EQUITY RESEARCH

Xtep International (01368.HK)

Revenue growth in FY2022 better than market expectations with Professional sports brands maintain rapid growth

Improvement of inventory turnover & discount level in 1Q2023

China | Consumer | Sportswear

14 June 2023

Xtep International principally engages in the design, development, manufacturing, sales, marketing and brand management of sports products covering footwear, apparel and accessories for adults and children. With a diverse brand portfolio encompassing the core Xtep brand, K-Swiss, Palladium, Saucony and Merrell to strategically target the mass market, athleisure and professional sports segments, has an extensive global distribution network and more than 8,000 stores in Asia-Pacific, North America and EMEA.

Revenue growth in FY2022 better than market expectations and ahead of peers

In FY2022, Xtep's revenue rose 29.1% to RMB12,930.4 million (FY2021: RMB10,013.2 million), slightly better than market expectations, and ahead of peers. Profit attributable to ordinary equity holders of reached RMB921.7 million (FY2021:RMB908.3 million), a slight increase of 1.5%. Net profit margin amounted to 7.1% (FY2021: 9.1%). Basic EPS was RMB36.6 cents (FY2021:RMB36.4 cents). The total dividend for FY2022 is HK20.1 cents (FY2021: HK25.0 cents), equivalent to a dividend payout ratio of 50.0% (FY2021: 60.0%).

During the year, overall gross profit margin decreased by 0.8 percentage points to 40.9% (FY2021: 41.7%). The decrease in the overall gross profit margin was mainly contributed by the change in product mix, margin contributions from different brands and products sold. Selling and distribution expenses amounted to RMB2,690.2 million (FY2021: RMB1,891.5 million), representing 20.8% (FY2021: 18.9%) of the total revenue. The increase mainly from the increase in advertising and promotional costs and staff costs. Due to increase in advertising campaigns, the advertising and promotional costs for the year amounted to RMB1,537.3 million (FY2021: RMB1,019.7 million), representing 11.9% (FY2021: 10.2%) of the total revenue. Although the operating profit for the year rose moderately by 4.9% to RMB1,464.3 million (FY2021: RMB1,396.2 million), due to the decrease in operating profit margin from mass market and athleisure during the year, caused the operating profit margin decreased by 2.6 percentage points.

As of 31 December 2022, the turnover days for inventories and trade payables increased by 13 days and 1 day to 90 days and 121 days respectively, while the turnover days for trade receivables decreased by 9 days to 98 days, resulting in an increase in overall working capital turnover days by 3 days to 67 days.

Professional sports brands maintain rapid growth

By brand nature, Revenue of the Mass market (signature brands: Xtep) increased by 25.9% to RMB11,128 million, accounting for 86.1% of the total revenue, and the segment operating profit increased by 9.4% to RMB1,758.6 million; Revenue of the Athleisure (signature brand: K-Swiss, Palladium) increased by 44.4% to RMB1,402.5 million, accounting for 10.8% of the total revenue, and the segment operating losses expanded by 115.3% to RMB188.7 million; Revenue of the Professional sports (signature brands: Saucony, Merrell) increased 99.0% to RMB400.0 million, segment operating loss narrowed 51.2% to RMB19.6 million.

During the year, strong consumer appetite for children's sportswear resulted in another year of accelerated growth for our Xtep Kids business. Its revenue surged 52.3% year on year to RMB1,671 million and accounted for 15.0% of the core Xtep brand's business.

Accumulate

CMP HKD8.34
(Closing price as of 9 June)
Target HKD 9.61 (+15.2%)

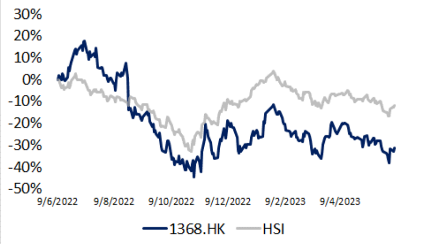
COMPANY DATA

O/S SHARES (MN) :	2,636.717
MARKET CAP (HKD MN) :	21673.8
52 - WK HI/LO (HKD):	14.779/6.719

SHARE HOLDING PATTERN, %

Mr. Ding Shui Po	49.10%

PRICE VS. HSI



Source: Phillip Securities (HK) Research

KEY FINANCIALS

CNY mn	FY21	FY22	FY23E	FY24E
Revenue	10,013	12,930	14,979	17,517
Net profit	908	922	1,062	1,294
Reported EPS	0.36	0.37	0.40	0.49
P/E ratio, x	18.7	20.2	18.3	15.0
Dividend Yield, %	3.0%	2.4%	3.2%	4.0%

Source: Company reports, Phillip Securities Est.

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Improvement of inventory turnover & discount level in 1Q2023

According to Xtep announced operating data of 1Q2023, core brand products retail sell-through (including offline and online channels) grew by 20% yoy, and the retail discount level at 30% – 25% (the same as 1Q2022, better than 30% discount at 4Q2022). Inventory turnover is less than five months (better than about five and a half months in 4Q2022). The turnover in March increased by 35% yoy, and the growth trend in March has been maintained since April. Xtep expects that the turnover performance in 2Q2023 will maintain a steady growth, and the 1H2023 core brand revenue growth target has been raised from flat to 5% - 10%.

Company valuation

With Mainland China's swift reopening after nearly three years of stringent epidemic control, the government's unprecedented efforts to promote sports development, and steady growth of sports participation and running population in the country. Xtep's professional sports brand, Saucony, is expected to achieve a break-even point this year, as it plans to open 30-50 new stores. The core Xtep brand and Xtep Kids will simultaneously open more next-generation stores, which is expected to boost store productivity and increase market share. Despite the short-term economic uncertainty triggered by the COVID-19 in China, we expect that consumer confidence will gradually recover, and we maintain a cautiously optimistic outlook for the mid-term recovery prospects of the Chinese sporting goods industry. We have upgraded our investment rating to "Accumulate", but adjusted our 2023 estimated EPS forecast to RMB0.40 (lower than our report in July 2022). Our target price is HKD 9.61, represents of 21.1x forward P/E (which is equivalent to the average P/E over the past two years).

Risk factors

1) Consumer demand recovery is slower than expected; 2) Slowdown in domestic sports apparel consumption expenditure; 3) Intensified competition in the industry; and 4) Slower-than-expected in new brands development.

Financial

Consolidated Statement of Profit or Loss

Dec Y/E, RMB mn	FY20	FY21	FY22	FY23E	FY24E
Revenue	8,172	10,013	12,930	14,979	17,517
COGS	(4,973)	(5,835)	(7,639)	(8,951)	(10,421)
Gross Profit	3,198	4,178	5,292	6,028	7,096
Selling expenses	(1,537)	(1,891)	(2,690)	(2,973)	(3,494)
General & Admin exp	(1,050)	(1,189)	(1,454)	(1,762)	(2,090)
Others	307	299	317	407	519
Operating Profit	918	1,396	1,464	1,701	2,031
Finance costs	(140)	(63)	(91)	(119)	(115)
Profit before tax	762	1,287	1,361	1,570	1,904
Income tax	(257)	(397)	(449)	(519)	(629)
Shareholders Net profit	513	908	922	1,062	1,294
Reported EPS	0.21	0.36	0.37	0.40	0.49
Reported EPS, Diluted	0.21	0.36	0.36	0.40	0.49
DPS	0.12	0.21	0.18	0.22	0.28
Shares outstanding	2,486	2,558	2,581	2,630	2,630

Key Financial Data

Dec Y/E	FY20	FY21	FY22	FY23E	FY24E
Valuation Ratio					
P/S ratio, x	2.1	1.7	1.5	1.3	1.1
P/E ratio, x	33.6	18.7	20.2	18.3	15.0
Dividend Yield, %	1.7%	3.0%	2.4%	3.2%	4.0%
Per share data (RMB)					
EPS	0.21	0.36	0.36	0.40	0.49
BVPS	2.88	3.11	3.13	3.37	3.64
DPS (HKD)	0.14	0.25	0.20	0.27	0.33
Growth & Margin					
Growth					
Revenue Growth	-0.1%	22.5%	29.1%	15.8%	16.9%
Gross Profit Growth	-9.9%	30.6%	26.7%	13.9%	17.7%
Operating Profit Growth	-25.6%	52.1%	4.9%	16.1%	19.4%
Net Profit Growth	-29.5%	77.1%	1.5%	15.2%	21.8%
Margin					
Gross Profit Margin	39.1%	41.7%	40.9%	40.2%	40.5%
Operating Profit Margin	11.2%	13.9%	11.3%	11.4%	11.6%
Net Profit Margin	6.3%	9.1%	7.1%	7.1%	7.4%
Key Ratios					
ROE	7.3%	12.0%	11.4%	12.4%	14.0%
ROA	4.1%	6.7%	5.9%	6.2%	7.1%

Consolidated Statement of Financial Position

Dec Y/E, RMB mn	FY20	FY21	FY22	FY23E	FY24E
Non Current Asset					
PPE	796	1,119	1,368	1,572	1,699
Others	2,748	3,064	2,788	2,863	2,931
Total Non Current Assets	3,544	4,183	4,155	4,435	4,630
Current Asset					
Inventory	975	1,497	2,287	2,083	2,528
Trade and other receivables	3,236	3,528	4,213	5,125	5,794
Bank balance and cash	3,472	3,930	3,414	3,652	3,358
Others	1,345	1,477	2,424	2,282	2,409
Total Current Assets	9,027	10,432	12,338	13,142	14,089
Total Assets	12,572	14,615	16,494	17,577	18,719
Non Current Liabilities					
Interest-bearing Borrowings	1,516	1,375	193	1,143	1,171
Other Non-current Liabilities	423	1,205	1,349	1,347	1,342
Total Non-current Liabilities	1,939	2,580	1,542	2,490	2,513
Current Liabilities					
Trade payables	1,479	2,352	2,772	3,428	3,849
Others	1,855	1,701	3,873	2,742	2,753
Total Current Liabilities	3,334	4,053	6,645	6,170	6,601
Equity					
Shareholders' equity	7,223	7,929	8,244	8,865	9,572
Non-controlling interests	75	53	63	51	33
Total equity	7,299	7,982	8,307	8,917	9,605
Total Liabilities and Equity	12,572	14,615	16,494	17,577	18,719

Consolidated Statement of Cash Flow

Dec Y/E, RMB mn	FY20	FY21	FY22	FY23E	FY24E
CFO					
Profit before income tax	762	1,287	1,361	1,570	1,904
D&A add-back	67	73	119	124	155
Others	(189)	(212)	(230)	(476)	(576)
Net (inc)/dec working capital	(320)	(447)	(678)	(52)	(693)
Net cash flow from operating activities	320	701	572	1,166	791
CFI					
Purchase of PP&E	(207)	(414)	(365)	(329)	(282)
Others	780	86	(508)	142	(127)
Net cash flow from investing activities	573	(329)	(873)	(187)	(409)
CFF					
Dividends paid	(279)	(356)	(550)	(441)	(587)
Others	(101)	453	314	(301)	(88)
Net cash flows from financing activities	(380)	96	(236)	(741)	(675)
Net Change in Cash	513	469	(537)	237	(294)
Cash and CE at Y/E	3,472	3,930	3,414	3,652	3,358

Current Price as of: 9 June

Source： PSHK Est.

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20%upside from the current price
-5% to +5%	Neutral	3	Trade within ± 5% from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20%downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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