

Company Report

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

Xtep International (1368 HK)

Discounts likely to increase in 1Q23

- Offline retail sales likely affected by COVID restrictions
- Discounts are likely to increase to reduce inventory
- Maintain BUY and TP of HKD12.5

Offline retail sales likely affected by COVID restrictions

We expect Xtep's 4Q22 retail sales to be negatively affected by COVID measures. While Xtep's retail sales during the recent 11/11 Singles Day grew by c. 30% yoy for all the brands combined, we believe its offline retail sales probably grew at a lower rate as some of its stores were likely closed by COVID restriction policies.

Discounts are likely to increase to reduce inventory

While Xtep did not announce its inventory or discount levels after 11/11 Singles Day, we believe that overall inventories likely remained similar to the levels at the end of 3Q22 (c. 4-5 months of inventory). While this level of inventory is still manageable, we suspect Xtep will want to reduce this inventory in Dec and into 1Q23. Hence, we now expect Xtep to increase its discount levels in order to reduce inventories. We note that the Xtep operates primarily under the wholesale model and hence increases in discount rates do not affect Xtep's revenues and margins as much as some of its peers.

Reducing our earnings forecasts

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 in 4Q22 and into 1Q23. Furthermore, with the low visibility in retail sales, we should expect Xtep's distributors to be more conservative with their FY23 orders thereby affecting FY23 revenue growth. We revise our FY22/23/24 EPS forecasts by -3.3%, -8.0% and -3.4% respectively.

Maintain BUY and TP of HKD12.5

Despite the reduction in our earnings forecasts, we maintain our BUY rating and TP of HKD12.5 as we believe that investors have basically discounted the negative effects of COVID on FY22 earnings. We believe that when COVID restrictions are lifted, retail sales, inventory levels and discounts rates should normalize and hence margins should normalize.

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 | 13,064 | 16,340 | 21,014 |
| yoy growth | -0.1% | 22.5% | 30.5% | 25.1% | 28.6% |
| Attributable net profit | 513 | 908 | 1,041 | 1,231 | 1,673 |
| Adj. EPS (RMB) | 0.21 | 0.36 | 0.40 | 0.48 | 0.65 |
| yoy growth | -31.6% | 72.0% | 12.6% | 19.4% | 36.0% |
| P/E | 41.6x | 24.2x | 21.5x | 18.0x | 13.2x |
| ROE | 7.2% | 11.9% | 12.7% | 14.1% | 17.6% |
| Net debt (cash)/ equity | -18.0% | -17.4% | -17.1% | -12.3% | -6.4% |
| Div yield | 1.4% | 2.4% | 2.7% | 3.2% | 4.4% |

Sources: Company data, CMS (HK) estimates; share price as of Dec 5, 2022

Johnny WONG
+852 3189 6357

johnnywong@cmschina.com.hk

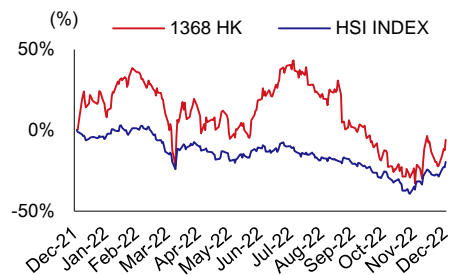
WHAT'S NEW

We reduce our FY22/23/24 earnings forecasts due to COVID restrictions but we our maintain BUY rating and TP of HKD12.5

BUY

| | |
|---|------------------|
| Previous | BUY |
| Price (Dec 5, 2022) | HKD 9.60 |
| 12-month Target Price (Potential up/downside) | HKD12.5 (+30.0%) |
| Previous | HKD12.5 |

Price Performance



Source: Bloomberg; share price as of Dec 5, 2022

| % | 1m | 6m | 12m |
|---------|------|--------|--------|
| 1368 HK | 26.5 | (16.4) | (3.0) |
| HSI | 20.8 | (7.4) | (17.9) |

Sector: Consumer

| | |
|-------------------------------|--------|
| Hang Seng Index (Dec 5, 2022) | 19,518 |
| HSCEI (Dec 5, 2022) | 6,706 |

Key Data

| | |
|------------------------|--------------|
| 52-week range (HKD) | 6.79 - 14.98 |
| Market cap (HKD mn) | 25,312 |
| Avg. daily volume (mn) | 12.25 |
| BVPS (RMB) | 3.14 |

Shareholding Structure

| | |
|-------------------------------|--------|
| Group Success Investments Ltd | 46.65% |
| Ding Shui Po | 2.45% |
| Free float | 50.90% |

Source: Bloomberg

Related Research

1. China Sportswear Sector - Singles Day sales likely good but companies remain cautious (OVERWEIGHT) (Nov 15, 2022)
2. Anta Sports (2020 HK) - Recent COVID restrictions negatively affect GMV (BUY) (Nov 24, 2022))

Figure 1: Key assumptions adjustment

| Unit: RMB mn | 2022E | | | 2023E | | | 2024E | | |
|---|---------------|---------------|----------------|---------------|---------------|----------------|---------------|---------------|----------------|
| | Original | New | diff % | Original | New | diff % | Original | New | diff % |
| Revenue | 13,091 | 13,064 | -0.2% | 16,618 | 16,340 | -1.7% | 21,005 | 21,014 | 0.0% |
| <i>Mass market (Xtep)</i> | 11,453 | 11,427 | -0.2% | 14,431 | 14,153 | -1.9% | 18,038 | 18,047 | 0.0% |
| <i>Athleisure (K-swiss, Palladium)</i> | 1,281 | 1,281 | 0.0% | 1,601 | 1,601 | 0.0% | 2,002 | 2,002 | 0.0% |
| <i>Professional sports (Saucony, Merrell)</i> | 357 | 357 | 0.0% | 586 | 586 | 0.0% | 965 | 965 | 0.0% |
| GPM | 41.8% | 41.4% | -0.3ppt | 42.4% | 42.0% | -0.4ppt | 42.5% | 42.5% | 0.0ppt |
| <i>Mass market (Xtep)</i> | 41.9% | 41.5% | -0.4ppt | 42.5% | 42.0% | -0.5ppt | 42.7% | 42.7% | 0.0ppt |
| <i>Athleisure (K-swiss, Palladium)</i> | 40.9% | 40.9% | 0.0ppt | 42.8% | 42.8% | 0.0ppt | 42.8% | 42.8% | 0.0ppt |
| <i>Professional sports (Saucony, Merrell)</i> | 40.4% | 40.4% | 0.0ppt | 40.6% | 40.6% | 0.0ppt | 40.8% | 40.8% | 0.0ppt |
| OPM | 12.6% | 12.3% | -0.3ppt | 12.1% | 11.4% | -0.8ppt | 12.3% | 11.9% | -0.4ppt |
| Attributable net profit | 1,077 | 1,041 | -3.3% | 1,338 | 1,231 | -8.0% | 1,732 | 1,673 | -3.4% |
| <i>NPM</i> | 8.2% | 8.0% | -0.3ppt | 8.0% | 7.5% | -0.5ppt | 8.2% | 8.0% | -0.3ppt |
| Diluted EPS (RMB) | 0.41 | 0.40 | -3.3% | 0.52 | 0.48 | -8.0% | 0.67 | 0.65 | -3.4% |

Sources: Company data, CMS (HK) estimates

Figure 2: Target price and valuation table

| Valuation - Xtep | | | |
|------------------------|-----------|-------|-------|
| Stock price (HKD) | 9.60 | | |
| HKD to RMB | 0.90 | | |
| Price date | 12/5/2022 | | |
| | FY22E | FY23E | FY24E |
| Year difference | 1.0 | 2.0 | 3.0 |
| EPS (RMB) | 0.40 | 0.48 | 0.65 |
| P/E | 21.5x | 18.0x | 13.2x |
| EPS CAGR since FY21 | 12.6% | 16.0% | 22.3% |
| PEG | 1.7x | 1.1x | 0.6x |
| Target PE | 29.2x | | |
| 12-month fwd EPS (RMB) | 0.48 | | |
| Target Price (HKD) | 12.5 | | |
| Upside | 30.0% | | |

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 | 2,148 | 2,217 | 2,820 |
| Receivables and prepayments | 4,143 | 4,972 | 5,781 | 7,278 | 9,270 |
| 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 | 3,584 | 3,119 |
| Other current assets | 437 | 33 | 256 | 256 | 256 |
| Current assets | 9,027 | 10,432 | 12,610 | 13,834 | 15,965 |
| Total assets | 12,572 | 14,615 | 16,639 | 18,109 | 20,456 |
| Account Payable | 1,479 | 2,352 | 2,456 | 3,042 | 3,868 |
| Due to Related Parties | 0 | 0 | 0 | 0 | 0 |
| Bank Borrowings | 642 | 405 | 943 | 943 | 943 |
| Other current liabilities | 1,213 | 1,296 | 1,730 | 2,094 | 2,607 |
| Current liabilities | 3,334 | 4,053 | 5,128 | 6,078 | 7,418 |
| 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 | 533 | 543 | 558 |
| Non-current liabilities | 1,939 | 2,580 | 3,033 | 3,043 | 3,058 |
| Total liabilities | 5,273 | 6,633 | 8,161 | 9,121 | 10,476 |
| Share Capital | 22 | 23 | 23 | 23 | 23 |
| Reserves | 7,201 | 7,906 | 8,403 | 8,916 | 9,912 |
| Non-controlling interests | 75 | 53 | 52 | 49 | 45 |
| Total equity | 7,299 | 7,982 | 8,478 | 8,988 | 9,980 |
| Total equity and liabilities | 12,572 | 14,615 | 16,639 | 18,109 | 20,456 |

Cashflow

| RMB mn | 2020 | 2021 | 2022E | 2023E | 2024E |
|-------------------------------------|-------------|-------------|-------------|-------------|-------------|
| Profit before tax | 762 | 1,287 | 1,499 | 1,753 | 2,389 |
| 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 | -922 | -606 | -1,241 |
| Others | 29 | -16 | 500 | 0 | 0 |
| Income tax paid and others | -429 | -382 | -410 | -525 | -720 |
| CF from operating activities | 320 | 701 | 899 | 883 | 721 |
| 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 | -599 | -717 | -677 |
| 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 | -262 | -802 | -761 |
| Net cash flow | 513 | 469 | -14 | -342 | -465 |

Profit & Loss Statement

| RMB mn | 2020 | 2021 | 2022E | 2023E | 2024E |
|--------------------------------|--------------|---------------|---------------|---------------|---------------|
| Revenue | 8,172 | 10,013 | 13,064 | 16,340 | 21,014 |
| Cost of Sales | -4,973 | -5,835 | -7,652 | -9,480 | -12,066 |
| Gross profits | 3,198 | 4,178 | 5,412 | 6,860 | 8,948 |
| Selling expenses | -1,537 | -1,891 | -2,567 | -3,366 | -4,350 |
| General & Admin exp | -1,050 | -1,189 | -1,588 | -2,063 | -2,652 |
| Others | 307 | 299 | 347 | 429 | 552 |
| Operating profits | 918 | 1,396 | 1,605 | 1,860 | 2,497 |
| D&A | -166 | -169 | -210 | -224 | -254 |
| EBITDA | 1,084 | 1,566 | 1,814 | 2,084 | 2,751 |
| Finance costs | -140 | -63 | -56 | -58 | -58 |
| Other income/expenses | -17 | -46 | -50 | -50 | -50 |
| Profit before tax | 762 | 1,287 | 1,499 | 1,753 | 2,389 |
| Income tax expense | -257 | -397 | -460 | -525 | -720 |
| Net profit | 505 | 889 | 1,039 | 1,228 | 1,669 |
| Non-controlling interest | 8 | 19 | 2 | 3 | 4 |
| Attributable net profit | 513 | 908 | 1,041 | 1,231 | 1,673 |
| Diluted EPS (RMB) | 0.21 | 0.36 | 0.40 | 0.48 | 0.65 |
| Div. per share (RMB) | 0.12 | 0.21 | 0.23 | 0.28 | 0.38 |

Financial

| | 2020 | 2021 | 2022E | 2023E | 2024E |
|---------------------------------|--------|--------|--------|--------|-------|
| yoY growth rate | | | | | |
| Revenue | -0.1% | 22.5% | 30.5% | 25.1% | 28.6% |
| Gross Profit | -9.9% | 30.6% | 29.5% | 26.8% | 30.4% |
| Operating profit | -25.6% | 52.1% | 14.9% | 15.9% | 34.2% |
| Net profit | -29.5% | 77.1% | 14.7% | 18.2% | 36.0% |
| EPS | -31.6% | 72.0% | 12.6% | 19.4% | 36.0% |
| Profitability | | | | | |
| Gross margin | 39.1% | 41.7% | 41.4% | 42.0% | 42.6% |
| Operating margin | 11.2% | 13.9% | 12.3% | 11.4% | 11.9% |
| Net margin | 6.3% | 9.1% | 8.0% | 7.5% | 8.0% |
| Liquidity | | | | | |
| AR days | 137.3 | 123.3 | 104.4 | 100.0 | 98.9 |
| Inventory days | 74.2 | 77.3 | 86.9 | 84.0 | 76.2 |
| AP days | 106.4 | 119.8 | 114.7 | 105.8 | 104.5 |
| Cash conversion cycle | 105.1 | 80.8 | 76.7 | 78.2 | 70.6 |
| Cash flow & leverage | | | | | |
| Free cash flow (RMB mn) | 217 | 279 | -4 | 486 | 324 |
| Net debt to equity | -18.0% | -17.4% | -17.1% | -12.3% | -6.4% |
| Dividend payout ratio | 60.0% | 58.1% | 57.6% | 58.3% | 58.3% |
| Dividend yield | 1.4% | 2.4% | 2.7% | 3.2% | 4.4% |
| Return analysis | | | | | |
| ROE | 7.2% | 11.9% | 12.7% | 14.1% | 17.6% |
| Asset turnover | 0.7 | 0.7 | 0.8 | 0.9 | 1.1 |
| Net margin | 6.3% | 9.1% | 8.0% | 7.5% | 8.0% |
| Financial leverage | 1.7 | 1.8 | 1.9 | 2.0 | 2.0 |
| ROA | 4.1% | 6.7% | 6.7% | 7.1% | 8.7% |
| Valuation ratios | | | | | |
| P/E | 41.6x | 24.2x | 21.5x | 18.0x | 13.2x |
| P/B | 3.2x | 2.9x | 2.8x | 2.6x | 2.3x |

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

China Merchants Securities (HK) Co., Ltd.

Address: 48/F, One Exchange Square, Central, Hong Kong

Tel: +852 3189 6888 Fax: +852 3101 0828