

Xtep International (1368 HK)

Buy (maintained)

Target price: HK\$5.90

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2Q18 SSSG beats; raise TP to HK\$5.90

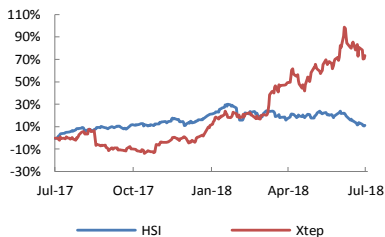
2Q18 SSSG beats Xtep reported mid-teen SSSG for 2Q18, up from low-teen growth in 1Q18 and better than our expectation for low-teen growth, thanks to the completion of a three-year transformation. This is an impressive QoQ SSSG improvement for 2Q18. In contrast, we believe the company's domestic peers may see retail sales growth soften slightly QoQ during the period due to high comparable bases. According to management, e-commerce sales growth during June 1-18 was better than industry growth of around 50%. Retail discount levels improved to 20-25%, from 30% in 2Q17. Retail inventory was kept at a healthy level of around four months.

1Q19 trade fair The trade fair is now over, and management thinks the response from distributors has been positive, underpinned by encouraging SSSG in 2Q18.

Stable GPM outlook Management expects a relatively stable GPM in FY18 despite increases in raw materials prices. Xtep has adopted a cost-plus model meaning it locks up raw material prices when the trade fair is completed. The company procures raw materials for both its own and manufacturing contractors' production needs to gain better bargaining power over suppliers. Replenishment orders would be affected by GPM uncertainty if the company did not lock in the prices of the raw materials it uses for replenishment orders.

Raise TP to HK\$5.90 We raise our FY18/19/20 net profit estimates by 3-4%, mainly to factor in higher SSSG assumptions (from 10%/6%/4% to 12%/7%/5%) and e-commerce sales growth assumptions (from 20%/13%/10% to 30%/18%/13%). We now estimate 18%/12% revenue growth and 58%/18% net profit growth in FY18/19. We lift our TP from HK\$5.20 to HK\$5.90, based on 17x FY18E P/E (vs 15x previously), at its historical average plus two standard deviations. We believe this valuation is justified as the company is experiencing its best fundamentals since its listing, following the completion of a three-year transformation of its brand (from being fashion-focused to functionality-focused), its improved product offerings and flattened distribution network (>60% of stores operated directly by distributors). Sales of more than 1m pairs of professional running shoes (Figure 3, 第五代减震旋, retail price Rmb399) within 1.5 months of their launch in 2Q18 is a good reflection of these improved fundamentals. We maintain our Buy rating.

Stock performance



Source: Bloomberg

Key data

9 Jul close (HK\$)	5.32
Shares in issue (m)	2242.3
Major shareholder	Ding Shui Po (59.98%)
Market cap (HK\$ bn)	11.7
3M avg. vol. (m)	5.3
52W high/low (HK\$)	4.95/2.49

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 (%)
2016	5,397	528	0.239	-18	19.1	13.9	3.1	2.2	2.0	10.8
2017	5,113	408	0.184	-23	25.1	17.9	4.3	2.3	2.0	8.0
2018E	6,016	645	0.289	57	15.3	10.7	3.9	2.4	1.8	12.1
2019E	6,722	762	0.340	18	13.6	9.3	4.4	2.6	1.8	13.5
2020E	7,344	851	0.379	12	12.3	8.2	4.9	2.8	1.7	14.1

Sources: Company data, GF Securities (Hong Kong)

Figure 1: Peer comparison – order book growth

	1Q17	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18
Anta (2020 HK)	mid single-digit growth	mid single-digit growth	low single-digit growth	high single-digit growth	na	na	na	na
Li Ning (2331 HK)	high single-digit growth	high single-digit growth	low single-digit growth	mid single-digit growth	high single-digit growth	low-teens growth	low-teens growth	low-teens growth
Xtep (1368 HK)	mid single-digit growth	low single-digit growth	low single-digit growth	low single-digit growth	na	na	na	na
Peak	na	na	na	na	na	na	na	na
361 Degrees (1361 HK)	high single-digit growth	high single-digit growth	high single-digit growth	low-teens growth	na	na	na	na
361 Degrees kids (1361 HK)	high single-digit growth	low double-digit growth	high-teens growth	high-teens growth	low-teens growth	mid-twenties growth	low-teens growth	high single-digit growth

Sources: Company data, GF Securities (Hong Kong)

Figure 2: Peer comparison – SSSG and retail sales growth

	1Q16	2Q16	3Q16	4Q16	1Q17	2Q17	3Q17	4Q17	1Q18	2Q18
Anta* (2020 HK)	mid single-digit growth	high single-digit growth	low-teens growth	high-teens growth	low-teens growth	20-30%	mid-teens growth	20-25%	20-25%	na
Anta - Non Anta brand* (2020 HK)	na	na	60-70%	50-60%	40-50%	50-60%	40-50%	85-90%	80-85%	na
Li Ning (2331 HK) ^	low single-digit growth	high single-digit growth	high single-digit growth	mid-teens growth	high single-digit growth	low-teens growth	low single-digit growth	mid-teens growth	mid-teens growth	na
Xtep (1368 HK)	mid single-digit growth	mid single-digit growth	mid single-digit growth	mid single-digit growth	low single-digit growth	mid single-digit growth	mid single-digit growth	high single-digit growth	low-teens growth	mid-teens growth
Peak	flat	na	na	na	na	na	na	na	na	na
361 Degrees (1361 HK)#	7%	7%	7%	8%	7%	high single-digit growth	high single-digit growth	high single-digit growth	high single-digit growth	na
361 Degrees - kids (1361 HK)#	8%	7%	7%	8%	7%	high single-digit growth	high single-digit growth	high single-digit growth	high single-digit growth	na
361 Degrees - One Way (1361 HK)#	na	na	na	na	na	high single-digit growth	high-teens growth	high single-digit growth	low-teens growth	na
Nike brand - Greater China revenue growth (%)	27%	23%	21%	17%	15%	16%	12%	15%	19%	25%
Adidas - Greater China revenue growth (%)	30%	30%	25%	26%	31%	28%	29%	31%	32%	26%

Sources: Company data, GF Securities (Hong Kong)

* Since 1Q16, Anta has reported retail sell-through growth of the Anta core brand and Anta Kids, instead of SSSG of the Anta core brand.

361 Degrees changed to reporting retail sales of the 361 Degrees core brand and kids instead of SSSG since 2Q17. The company also began reporting retail sales growth for the One Way brand in 2Q17.

^ We use overall platform retail sales value growth instead of SSSG for Li Ning beginning 1Q17

Figure 3: Xtep's best-ever selling professional running footwear (Rmb399/pair). Sales volume surpassed 1m pairs in 1.5 months



Source: GF Securities (Hong Kong)

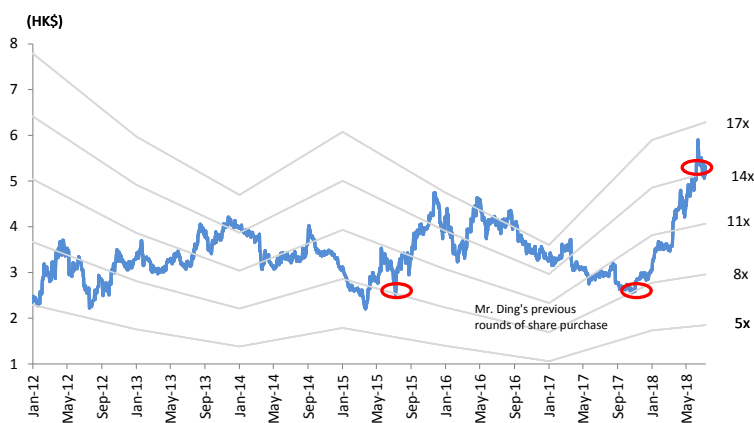
Figure 4: Key assumptions

(Rmb m)	FY16	FY17	FY18E	FY19E	FY20E
Total revenue	5,397	5,113	6,016	6,722	7,344
growth %	1.9%	-5.2%	17.6%	11.7%	9.2%
Xtep products	4,392	3,920	4,425	4,828	5,171
growth %	-2.3%	-10.8%	12.9%	9.1%	7.1%
Other products	1,004	1,194	1,591	1,894	2,173
growth %	25.9%	18.8%	33.2%	19.1%	14.7%
Gross profit	2,331	2,244	2,623	2,944	3,224
Gross margin	43.2%	43.9%	43.6%	43.8%	43.9%
Selling & distribution expenses ratio	15.8%	17.8%	18.4%	18.6%	18.6%
Administrative expenses ratio	12.3%	15.0%	10.6%	9.8%	9.7%
Operating profit margin	17.0%	14.2%	17.5%	18.4%	18.8%
Effective tax rate	33.8%	33.5%	26.7%	26.7%	26.7%
Net profit	528	408	645	762	851
growth %	-15.2%	-22.7%	58.1%	18.0%	11.7%
Net profit margin	9.8%	8.0%	10.7%	11.3%	11.6%
Payout ratio	60.0%	103.8%	60.0%	60.0%	60.0%

Sources: Company data, GF Securities (Hong Kong) estimates

Note: Revenue figures for other products in FY13-17 are our estimates.

Figure 5: P/E band



Sources: Bloomberg, GF Securities (Hong Kong) estimates

Figure 6: The Chairman's share trading record

Date	Buy/ Sell	No of shares (m)	% of outstanding shares	Avg price (HK\$)
26/6/2018	B	1.00	0.04%	5.37
25/6/2018	B	1.72	0.08%	5.21
9/5/2018	B	1.00	0.04%	4.89
8/5/2018	B	1.00	0.04%	4.83
7/5/2018	B	1.00	0.04%	4.80
4/5/2018	B	1.00	0.04%	4.70
3/5/2018	B	1.00	0.04%	4.49
2/5/2018	B	1.00	0.04%	4.48
30/4/2018	B	0.89	0.04%	4.53
27/4/2018	B	1.00	0.04%	4.34
29/12/2017	B	0.21	0.01%	3.05
28/12/2017	B	0.28	0.01%	3.04
27/12/2017	B	1.00	0.05%	2.85
22/12/2017	B	0.31	0.01%	2.85
21/12/2017	B	0.67	0.03%	2.85
20/12/2017	B	0.47	0.02%	2.85
19/12/2017	B	0.44	0.02%	2.85
18/12/2017	B	0.70	0.03%	2.87
15/12/2017	B	0.61	0.03%	2.86
14/12/2017	B	0.68	0.03%	2.85
13/12/2017	B	0.61	0.03%	2.85
12/12/2017	B	1.01	0.05%	2.87
10/7/2015	B	1.11	0.05%	2.92
8/7/2015	B	0.89	0.04%	2.49
7/7/2015	B	2.20	0.10%	2.46
6/7/2015	B	1.30	0.06%	2.60
9/5/2012	B	0.50	0.02%	3.03
7/5/2012	B	0.32	0.01%	3.14
19/4/2012	B	0.50	0.02%	3.60
2/4/2012	B	0.15	0.01%	3.49
27/3/2012	B	0.35	0.02%	3.42
26/3/2012	B	0.50	0.02%	3.39
23/3/2012	B	1.00	0.05%	3.40
22/3/2012	B	1.50	0.07%	3.34
13/7/2011	B	4.53	0.21%	4.53
12/7/2011	B	4.54	0.21%	4.54
26/10/2010	S	108.00	4.96%	6.76

Sources: HKEX, GF Securities (Hong Kong)

Figure 7: Financial statements

Income Statement						Balance Sheet					
Year-end Dec 31 (Rmb m)	FY16	FY17	FY18E	FY19E	FY20E	Year-end Dec 31 (Rmb m)	FY16	FY17	FY18E	FY19E	FY20E
Revenue	5,397	5,113	6,016	6,722	7,344	Fixed assets					
Cost of sales	(3,065)	(2,869)	(3,393)	(3,778)	(4,120)	PPE	618	646	683	711	736
Gross profit	2,331	2,244	2,623	2,944	3,224	Investment properties	0	40	36	31	26
Other income	99	158	172	203	234	Prepaid land lease payments	226	241	235	229	223
Selling & distribution expenses	(851)	(911)	(1,105)	(1,250)	(1,368)	Intangible assets	5	8	8	9	9
Administration expenses	(662)	(767)	(636)	(662)	(710)	AFS investments	82	92	92	92	92
Operating profit	917	725	1,055	1,236	1,380	Deposits	25	26	26	26	26
Net finance cost	(51)	(54)	(63)	(79)	(87)	Pledged bank deposits	0	0	0	0	0
Share of profit of associates	2	3	0	0	0	Non-current time deposits	0	0	0	0	0
Profit before tax	866	671	991	1,157	1,294		957	1,052	1,080	1,098	1,113
Income tax expense	(293)	(224)	(298)	(339)	(378)	Current assets					
Non-controlling interests	(45)	(38)	(48)	(56)	(65)	Inventories	460	718	807	898	979
Net profit	528	408	645	762	851	A/C receivables	2,103	1,807	2,104	2,351	2,569
EPS (Rmb)	0.24	0.18	0.29	0.34	0.38	Prepayments	408	572	673	752	822
Growth rates (%)						Tax recoverable	1	1	1	1	1
Revenue	2	(5)	18	12	9	AFS investments	0	0	0	0	0
Net profit	(15)	(23)	58	18	12	Structured bank deposits	0	715	715	715	715
EPS	(18)	(23)	57	18	12	Pledged bank deposits	799	57	90	109	127
Margin & ratios (%)						Time deposits	600	180	180	480	680
Gross margin	43.2	43.9	43.6	43.8	43.9	Cash and cash equivalents	2,847	3,832	4,292	4,675	5,181
OP margin	17.0	14.2	17.5	18.4	18.8		7,217	7,882	8,863	9,982	11,074
Net margin	9.8	8.0	10.7	11.3	11.6	Total assets	8,174	8,934	9,942	11,080	12,187
Effective tax rate	33.8	33.5	30.1	29.3	29.2	Current liabilities					
Payout ratio	60.0	103.8	60.0	60.0	60.0	A/C payables	896	1,028	1,215	1,353	1,476
						Other payables	544	565	668	743	811
						Bank borrowings	1,502	831	1,238	1,712	2,149
						Tax payables	88	66	86	98	110
							3,029	2,489	3,207	3,907	4,545
						Non-current liabilities					
						Bank borrowings	0	1,019	1,019	1,019	1,019
						Other payables	0	0	0	0	0
						Deferred tax liabilities	109	97	97	97	97
						Deferred subsidy	12	0	0	0	0
							122	1,116	1,116	1,116	1,116
						Equity					
						Shareholders' equity	4,953	5,221	5,463	5,844	6,249
						Non-controlling interests	69	108	156	212	277
							5,023	5,329	5,619	6,056	6,526
						Total liabilities & equity	8,174	8,934	9,942	11,080	12,187
						Financial Ratios					
						Year-end Dec 31	FY16	FY17	FY18E	FY19E	FY20E
						Current ratio	2.4	3.2	2.8	2.6	2.4
						Quick ratio	2.2	2.9	2.5	2.3	2.2
						A/C receivable turnover days	135	140	119	121	122
						A/C payable turnover days	107	122	121	124	125
						Inventory turnover days	51	75	82	82	83
						Asset turnover	0.7	0.6	0.6	0.6	0.6
						Total assets/total equity	1.6	1.7	1.8	1.8	1.9
						Net cash balance (Rmb m)	2,744	2,934	3,020	3,248	3,535
						ROE (%)	10.8	8.0	12.1	13.5	14.1
						ROA (%)	6.5	4.8	6.8	7.2	7.3

Cash Flow Statement					
Year-end Dec 31 (Rmb m)	FY16	FY17	FY18E	FY19E	FY20E
Profit before tax	866	671	991	1,157	1,294
Share of profit of associates	0	0	0	0	0
Depreciation and amortization	59	68	71	79	82
Net finance cost	51	53	63	79	87
(Reversal of)/provision for impairment of receivables	222	67	30	15	15
Income derived from AFS investment	(42)	(63)	(99)	(122)	(144)
Others	1	192	38	20	15
Change of working capital	(510)	(119)	(196)	(204)	(179)
Interest received	51	53	57	66	78
Interest paid	(104)	(104)	(120)	(145)	(164)
Tax paid	(249)	(259)	(261)	(319)	(358)
Operating cash flow	346	558	574	627	725
Capex	(86)	(138)	(102)	(102)	(102)
(Acquisition)/disposal of subsidiaries	0	0	0	0	0
Receipt of government subsidy	0	0	0	0	0
Increase in pledged deposit	(93)	742	(34)	(19)	(17)
Increase in time deposit with maturity over three	(536)	420	0	(300)	(200)
Change of AFS financial investments	90	(10)	0	0	0
Change of structured bank deposits	0	(715)	0	0	0
Others	58	(24)	99	122	144
Investing cash flow	(567)	275	(37)	(299)	(175)
Change of borrowings	(228)	421	407	474	437
Cap contr from non-controlling shareholder	0	0	0	0	0
Dividend paid	(394)	(271)	(401)	(422)	(484)
Others	17	(3)	(86)	0	0
Share issue	62	7	3	3	4
Financing cash flow	(542)	154	(77)	55	(43)
Net change of cash flow	(764)	987	460	383	507
Forex changes	3	(1)	0	0	0

Sources: Company data, GF Securities (Hong Kong) estimates

Rating definitions

Benchmark: Hong Kong Hang Seng Index

Time horizon: 12 months

Company ratings

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

Sector ratings

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

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