

## Saucony stands out among the new brands

Rating	<b>BUY</b>	Maintain
Target price	<b>HK\$6.64</b>	
Current price	HK\$5.04	Upside: +31.7%

### FY23 results inline (breakdown in Exhibit 1):

Xtep reported FY23 result with revenue and net profit at RMB14.3bn and RMB1,030mn. up 10.9%/11.8% YoY. While excluding inventory and receivables provisions and write-backs, the group's core operating profit/earnings at RMB1,546/RMB996mn, up 4.4%/6.1% YoY. The key highlight was Saucony and Merrell (S&M) recorded robust sales growth of 99% YoY to RMB796mn with GPM at 55.6% and turned profitable at OP level at RMB8mn (vs. loss of RMB67mn in FY22).

### YTD Core brand's retail sales growth remain resilient

- YTD core brand's retail sales growth remains at positive territory (est. 3-4%) despite high base (1Q23; +20% YoY), while management see polarizing trend in consumption behavior on running shoes with premium (>RMB900) and value-for-money (RMB200-300) outperformed mass market (RMB500-600) SKUs
- Average retail discount see improvement at ~27.5% (vs. ~30% in 4Q23)
- Current channel inventory level maintains at around 4 to 4.5 months

### Core brand's FY24E outlook remains solid

- Management sounds conservative on core brands' FY24E outlook and guide 8-9% sales growth mainly driven by kids and online channel, given consumers' relatively cautious spending appetite.
- Company eyes core brands' GPM at 41-42%, with group's A&P to sales to stay at 11-13% for continual sponsorship of sports events and group's net profit outpacing topline growth in FY24E.
- For new brands, they target S&M revenue growth at 30-40% in FY24E with long-term OPM target >20% (FY23: 1.0%) for Saucony, while K-swiss & Palladium (K&P)'s sales growth at solid level with similar net loss level as FY23 (FY23: loss of RMB184m).
- For network strategies, core brand target net opening of 100-200 stores with more larger format stores, while Saucony/K-swiss/Palladium target net opening of 30-50/30-40/30-40 respectively.

### Maintain BUY with TP at HK\$6.64 based on 13.3x FY24E P/E

Xtep's share price has surged >10% since results announcement on 18<sup>th</sup> March, we believe it was mainly attributed to strong RSV growth and margin expansion on Saucony with potential to be the next earning driver in medium term. Our estimate on Xtep's FY24E/25E/26E revenue and earnings at RMB16.0bn/18.1bn/20.8bn and RMB1.16bn/1.39bn/1.67bn respectively, corresponding to 10.6x/8.8x FY24E/25E P/E. We maintain "BUY" rating on Xtep with TP at HK\$6.64 based on 13.3x FY24E P/E, equivalent to 0.5 standard deviation below 5-year average P/E, as core brand's outlook remains solid with healthy inventory level, ample room for efficiency gain on Saucony and earnings turnaround on other new brands.

## Company update

21 Mar 2024

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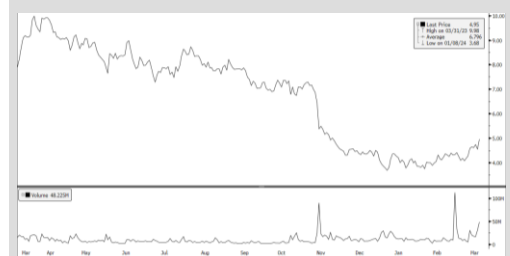
### Trading data

52-Week Range (HK\$)	3.61/10.15
3 Mth Avg Daily Vol (m)	10.4
No. of Shares (m)	2,641.46
Market Cap (HK\$m)	13,075.27
Major Shareholders (%)	Ding's family (52.0)
Auditors	ERNST & YOUNG
Result Due	1H24E: Aug 2024

### Company description

Founded in 1999, Xtep is a leading PRC-based fashion sportswear brand enterprise, which principally engages in the design, development, manufacturing, distributing and marketing, as well as brand management of its brand sports footwear, apparel and accessories. As of 31 Dec, 2023, Xtep's retail network comprises of 8,583 POS.

### Price chart



**Exhibit 1: Xtep Group's FY23 and 2H23 results snapshot**

	2H23	YoYΔ	Cons	vs. Cons	FY23	YoYΔ
Revenue (RMB'm)	7,823	8.0%	7,923	-1.3%	14,346	10.9%
Gross profit (RMB'm)	3,253	12.0%	3,193	1.9%	6,050	14.3%
GPM (%)	41.6	1.5ppt	40.3	1.3ppt	42.2	1.2ppt
Operating profit (RMB'm)	593	9.4%	651	-8.9%	1,580	7.9%
OPM (%)	7.6	0.1ppt	8.2	-0.6ppt	11.0	-0.3ppt
Net profit (RMB'm)	370	11.7%	384	-3.6%	1,030	11.8%
NPM (%)	4.7	0.2ppt	4.8	-0.1ppt	7.2	0.1ppt
*Adj. Net profit (RMB'm)	360	5.5%	409	-11.8%	996	6.1%
*Adj. NPM (%)	4.6	-0.1ppt	5.2	-0.6ppt	6.9	-0.3ppt
Basic EPS (RMB'cents)	14.6	11.2%	13.9	4.9%	40.8	11.3%
DPS (HKD'cents)	8.0	12.7%	7.0	14.7%	21.7	1.6ppt

Source: Company data, CIRL

**Exhibit 2: Xtep Group's key financial**

	1H20	2H20	1H21	2H21	1H22	2H22	1H23	2H23
Revenue (RMB'm)	3,679	4,493	4,135	5,878	5,684	7,247	6,522	7,823
Gross profit (RMB'm)	1,489	1,709	1,729	2,449	2,387	2,905	2,797	3,253
GPM (%)	40.5	38.0	41.8	41.7	42.0	40.1	42.9	41.6
Operating profit (RMB'm)	501	417	684	713	922	543	987	593
OPM (%)	13.6	9.3	16.5	12.1	16.2	7.5	15.1	7.6
Net profit (RMB'm)	248	265	427	482	590	331	660	370
NPM (%)	6.7	5.9	10.3	8.2	10.4	4.6	10.1	4.7
*Adj. Net profit (RMB'm)	307	264	400	485	597	342	635	360
*Adj. NPM (%)	8.3	5.9	9.7	8.3	10.5	4.7	9.7	4.6
Basic EPS (RMB'cents)	10.1	10.8	17.1	19.3	23.5	13.2	26.2	14.6
DPS (HKD'cents)	6.5	7.5	11.5	13.5	13.0	7.1	13.7	8.0

Source: Company data, CIRL

**Exhibit 3: Xtep brand's quarterly operational results**

Quarterly operational results	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23	4Q23
Overall channel Retail Sell-through YoY	32.5%	15.0%	22.5%	-8.0%	20.0%	18.0%	18.0%	>30%
Average retail discount	25.0%	27.5%	27.5%	30.0%	27.5%	25.0%	27.5%	30.0%
Channel inventory turnover (months)	4.0	4.5	4.8	5.5	4.8	4.7	4.8	4.3

Source: Company data, CIRL

**Exhibit 4: Xtep's store count and changes**

	1H19	2H19	1H20	2H20	1H21	2H21	1H22	2H22	1H23	2H23
<b>Total stores count</b>	<b>7,050</b>	<b>7,273</b>	<b>7,013</b>	<b>6,959</b>	<b>7,161</b>	<b>7,481</b>	<b>7,905</b>	<b>8,034</b>	<b>8,256</b>	<b>8,583</b>
Xtep Adult	6,400	6,379	6,124	6,021	6,015	6,151	6,251	6,313	6,443	6,571
Xtep Kids	650	825	800	800	1,000	1,179	1,480	1,520	1,588	1,703
K-Swiss	-	40	42	43	44	44	50	72	80	101
Palladium	-	29	35	57	60	57	71	56	60	94
Saucony	-	-	12	32	36	44	46	69	80	110
Merrell	-	-	-	6	6	6	7	4	5	4
<b>Store changes</b>	<b>370</b>	<b>223</b>	<b>(260)</b>	<b>(54)</b>	<b>202</b>	<b>320</b>	<b>424</b>	<b>129</b>	<b>222</b>	<b>327</b>
Xtep Adult	170	(21)	(255)	(103)	(6)	136	100	62	130	128
Xtep Kids	200	175	(25)	-	200	179	301	40	68	115
K-Swiss	-	40	2	1	1	-	6	22	8	21
Palladium	-	29	6	22	3	(3)	14	(15)	4	34
Saucony	-	-	12	20	4	8	2	23	11	30
Merrell	-	-	-	6	-	-	1	(3)	1	(1)
<b>% change (HoH)</b>	<b>5.5%</b>	<b>3.2%</b>	<b>-3.6%</b>	<b>-0.8%</b>	<b>2.9%</b>	<b>4.5%</b>	<b>5.7%</b>	<b>1.6%</b>	<b>2.8%</b>	<b>4.0%</b>
Xtep Adult	2.7%	-0.3%	-4.0%	-1.7%	-0.1%	2.3%	1.6%	1.0%	2.1%	2.0%
Xtep Kids	44.4%	26.9%	-3.0%	0.0%	25.0%	17.9%	25.5%	2.7%	4.5%	7.2%
K-Swiss	-	-	5.0%	2.4%	2.3%	0.0%	13.6%	44.0%	11.1%	26.3%
Palladium	-	-	20.7%	62.9%	5.3%	-5.0%	24.6%	-21.1%	7.1%	56.7%
Saucony	-	-	-	166.7%	12.5%	22.2%	4.5%	50.0%	15.9%	37.5%
Merrell	-	-	-	-	0.0%	0.0%	16.7%	-42.9%	25.0%	-20.0%

Source: The Company, CIRL

**Exhibit 5: Financial Summary**

Year ended 31 Dec	2022	2023	2024E	2025E	2026E	Year ended 31 Dec	2022	2023	2024E	2025E	2026E
<b>Income Statement (RMBm)</b>						<b>Ratios</b>					
<b>Turnover</b>	<b>12,930</b>	<b>14,346</b>	<b>16,017</b>	<b>18,108</b>	<b>20,804</b>	Gross margin (%)	40.9	42.2	41.7	41.9	42.0
YoY%	29.1	10.9	11.7	13.1	14.9	Operating margin (%)	11.3	11.0	11.1	11.6	12.1
COGS	(7,639)	(8,296)	(9,338)	(10,527)	(12,057)	Net margin (%)	7.1	7.2	7.3	7.7	8.1
<b>Gross profit</b>	<b>5,292</b>	<b>6,050</b>	<b>6,679</b>	<b>7,581</b>	<b>8,746</b>	Selling & dist'n exp/Sales (%)	20.8	23.5	22.0	21.6	21.3
Gross margin	40.9%	42.2%	41.7%	41.9%	42.0%	Admin exp/Sales (%)	8.9	8.0	8.6	8.5	8.4
Other income	317	439	449	463	481	Payout ratio (%)	49.0	47.5	49.1	49.1	49.1
R&D	(299)	(398)	(448)	(489)	(541)	Effective tax (%)	33.0	28.7	30.0	30.0	30.0
Selling & distribution	(2,690)	(3,369)	(3,524)	(3,911)	(4,431)	Total debt/equity (%)	29.2	29.6	26.0	23.7	21.4
Admin	(1,155)	(1,141)	(1,377)	(1,539)	(1,748)	Net debt/equity (%)	Net cash	Net cash	Net cash	Net cash	Net cash
<b>Total opex</b>	<b>(3,827)</b>	<b>(4,470)</b>	<b>(4,901)</b>	<b>(5,476)</b>	<b>(6,238)</b>	Current ratio (x)	1.9	2.3	2.2	2.5	2.3
<b>Operating profit (EBIT)</b>	<b>1,464</b>	<b>1,580</b>	<b>1,778</b>	<b>2,105</b>	<b>2,508</b>	Quick ratio (x)	1.5	2.0	1.8	2.0	1.8
Operating margin	11.3%	11.0%	11.1%	11.6%	12.1%	Inventory T/O (days)	90	90	90	88	85
Interest Income	0	0	0	0	0	AR T/O (days)	98	106	96	85	85
Finance costs	(91)	(145)	(106)	(103)	(103)	AP T/O (days)	121	113	118	115	114
Share of losses of associates	(12)	15	(8)	(5)	(4)	Cash conversion cycle (days)	67	82	68	58	56
Pre-tax profit after financing costs	1,361	1,449	1,665	1,997	2,401	Asset turnover (x)	0.89	0.98	0.98	1.08	1.06
Tax	(449)	(416)	(499)	(599)	(720)	Financial leverage (x)	1.75	1.64	1.61	1.51	1.58
Minority interests	9	(3)	(3)	(4)	(5)	EBIT margin (%)	11.3	11.0	11.1	11.6	12.1
<b>Net profit</b>	<b>922</b>	<b>1,030</b>	<b>1,162</b>	<b>1,394</b>	<b>1,676</b>	Interest burden (x)	0.93	0.92	0.94	0.95	0.96
YoY%	1.5	11.8	12.8	20.0	20.2	Tax burden (x)	0.68	0.71	0.70	0.70	0.70
Net margin	7.1%	7.2%	7.3%	7.7%	8.1%	<b>Return on equity (%)</b>	<b>11.1%</b>	<b>11.5%</b>	<b>11.4%</b>	<b>12.5%</b>	<b>13.6%</b>
<b>EBITDA</b>	<b>1,705</b>	<b>1,885</b>	<b>2,098</b>	<b>2,435</b>	<b>2,847</b>	<b>ROIC (%)</b>	<b>9.9%</b>	<b>8.5%</b>	<b>9.0%</b>	<b>10.1%</b>	<b>11.2%</b>
EBITDA margin	13.2%	13.1%	13.1%	13.4%	13.7%						
<b>EPS (RMB Cents)</b>	<b>36.6</b>	<b>40.8</b>	<b>46.0</b>	<b>55.2</b>	<b>66.3</b>						
YoY%	0.7	11.3	12.8	20.0	20.2						
DPS (HK Cents)	20.1	21.7	25.3	30.3	36.5						
Year ended 31 Dec	2022	2023	2024E	2025E	2026E	Year ended 31 Dec	2022	2023	2024E	2025E	2026E
<b>Cash Flow (RMBm)</b>						<b>Balance Sheet (RMBm)</b>					
Profit before tax	1,361	1,449	1,665	1,997	2,401	PP&E	1368	1593	1853	2096	2325
Depreciation & Amortization	241	305	320	330	339	Land use right	0	0	0	0	0
Chg in working cap	(678)	(21)	224	(709)	(608)	Deposits and prepayments	85	238	238	238	238
Others	146	156	125	143	141	AFS investments	0	0	0	0	0
<b>Operating cash</b>	<b>1,070</b>	<b>1,889</b>	<b>2,334</b>	<b>1,760</b>	<b>2,273</b>	Other financial asset	723	723	707	692	676
Interest received/(paid)	(93)	(145)	(104)	(114)	(121)	<b>Non-current assets</b>	<b>2,175</b>	<b>2,555</b>	<b>2,798</b>	<b>3,025</b>	<b>3,239</b>
Tax	(431)	(531)	(430)	(464)	(475)	Cash	3,414	3,295	4,110	4,165	4,564
<b>Net cash from operating activities</b>	<b>546</b>	<b>1,214</b>	<b>1,800</b>	<b>1,182</b>	<b>1,677</b>	Short term deposits	500	0	0	0	0
Capex	(370)	(496)	(400)	(420)	(440)	Pledged bank deposits	547	862	862	862	862
Change in pledged bank deposits	(514)	(315)	0	0	0	Inventories	2,287	1,794	2,811	2,265	3,351
Change in deposits with banks	(0)	0	0	0	1	Account receivables	4,213	4,975	4,503	5,122	5,936
Interest received	25	41	29	32	34	Available-for-sale investments	0	0	0	0	0
Others	11	(105)	0	0	0	Tax recoverable	1	0	0	0	0
<b>Net cash from investing activities</b>	<b>(847)</b>	<b>(874)</b>	<b>(371)</b>	<b>(388)</b>	<b>(405)</b>	Prepayment, deposits and other receivables	1,371	1,112	1,241	1,403	1,612
FCF	(301)	340	1,429	794	1,272	<b>Current assets</b>	<b>12,333</b>	<b>12,037</b>	<b>13,527</b>	<b>13,817</b>	<b>16,325</b>
Issue of shares	0	0	0	0	0	Account payables	2,772	2,531	3,707	3,127	4,605
Change in borrowing	466	189	0	0	0	Other payables	1,426	1,665	1,387	1,493	1,515
Dividends paid	(550)	(469)	(606)	(727)	(874)	Bank borrowings	2,231	954	954	954	954
Others	(50)	20	(8)	(13)	(0)	Tax payable	108	63	63	63	63
<b>Net cash from financing activities</b>	<b>(134)</b>	<b>(260)</b>	<b>(614)</b>	<b>(740)</b>	<b>(874)</b>	<b>Current liabilities</b>	<b>6,536</b>	<b>5,212</b>	<b>6,111</b>	<b>5,636</b>	<b>7,137</b>
<b>Net change in cash</b>	<b>(435)</b>	<b>80</b>	<b>815</b>	<b>55</b>	<b>398</b>	Bank borrowings	193	1,691	1,691	1,691	1,691
Adj	21	2	0	0	1	Other payables	0	0	0	0	0
Opening cash	3,929	3,414	3,294	4,110	4,165	Deferred tax liabilities	310	243	243	243	243
<b>Closing cash</b>	<b>3,516</b>	<b>3,495</b>	<b>4,110</b>	<b>4,165</b>	<b>4,563</b>	Deferred subsidy	19	19	19	19	19
						<b>Non-current liabilities</b>	<b>522</b>	<b>1,953</b>	<b>1,953</b>	<b>1,953</b>	<b>1,953</b>
						Share capital	23	23	23	23	23
						Reserves	8,221	8,841	10,073	11,051	12,265
						<b>Shareholders' equity</b>	<b>8,244</b>	<b>8,864</b>	<b>10,096</b>	<b>11,074</b>	<b>12,288</b>
						Minority interest	63	61	64	68	73
						<b>Total Equity</b>	<b>8,307</b>	<b>8,925</b>	<b>10,160</b>	<b>11,143</b>	<b>12,361</b>
						Total debts	2,424	2,645	2,645	2,645	2,645
						Net cash/(debts)	990	650	1,465	1,520	1,919

Source: Company, CIRL estimates

## Rating Policy

	Rating	Definition
<b>Stock Rating</b>	Buy	Outperform HSI by 15%
	Neutral	Between -15% ~ 15% of the HSI
	Sell	Underperform HSI by -15%
<b>Sector Rating</b>	Accumulate	Outperform HSI by 10%
	Neutral	Between -10% ~ 10% of the HSI
	Reduce	Underperform HSI by -10%

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## Analyst Certification

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