

Company Report: Xtep International (01368 HK)

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公司报告: 特步国际 (01368 HK)

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Growth on Track but Seriously Undervalued, "Buy"

增长步入正轨但被严重低估, “买入”

- Strong sales performance during the Double-Eleven Festival in China.** During the single day of the Double-Eleven Festival, Xtep recorded online sales of over RMB350 million, reaching a new high in its history, and the Xtep Kids brand registered 85.0% YoY growth in its online sales. 3Q19 same-store sales grew by 10% YoY, which slightly missed expectations mainly due to unseasonably warm weather in China, but according to the management of Xtep, sales momentum returned to the previous level during October 2019.
- Revise down 2019-2021 EPS forecasts by 2.8%, 5.3% and 9.7% to RMB0.301, RMB0.350 and RMB0.407, respectively.** We forecast revenue from the Xtep core brand to achieve around 20% YoY growth in 2019, and maintain YoY growth of 10%-15% during 2020 and 2021. We forecast the K-Swiss and Palladium brands to contribute RMB500 million to 2019 revenue and RMB1.3 billion to 2020 revenue, but they will negatively impact the Company's overall GPM due to their relatively low GPM. The Saucony and Merrell brands are expected to generate losses due to the network expansion plan over the next few years.
- Cut TP to HK\$6.20 but maintain "Buy".** We believe that the new brands will gradually grow on track over the next few years and create synergy with the Xtep core brand by sharing supply chain and marketing resources. We forecast the Company's 2018-2021 EPS to grow at a CAGR of 10.5%. Our new TP reflects 18.5x, 16.0x and 13.7x 2019, 2020 and 2021 PER, respectively, as well as 45.5% upside potential.
- 中国双十一期间销售表现强劲。**在双十一当天, 特步线上销售额录得 3.5 亿元人民币, 为历史新高, 特步童装品牌的线上销售额录得 85% 的同比增长。2019 年 3 季度同店销售同比增长 10%, 小幅差于预期, 主要是由于国内反常的温暖天气, 但特步管理层表示, 2019 年 10 月销售增速已经恢复到此前的水平。
- 分别下调 2019-2021 年每股盈利预测 2.8%、5.3% 和 9.7% 至 0.301 元人民币、0.350 元人民币和 0.407 元人民币。**我们预期特步主品牌收入在 2019 年可实现约 20% 的同比增长, 并在 2020 年及 2021 年保持 10%-15% 的同比增长。我们预期 K-Swiss 和 Palladium 两个品牌对公司 2019 年收入贡献 5 亿元人民币, 对 2020 年收入贡献 13 亿元人民币, 但由于这两个品牌的毛利率相对较低, 这将对公司的整体毛利率造成负面影响。Saucony 和 Merrell 品牌将在接下来几年中进行品牌扩张, 我们预期其将产生一定亏损。
- 下调目标价至 6.20 港元但维持“买入”。**我们预期新品牌将在接下来几年中逐渐步入正轨, 并通过跟特步主品牌共享供应链及市场资源而形成协同效应。我们预期公司的每股盈利在 2018-2021 年期间实现 10.5% 的年复合增长率。我们的新目标价分别相当于 18.5 倍、16.0 倍和 13.7 倍 2019 年、2020 年和 2021 年市盈率, 以及 45.5% 的上涨空间。

Rating:

Buy

Maintained

评级:

买入 (维持)

6-18m TP 目标价:

HK\$6.20

Revised from 原目标价:

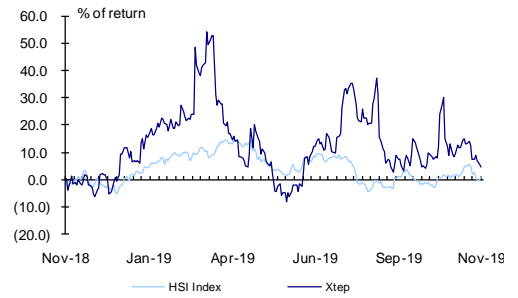
HK\$6.75

Share price 股价:

HK\$4.260

Stock performance

股价表现



Change in Share Price	1 M	3 M	1 Y
股价变动	1 个月	3 个月	1 年
Abs. % 绝对变动 %	(9.0)	(20.3)	(2.1)
Rel. % to HS Index 相对恒指变动 %	(8.8)	(24.0)	(4.0)
Avg. Share price(HK\$) 平均股价 (港元)	4.5	4.5	4.6

Source: Bloomberg, Guotai Junan International.

Year End	Turnover	Net Profit	EPS	EPS	PER	BPS	PBR	DPS	Yield	ROE
年结	收入	股东净利	每股净利	每股净利变动	市盈率	每股净资产	市净率	每股股息	股息率	净资产收益率
12/31	(RMB m)	(RMB m)	(RMB)	(Δ %)	(x)	(RMB)	(x)	(RMB)	(%)	(%)
2017A	5,113	408	0.188	(21.3)	18.9	2.348	1.5	0.119	3.3	8.0
2018A	6,383	657	0.302	60.5	12.4	2.374	1.6	0.174	4.7	12.4
2019F	8,166	694	0.301	(0.3)	12.7	2.211	1.7	0.178	4.7	12.7
2020F	10,023	852	0.350	16.2	11.0	2.372	1.6	0.215	5.6	14.8
2021F	11,151	991	0.407	16.5	9.4	2.542	1.5	0.262	6.8	16.0

Shares in issue (m) 总股数 (m)	2,512.4	Major shareholder 大股东	Ding's Family 54.2%
Market cap. (HK\$ m) 市值 (HK\$ m)	10,702.8	Free float (%) 自由流通比率 (%)	45.8
3 month average vol. 3 个月平均成交股数('000)	10,076.6	FY19 Net gearing (%) FY19 净负债/股东资金 (%)	Net Cash
52 Weeks high/low (HK\$) 52 周高/低 (HK\$)	6.740 / 3.810	FY19 Est. NAV (HK\$) FY19 每股估值 (港元)	7.2

Source: the Company, Guotai Junan International.

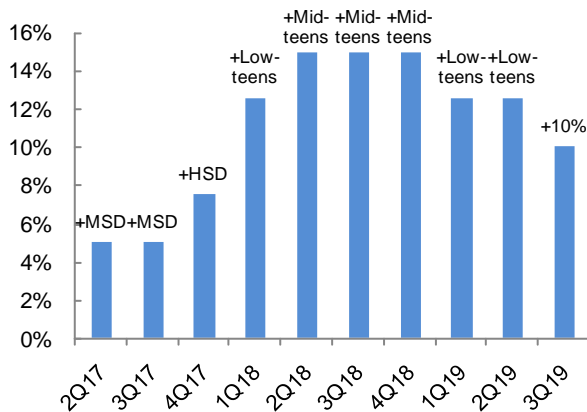
Strong sales performance during the Double-Eleven Festival (11 November 2019) in China. Xtep Int'l ("Xtep" or the "Company") recorded online sales of over RMB350 million during the single day of the Double-Eleven Festival, reaching a new high in its history. The Xtep Kids brand was also stated to expand after years of restructuring and registered 85.0% YoY growth in its online sales during the Double-Eleven Festival. The Company launched a new series of basketball shoes, "Xtep Levitation IV", which was specially designed for Jeremy Lin, Xtep's new brand ambassador. The "Xtep Youyun 4th Generation" was a limited edition with only 666 pairs at the price of RMB539 a pair, which sold out within one minute. The joining of Jeremy Lin is conducive in enhancing Xtep's brand image. The popularity of the new basketball shoes indicated strong customer recognition of the Xtep brand. The Company also took this opportunity to strengthen its membership system. During the promotional period for the Double-Eleven festival, the number of Xtep members surged by 1500% and purchases made by members accounted for 26% of total online sales. In addition, Xtep strengthened its product delivery by cooperating with Cainiao and SF Express, and was able to achieve one-day delivery ratio of 60% and three-day delivery ratio of 100%. The fast-growing online business will benefit the Company's top-line growth, but on the other side, the relatively low profitability of online business, especially during large promotional activities, will create pressure on the Company's overall GPM.

Figure-1: Xtep's New Brand Ambassador Jeremy Lin and The "Xtep Levitation IV" Shoes

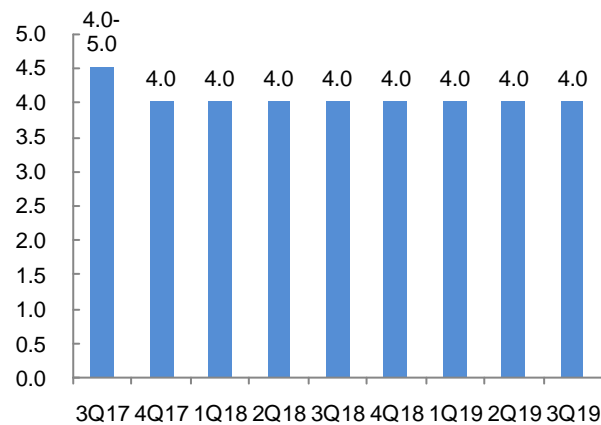


Source: the Company, Guotai Junan International.

Retail channel performance is expected to remain healthy in 4Q19. Xtep maintained healthy channel performance in 3Q19. 3Q19 same-store sales recorded around 10% YoY growth, which was lower than the low-teens percentage growth in 1H19 and slightly weaker than expected. Retail sell-through (including both offline and online channels) recorded growth of around 20% YoY in 3Q19, also slightly lower than the "over 20%" growth in 1H19. Retail sales growth in July and August 2019 maintained steady momentum as compared with the first half of 2019, but slightly slowed down in September 2019, mainly due to 1) relatively high sales base for the same period last year and 2) unseasonably warm weather in the northern part of mainland China, affecting sales of fall/winter collections. According to the management of Xtep, sales momentum returned to the previous level during October 2019. Inventory turnover of the Company's retail distribution channels was kept at a healthy level of around 4 months. Retail discount level was around 22%-25% in 3Q19, which is also at a healthy level. We believe that the Company will achieve stable and healthy channel performance in 4Q19.

Figure-2: SSSG of Xtep's Retail Stores


Source: the Company, Guotai Junan International.

Figure-3: Xtep's Channel Inventory Turnover Ratio


Source: the Company, Guotai Junan International.

Development plans for the new brands. The Company has included four new brands: Saucony, Merrell (through a JV company), K-Swiss and Palladium (through M&A). The Company has set up development plans for the new brands, and details are as follows:

- Saucony:** the Saucony brand will adopt a directly operated model. The first Saucony store will be opened in 2Q20, and the Company plans to have a total of 30-40 Saucony stores by the end of 2020, all located in first-tier cities in China, and the number will reach 400-500 in the long run. The Company will participate in the design of Saucony products to be sold in the China market. In the future, 70% of total SKUs will be tailor-made products for the China market that are designed by Xtep and have a lower price range of around RMB400-600, and the other 30% will be international products that are the same as the ones sold in overseas markets and have a price range over RMB1,000. The Saucony brand will benefit the most amongst all the new brands from sharing the Company's marketing resources like the sponsorship of Marathons, as it focuses on the running sports. The Company expects the Saucony brand to be the first one to make a profit.
- Merrell:** the Merrell brand will also adopt a directly operated model. The Company plans to have a total of 20 Merrell stores by the end of 2020, and the first one will be opened in 3Q20. The Merrell brand focuses on the outdoor sports, which is still a niche market in China and takes time to grow. Therefore, the Company decided to control the speed of expansion at current stage, but in the long run the Company plans to have a total of 400-500 Merrell stores in China.
- K-Swiss:** Xtep aims to position the K-Swiss brand as a counterpart of FILA in China, as K-Swiss is also an international famous lifestyle brand with a lot of heritage. However, there are many problems to be solved before commencing business in China. the K-Swiss brand used to enter in China market but end up with a complete evacuation. Currently, the K-Swiss brand primarily conduct wholesale business in the U.S. and is making a loss. Xtep will take a series of restructuring initiatives including moving its headquarter from the U.S. to China, streamlining organizational structure, reducing headcount, etc. The Company aims to finish the restructuring and open the first K-Swiss store in China by the end of 2021. The K-Swiss brand will adopt a directly operated model at first.
- Palladium:** Palladium is a French fashion brand which mainly sells footwear products. Currently, Palladium has around 170 stores in China which are operated by the distributors of E-Land. These stores in China contribute around 30%-40% to Palladium's total revenue and are profitable. Therefore Xtep plans to grant E-land the right to maintain operations of the Palladium brand in China in the near future, but will gradually transfer its operation to Xtep's own distributor in the long run.

Revise down 2019-2021 EPS forecasts by 2.8%, 5.3% and 9.7% to RMB0.301, RMB0.350 and RMB0.407, respectively.

The Xtep core brand maintains strong growth momentum, driven by stable channel performance and strengthening of its brand image. We forecast revenue from the Xtep core brand to achieve around 20% YoY growth for the full year of 2019, and maintain YoY growth of 10%-15% during 2020 and 2021. Since the Company acquired the K-Swiss and Palladium brands through M&A, we have included the new brands in our forecast on the Company's total revenue. We forecast the M&A to contribute around RMB500 million to 2019 revenue and around RMB1.3 billion to 2020 revenue. Therefore we revise up 2019-2021 revenue forecasts by 6.5%, 13.4% and 12.0%, respectively. The Xtep core brand is expected to maintain stable GPM at 43%-45% over the next few years, while the K-Swiss and Palladium brands have relatively lower GPM at around 35%-38%. Therefore the inclusion of the two new brands will weaken the Company's overall GPM. We have revised down 2019-2021 GPM forecasts by 1.0 ppt, 1.5 ppt and 1.4 ppt to 43.6%, 43.3% and 43.5%, respectively. The Company estimates that there will be a one-off cost in 2H19 amounting to around RMB100 million in relation to the acquisition of the new brands, including RMB35 million in professional cost and RMB65 million in restructuring cost. The K-Swiss brand is making a loss while the Palladium brand is making a profit, and the Company aims to maintain breakeven for the two brands combined over the next few years. However, the Saucony and Merrell brands will generate losses due to the network expansion over the next few years. We forecast the loss to be RMB10-20 million in 2019 and RMB30-40 million in 2020. Increasing operating expenses has resulted in lower bottom line forecasts. We revise down 2019-2021 net profit forecasts by 2.5%, 4.7% and 9.2%, respectively. We forecast the Company's dividend payout ratio to remain stable at around 60% during 2019-2021.

Table-1: Key Assumptions and Adjustments

RMB mn	OLD			NEW			CHANGE		
	2019F	2020F	2021F	2019F	2020F	2021F	2019F	2020F	2021F
Revenue	7,666	8,839	9,958	8,166	10,023	11,151	6.5%	13.4%	12.0%
Gross profit	3,420	3,961	4,481	3,563	4,337	4,856	4.2%	9.5%	8.4%
Operating profit	1,166	1,450	1,742	1,154	1,403	1,610	(1.0%)	(3.2%)	(7.6%)
Net profit	711	894	1,091	694	852	991	(2.5%)	(4.7%)	(9.2%)
Basic EPS (RMB)	0.310	0.369	0.451	0.301	0.350	0.407	(2.8%)	(5.3%)	(9.7%)
Gross margin	44.6%	44.8%	45.0%	43.6%	43.3%	43.5%	(1.0) ppt	(1.5) ppt	(1.4) ppt
% A&P of turnover	14.0%	13.9%	13.8%	13.8%	13.8%	14.0%	(0.3) ppt	(0.1) ppt	0.2 ppt
% SG&A of turnover	30.6%	30.7%	29.6%	30.5%	31.1%	31.0%	(0.1) ppt	0.3 ppt	1.4 ppt
Operating margin	15.2%	16.4%	17.5%	14.1%	14.0%	14.4%	(1.1) ppt	(2.4) ppt	(3.1) ppt
Effective tax rate	33.0%	33.0%	33.0%	33.0%	33.0%	33.0%	0.0 ppt	0.0 ppt	0.0 ppt
Net margin	9.3%	10.1%	11.0%	8.5%	8.5%	8.9%	(0.8) ppt	(1.6) ppt	(2.1) ppt

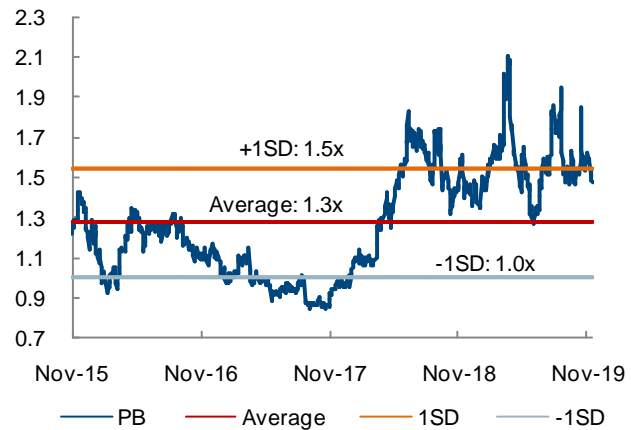
Source: the Company, Guotai Junan International.

Cut TP to HK\$6.20 but maintain "Buy". The Company has been adopting a multi-brand strategy with the introduction of four new brands: Merrell, Saucony, K-Swiss and Palladium. The Xtep core brand has already entered a path of fast and stable growth due to the transformation initiatives conducted over the past few years. Therefore, we believe that the Company is ready to and capable of operating multiple brands. With the joining of the new brands, we expect to see enhancement in the Company's top line, which will help the Company gain more market share, but there will also be negative impacts to the Company's bottom line in the short term. We believe that the new brands will gradually grow on track over the next few years and create synergy with the Xtep core brand by sharing supply chain and marketing resources. We forecast the Company's 2018-2021 EPS to grow at a CAGR of 10.5%. We cut our TP from HK\$6.75 to HK\$6.20 to reflect adjustment in our earnings forecasts. The new TP represents 18.5x, 16.0x and 13.7x 2019, 2020 and 2021 PER, respectively. Our TP also reflects 45.5% upside potential, therefore we maintain our investment rating at "Buy".

Risks: 1) a slowdown in China's sportswear industry growth, 2) fierce competition in the e-commerce business sector, 3) increase of channel inventory, 4) potential impact from the Sino-US trade dispute, and 5) failure in operating the new brands.

Figure-4: Xtep's PE Ratio (Next four Quarters)


Source: Bloomberg, Guotai Junan International.

Figure-5: Xtep's PB Ratio (Current Annual)


Source: Bloomberg, Guotai Junan International.

Table-2: Peers Valuation Comparison

Company	Stock Code	Currency	Last price	Market Cap HKD mn	PE(x)				PB(x)				ROE(%) 19F	D/Y(%) 19F	EV/EBITDA(x) 19F	Gross Margin(%) 19F	Operating Margin(%) 19F
					18A	19F	20F	21F	18A	19F	20F	21F					
Sportswear - domestic																	
Xtep Intl	1368 HK	HKD	4.26	10,703	12.4	12.7	11.0	9.4	1.6	1.7	1.6	1.5	12.7	4.7	6.9	43.6	14.1
Anta	2020 HK	HKD	75.85	204,933	41.9	32.0	25.4	21.0	11.3	9.2	7.4	6.0	31.3	1.0	22.3	54.2	24.8
Lining	2331 HK	HKD	25.15	58,231	71.6	38.8	31.9	24.9	8.2	7.7	6.5	5.4	21.4	0.8	26.2	49.1	10.9
361 Degrees Intl	1361 HK	HKD	1.31	2,709	7.5	5.4	4.8	4.2	0.4	0.4	0.4	0.4	7.8	8.1	2.4	40.7	16.1
China Dongxiang**	3818 HK	HKD	0.84	4,944	13.0	n.a.	6.8	9.0	0.4	0.4	0.4	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Simple Average					29.3	22.2	16.0	13.7	4.4	3.9	3.3	3.3	18.3	3.7	14.4	46.9	16.5
Weighted Average					46.0	32.4	25.7	21.0	10.0	8.4	6.8	5.7	28.2	1.2	22.4	52.6	21.4
Sportswear - International																	
Nike**	NKE US	USD	93.04	147,020	79.8	36.5	31.3	27.0	15.2	16.1	17.6	12.4	42.7	1.1	21.9	44.7	12.2
Adidas	ADS GR	EUR	267.10	54,253	31.6	27.3	24.3	21.6	8.3	7.3	6.5	5.6	28.8	1.4	15.0	52.5	11.4
Under Armour	UAA US	USD	17.79	7,429	n.a.	52.0	37.4	27.5	4.0	3.6	3.3	3.0	7.3	0.0	17.4	46.6	4.4
Lululemon**	LULU US	USD	215.91	28,460	113.6	59.5	45.3	38.2	18.3	19.6	15.8	12.7	31.8	0.0	22.0	55.2	21.5
Simple Average					75.0	43.8	34.6	28.6	11.4	11.7	10.8	8.4	27.7	0.6	19.1	49.7	12.4
Weighted Average					72.6	37.6	31.6	27.1	13.6	14.1	14.4	10.6	37.1	1.0	20.2	47.8	12.9
Apparel																	
China Lilang	1234 HK	HKD	6.40	7,664	8.6	7.9	7.0	6.3	2.0	1.8	1.7	1.6	23.8	8.6	5.0	40.7	27.9
Bosideng	3998 HK	HKD	3.67	39,708	53.4	33.7	26.6	21.7	3.3	3.4	3.3	3.1	10.1	4.9	10.9	53.1	13.2
Giordano Intl	709 HK	HKD	2.36	3,725	7.7	13.1	11.5	9.8	1.3	1.4	1.4	1.4	11.2	8.1	n.a.	59.0	9.3
I.T**	999 HK	HKD	2.04	2,439	5.7	5.5	7.0	6.4	0.7	0.7	0.7	0.6	12.3	4.7	3.8	63.9	8.3
Esprit*	330 HK	HKD	1.45	2,736	n.a.	n.a.	n.a.	n.a.	0.3	0.4	0.4	0.5	(27.2)	0.0	n.a.	50.3	(15.8)
Simple Average					18.9	15.1	13.0	11.1	1.8	1.8	1.8	1.7	14.3	6.6	6.6	54.2	14.7
Weighted Average					41.7	27.3	21.9	18.0	2.8	2.9	2.8	2.7	12.2	5.6	9.6	52.2	14.8

Source: Bloomberg, Guotai Junan International. All forecasts are based on Bloomberg consensus.

* Note: Esprit (330) as outliers is excluded from the calculation of simple and weighted average. The financial year-end date of Esprit is 30 June. For easier comparison with peers, "18A" means "FY18A" and "19F" means "FY19F" and so on for Esprit.

** Note: The financial year-end date of Nike (NKE), Lululemon (LULU) and IT (999) is not 31 December. For easier comparison with peers, "18A" means "FY19A" and "19F" means "FY20F" and so on for the aforementioned companies.

Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index

Time Horizon: 6 to 18 months

Rating		Definition
Buy	买入	Relative Performance > 15%; or the fundamental outlook of the company or sector is favorable.
Accumulate	收集	Relative Performance is 5% to 15%; or the fundamental outlook of the company or sector is favorable.
Neutral	中性	Relative Performance is -5% to 5%; or the fundamental outlook of the company or sector is neutral.
Reduce	减持	Relative Performance is -5% to -15%; or the fundamental outlook of the company or sector is unfavorable.
Sell	卖出	Relative Performance < -15%; or the fundamental outlook of the company or sector is unfavorable.

Sector Rating Definition

The Benchmark: Hong Kong Hang Seng Index

Time Horizon: 6 to 18 months

Rating		Definition
Outperform	跑赢大市	Relative Performance > 5%; or the fundamental outlook of the sector is favorable.
Neutral	中性	Relative Performance is -5% to 5%; or the fundamental outlook of the sector is neutral.
Underperform	跑输大市	Relative Performance < -5%; Or the fundamental outlook of the sector is unfavorable.

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