INITIATION REPORT

07 Mar 2011

Xingquan International Sports Holdings Ltd		***Market Price:***	*RM1.27*
		Market Capitalisation:	*RM390.3m*
		Board:	*Main Market*
Recommendation:	*BUY*	***Sector:***	*Consumer*
Target Price	*RM1.96*	***Stock Code/Name:***	*5155 / XINQUAN*

Analyst: *Edmund Tham*

Source: Xingquan's website

BACKGROUND

Xingquan International Sports Holdings Limited (XINQUAN) was incorporated in Bermuda under the Bermuda Companies Act in December 2008 as an exempted company limited by shares. In February 2009, the company was registered in Malaysia as a foreign company. Thereafter, the company commenced business on 1st June 2009. Xingquan was listed on Bursa Malaysia in July 2009, making history as the first company from China to list on Bursa.

"Shoes, shoe soles, apparels and accessories"

The company's principal activities are investment holding and provision of management services and the group is principally engaged in (1) the manufacturing of shoe soles and shoes and (2) sales of shoe soles, shoes, apparels and accessories.

The group's business and manufacturing premises are located in Quanzhou City, Fujian Province in China. The group commenced its business operations in 1995 via Jinjiang Xingquan. This particular company was established for OEM (original equipment manufacturing) operations.

In the year 1999, Xingquan Footwear was established to manufacture shoe soles, while in year 2000, Xingquan Plastics was established and began manufacturing for foreign brands such as FILA, Spalding and Prince. During the year 2002, Xingquan Plastics starts manufacturing shoe soles for well-known PRC sports brands Xtep, China Peak, 361 Degrees and Qiaodan.

"Starts OBM business"

During year 2003, Addnice Sports was established while in the year 2004, Addnice starts manufacturing footwear products under the "**Addnice**" brand. This was the start of the group's OBM (own brand manufacturing) business.

In the year 2005, the group expands its business operations into the sports apparel and accessories segment. The group then began using renowned sports personalities to endorse its products, starting with WNBA player Miao Lijie (2006) and also NBA players Jason Kapono and JR Smith in the year 2007. In the year 2010, the group launched its new "**Gertop**" brand.

Currently, the group's management team is led by Mr Wu Qingquan, a citizen of China, the group Executive Chairman and Chief Executive Officer (CEO). Mr W has a Master of Business Administration degree from Renmin University of China. He has an accumulated experience of more than 20 years in the shoe manufacturing industry. Mr Wu's brother, sister and brother-in-law are also involved with the group.

Xingquan's core subsidiaries:

Name	**Date/place of incorporation**	**Principal activities (intended change)***
Addnice Holdings	20 March 2008/Hong Kong	Investment Holdings
Addnice China	7 March 2006 /PRC	Inactive (Manufacturing of shoes and sales of shoes, apparels and accessories)
Addnice Sports	1 August 2003 /PRC	Manufacturing of shoes and sales of shoes, apparels and accessories (Inactive)
Xingquan Plastics	31 January 2000/PRC	Manufacturing and sales of shoes soles
Xingquan Footwear	8 February 1999/PRC	Lease of factory and land

Source: Xingquan website
**Changes planned for year 2011*
PRC=People's Republic of China

"Xingquan's 3 Product Segments"

Shoe Soles:
Comprise athletic shoe sole products designed for specific sporting activities such as running, tennis, basketball and mountain climbing, as well as leisure shoes.

Outdoor and Indoor Sports and Leisure Shoes:
Comprise mainly of outdoor sports shoes designed for specific outdoor and indoor sporting activities such as running, tennis, basketball and mountain climbing, as well as leisure shoes, marketed under its "Addnice" brand.

Outdoor and Indoor Sports and Leisure Apparels and Accessories:
Comprise apparels for specific outdoor and indoor sporting activities such as running, tennis, basketball and mountain climbing and leisure and functional apparels such as t-shirts, polo shirts and windbreakers and accessories such as sport bags, caps, socks and head and wrist bands, designed for various outdoor and indoor sporting activities and marketed under its "Addnice" brand.

PERFORMANCE – 1H/FY11

Xingquan recorded higher revenue of RM352.7 million for 1H/FY11 ended 31st December 2010 compared to revenue of RM289.5 million during 1H/FY10 ended 31st December 2009. This represented an increase of 21.8% in revenue.

The group registered a net profit after tax (NPAT) of RM47.4 million for 1H/FY11, which represented a slight decrease of 5.5% as compared to its NPAT of RM50.2 million recorded for 1H/FY10.

"Solid top-line growth"

Xingquan had achieved a revenue and profit before tax (PBT) of RM190.7 million and RM33.2million respectively for 2Q/FY11, representing an increase of 14.1% and 2.3% y-o-y. Meanwhile, Xingquan's group PBT of RM65.2 million for 1H/FY11 represents an increase of 17.2% as compared to the PBT of RM55.7 million in 1H/FY10.

The better y-o-y PBT was mainly due to the increase in sales volume of shoe soles and the "outdoor sports and leisure product" segments. In particular, the sale of soles had increased from 6.2 million pairs in 1H/FY10 to approximately 7.7 million pairs in 1H/FY11, while the sales of sports apparels and accessories had increased from approximately 3.3 million units in 1H/FY10 to 4.3 million units in 1H/FY11.

The group also enjoyed an increase in average selling prices (ASPs) of shoe soles from RMB17.30 per pair in 1H/FY10 to RMB18.30 per pair in 1H/FY11, an increase in ASPs of outdoor and indoor sports and leisure shoes from RMB93.00 per pair in 1H/FY10 to RMB112.20 per pair in 1H/FY11.

The group recorded a higher selling and distribution expenses from RM26.0 million in 1H/FY10 to RM43.7 million in 1H/FY11. This was mainly due to the higher expenses from renovation subsidies for outlets, display shelves and also expenses for the expansion of sales networks. The group's effective tax rate had increased from 20.8% in 1H/FY10 to 27.4% in 1H/FY11 due to the standard 10% provision for deferred tax liabilities and also other provisions amounting to RMB9.7 million.

OUTLOOK/CORP. UPDATES

Currently, Xingquan's prospects for the coming year appear promising, due to the strong demand for consumer goods in China's domestic market. Very recently, the country's leadership has targeted a future economic growth rate of at least 7% per annum.

"Burgeoning consumer demand in China"

For the first 9 months up to 30th September 2010, according to the National Bureau of Statistics of China, the total retail sales of consumer goods had reached an astounding figure of RMB11,102.9 billion, representing a y-o-y of 18.3%.

Xingquan primarily targets the middle class segment in China, focusing on an increasingly urban and discerning population within the 10-40 years age group. The group's stores are typically located in popular shopping areas within first, second and third tier cities in China.

China's middle class had increased by 22.1% to 80 million people in January 2007, up from just 65.5 million people in January 2005 and this segment is expected to increase to the huge number of 700 million people by the year 2020. With purchasing power increasing among Chinese consumers, especially among the emerging middle class, private consumption is seen as a major driver for the growth of the Chinese economy in the future.

"New factory now ready"

Xingquan has recently built a large new factory with a production floor area of approximately 55,000 sq metres costing approximately RMB260 million. Production at this new factory has commenced during the month of February 2011. Upon full utilisation, the group's production capacity for shoes and shoe sole products is expected to increase from approximately 5.9 million and 14 million pairs per annum to at least 10 million and 28 million pairs per annum respectively.

Artist's impression of Xingquan's new plant:

Source: Xingquan annual report

Xingquan's products are sold to regional distributors and direct retailers in China. In turn, its products are sold and marketed to end-customers by the regional distributors, direct retailers or third parties appointed by the distributors via specialty stores that they own or operate. Additionally, the distributors may distribute its products via retail stores owned by third parties. Meanwhile, the group's shoe sole products are used by Addnice Sports in its manufacture of shoes or sold directly to other shoe manufacturers. The group distributes its OEM sports shoe products via export distributors.

"Biannual trade shows"

Xingquan participates in trade shows twice a year – i.e. Autumn/Winter Trade Show in March/April and Spring/Summer Trade Show in September/October. During the most recent 2 trade shows, Xingquan received significant orders of RMB673 million (Autumn/Winter 2010) and RMB605 million (Spring/Summer 2011). Xingquan's products are currently available across 26 provinces in China. The group targets to have approximately 2300 stores by June 2011. As at 31st December 2010, the group has 2100 stores. The group plans to expand into 5 new provinces and autonomous regions, namely Shaanxi, Gansu, Qing Hai, Ningxia and Guizhou.

Based on the income tax law of China for enterprises with foreign investments and foreign entreprises, Addnice Sports, Addnice China and Xingquan Plastic are entitled for full exemption from income tax for the first 2 years and a 50% reduction in income tax for the next 3 years starting from their first profitable year of operations Addnice Sports is fully exempted for 2006-2007 and 50% exempted for 2008-2010. Addnice China commenced its 5 year tax holiday from January 2008. Meanwhile, Xingquan Plastic has fully utilised its tax incentive, and is subject to the full 25% corporate tax rate.

"Focus on outdoor shoes & apparel segment"

Xingquan's management has focused its business operations to cater for the outdoor shoes and apparels market segment. Outdoor wear are usually made of tougher materials and meant for harsher weather and physical activities (such as mountain climbing, hiking and hunting). The outdoor shoe and apparel segment is not as competitive as the sports shoe and apparel segment. Nevertheless, Xingquan faces competition from outdoor brands such as The North Face, Columbia, Timberland, Toread, Ozark, Kolumb, Jeep and Camel.

"Proposed TDR issue"

Xingquan is in the process of preparing for its Taiwan Depositary Receipts (TDR) programme in Taiwan. The group had proposed to issue and allot up to 46,099,500 new Xingguan shares of USD0.10, at an issue price to be determined later, that represent the underlying shares for the TDR to be issued and allotted in Taiwan.

The Xingguan group does face a number of risk factors such as possible price competition, escalating raw material/labour costs, foreign exchange translation risk (RMB to RM), changes in China regulations/laws and, fluctuations in consumer demand. The group's raw material costs may be impacted by fluctuating oil, latex or fabric prices. Nevertheless, Xingguan's management has indicated that it is able to adjust its ASPs (average selling prices) in order to pass on any higher production costs to its customers.

VALUATION

We are comfortable with Xingquan's expansion plans, business model and strategy, going forward. China's economy is still growing at a strong pace while its expanding middle class would contribute to the strong demand for consumer products, such as shoes and apparels.

Xingquan had paid out a tax exempt final dividend of RM0.025 per share for its FY10 during December 2010. Earlier on, the group had also paid out a similar amount of interim dividend for its FY10. The group's management has targeted a dividend payout of at least 10-20% of its net profits after tax.

"FY10 dividends paid out"

With an adjusted beta of 0.78 to the KLCI, Xingquan has underperformed the KLCI this year (by -14.2% vs. -0.27% year-to-date (YTD)). In recent months, Xingquan's stock price has faced some weakness despite of its institutional investor portion remaining intact. Recently, equity markets have been impacted by the political unrest and upheavals in a number of Middle East and North African nations.

Based on our forecast of Xingquan's FY11 EPS and estimated P/E of 5 times, we set a **FY11-end Target Price (TP) of RM1.96.** This TP represents a substantial 54.1% upside from its current market price. Our TP for Xingquan reflects a P/BV of 1.35 times over its FY11E BV/share. Meanwhile, the regional sector's average P/E and P/BV is 15.5 times and 2.7 times, respectively. We are aware that the peer P/E valuations in the Hong Kong and Singapore markets are much higher. Currently, RM1 approximates to RMB0.46.

"Undemanding valuations"

We like Xingquan due to its business model, expansion strategy, undemanding P/E and P/BV valuations, reasonable dividend yield, net cash position and strong ROE. With its new factory in operations and expansion in retail point-of sales, Xingquan is well poised to grow its sales volumes. Further earnings upside would also be dependent on factors such as consumer sentiment and economic conditions.

Xingquan: 6-month Share Price

Source: NextView

KEY FINANCIALS

Key Stock Statistics	2011E
EPS (sen)	39.1
P/E (x)	3.2
Dividend/Share (sen)	6.7
NTA/Share (RM)	1.45
Book Value/Share (RM)	1.45
Issued Capital (mil shares)	307.3
52-weeks share price (RM)	1.11 – 1.90
Major Shareholders:	%
Tai Zhen Xiang Holdings Ltd	58.4
Koon Yew Yin	5.5
Lembaga Tabung Haji	5.1

^ USD0.10 par value

Per Share Data	2008*	2009*	2010	2011E
Book Value (RM)	0.46	0.52	1.11	1.45
Earnings (sen)	31.0	31.9	33.8	39.1
Dividend (sen)	0.0	0.0	6.7	6.7
Payout Ratio (%)	0.0	0.0	14.8	12.8
PER (x)	4.1	4.0	3.8	3.2
P/Book Value (x)	2.8	2.4	1.1	0.9
Dividend Yield (%)	0.0	0.0	5.2	5.2
ROE (%)	67.3	61.3	30.4	26.9
Net Gearing (cash) (x)	(0.25)	(0.60)	(0.72)	(0.61)

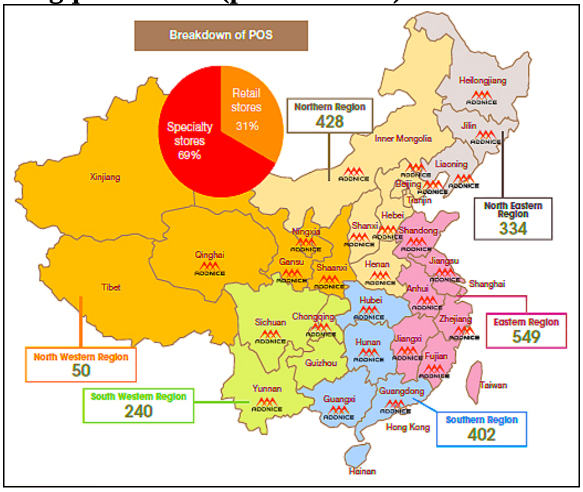
**2008 and 2009 figures are proforma (pre-IPO)*

P&L Analysis (RM mil)	2008*	2009*	2010	2011E
Year end: Jun 30				
Revenue	327.6	403.3	609.3	726.6
Operating Profit	77.7	88.0	131.4	153.2
Depreciation	(5.2)	(5.5)	(5.8)	(6.1)
Interest Expenses	(1.8)	(2.1)	(1.2)	(1.3)
Pre-tax Profit	75.8	85.9	130.5	150.8
Effective Tax Rate (%)	12.2	20.1	20.4	20.2
Net Profit	66.6	68.7	103.9	120.3
Operating Margin (%)	23.7	21.8	21.6	21.1
Pre-tax Margin (%)	23.1	21.3	21.4	20.8
Net Margin (%)	20.3	17.0	17.1	16.6

#RM at time of past reporting

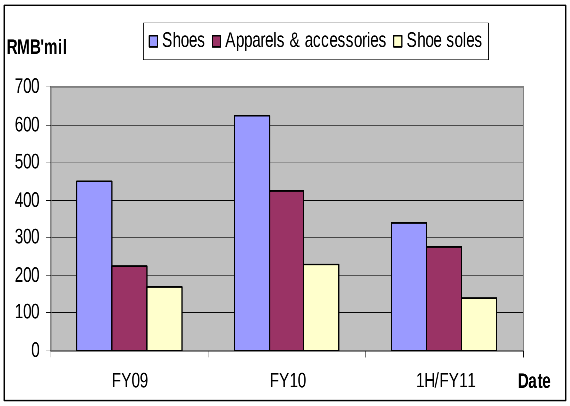
APPENDIX

Xingquan's POS (point of sales):



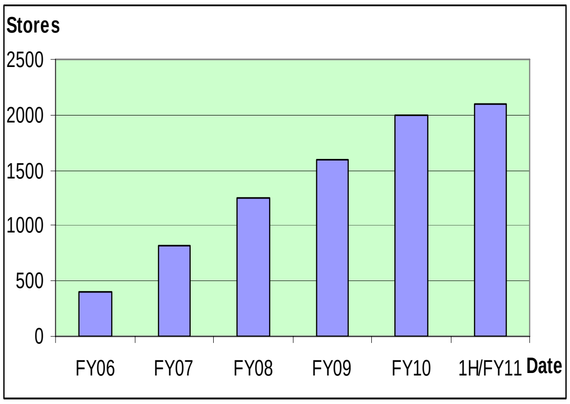
Source: Xingquan

Xingquan – revenue by product segment:



Source: Xingquan

Xingquan – number of retail stores:



Source: Xingquan

Some of Xingquan's 2010 collection:

(1) Shoe collection:

Source: Xingquan

(2) Clothing collection:

Source: Xingquan