

## Xtep International (1368 HK)

**Hold** (maintained)

Target price: HK\$2.85



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FY14 results miss, receivables days up; cut TP to HK\$2.85

**FY14 results miss** Net profit fell 21% YoY to Rmb478m, 16% below consensus and 17% below our estimate, mainly due to the additional Rmb104m provision for impaired receivables in 2H14.

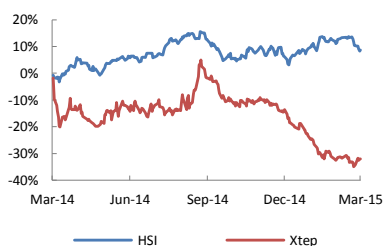
**Net cash balance declined** Average turnover days of trade and bills receivables rose 9 days YoY to 102 days, even with provisions made up 149% YoY. The proportion of past due receivables was still high at 30% (36% in FY13) or Rmb373m (Rmb410m in FY13). Without the provision made in FY14, total past due receivables would have increased 22% YoY (see figure 1). Credit period was extended from three to four months to support distributors. Net cash balance fell 9% YoY to Rmb2.6bn. So far, Xtep is the only sportswear company to record an increase in receivables days and a decrease in net cash balance in FY14, while its peers are seeing an improving trend.

**Results highlights** Revenue +10% YoY, led by high single-digit growth in replenishment orders. 4Q14 SSSG remained mid single-digit. The number of Xtep brand stores fell 3% to 7,110. Revenue in its kids and e-commerce segments grew significantly. The number of POS in the company's kids segment increased from 300 to 500 in FY14. The proportion of sales from its kids and e-commerce segments each rose to a mid single-digit percentages of total revenue, according to management. GM rose 0.6pp YoY to 40.8% on an increased contribution from footwear, up from 52% to 64% of total revenue (footwear GM was 42.1%). Both revenue and GM came in above market expectation. Excluding provisions, OP margin fell 2.2pp to 19.6%, driven by a 1.9pp increase in A&P expenses ratio (see figure 2).

**FY15 outlook** 1) The number of kids stores is set to rise from 500 to 600-800, while the number of Xtep brand stores should remain at ~7,110. The company will further optimize its retail network and continue to implement the "Xtep 7th generation" store image across its retail channels. 2) It will introduce a new marketing campaign for its kids segment with an animated cartoon: the "Dream Corps" cartoon series recently launched in China. 3) The company will also strengthen its running footwear product portfolio.

**Maintain Hold; TP cut to HK\$2.85** We lower our FY15/16 net profit forecasts by 16%/15%, mainly to reflect a higher receivables provision and A&P expenses ratio. We cut our target price from HK\$3.66 to HK\$2.85, still based on 9.6x FY15E P/E, its historical average forward P/E. Although we estimate Xtep brand revenue growth (excl. kids and e-commerce) had increased 9-10% YoY in 2H14 (vs ~-2% in 1H14) driven by replenishment orders, we are concerned that this sales recovery may not be sustainable given a lack of improvement in order book growth (still at low single-digits) and SSSG (at mid single-digits in 2-4Q14), and the rising receivables days. In addition, compared to the higher weighting of performance sportswear in peers' product portfolios, Xtep's focus on more casual sportswear means it faces intense competition from other casual wear brands, including international fast fashion brands and Adidas' NEO brand.

### Stock performance



Source: Bloomberg

### Key data

Mar 12 close (HK\$)	2.61
Shares in issue (m)	2178.1
Major shareholder	Ding Shuibao (60.7%)
Market cap (HK\$ bn)	5.7
3M avg. vol. (m)	0.8
52W high/low (HK\$)	4.03/2.46

Source: Bloomberg

### Stock valuation

	Turnover (Rmb m)	Net profit (Rmb m)	EPS (Rmb)	EPS YoY (%)	P/E	Ex-net cash P/E	Yield (%)	BPS (Rmb)	P/B	ROE (%)
2012	5,550	810	0.372	-16	5.7	2.3	10.6	2.0	1.1	19.8
2013	4,343	606	0.278	-25	7.4	2.7	6.9	2.1	1.0	13.8
2014	4,778	478	0.220	-21	9.4	4.0	6.3	2.2	0.9	10.4
2015E	5,205	516	0.237	8	8.8	3.3	5.7	2.3	0.9	10.7
2016E	5,647	559	0.257	8	8.0	2.4	6.3	2.4	0.8	10.9

Sources: Company data, GF Securities (HK)

Figure 1: Trade and bills receivables

(Rmb m)	Remarks	FY13	FY14	Change (YoY)
Gross trade receivables		1,266	1,487	
Less: provisions made		(128)	(256)	
Net trade receivables	(1)	1,138	1,231	8%
Breakdown by aging analysis:				
Neither past due nor impaired		728	859	
Less than 3 mth past due		298	266	
past due over 3 to 6 mths		82	107	
past due over 6 mth		30	0	
		1,138	1,231	8%
Bills receivables	(2)	13	259	1889%
Trade and bills receivables	(1)+(2)	1,151	1,490	29%
Average trade and bills receivables days		92	101	+9
Total past due trade receivables	(3)	410	373	-9%
Proportion of past due trade receivables	(3)/(1)	36%	30%	-6ppt
Provisions made in FY14				
Growth of past due trade receivables if no provision made in FY14		410	500	22%

Sources: Company data, GF Securities (HK) estimates

Figure 2: Results review

Y/E Dec (Rmb m)	FY14	FY13	% change	2H14	2H13	% change	1H14	1H13	% change
<b>Revenue</b>	<b>4,778</b>	<b>4,343</b>	<b>10%</b>	<b>2,643</b>	<b>2,245</b>	<b>18%</b>	<b>2,135</b>	<b>2,098</b>	<b>2%</b>
Cost of sales	(2,831)	(2,596)	9%	(1,558)	(1,341)	16%	(1,273)	(1,255)	1%
Gross profit	1,947	1,748	11%	1,085	905	20%	862	843	2%
Other income	149	158	-6%	72	103	-29%	76	56	37%
Selling and distribution expenses	(799)	(595)	34%	(471)	(364)	29%	(328)	(231)	42%
Administrative expenses	(488)	(416)	18%	(303)	(223)	36%	(185)	(192)	-4%
Operating profit	809	895	-10%	383	420	-9%	426	476	-10%
Adj. operating profit (excl. write-down of doubtful debts)	936	947	-1%	487	441	11%	449	506	-11%
Finance income	41	46	-11%	23	21	11%	18	25	-29%
Finance costs	(80)	(79)	1%	(49)	(55)	-10%	(31)	(24)	27%
Profit before tax	770	863	-11%	357	386	-8%	413	476	-13%
Tax expense	(284)	(260)	9%	(156)	(124)	26%	(128)	(136)	-6%
Profit after tax	486	603	-19%	201	263	-23%	285	340	-16%
Non-controlling interests	(8)	3	-396%	(8)	2	-454%	(0)	1	-166%
<b>Net profit</b>	<b>478</b>	<b>606</b>	<b>-21%</b>	<b>194</b>	<b>265</b>	<b>-27%</b>	<b>284</b>	<b>341</b>	<b>-17%</b>
EPS (HK\$)	0.22	0.28	-21%	0.09	0.12	-27%	0.13	0.16	-17%
DPS (HK\$)	0.17	0.18	-8%				0.09	0.10	-15%
<b>Margin &amp; Ratio (%)</b>									
Gross margin	40.8	40.2	0.6	41.0	40.3	0.7	40.4	40.2	0.2
Operating margin	16.9	20.6	(3.7)	14.5	18.7	(4.2)	19.9	22.7	(2.8)
Adj. Operating margin	19.6	21.8	(2.2)	18.4	19.6	(1.2)	21.1	24.1	(3.0)
SG&A expense/revenue	26.9	23.3	3.6	29.3	26.2	3.1	24.0	20.2	3.8
A&P expense ratio	13.1	11.2	1.9	13.5	13.2	0.3	12.5	9.0	3.5
R&D expense ratio	2.2	2.6	(0.4)	2.1	2.9	(0.8)	2.4	2.3	0.1
Staff expense ratio	9.5	9.5	0.0	9.3	10.4	(1.1)	9.8	8.5	1.3
Net margin	10.0	14.0	(4.0)	7.3	11.8	(4.5)	13.3	16.2	(2.9)
Effective tax rate	36.9	30.1	6.8	43.6	32.0	11.6	31.1	28.6	2.5
Payout ratio	60.0	51.3	8.7				51.6	50.8	0.8
	<b>FY14</b>	<b>FY13</b>	<b>change</b>				<b>1H14</b>	<b>1H13</b>	<b>change</b>
Inventory days	71	79	(8)				94	86	8
A/C and bills receivables days	101	92	9				96	96	0
A/C payable days	85	76	9				101	84	17
Number of stores	7,110	7,360	-3%				7,310	7,435	-2%
Net cash (Rmb m)	2,604	2,863	-9%				2,268	2,796	-19%

Sources: Company data, GF Securities (HK)

Figure 3: Order book growth for sportswear companies

	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15
Anta	20-30% decline	15-25% decline	10-20% decline	5-15% decline	high single-digit growth	high single-digit growth	high single-digit growth	low double-digit growth	low double-digit growth	low double-digit growth	low double-digit growth
Li Ning	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Xtep	15-20% decline	15-20% decline	20% decline	15-17% decline	high single-digit decline	mid single-digit decline	low single-digit decline	0%	low single-digit growth	low single-digit growth	low single-digit growth
Peak	0%	25-30% decline	NA	NA	low single-digit decline	high single-digit growth	mid-teens growth	mid-teens growth	mid-teens growth	mid-teens growth	mid-teens growth
361 Degrees	23% decline	23% decline	NA	17% decline	11% decline	11% decline	7% decline	8%	11%	11%	16%

Source: Company data, GF Securities (HK)

Figure 4: SSS trend for sportswear companies

	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14	3Q14	4Q14
Anta	0%	0%	0%	mid single-digit growth	mid single-digit growth	low double-digit growth	high single-digit growth	high single-digit growth
Li Ning	----- 9% -----		NA	NA	NA	NA	NA	NA
Xtep	0%	0%	0%	0%	low single-digit growth	mid single-digit growth	mid single-digit growth	mid single-digit growth
Peak	0%	0%	low single-digit growth	low single-digit growth	low single-digit growth	low single-digit growth	low single-digit growth	low single-digit growth
361 Degrees	-2%	-1%	0%	2%	2%	3%	5%	6%

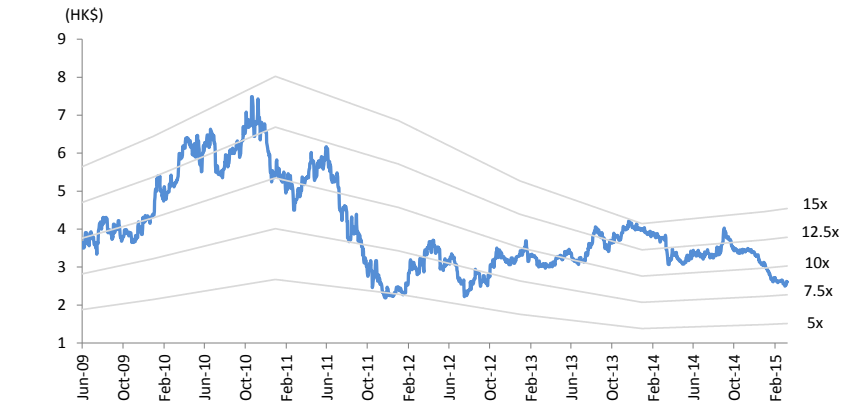
Source: Company data, GF Securities (HK)

Figure 5: Key assumptions

(Rmb m)	FY11	FY12	FY13	FY14	FY15E	FY16E
<b>Total revenue</b>	<b>5,540</b>	<b>5,550</b>	<b>4,343</b>	<b>4,778</b>	<b>5,205</b>	<b>5,647</b>
growth %	24.3%	0.2%	-21.8%	10.0%	8.9%	8.5%
Xtep products	5,375	5,475	4,180	4,343	4,604	4,882
growth %	27.7%	1.9%	-23.6%	3.9%	6.0%	6.0%
Other products	165	76	163	435	600	765
growth %	-33.3%	-54.0%	114.8%	167.2%	38.0%	27.4%
Gross profit	2,258	2,258	1,748	1,947	2,146	2,341
Gross margin	40.8%	40.7%	40.2%	40.8%	41.2%	41.5%
Selling & distribution expenses ratio	13.2%	13.3%	13.7%	16.7%	17.9%	18.6%
Administrative expenses ratio	5.8%	8.2%	9.6%	10.2%	9.5%	9.0%
Operating profit margin	22.0%	20.4%	20.6%	16.9%	16.4%	16.2%
Effective tax rate	20.3%	27.0%	30.1%	36.9%	34.0%	32.5%
<b>Net profit</b>	<b>966</b>	<b>810</b>	<b>606</b>	<b>478</b>	<b>516</b>	<b>559</b>
growth %	18.8%	-16.2%	-25.2%	-21.1%	8.0%	8.3%
Net profit margin	17.4%	14.6%	14.0%	10.0%	9.9%	9.9%
Payout ratio	50.0%	61.0%	51.3%	60.0%	50.0%	50.0%

Sources: Company data, GF Securities (HK) estimates

Figure 6: P/E band



Sources: Bloomberg, GF Securities (HK) estimates

Figure 7: Financial statements

Income Statement						Balance Sheet					
Year end Dec 31 (Rmb m)	FY12	FY13	FY14	FY15E	FY16E	Year end Dec 31 (Rmb m)	FY12	FY13	FY14	FY15E	FY16E
<b>Revenue</b>	<b>5,550</b>	<b>4,343</b>	<b>4,778</b>	<b>5,205</b>	<b>5,647</b>	<b>Fixed assets</b>					
Cost of sales	(3,293)	(2,596)	(2,831)	(3,058)	(3,306)	PPE	387	545	585	664	738
Gross profit	2,258	1,748	1,947	2,146	2,341	Prepaid land lease payments	225	221	216	216	211
Other income	68	158	149	133	133	Intangible assets	1	1	2	2	2
Selling & distribution expenses	(739)	(595)	(799)	(930)	(1,052)	AFS investments	33	33	48	48	48
Administration expenses	(455)	(416)	(488)	(495)	(506)	Deposits	17	45	66	66	66
Operating profit	1,131	895	809	853	916	Non-current time deposits	0	110	0	0	0
Net finance cost	(25)	(32)	(38)	(47)	(54)		663	955	917	996	1,065
Profit before tax	1,106	863	770	806	862	<b>Current assets</b>					
Income tax expense	(299)	(260)	(284)	(274)	(280)	Inventories	583	537	569	615	664
Non-controlling interests	3	3	(8)	(16)	(22)	A/C receivables	1,036	1,151	1,490	1,542	1,589
<b>Net profit</b>	<b>810</b>	<b>606</b>	<b>478</b>	<b>516</b>	<b>559</b>	Prepayments	421	386	424	462	501
<b>EPS (Rmb)</b>	<b>0.37</b>	<b>0.28</b>	<b>0.22</b>	<b>0.24</b>	<b>0.26</b>	Tax recoverable	16	0	21	21	21
						AFS investments	100	0	450	450	450
<b>Growth rates (%)</b>						Pledged bank deposits	557	715	746	933	1,092
Revenue	0	(22)	10	9	8	Time deposits	0	0	110	110	110
Net profit	(16)	(25)	(21)	8	8	Cash and cash equivalents	3,123	3,563	3,137	3,531	4,016
EPS	(16)	(25)	(21)	8	8		5,836	6,352	6,947	7,664	8,443
<b>Margin &amp; ratios (%)</b>						<b>Total assets</b>	<b>6,499</b>	<b>7,307</b>	<b>7,864</b>	<b>8,660</b>	<b>9,508</b>
Gross margin	40.7	40.2	40.8	41.2	41.5	<b>Current liabilities</b>					
OP margin	20.4	20.6	16.9	16.4	16.2	A/C payables	483	601	729	788	851
Net margin	14.6	14.0	10.0	9.9	9.9	Other payables	287	333	323	370	400
Effective tax rate	27.0	30.1	36.9	34.0	32.5	Bank borrowings	511	1,351	1,222	1,432	1,676
Payout ratio	61.0	51.3	60.0	50.0	50.0	Tax payables	156	72	77	77	78
							1,437	2,356	2,350	2,667	3,005
						<b>Non-current liabilities</b>					
<b>Cash Flow Statement</b>						Bank borrowings	535	175	617	738	863
<b>Year end Dec 31 (Rmb m)</b>	<b>FY12</b>	<b>FY13</b>	<b>FY14</b>	<b>FY15E</b>	<b>FY16E</b>	Deferred tax liabilities	133	153	121	153	153
Profit before tax	1,106	863	770	806	862	Deferred tax liabilities	115	115	65	115	115
Depreciation and amortization	39	49	45	46	52		783	443	804	1,006	1,132
Net finance cost	23	32	38	47	54	<b>Equity</b>					
(Reversal of)/provision for impairment of receivables	77	51	128	100	70	Shareholders' equity	4,274	4,506	4,700	4,961	5,323
Income derived from AFS investment	0	(100)	(115)	(100)	(100)	Non-controlling interests	5	2	10	26	48
Others	43	14	5	0	0		4,280	4,508	4,710	4,987	5,371
Change of working capital	329	75	(417)	(30)	(43)	<b>Total liabilities &amp; equity</b>	<b>6,499</b>	<b>7,307</b>	<b>7,864</b>	<b>8,660</b>	<b>9,508</b>
Interest received	40	46	41	47	54						
Interest paid	(51)	(65)	(69)	(94)	(108)	<b>Financial Ratios</b>					
Tax paid	(276)	(308)	(332)	(279)	(277)	<b>Year end Dec 31</b>	<b>FY12</b>	<b>FY13</b>	<b>FY14</b>	<b>FY15E</b>	<b>FY16E</b>
<b>Operating cash flow</b>	<b>1,330</b>	<b>658</b>	<b>95</b>	<b>543</b>	<b>564</b>	Current ratio	4.1	2.7	3.0	2.9	2.8
Capex	(176)	(230)	(157)	(120)	(120)	Quick ratio	3.7	2.5	2.7	2.6	2.6
(Acquisition)/disposal of subsidiaries	0	4	0	0	0	A/C receivable turnover days	74	92	101	106	101
Receipt of government subsidy	0	0	0	0	0	A/C payable turnover days	54	76	86	90	90
Increase in pledged deposit	(36)	(158)	(31)	(187)	(159)	Inventory turnover days	70	79	71	71	71
Increase in time deposit with maturity over three months	0	(110)	(465)	0	0	Asset turnover	0.9	0.6	0.6	0.6	0.6
Change of AFS financial investments	(133)	100	0	0	0	Total assets/total equity	1.5	1.6	1.7	1.7	1.8
Others	0	100	115	100	100	Net gearing ratio (%)	net cash	net cash	net cash	net cash	net cash
<b>Investing cash flow</b>	<b>(345)</b>	<b>(294)</b>	<b>(538)</b>	<b>(207)</b>	<b>(179)</b>	ROE (%)	19.8	13.8	10.4	10.7	10.9
Change of borrowings	556	503	301	331	369	ROA (%)	13.5	8.8	6.3	6.2	6.2
Cap contr from non-controlling shareholder	4	0	0	0	0						
Dividend paid	(490)	(428)	(288)	(273)	(269)						
Others	(1)	3	2	0	0						
Share issue	0	1	2	0	0						
<b>Financing cash flow</b>	<b>69</b>	<b>78</b>	<b>17</b>	<b>58</b>	<b>100</b>						
<b>Net change of cash flow</b>	<b>1,055</b>	<b>442</b>	<b>(426)</b>	<b>394</b>	<b>485</b>						

Sources: Company data, GF Securities (HK) estimates

## Rating definitions

Benchmark: Hong Kong Hang Seng Index  
Time horizon: 12 months

### Company ratings

<b>Buy</b>	Stock expected to outperform benchmark by more than 15%
<b>Accumulate</b>	Stock expected to outperform benchmark by more than 5% but not more than 15%
<b>Hold</b>	Expected stock relative performance ranges between -5% and 5%
<b>Underperform</b>	Stock expected to underperform benchmark by more than 5%

### Sector ratings

<b>Positive</b>	Sector expected to outperform benchmark by more than 10%
<b>Neutral</b>	Expected sector relative performance ranges between -10% and 10%
<b>Cautious</b>	Sector expected to underperform benchmark by more than 10%

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