Kong Equity Research

Xtep International (1368 HK)

Better-than-expected 1H22 results; Strong sales momentum in 2H22

- 1H22 results turn out better than expected
- Mgmt is confident in meeting guidance; inventory manageable
- Maintain BUY and TP of HKD16.0

1H22 net profit exceeds previous positive profit alert

Xtep reported its 1H22 revenue of RMB5,684mn, +37.5% yoy, +1.8% vs CMS est. 1H22 net profit was RMB589mn, +39.7% yoy, +7.2% vs CMS est. and higher than the +35% yoy guidance from its positive profit alert.

Making a push for Xtep Kids products

1H22 GPM was 42.0%, +0.2ppts yoy, -0.1ppts vs CMS est. OPM was 16.2%, -0.3ppts yoy, +0.3ppts vs CMS est. Due to higher average selling prices, the GPM for Xtep brand products actually all improved by 1-2 ppts yoy. It was only because the sales proportion of Xtep Kids products (which carries a lower GPM due to lower scale) increased that the overall GPM did not increase even more. Another drag on consolidated GPM was the increased overseas logistic costs which negatively affected the new brand products. Xtep will continue to ramp up the Xtep Kids products and hence will likely increase promotions and marketing expenses.

Maintain revenue guidance for FY22

1H22 retail sales grew by 20%-25% yoy. Retail sales in July and Aug have continued to be strong at 20%-30% yoy and +30% yoy respectively. Overall, Xtep maintains its FY22E retail sales growth guidance of +25% yoy and its FY22E revenue growth guidance of 25%-30% yoy. Xtep also maintained its loss guidance for the new brands of RMB150mn or less.

Increase in inventory is manageable

Xtep's inventory increased 111.0% yoy and 54.5% hoh to RMB2,313mn. Xtep explained the increase was a combination of 1) Xtep deliberately cut orders to some distributors in NE China to minimize risk of COVID restrictions; 2) overseas logistics bottlenecks in 2Q22 leading to shipment delays; and 3) the need to support continued increases in retail sales. Overall, some of the built up inventory has been sold in 2H22 and mgmt. feels confident that inventory can be managed back to more reasonable levels without heavy discounting as the bulk of the inventory is new.

Maintain BUY and TP at HKD16.0

We cut our FY22E/23E/24E EPS forecasts by 4.9%, 10.5% and 9.6%, mainly to account for increasing promotional expenses related to Xtep Kids. Maintain BUY and TP of HKD16.0, which implies a P/E of 30.0x (previous 26.4x) our next 12 months' forward EPS.

Key catalysts: Sooner-than-expected breakeven for new brands.

Key risks: More large scale COVID lockdowns.

Financials

Year ended 31 Dec (RMB mn)	2020	2021	2022E	2023E	2024E
Revenue	8,172	10,013	13,091	16,618	21,005
yoy growth	-0.1%	22.5%	30.7%	26.9%	26.4%
Attributable net profit	513	908	1,122	1,373	1,777
Adj. EPS (RMB)	0.21	0.36	0.43	0.53	0.69
yoy growth	-31.6%	72.0%	21.4%	23.5%	29.4%
P/E	52.6x	30.6x	25.2x	20.4x	15.7x
ROE	7.2%	11.9%	13.6%	15.6%	18.5%
Net debt (cash)/ equity	-18.0%	-17.4%	-17.2%	-13.0%	-8.0%
Div yield	1.1%	1.9%	2.3%	2.9%	3.7%

Sources: Company data, CMS (HK) estimates; share price as of Aug 23, 2022

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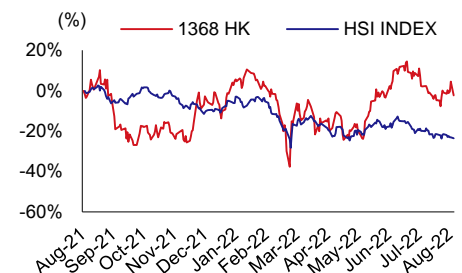
WHAT'S NEW

1H22 results in line with previous positive profit alert. Maintain BUY and TP at HKD 16.0

BUY

Previous	BUY
Price (Aug 23, 2022)	HKD 12.6
12-month Target Price (Potential up/downside)	HKD16.0 (+26.8%)
Previous	HKD16.0

Price Performance



Source: Bloomberg; share price as of Aug 23, 2022

%	1m	6m	12m
1368 HK	(4.5)	(1.7)	0.8
HSI	(5.4)	(17.6)	(22.3)

Sector: Consumer

Hang Seng Index (Aug 23, 2022)	19,503
HSCEI (Aug 23, 2022)	6,649

Key Data

52-week range (HKD)	8.08 - 14.98
Market cap (HKD mn)	33,252
Avg. daily volume (mn)	8.39
BVPS (RMB)	3.4

Shareholding Structure

Group Success Investments Ltd	49.7%
Ding Shui Po	2.3%
Free float	48.0%

Source: Bloomberg

Related Research

1. Xtep International (1368 HK) - Controlling shareholder's sale of existing shares may cause ST hiccup. Remain LT positive (BUY) (Jul 22, 2022)
2. Xtep International (1368 HK) - Better-than-expected 2Q22 retail sales (BUY) (Jul 13, 2022)

Figure 1: 1H22 results vs our estimates

Unit: RMB mn	1H22 CMS HK estimate	1H22 actual	% diff	yoy %
Revenue	5,586	5,684	1.8%	37.5%
Mass market (Xtep)	4,817	4,898	1.7%	36.2%
Athleisure (K-swiss, Palladium)	610	630	3.2%	36.3%
Professional sports (Saucony, M)	159	156	-1.7%	106.3%
COGS	(3,234)	(3,297)	1.9%	37.1%
Gross profit	2,352	2,387	1.5%	38.0%
Other income	265	237	-10.6%	12.4%
Selling & distribution expense	(1,046)	(1,046)	0.0%	35.1%
Admin expense	(680)	(656)	-3.4%	36.0%
Operating profit	892	922	3.4%	34.8%
Finance costs, net	(40)	(28)	-28.7%	-6.9%
Associate earnings	(8)	(11)	45.6%	45.6%
Pretax profit	844	882	4.5%	36.7%
Taxation	(295)	(293)	-0.5%	31.0%
Profit for the year	550	589	7.2%	39.7%
Attributable to:				
Equity holders of the Company	556	590	6.1%	38.4%
Minority interests	(7)	(1)	-79.2%	-71.8%
EPS, diluted (RMB)	0.22	0.23	5.4%	37.3%
DPS (RMB)	0.12	0.11	-8.8%	16.5%
Key metrics (%)				
GPM	42.1%	42.0%	-0.1ppt	0.2ppt
Mass market (Xtep)	41.8%	42.2%	0.4ppt	0.7ppt
Athleisure (K-swiss, Palladium)	43.6%	39.8%	-3.8ppt	-3.6ppt
Professional sports (Saucony, M)	45.5%	44.3%	-1.2ppt	-1.0ppt
Selling & distribution expense ratio	-18.7%	-18.4%	0.3ppt	0.3ppt
Admin expense ratio	-12.2%	-11.5%	0.6ppt	0.1ppt
OPM	15.96%	16.22%	0.3ppt	-0.3ppt
Attributable NPM	10.0%	10.4%	0.4ppt	0.1ppt

Sources: Company data, CMS (HK) estimates

Figure 2: Key assumptions adjustment

Unit: RMB mn	2022E			2023E			2024E		
	Original	New	diff %	Original	New	diff %	Original	New	diff %
Revenue	12,772	13,091	2.5%	16,340	16,618	1.7%	20,676	21,005	1.6%
Mass market (Xtep)	11,110	11,453	3.1%	14,109	14,431	2.3%	17,636	18,038	2.3%
Athleisure (K-swiss, Palladium)	1,271	1,281	0.8%	1,589	1,601	0.8%	1,987	2,002	0.8%
Professional sports (Saucony, Merrell)	391	357	-8.7%	641	586	-8.5%	1,053	965	-8.4%
GPM	42.0%	42.1%	0.1ppt	42.1%	42.4%	0.3ppt	42.2%	42.6%	0.4ppt
Mass market (Xtep)	41.7%	42.3%	0.6ppt	41.9%	42.5%	0.6ppt	42.1%	42.7%	0.6ppt
Athleisure (K-swiss, Palladium)	44.7%	40.9%	-3.8ppt	44.9%	42.8%	-2.1ppt	44.1%	42.8%	-1.3ppt
Professional sports (Saucony, Merrell)	40.6%	40.4%	-0.3ppt	40.8%	40.6%	-0.3ppt	41.1%	40.8%	-0.3ppt
OPM	13.9%	13.1%	-0.8ppt	14.1%	12.4%	-1.7ppt	14.2%	12.6%	-1.6ppt
Attributable net profit	1,160	1,122	-3.3%	1,522	1,373	-9.8%	1,950	1,777	-8.9%
NPM	9.1%	8.6%	-0.5ppt	9.3%	8.3%	-1.1ppt	9.4%	8.5%	-1.0ppt
Diluted EPS (RMB)	0.45	0.43	-4.9%	0.60	0.53	-10.5%	0.76	0.69	-9.6%

Sources: Company data, CMS (HK) estimates

Figure 3: Target price and valuation table

Valuation - Xtep

Stock price (HKD)	12.6		
HKD to RMB	0.86		
Price date	23/8/2022		
	FY22E	FY23E	FY24E
Year difference	1.0	2.0	3.0
EPS (RMB)	0.43	0.53	0.69
P/E	25.2x	20.4x	15.7x
EPS CAGR since FY21	21.4%	22.5%	24.7%
PEG	1.2x	0.9x	0.6x
Target PE	30.0x		
12-month fwd EPS (RMB)	0.46		
Target Price (HKD)	16.0		
Upside	26.8%		
22E Div yield	2.3%		
Total return	29.1%		

Sources: Company data, Bloomberg, CMS (HK) estimates

Financial statement

Balance Sheet

RMB mn	2020	2021	2022E	2023E	2024E
PP&E	796	1,119	1,395	1,624	1,823
Right of use assets	429	668	655	659	663
Goodwill	787	756	786	786	786
Investment in associate/JV	34	144	178	199	219
Other non-current assets	1,498	1,496	1,014	1,007	1,000
Non-current assets	3,544	4,183	4,029	4,275	4,491
Inventories	975	1,497	2,114	2,225	2,801
Receivables and prepayments	4,143	4,972	5,766	7,303	9,210
Financial assets at FVTPL	0	0	0	0	0
Deposits	0	0	500	500	500
Bank Balances and Cash	3,472	3,930	3,945	3,661	3,286
Other current assets	437	33	256	256	256
Current assets	9,027	10,432	12,580	13,945	16,053
Total assets	12,572	14,615	16,609	18,220	20,544
Account Payable	1,479	2,352	2,416	3,052	3,843
Due to Related Parties	0	0	0	0	0
Bank Borrowings	642	405	943	943	943
Other current liabilities	1,213	1,296	1,706	2,101	2,591
Current liabilities	3,334	4,053	5,065	6,096	7,377
Deferred Tax Liabilities	237	253	339	339	339
Lease Liabilities	131	102	123	123	123
Bank Borrowing	1,516	2,133	2,037	2,037	2,037
Other Borrowing	-	-	-	-	-
Provision and other liabilities	55	92	532	543	557
Non-current liabilities	1,939	2,580	3,032	3,043	3,057
Total liabilities	5,273	6,633	8,096	9,139	10,434
Share Capital	22	23	23	23	23
Reserves	7,201	7,906	8,437	9,010	10,042
Non-controlling interests	75	53	52	48	44
Total equity	7,299	7,982	8,512	9,082	10,110
Total equity and liabilities	12,572	14,615	16,609	18,220	20,544

Cashflow

RMB mn	2020	2021	2022E	2023E	2024E
Profit before tax	762	1,287	1,609	1,960	2,537
Finance Costs	112	90	56	58	58
Shares of profit of associate/JV	0	0	-35	-20	-20
D&A	166	169	210	224	254
Changes in OWC	-320	-447	-936	-607	-1,187
Others	29	-16	500	0	0
Income tax paid and others	-429	-382	-440	-590	-764
CF from operating activities	320	701	964	1,024	878
Capital expenditure	-207	-414	-416	-400	-400
Investments	-4	-3	-25	0	0
Others	784	89	-210	-24	-24
CF from investing activities	573	-329	-652	-424	-424
Dividend paid	-279	-356	-645	-800	-745
Equity financing	0	823	0	0	0
Debt financing (repaid)	-77	-339	442	0	0
Others	-25	-31	-104	-84	-84
CF from financing activities	-380	96	-307	-884	-829
Net cash flow	513	469	6	-284	-375

Profit & Loss Statement

RMB mn	2020	2021	2022E	2023E	2024E
Revenue	8,172	10,013	13,091	16,618	21,005
Cost of Sales	-4,973	-5,835	-7,583	-9,569	-12,061
Gross profits	3,198	4,178	5,508	7,049	8,944
Selling expenses	-1,537	-1,891	-2,550	-3,324	-4,201
General & Admin exp	-1,050	-1,189	-1,591	-2,098	-2,651
Others	307	299	348	439	553
Operating profits	918	1,396	1,715	2,067	2,645
D&A	-166	-169	-210	-224	-254
EBITDA	1,084	1,566	1,924	2,291	2,899
Finance costs	-140	-63	-56	-58	-58
Other income/expenses	-17	-46	-50	-50	-50
Profit before tax	762	1,287	1,609	1,960	2,537
Income tax expense	-257	-397	-490	-590	-764
Net profit	505	889	1,119	1,370	1,773
Non-controlling interest	8	19	3	3	4
Attributable net profit	513	908	1,122	1,373	1,777
Diluted EPS (RMB)	0.21	0.36	0.43	0.53	0.69
Div. per share (RMB)	0.12	0.21	0.25	0.31	0.40

Financial

	2020	2021	2022E	2023E	2024E
YoY growth rate					
Revenue	-0.1%	22.5%	30.7%	26.9%	26.4%
Gross Profit	-9.9%	30.6%	31.8%	28.0%	26.9%
Operating profit	-25.6%	52.1%	22.8%	20.6%	27.9%
Net profit	-29.5%	77.1%	23.5%	22.4%	29.4%
EPS	-31.6%	72.0%	21.4%	23.5%	29.4%
Profitability					
Gross margin	39.1%	41.7%	42.1%	42.4%	42.6%
Operating margin	11.2%	13.9%	13.1%	12.4%	12.6%
Net margin	6.3%	9.1%	8.6%	8.3%	8.5%
Liquidity					
AR days	137.3	123.3	104.4	98.7	98.7
Inventory days	74.2	77.3	86.9	82.7	76.1
AP days	106.4	119.8	114.8	104.3	104.3
Cash conversion cycle	105.1	80.8	76.6	77.1	70.5
Cash flow & leverage					
Free cash low (RMB mn)	217	279	62	627	480
Net debt to equity	-18.0%	-17.4%	-17.2%	-13.0%	-8.0%
Dividend payout ratio	60.0%	58.1%	57.5%	58.3%	58.3%
Dividend yield	1.1%	1.9%	2.3%	2.9%	3.7%
Return analysis					
ROE	7.2%	11.9%	13.6%	15.6%	18.5%
Asset turnover	0.7	0.7	0.8	1.0	1.1
Net margin	6.3%	9.1%	8.6%	8.3%	8.5%
Financial leverage	1.7	1.8	1.9	2.0	2.0
ROA	4.1%	6.7%	7.2%	7.9%	9.2%
Valuation ratios					
P/E	52.6x	30.6x	25.2x	20.4x	15.7x
P/B	4.1x	3.7x	3.5x	3.3x	2.9x

Sources: Company data, CMS (HK) estimates

Investment Ratings

Industry Rating	Definition
OVERWEIGHT	Expect sector to outperform the market over the next 12 months
NEUTRAL	Expect sector to perform in-line with the market over the next 12 months
UNDERWEIGHT	Expect sector to underperform the market over the next 12 months

Company Rating	Definition
BUY	Expect stock to generate 10%+ return over the next 12 months
HOLD	Expect stock to generate +10% to -10% over the next 12 months
SELL	Expect stock to generate loss of 10%+ over the next 12 months

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Hong Kong

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