

Analyst: Paul Sham

Main Board Listing – Research

特步國際控股有限公司

Xtep International Holdings Limited [Stock Code: 1368]
**Joint Global Coordinators, Joint Bookrunners,
Joint Lead Managers and Joint Sponsors**

: J.P. Morgan Securities (Asia Pacific) Limited
UBS Investment Bank

Sector : Consumer Durables & Apparel

Business : Design and manufacture of sportswear

Total share offer: * <u>550,000,000</u> shares (25.0% of the enlarged share capital) Public Offer: 55,000,000 shares (10%) Placing: 495,000,000 shares (90%) Greenshoe: 82,500,000 shares <i>*All 550,000,000 shares are New Shares</i>	<u>Business of Xtep</u> Xtep is one of the leading domestic fashion sportswear enterprises in the PRC and has a market share of approximately 3.4% in the total PRC sportswear market in 2007. The business of Xtep began in 1999 as an OEM enterprise which manufactures sports footwear products for various international brands and started to develop its own brands in 2002. Since then, the Company has engaged in the design, development, manufacture and marketing of sportswear, including footwear, apparel and accessory products, sold under two proprietary brands - Xtep and Koling, and one licensed brand - Disney Sport. Xtep distributes the products through an extensive network of distributors covering all 31 provinces, autonomous regions and municipalities in the PRC. As of 31 Mar 2008, those distributors owned, directly operated or managed 4,678, 265 and 50 retail outlets for the brands Xtep, Disney Sport and Koling, respectively. Xtep also grew rapidly in the past 3 years, with revenue increasing from RMB297.4million in 2005 to RMB1,364.9million, representing a CAGR of 114.2%. The net profit also grew significantly from RMB8.2million in 2005 to RMB221.9million in 2007.
Price: HK\$4.05 – HK\$5.50 per share Market Cap: HK\$8,910 million – HK\$12,100 million Unaudited pro forma fully diluted FY08E PER: 17.1x – 23.3x Adjusted NTA per share: RMB0.97 – RMB1.28 or HK\$1.08 – HK\$1.43 Staffing: 6,188 (as of 30 th April 2008)	
HK Public Offer period: 21 st May 2008 – 26 th May 2008 Receiving banks: Bank of China (Hong Kong) Limited Hang Seng Bank Limited Share registrar: Computershare Hong Kong Investor Services Ltd. Listing date: 3 rd June 2008	

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**Shareholding Structure after Listing** (Assuming the over-allotment option is not exercised)

Group Success (BVI) – 63.2% owned by Mr. Ding Shui Po, the founder, the chairman and the CEO of the Company, and; 36.8% owned by Ms. Ding Mei Qing, an executive Director and the sister of Mr. Ding Shui Po	64.5%
Henley Hope (GVI) – 100% owned by Mr. Ding Jin Chao, the father of Mr. Ding Shui Po	3.3%
CAGP L.P & CAGP III – investment funds managed by Carlyle, a global private equity firm	7.2%
Public Investors	25.0%
	100.00%

Use of Proceeds

Net proceeds from the offer are estimated to be HK\$2,451 million (Assuming the over-allotment option is not exercised, and at an issue price of HK\$4.78 each, being the midpoint of the indicative price range)

	HK\$ million
For media advertising and brand promotional activities	539
For expanding and improving the coverage of the distribution network	417
For expanding the apparel production facilities	466
For acquiring brands	588
For recruiting designers, engaging design and consultancy firms and upgrading the laboratories	172
For working capital and other general corporate proposes	195
For upgrading the information management system	74

Financial Highlights

	Year ended 31 st December		
	2005 <u>RMB'000</u>	2006 <u>RMB'000</u>	2007 <u>RMB'000</u>
Revenue	297,445	483,562	1,364,947
Gross profit	59,714	136,088	443,143
Attributable profit	8,211	50,069	221,878
Gross margin	20.1%	28.1%	32.5%
Net margin	2.8%	10.4%	16.3%

Revenue Breakdown by product (% of Total Revenues)

	Year ended 31 st December					
	2005 <u>RMB'000</u>	%	2006 <u>RMB'000</u>	%	2007 <u>RMB'000</u>	%
Footwear	294,817	99.1	441,948	91.4	849,135	62.2
Apparel	2,628	0.9	40,596	8.4	497,635	36.5
Accessories	-	0.0	1,018	0.2	18,177	1.3
Total	297,445	100.0	483,563	100.0	1,364,947	100.0



Strengths/Opportunities

- ✓ **High growth potential of sportswear market** Sportswear market in the PRC grew at a CAGR of 19.4% from 2003 to 2007, along with the nominal GDP CAGR growth of 16.1% in the same period. Demand for branded sports goods are expected to rise at the pace of the overall economy going forward. Moreover, sportswear market worth about RMB40.7b in 2007, or only 0.17% of the country's GDP. This ratio is low compared to developed markets such as the US, Germany, Italy, Japan, and South Korea, where this is at 1.5%–3% of GDP.
- ✓ **Fast-paced retail network expansion** Xtep has been aggressively expanding the brand's retail network. The number of retail outlets increased from 739 in 2005 to 4,380 in 2006, representing a CAGR of 144%. The fast-paced expansion of the retail network has an immediate impact on sales, which boosted the revenue to grow from RMB297m to RMB1,364m in the same period.
- ✓ **Fair valuation** With shares priced at 2008E P/E of 17x-23x, valuation of Xtep is fair, when compared with other sportswear-related peers Li Ning (2331.HK)'s 2008E P/E of 34.8x, Anta Sports (2020.HK)'s 2008E P/E of 27.4x and Dongxiang (3818.HK)'s 2008E P/E of 21.8x.

Weaknesses/Threats

- × **Limited operating history** Unlike the leading domestic brands such as Li Ning and Anta Sports with more than 15-year history, Xtep has less experience in the PRC sportswear industry as most of its revenues were derived from its OEM activities before 2005.
- × **2nd tier brand reflected in the low gross margin** The 2007 gross margin of Xtep, Li Ning and Dongxiang were 32.4%, 47.9% and 58.5% respectively. The lower gross margin of Xtep's products suggests the Xtep brand is not among the premium brands such as Li Ning and Dongxiang, not to mention the international players Nike and Adidas.
- × **Unstable cash flow** Xtep recorded negative operating cash flow of RMB13.7m and RMB62.9m in 2005 and 2006, respectively. Management attributed the problem to the lengthened credit terms to its customers in order to promote the Xtep branded products. Despite the Company turned the operating cash flow to positive amount of RMB12.9m in 2007, its operating cash flow as a percentage of revenue is still very low, compared with other listed peers.

Recommendation: Unattractive



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