Company Report

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

Xtep International (1368 HK)

Slowing sales may lead to higher discounts in 4Q22

- **Xtep 3Q22 retail sales growth inline, but slowing**
- **Healthy discount in 3Q22 but could widen in 4Q22**
- **Maintain BUY. Cut TP to HKD12.5**

Xtep 3Q22 retail sales growth inline; Saucony doubles

Xtep announced that 3Q22 retail sales (incl. offline and online channels) grew by 20%-25% yoy, compared to the mid-teen ppts yoy increase in 3Q21 and the 30%-35% yoy growth in 2Q22. Saucony grew by over 100% yoy in 3Q22 and Xtep is considering franchising in FY23.

Growth slowing due to COVID restrictions

While the 3Q22 growth was relatively in-line with expectations, it was affected by COVID restrictions. July and August retail sales grew by 25%-30% yoy respectively while Sept sales slowed to low teen ppts yoy and to mid-teen ppts yoy during the National Day holidays. Mgmt pointed out that unlike April, COVID restrictions are no longer confined to tier 1 and 2 cities and hence some 20% of Xtep shops are affected in some way.

Healthy discount in 3Q22 but could widen in 4Q22

The retail inventory level was 4.5 - 5 months, slightly higher than the c. 4.5 months in 2Q22 and the estimated c. 4 months in 3Q21. Some 70%-80% of the built-up in Palladium/KSwiss inventory at the end of 2H22 has been shipped. The retail discount level in 3Q22 was 25%-30%, compared to the 20%-25% in 3Q21 and the 20%-25% in 2Q22. Given the slowing retail sales from the current COVID situation, Xtep has prioritized maintaining healthy inventory levels and hence discount levels should widen in 4Q22 especially for the 11/11 sales festival.

Too much current uncertainty to give FY23 guidance

Because Xtep operates a wholesale model, its 2H22 revenues and GPM are relatively locked in. However, its self-operated e-commerce sales' GPM may be affected by wider retail discounts. Xtep also mentioned that it may spend more on advertising for marathons in 4Q22. Xtep feels it is too early to guidance for FY23 as revenues and GMV will depend on the inventory levels after the 11/11 sales festival.

Maintain BUY. New TP of HKD12.5

We tweak our FY22/23/24 EPS forecasts by -4.0%, -2.6% and -2.5% respectively. We cut our target price from HKD16 to HKD12.5. Our new target price implies a PE of 26.3x on our next 12 months' forward EPS (previous 26.4x). Maintain BUY. **Key catalysts**: Better-than-expected 4Q22 retail sales. **Key risks:** More large scale COVID restrictions.

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	1,077	1,338	1,732
Adj. EPS (RMB)	0.21	0.36	0.41	0.52	0.67
yoy growth	-31.6%	72.0%	16.5%	25.4%	29.5%
P/E	35.8x	20.8x	17.8x	14.2x	11.0x
ROE	7.2%	11.9%	13.1%	15.3%	18.1%
Net debt (cash)/ equity	-18.0%	-17.4%	-17.0%	-12.7%	-7.6%
Div yield	1.6%	2.8%	3.3%	4.1%	5.3%

Sources: Company data, CMS (HK) estimates; share price as of Oct 18, 2022

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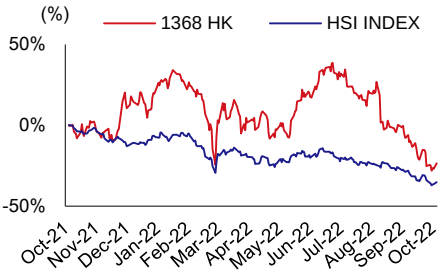
WHAT'S NEW

3Q22 retail sales inline but slowing due to COVID. Cut TP to HKD12.5 due to increased uncertainty. Maintain BUY

BUY

Previous	BUY
Price (Oct 18, 2022)	HKD 8.05
12-month Target Price (Potential up/downside)	HKD12.5 (+55.3%)
Previous	HKD16.0

Price Performance



Source: Bloomberg; share price as of Oct 18, 2022

%	1m	6m	12m
1368 HK	(19.7)	(26.9)	(13.7)
HSI	(9.8)	(21.4)	(33.4)

Sector: Consumer	
Hang Seng Index (Oct 18, 2022)	16,915
HSCEI (Oct 18, 2022)	5,756
Key Data	
52-week range (HKD)	7.12 - 14.98
Market cap (HKD mn)	21,210
Avg. daily volume (mn)	10.31
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. China Sportswear Sector - Nike China sales continue to decline during June - Aug (OVERWEIGHT) (Sept 30, 2022)
2. Anta Sports (2020 HK) - 3Q22 retail sales grew; 4Q22 discounts could widen (BUY) (Oct 17, 2022))

Figure 1: Key assumptions adjustment

Unit: RMB mn	2022E			2023E			2024E		
	Original	New	diff %	Original	New	diff %	Original	New	diff %
Revenue	**13,091**	**13,091**	***0.0%***	**16,618**	**16,618**	**0.0%**	**21,005**	**21,005**	**0.0%**
Mass market (Xtep)	*11,453*	*11,453*	*0.0%*	*14,431*	*14,431*	*0.0%*	*18,038*	*18,038*	*0.0%*
Athleisure (K-swiss, Palladium)	*1,281*	*1,281*	*0.0%*	*1,601*	*1,601*	*0.0%*	*2,002*	*2,002*	*0.0%*
Professional sports (Saucony, Merrell)	*357*	*357*	*0.0%*	*586*	*586*	*0.0%*	*965*	*965*	*0.0%*
GPM	**42.1%**	**41.8%**	**-0.3ppt**	**42.4%**	**42.4%**	**0.0ppt**	**42.6%**	**42.6%**	**0.0ppt**
Mass market (Xtep)	*42.3%*	*41.9%*	*-0.3ppt*	*42.5%*	*42.5%*	*0.0ppt*	*42.7%*	*42.7%*	*0.0ppt*
Athleisure (K-swiss, Palladium)	*40.9%*	*40.9%*	*0.0ppt*	*42.8%*	*42.8%*	*0.0ppt*	*42.8%*	*42.8%*	*0.0ppt*
Professional sports (Saucony, Merrell)	*40.4%*	*40.4%*	*0.0ppt*	*40.6%*	*40.6%*	*0.0ppt*	*40.8%*	*40.8%*	*0.0ppt*
OPM	**13.1%**	**12.6%**	***-0.5ppt***	**12.4%**	**12.1%**	***-0.3ppt***	**12.6%**	**12.3%**	***-0.3ppt***
Attributable net profit	**1,122**	**1,077**	***-4.0%***	**1,373**	**1,338**	**-2.6%**	**1,777**	**1,732**	**-2.5%**
NPM	8.6%	8.2%	*-0.3ppt*	8.3%	8.0%	*-0.2ppt*	8.5%	8.2%	*-0.2ppt*
Diluted EPS (RMB)	**0.43**	**0.41**	***-4.0%***	**0.53**	**0.52**	**-2.6%**	**0.69**	**0.67**	**-2.5%**

Sources: Company data, CMS (HK) estimates

Figure 2: Target price and valuation table

Valuation - Xtep

Stock price (HKD)	8.05		
HKD to RMB	0.92		
Price date	10/18/2022		
	FY22E	**FY23E**	**FY24E**
Year difference	1.0	2.0	3.0
EPS (RMB)	0.41	0.52	0.67
P/E	**17.8x**	**14.2x**	**11.0x**
EPS CAGR since FY21	16.5%	20.9%	23.7%
PEG	**1.1x**	**0.7x**	**0.5x**
Target PE	**26.3x**		
12-month fwd EPS (RMB)	0.44		
Target Price (HKD)	**12.5**		
Upside	**55.3%**		
22E Div yield	3.3%		
Total return	**58.5%**		

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	2,133	2,225	2,801
Receivables and prepayments	4,143	4,972	5,782	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	3,926	3,627	3,241
Other current assets	437	33	256	256	256
Current assets	**9,027**	**10,432**	**12,597**	**13,911**	**16,008**
Total assets	**12,572**	**14,615**	**16,626**	**18,186**	**20,499**
Account Payable	1,479	2,352	2,438	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	1,719	2,101	2,591
Current liabilities	**3,334**	**4,053**	**5,101**	**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**	**8,133**	**9,139**	**10,434**
Share Capital	22	23	23	23	23
Reserves	7,201	7,906	8,418	8,976	9,997
Non-controlling interests	75	53	52	49	45
Total equity	**7,299**	**7,982**	**8,493**	**9,048**	**10,065**
Total equity and liabilities	**12,572**	**14,615**	**16,626**	**18,186**	**20,499**

Cashflow

RMB mn	2020	2021	2022E	2023E	2024E
Profit before tax	762	1,287	1,547	1,910	2,474
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	-423	-575	-745
CF from operating activities	**320**	**701**	**920**	**988**	**833**
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	-619	-780	-711
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**	**-282**	**-864**	**-795**
Net cash flow	**513**	**469**	**-13**	**-299**	**-386**

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	-7,622	-9,569	-12,061
Gross profits	**3,198**	**4,178**	**5,469**	**7,049**	**8,944**
Selling expenses	-1,537	-1,891	-2,572	-3,373	-4,264
General & Admin exp	-1,050	-1,189	-1,591	-2,098	-2,651
Others	307	299	348	439	553
Operating profits	**918**	**1,396**	**1,653**	**2,017**	**2,582**
D&A	-166	-169	-210	-224	-254
EBITDA	**1,084**	**1,566**	**1,863**	**2,241**	**2,836**
Finance costs	-140	-63	-56	-58	-58
Other income/expenses	-17	-46	-50	-50	-50
Profit before tax	**762**	**1,287**	**1,547**	**1,910**	**2,474**
Income tax expense	-257	-397	-473	-575	-745
Net profit	**505**	**889**	**1,074**	**1,334**	**1,728**
Non-controlling interest	8	19	2	3	4
Attributable net profit	**513**	**908**	**1,077**	**1,338**	**1,732**
Diluted EPS (RMB)	0.21	0.36	0.41	0.52	0.67
Div. per share (RMB)	0.12	0.21	0.24	0.30	0.39

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%	30.9%	28.9%	26.9%
Operating profit	-25.6%	52.1%	18.4%	22.0%	28.0%
Net profit	-29.5%	77.1%	18.5%	24.2%	29.5%
EPS	-31.6%	72.0%	16.5%	25.4%	29.5%
Profitability					
Gross margin	39.1%	41.7%	41.8%	42.4%	42.6%
Operating margin	11.2%	13.9%	12.6%	12.1%	12.3%
Net margin	6.3%	9.1%	8.2%	8.0%	8.2%
Liquidity					
AR days	137.3	123.3	104.4	98.7	98.7
Inventory days	74.2	77.3	86.9	83.1	76.1
AP days	106.4	119.8	114.7	104.7	104.3
Cash conversion cycle	105.1	80.8	76.6	77.1	70.5
Cash flow & leverage					
Free cash flow (RMB mn)	217	279	17	591	436
Net debt to equity	-18.0%	-17.4%	-17.0%	-12.7%	-7.6%
Dividend payout ratio	60.0%	58.1%	57.5%	58.3%	58.3%
Dividend yield	1.6%	2.8%	3.3%	4.1%	5.3%
Return analysis					
ROE	7.2%	11.9%	13.1%	15.3%	18.1%
Asset turnover	0.7	0.7	0.8	1.0	1.1
Net margin	6.3%	9.1%	8.2%	8.0%	8.2%
Financial leverage	1.7	1.8	1.9	2.0	2.0
ROA	4.1%	6.7%	6.9%	7.7%	9.0%
Valuation ratios					
P/E	35.8x	20.8x	17.8x	14.2x	11.0x
P/B	2.8x	2.5x	2.4x	2.2x	2.0x

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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