

# Xtep International

## Recovery on the way as business transformation nears end

### Results Review

#### 2017 results beat expectation

**Xtep International announced 2017 results:** Revenue slipped 5.2% to Rmb5,113mn; net profit of Rmb408mn (Rmb0.18/share) was down 22.7%, **less than the 30% we originally forecast and the 25–35% the company previously warned of.** Net of a Rmb121mn one-off loss due to product repurchases, net profit edged up 0.2%. Including a special dividend of HK\$0.10, Xtep paid a DPS of HK\$0.23 (for a yield of 6%).

**Retail overview:** E-business contributed over 20% of sales, while offline stores totaled around 6,000 (down 12% from around 6,800 at end-2016 due to channel adjustments), and 250 of these are Xtep Kids stores. Store efficiency improved on increases in stores directly operated by distributors (accounting for more than 60% of POS) and more renovated stores. **SSSG in 2017 was in the mid-single digits.** Retail inventory remained below the industry average at four months.

Gross margin rose 0.7ppt to 43.9%. SD&A expense ratio rose 4.8ppt on higher A&P and R&D costs, product buybacks and inventory write-downs.

#### Trends to watch

SSSG continued to improve in January–February (it was in the high single digits in 4Q17). We expect channel restocking and positive sales growth for the whole year. Xtep intends to launch footwear of international standards this year thanks to extensive R&D efforts.

#### Earnings forecast

**We raise our 2018 and 2019 EPS forecasts by 19.4% and 20.6% to Rmb0.24 and Rmb0.28 (implying growth of 33.3% and 15.7%).**

#### Valuation and recommendation

The stock is trading at 12x 2018e and 11x 2019e P/E. **We maintain HOLD but raise our target 24.3% to HK\$4.29 (based on 12x 2019e P/E and offering 11.8% upside).** We believe a strategic transformation in 2017 will drive long-term organic growth despite short-term pains, but Xtep should be cautious in initiating a multi-brand strategy.

#### Risks

Retail performance recovers more slowly than expected.

#### Haiyan GUO

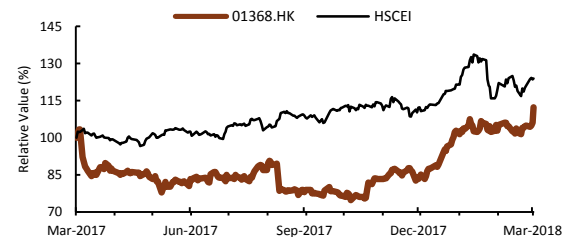
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### Maintain HOLD

Ticker	01368.HK
CICC investment rating	HOLD
Last close	HK\$3.84
CICC target	HK\$4.29
52wk price range	HK\$3.86~2.54
Market cap (bn)	HK\$9
Daily value (mn)	HK\$6.40
Shares outstanding (mn)	2,221
Free float (%)	100
Daily volume (mn sh)	1.78
Business sector	Apparel



(Rmb mn)	2016A	2017A	2018E	2019E
Revenue	5,397	5,113	5,651	6,468
(+/-)	1.9%	-5.2%	10.5%	14.5%
Net profit	528	408	544	629
(+/-)	-15.2%	-22.7%	33.3%	15.7%
EPS	0.24	0.18	0.24	0.28
BPS	2.26	2.40	2.48	2.64
DPS	0.14	0.19	0.15	0.17
CPS	0.16	0.25	0.33	0.29
P/E	14.5	17.4	12.4	10.7
P/B	1.5	1.3	1.2	1.2
EV/EBITDA	6.5	6.5	4.7	4.0
Dividend yield	4.2%	5.8%	4.8%	5.6%
ROAA	6.5%	4.8%	5.9%	6.3%
ROAE	10.7%	7.9%	10.0%	11.1%

Source: Wind, Bloomberg, Corporate filings, CICC Research



## Financial summary

Financial statement (Rmb mn)	2016A	2017A	2018E	2019E	Financial ratios	2016A	2017A	2018E	2019E
<b>Income statement</b>					<b>Growth ability</b>				
Revenue	5,397	5,113	5,651	6,468	Revenue	1.9%	-5.2%	10.5%	14.5%
COGS	-3,065	-2,869	-3,142	-3,577	Operating profit	-0.4%	-21.0%	29.5%	15.9%
Selling expenses	-851	-911	-1,011	-1,164	EBITDA	-0.8%	-18.1%	24.1%	15.7%
Administrative expenses	-662	-767	-712	-815	Net profit	-15.2%	-22.7%	33.3%	15.7%
Other ops income (expense)	0	0	0	0	<b>Profitability</b>				
Operating profit	917	725	938	1,087	Gross margin	43.2%	43.9%	44.4%	44.7%
Finance costs	-51	-54	-69	-81	Operating margin	17.0%	14.2%	16.6%	16.8%
Other income (expense)	0	0	0	0	EBITDA margin	18.2%	15.7%	17.6%	17.8%
Profit before income tax	866	671	869	1,006	Net margin	9.8%	8.0%	9.6%	9.7%
Income tax	-293	-224	-278	-322	<b>Liquidity</b>				
Minority interest	45	38	47	55	Current ratio	2.38	3.17	3.40	3.25
Net profit	528	408	544	629	Quick ratio	2.23	2.88	3.20	2.97
EBITDA	980	802	996	1,152	Cash ratio	0.94	1.54	1.71	1.64
Recurrent net income	528	408	544	629	Liabilities / assets	38.6%	40.4%	42.1%	43.4%
<b>Balance sheet</b>					Net debt / equity	net cash	net cash	net cash	net cash
Cash and bank balances	2,847	3,832	4,235	4,654	<b>Return</b>				
Trade and bill receivables	2,103	1,807	2,219	2,212	RoA	6.5%	4.8%	5.9%	6.3%
Inventories	460	718	487	787	RoE	10.7%	7.9%	10.0%	11.1%
Other current assets	1,808	1,525	1,464	1,576	<b>Per-share data</b>				
Total current assets	7,217	7,882	8,405	9,229	EPS (Rmb)	0.24	0.18	0.24	0.28
Fixed assets and CIP	618	646	684	717	BPS (Rmb)	2.26	2.40	2.48	2.64
Intangible assets and others	339	406	413	420	DPS (Rmb)	0.14	0.19	0.15	0.17
Total non-current assets	957	1,052	1,098	1,137	Cash flow per share (Rmb)	0.16	0.25	0.33	0.29
Total assets	8,174	8,934	9,503	10,366	<b>Valuation</b>				
Short-term borrowings	1,502	831	611	672	P/E	14.5	17.4	12.4	10.7
Trade and bill payables	896	1,028	1,124	1,345	P/B	1.5	1.3	1.2	1.2
Other current liabilities	632	630	741	822	EV/EBITDA	6.5	6.5	4.7	4.0
Total current liabilities	3,029	2,489	2,475	2,839	Dividend yield	4.2%	5.8%	4.8%	5.6%
Long-term borrowings	0	1,019	1,425	1,567					
Total non-current liabilities	122	1,116	1,522	1,664					
Total liabilities	3,151	3,605	3,997	4,503					
Share capital	20	20	20	20					
Retained profit	4,934	5,201	5,331	5,634					
Equity	5,023	5,329	5,506	5,864					
Total liabilities & equity	8,174	8,934	9,503	10,366					
<b>Cash flow statement</b>									
Pretax profit	866	671	869	1,006					
Depreciation & amortization	63	78	58	65					
Change in working capital	-510	-119	87	-103					
Others	-73	-72	-278	-322					
Cash flow from operations	346	558	736	646					
Capital expenditure	-114	-177	-104	-105					
Others	-453	452	0	0					
Cash flow from investing	-567	275	-104	-105					
Equity financing	62	7	0	0					
Bank borrowings	-228	421	185	204					
Others	-377	-274	-414	-326					
Cash flow from financing	-542	154	-229	-123					
Foreign exchange gain (loss)	3	-1	0	0					
Net changes in cash	-760	986	403	419					

Source: Corporate filings, CICC Research

## Company description

Xtep International Holdings Limited designs, develops, manufactures and markets sportswear, including footwear, apparel and accessory products. Its products are sold under the company's Xtep and Koling brands and the Disney Sport brand, which is licensed by The Walt Disney Company (Shanghai) Limited to the company in the People's Republic of China and by the Walt Disney Company (Asia Pacific) Limited to Xtep International Holdings Limited in Hong Kong and Macau.



Figure 1: Results review

(Rmb mn)	2016A	2017E	2017A	2017A YoY	vs CICC estimate	2018E	2018E YoY
Revenue	5,397	4,991	5,113	-5.2%	2.5%	5,651	10.5%
Gross profit	2,331	2,176	2,244	-3.7%	3.1%	2,509	11.8%
Operating profit	917	674	725	-21.0%	7.5%	938	29.5%
Net profit	528	368	408	-22.7%	10.9%	544	33.3%
<b>Fully-diluted EPS (Rmb)</b>	<b>0.24</b>	<b>0.17</b>	<b>0.18</b>	<b>-22.7%</b>	<b>10.9%</b>	<b>0.24</b>	<b>33.3%</b>
Gross margin	43.2%	43.6%	43.9%	0.7ppt	0.3ppt	44.4%	0.5ppt
Operating margin	17.0%	13.5%	14.2%	-2.8ppt	0.7ppt	16.6%	2.4ppt
Net margin	9.8%	7.4%	8.0%	-1.8ppt	0.6ppt	9.6%	1.6ppt

Source: Company annual results, CICC Research

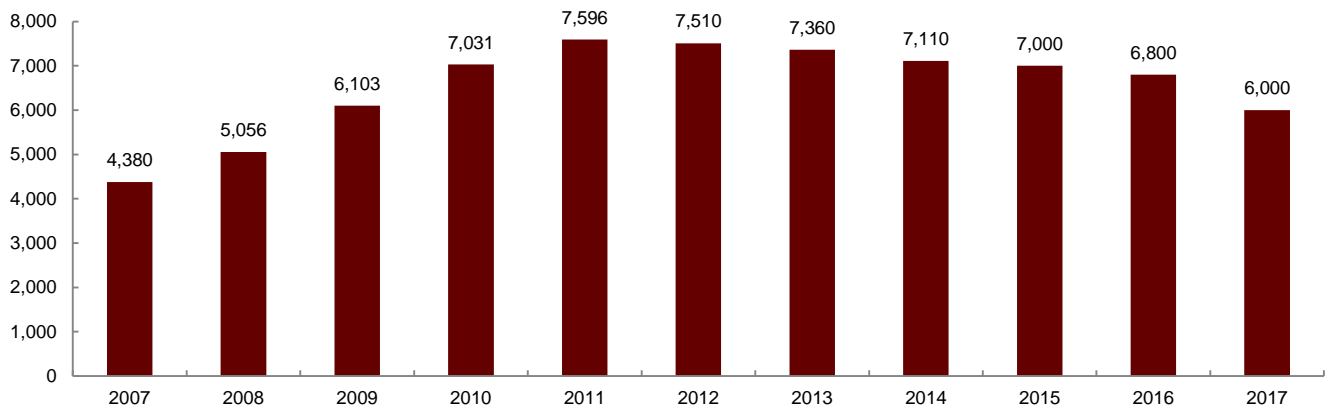
Figure 2: Historical interim results breakdown

(Rmb mn)	1H16	2H16	2016	1H17	2H17	2017	1H17(+/-)	2H17(+/-)	2017(+/-)
<b>Revenue</b>	<b>2,535</b>	<b>2,862</b>	<b>5,397</b>	<b>2,311</b>	<b>2,803</b>	<b>5,113</b>	<b>-8.8%</b>	<b>-2.1%</b>	<b>-5.2%</b>
Cost of sales	-1,436	-1,629	-3,065	-1,295	-1,574	-2,869	-9.8%	-3.4%	-6.4%
<b>Gross profit</b>	<b>1,099</b>	<b>1,233</b>	<b>2,331</b>	<b>1,016</b>	<b>1,229</b>	<b>2,244</b>	<b>-7.5%</b>	<b>-0.3%</b>	<b>-3.7%</b>
Other income and gains	48	51	99	96	63	158	100.5%	22.9%	60.5%
Selling and distribution expenses	-320	-530	-851	-385	-526	-911	20.2%	-0.8%	7.1%
General and administrative expenses	-242	-420	-662	-247	-520	-767	1.8%	23.9%	15.8%
<b>Operating income</b>	<b>583</b>	<b>334</b>	<b>917</b>	<b>479</b>	<b>245</b>	<b>725</b>	<b>-17.9%</b>	<b>-26.5%</b>	<b>-21.0%</b>
Net finance cost	-7	-45	-51	-12	-42	-54	77.5%	-6.6%	4.6%
Profit before tax	577	289	866	467	204	671	-19.0%	-29.5%	-22.5%
Income tax expense	-173	-120	-293	-131	-93	-224	-24.0%	-22.4%	-23.3%
Noncontrolling interests	-24	-21	-45	-25	-13	-38	6.8%	-40.0%	-15.3%
<b>Net profit</b>	<b>380</b>	<b>148</b>	<b>528</b>	<b>310</b>	<b>98</b>	<b>408</b>	<b>-18.4%</b>	<b>-33.8%</b>	<b>-22.7%</b>
Financial ratios	1H16	2H16	2016	1H17	2H17	2017	1H17(+/-)	2H17(+/-)	2017(+/-)
Gross Margin	43.3%	43.1%	43.2%	43.9%	43.8%	43.9%	0.6%	0.8%	0.7%
Distribution costs/Turnover	12.6%	18.5%	15.8%	16.7%	18.8%	17.8%	4.0%	0.2%	2.1%
Administrative Expenses/Turnover	9.6%	14.7%	12.3%	10.7%	18.6%	15.0%	1.1%	3.9%	2.7%
Operation Margin	23.0%	11.7%	17.0%	20.7%	8.8%	14.2%	-2.3%	-2.9%	-2.8%
Effective tax rate	29.9%	41.5%	33.8%	28.1%	45.7%	33.5%	-1.8%	4.2%	-0.4%
Net Margin	15.0%	5.2%	9.8%	13.4%	3.5%	8.0%	-1.6%	-1.7%	-1.8%

Source: Company annual results, CICC Research

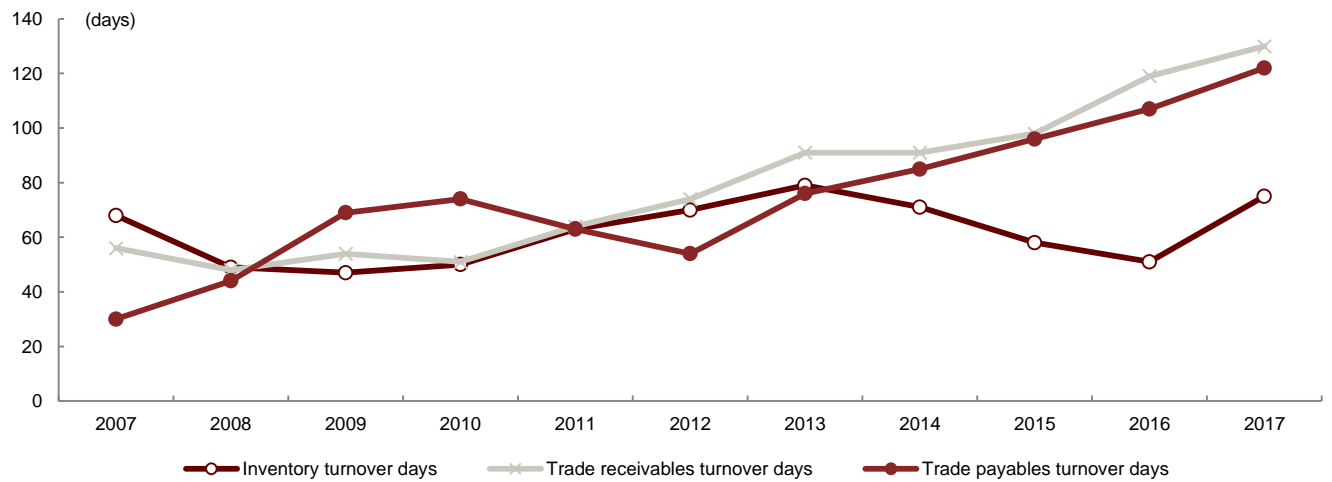


Figure 3: Number of POS (2007–2017)



Source: Company annual results, CICC Research

Figure 4: Working capital cycle (2007-2017)



Source: Company annual results, CICC Research



Figure 5: Same-store and retail sales growth trends of various sports brands

Ticker	Xtep 1368.HK	Peak (Unlisted)	361 Degrees 1361.HK	China Dongxiang 3818.HK	Anta 2020.HK	Li Ning 2331.HK
<b>SSSG</b>						
1Q14	Low-single digit growth	Low-single digit growth	1.8%	n.a	Mid-single digit growth	n.a
2Q14	Mid-single digit growth	Low-single digit growth	2.8%	n.a	Low-double digit growth	n.a
3Q14	Mid-single digit growth	Low-single digit growth	4.7%	n.a	High-single digit growth	n.a
4Q14	Mid-single digit growth	Low-single digit growth	5.5%	n.a	High-single digit growth	n.a
1Q15	Mid-single digit growth	Mid-single digit growth	6.3%	23%	High-single digit growth	Mid-single digit growth
2Q15	High-single digit growth	Mid-single digit growth	7.2%	21.5%	High-single digit growth	Low-double digit growth
3Q15	High-single digit growth	High-single digit growth	8.4%	Mid-single digit growth	High-single digit growth	Mid-single digit growth
4Q15	Mid-single digit growth	Mid-single digit growth	7.9%		Mid-single digit growth	Low-single digit growth
1Q16	Mid-single digit growth	Flat	7.2%		Mid-single digit growth *(Retail sales)	Low-single digit growth
2Q16	Mid-single digit growth		7.0%		High-single digit growth *(Retail sales)	High-single digit growth
3Q16	Mid-single digit growth		7.3%		Low-double digit growth *(Retail sales)	High-single digit growth
4Q16	Mid-single digit growth		7.5%		High-teens growth *(Retail sales)	Mid-teens growth
1Q17	Low-single digit growth		7.0%		Low-teens growth *(Retail sales)	Flat
2Q17	Mid-single digit growth		High-single digit growth *(Retail sales)		20-30% growth *(Retail sales)	High-single digit growth
3Q17	Mid-single digit growth		High-single digit growth *(Retail sales)		Mid-teens growth *(Retail sales)	Low-single digit growth *(Retail sales)
4Q17	High-single digit growth		High-single digit growth *(Retail sales)		20-25% growth *(Retail sales)	

Source: Corporate filings, CICC Research

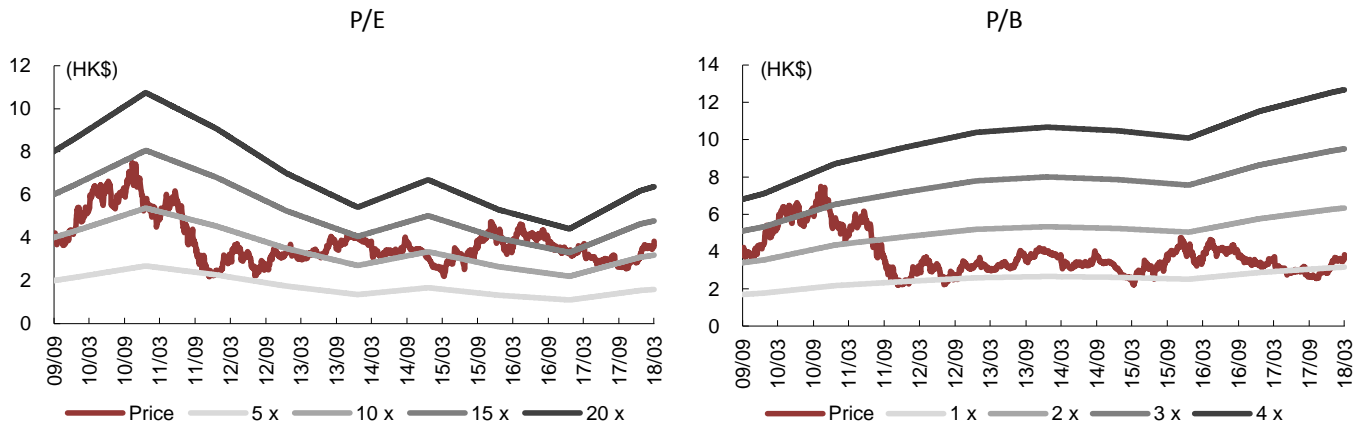
Figure 6: Earnings forecast revisions

Earnings Forecast (Rmb mn)	2017A	2018E			2019E		
		New	Old	Changes (+/-%)	New	Old	Changes (+/-%)
<b>Revenue</b>	<b>5,113</b>	<b>5,651</b>	<b>5,584</b>	<b>1.2%</b>	<b>6,468</b>	<b>6,274</b>	<b>3.1%</b>
<b>Gross profit</b>	<b>2,244</b>	<b>2,509</b>	<b>2,457</b>	<b>2.1%</b>	<b>2,891</b>	<b>2,761</b>	<b>4.7%</b>
Gross Margin	43.9%	44.4%	44.0%	0.4%	44.7%	44.0%	0.7%
Other Income	158	153	112	36.6%	175	125	39.2%
Selling and distribution costs	-911	-1,011	-1,039	-2.6%	-1,164	-1,167	-0.2%
S&D Costs/Revenue	17.8%	17.9%	18.6%	-0.7%	18.0%	18.6%	-0.6%
Administrative expenses	-767	-712	-726	-1.9%	-815	-816	-0.1%
Administrative Costs/Revenue	15.0%	12.6%	13.0%	-0.4%	12.6%	13.0%	-0.4%
<b>Equity holders of the parent</b>	<b>408</b>	<b>544</b>	<b>455</b>	<b>19.4%</b>	<b>629</b>	<b>522</b>	<b>20.6%</b>
Net Margin	8.0%	9.6%	8.2%	1.5%	9.7%	8.3%	1.4%

Source: Company annual results, CICC Research



Figure 7: Historical P/E and P/B bands



Source: Bloomberg, company annual results, CICC Research

Figure 8: Valuations of comparable companies

Sector	Ticker	Company	Price (Local)	Mkt cap (mn)	Net Profit (mn, report currency)					EPS (local currency)			P/E			2016-2018 Net Profit CAGR	PEG	
					2016A	YoY	2017A/E	YoY	2018E	YoY	2016A	2017A/E	2018E	2016A	2017A/E			2018E
<b>Apparel &amp; Textiles (A shares)</b>																		
Casual wear	002269.SZ	Metersbonwe	2.91	7,311	36	NM	47	29%	68	46%	0.01	0.02	0.03	202.2	156.4	107.4	37.2%	5.4
Casual wear	002563.SZ	Semir	10.66	28,716	1,427	6%	1,593	12%	1,810	14%	0.53	0.59	0.67	20.1	18.0	15.9	12.6%	1.6
	002503.SZ	SYT	5.54	17,308	362	86%	784	117%	1,025	31%	0.12	0.25	0.33	47.9	22.1	16.9	68.4%	0.7
Menswear	002029.SZ	Septwolves	9.31	7,035	267	-2%	299	12%	343	15%	0.35	0.40	0.45	26.3	23.5	20.5	13.3%	2.0
	600398.SH	Heilan Home	12.36	55,530	3,123	6%	3,444	10%	3,882	13%	0.70	0.77	0.86	17.8	16.1	14.3	11.5%	1.5
	600177.SH	Youngor	8.83	31,624	3,685	-16%	3,992	8%	4,208	5%	1.03	1.11	1.18	8.6	7.9	7.5	6.9%	1.2
	002154.SZ	Baoxiniao	3.11	3,929	(387)	-487%	(30)	NM	28	NM	-0.31	-0.02	0.02	NM	NM	138.4	NM	NM
Home textiles	002293.SZ	Luolai	15.84	11,788	317	-23%	385	21%	440	14%	0.43	0.52	0.59	37.2	30.6	26.8	17.8%	2.1
	002327.SZ	Fuanna	11.63	10,132	439	9%	481	10%	523	9%	0.50	0.55	0.60	23.1	21.1	19.4	9.2%	2.5
	002397.SZ	Mendale	6.31	4,816	97	-37%	124	28%	154	24%	0.13	0.16	0.20	49.5	38.7	31.3	25.8%	1.9
Outdoor	300005.SZ	Toread	5.20	4,635	166	-37%	141	-15%	163	15%	0.19	0.16	0.18	28.0	32.9	28.5	-0.9%	NM
Footwear	603001.SH	Aokang	13.52	5,421	305	-22%	299	-2%	322	7%	0.76	0.75	0.80	17.8	18.1	16.8	2.7%	6.6
Textiles	000726.SZ	Luthai A	10.57	8,853	805	13%	905	12%	1,004	11%	0.87	0.98	1.09	12.1	10.8	9.7	11.7%	1.0
	200726.SZ	Luthai B	8.83	8,853	805	13%	905	12%	1,004	11%	0.97	1.18	1.37	9.1	7.5	6.4	11.7%	0.8
<b>Apparel &amp; Textiles (H shares)</b>																		
Intimate wear	2298.HK	Cosmo Lady	4.44	9,530	242	-55%	274	13%	320	17%	0.13	0.15	0.19	35.3	29.0	23.6	15.0%	2.4
	2199.HK	Regina Miracle	6.61	8,092	98	-78%	239	144%	300	26%	0.08	0.19	0.24	82.9	33.9	27.0	75.2%	1.1
Menswear	1234.HK	China Liliang	8.40	10,054	540	-14%	611	13%	717	17%	0.50	0.61	0.76	16.7	13.7	11.1	15.2%	1.1
Womenswear	6116.HK	La Chapelle	8.44	4,622	532	-14%	538	1%	559	4%	1.08	1.18	1.29	7.8	7.2	6.6	2.5%	3.1
Sportswear	2331.HK	Li Ning	8.32	18,129	643	4395%	496	-23%	636	28%	0.33	0.27	0.37	25.3	22.7	22.5	-0.5%	NM
	3818.HK	China Dongxiang	1.52	8,626	870	8%	918	6%	969	6%	0.17	0.19	0.22	8.9	7.8	7.1	5.5%	1.6
	2020.HK	Anta sports	41.75	112,081	2,386	17%	3,088	29%	3,859	25%	0.99	1.38	1.81	42.1	30.2	23.0	27.2%	1.5
	1368.HK	Xtep International	3.84	8,530	528	-15%	408	-23%	544	33%	0.26	0.22	0.31	14.5	17.4	12.4	1.5%	NM
Textiles	2313.HK	Shenzhou International	79.70	119,807	2,948	25%	3,598	22%	4,281	19%	2.19	2.87	3.59	36.5	23.6	19.8	20.5%	1.8
	1382.HK	Pacific Textile	7.95	11,499	976	-13%	1,002	3%	1,070	7%	0.67	0.69	0.74	11.8	11.5	10.7	4.7%	2.5
	2678.HK	Texhong Textile	10.94	10,010	1,188	101%	1,152	-3%	1,370	19%	1.45	1.51	1.89	7.6	7.2	5.8	7.4%	1.0
<b>Luxury &amp; Jewelry (A shares)</b>																		
	600612.SH	Lao Feng Xiang	42.91	18,577	1,057	-5%	1,221	15%	1,331	9%	2.02	2.33	2.54	21.2	18.4	16.9	12.2%	1.7
	900905.SH	Lao Feng Xiang B	3.72	18,577	1,057	-5%	1,221	15%	1,331	9%	0.29	0.34	0.36	12.8	10.8	10.2	12.2%	1.0
	002345.SZ	CHJ	10.75	9,733	234	-8%	264	13%	291	10%	0.26	0.29	0.32	41.7	36.9	33.5	11.5%	3.6
	000026.SZ	Fiyta	10.14	4,034	111	-9%	154	39%	198	29%	0.25	0.35	0.45	40.2	29.0	22.5	33.6%	1.2
	200026.SZ	Fiyta B	6.04	4,034	111	-9%	154	39%	198	29%	0.28	0.42	0.57	21.5	14.4	10.6	33.6%	0.5
<b>Luxury &amp; Jewelry (H shares)</b>																		
	1929.HK	Chow Tai Fook	8.99	89,900	3,055	4%	3,956	29%	4,358	10%	0.31	0.40	0.44	29.4	22.7	20.6	19.4%	1.5
	0590.HK	Luk Fook	27.55	16,175	1,017	6%	1,148	13%	1,303	13%	1.73	1.96	2.22	15.9	14.1	12.4	13.2%	1.2
	0116.HK	Chow Sang Sang	17.60	11,922	742	-34%	834	12%	900	8%	1.10	1.23	1.33	16.1	14.3	13.2	10.1%	1.6

Note: Highlighted companies are covered by CICC; other estimates are based on market consensus

Source: Bloomberg, Wind Info, company annual results, CICC Research



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