

# Pacific Textiles Holdings (1382 HK)

 Target price: **HKD11.30** (from HKD10.70)

 Share price (14 Sep): **HKD10.40** | Up/downside: **+8.6%**

 5 4 3 **2** 1


**Outperform**  
 (unchanged)

## Order book to play catch-up in 2H FY17

- We expect 1H FY17 revenue to fall by a double-digit percentage YoY
- “Fast-track orders” becoming increasingly dominant
- Raising TP by 6% to HKD11.30; reiterating Outperform (2) rating

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**What's new:** We met with Pacific Textiles' management for a business update. We expect 1H FY17 revenue to be weak, albeit partially offset by an improving order book in 2H FY17. Major brands appear to be further squeezing their key suppliers for shorter lead times, which could, in the long run, help strengthen Pacific Textile's position as a top OEM partner.

**What's the impact:** 1H FY17E revenue likely to be weak; second half should be slightly better. Management said the weakness in the US mass-market and retailers' private label brands, which it saw in 2H FY16, has continued into 1H FY17. The key issue still seems to stem from the relatively weak retail sentiment and the poor demand for low-end private label apparel. On the other hand, UNIQLO orders remain solid, and this company is said to be requesting additional capacity from Pacific Textiles over the long term, which we view as a very positive sign. Management said the overall order book had improved on a QoQ basis in 2Q FY17, but we still look for a double-digit YoY revenue decline in 1H FY17E, which nevertheless should be partially offset by an order catch-up in 2H FY17E.

**Tighter squeeze on order lead-times.** Management echoed what we have heard from another major UNIQLO supplier, Shenzhou International (2313 HK, HKD51.30, Buy [1]), that UNIQLO seems to be further reducing order lead-times for its key suppliers (see [Still a class above the rest](#), 22 August 2016). In 1H FY17, UNIQLO has increased the portion of “fast-track orders” to Pacific Textiles substantially (ie, orders that are to be filled and delivered via air freight, all within 3-4 weeks). Note that these orders do not necessarily translate into higher gross margins, but we believe the largest benefit to Pacific Textiles is that it raises the value of the company's services to UNIQLO and enhances their relationship, as not all OEMs can deliver fast-track orders. Victoria's Secret, Pacific Textile's second-largest customer, has also sharply cut its lead times.

While we trim our top line by 3% for FY17-18E, there is little change to our EPS as any decline in ASPs would likely be milder than expected.

**What we recommend:** We raise our 12-month target price to HKD11.30 (from HKD10.70), as we roll over our valuation basis to average FY17-18E EPS (previously FY17E EPS) and use an unchanged target PER of 15x (in line with its peers' average trading multiple). Considering the expected strong 7%+ dividend yield in FY18-19E, we reiterate our Outperform (2) rating. Key risk would be a sharp fall in orders from its main customers.

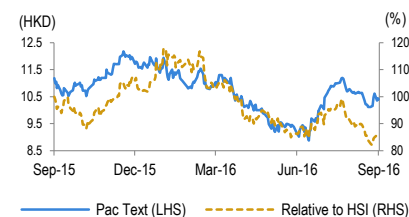
**How we differ:** Our FY17-18E EPS are 13-19% below consensus, as we believe we are one of the first to build in ASP pressure from FY17 onwards.

### Forecast revisions (%)

Year to 01 Apr	17E	18E	19E
Revenue change	(2.7)	(2.8)	1.1
Net profit change	(0.1)	(0.2)	1.0
Core EPS (FD) change	(0.1)	(0.2)	1.0

Source: Daiwa forecasts

### Share price performance



12-month range	8.88-12.18
Market cap (USDbn)	1.93
3m avg daily turnover (USDm)	3.64
Shares outstanding (m)	1,446
Major shareholder	Directors (48.8%)

### Financial summary (HKD)

Year to 01 Apr	17E	18E	19E
Revenue (m)	6,877	7,628	8,919
Operating profit (m)	1,159	1,280	1,475
Net profit (m)	1,033	1,139	1,308
Core EPS (fully-diluted)	0.714	0.787	0.903
EPS change (%)	0.3	10.2	14.8
Daiwa vs Cons. EPS (%)	(19.1)	(12.6)	0.4
PER (x)	14.6	13.2	11.5
Dividend yield (%)	6.9	7.6	8.7
DPS	0.714	0.787	0.904
PBR (x)	4.5	4.5	4.5
EV/EBITDA (x)	10.7	9.8	8.8
ROE (%)	30.8	33.9	38.9

Source: FactSet, Daiwa forecasts

**Pacific Textiles: key changes to Daiwa forecasts**

	FY17E			FY18E			FY19E		
	New	Previous	Changes (%)	New	Previous	Changes (%)	New	Previous	Changes (%)
Volume (m lbs)	184.9	189.9	-2.7%	203.4	209.2	-2.8%	234.7	232.2	1.1%
ASP (HKD/lbs)	37.2	37.2	0.0%	37.5	37.5	0.0%	38.0	38.0	0.0%
Sales (HKDm)	6,877	7,065	-2.7%	7,628	7,845.5	-2.8%	8,919	8,825.2	1.1%
Gross-profit margin (%)	18.6	18.2	0.4 pp	18.7	18.4	0.3 pp	18.7	18.7	0.0 pp
Operating-profit margin (%)	16.8	16.4	0.4 pp	16.8	16.3	0.4 pp	16.5	16.6	0.0 pp
Net profit (HKDm)	1,033	1,034	-0.1%	1,139	1,140.7	-0.2%	1,308	1,295.2	1.0%
EPS (HKD)	0.71	0.71	-0.1%	0.79	0.8	-0.2%	0.90	0.9	1.0%

Source: Daiwa forecasts

## Financial summary

### Key assumptions

Year to 01 Apr	2012	2013	2014	2015	2016	2017E	2018E	2019E
Output volume (m lbs)	155	172	187	185	179	185	203	235
ASP (HKD/lb)	41.5	38.6	39.7	37.4	38.7	37.2	37.5	38.0
Gross profit per unit (HKD/lbs)	7.1	6.9	7.3	6.4	7.3	6.9	7.0	7.1

### Profit and loss (HKDm)

Year to 01 Apr	2012	2013	2014	2015	2016	2017E	2018E	2019E
Textiles Revenues	6,420	6,649	7,423	6,907	6,928	6,877	7,628	8,919
Other Revenue	0	0	0	0	0	0	0	0
Other Revenue	0	0	0	0	0	0	0	0
<b>Total Revenue</b>	<b>6,420</b>	<b>6,649</b>	<b>7,423</b>	<b>6,907</b>	<b>6,928</b>	<b>6,877</b>	<b>7,628</b>	<b>8,919</b>
Other income	99	92	125	109	81	100	106	111
COGS	(5,321)	(5,468)	(6,062)	(5,729)	(5,625)	(5,597)	(6,202)	(7,251)
SG&A	(236)	(204)	(197)	(176)	(224)	(220)	(252)	(303)
Other op.expenses	0	0	0	0	0	0	0	0
<b>Operating profit</b>	<b>961</b>	<b>1,069</b>	<b>1,289</b>	<b>1,111</b>	<b>1,159</b>	<b>1,159</b>	<b>1,280</b>	<b>1,475</b>
Net-interest inc./(exp.)	9	15	7	13	4	(9)	(12)	(15)
Assoc/forex/extraord./others	3	26	16	96	131	36	37	38
<b>Pre-tax profit</b>	<b>974</b>	<b>1,111</b>	<b>1,311</b>	<b>1,220</b>	<b>1,295</b>	<b>1,185</b>	<b>1,306</b>	<b>1,498</b>
Tax	(158)	(186)	(197)	(150)	(172)	(154)	(170)	(195)
Min. int./pref. div./others	77	1	2	5	3	2	3	4
<b>Net profit (reported)</b>	<b>893</b>	<b>925</b>	<b>1,117</b>	<b>1,075</b>	<b>1,126</b>	<b>1,033</b>	<b>1,139</b>	<b>1,308</b>
<b>Net profit (adjusted)</b>	<b>815</b>	<b>925</b>	<b>1,117</b>	<b>1,012</b>	<b>1,031</b>	<b>1,033</b>	<b>1,139</b>	<b>1,308</b>
<b>EPS (reported)(HKD)</b>	<b>0.623</b>	<b>0.644</b>	<b>0.773</b>	<b>0.743</b>	<b>0.778</b>	<b>0.714</b>	<b>0.787</b>	<b>0.904</b>
<b>EPS (adjusted)(HKD)</b>	<b>0.569</b>	<b>0.644</b>	<b>0.773</b>	<b>0.700</b>	<b>0.713</b>	<b>0.714</b>	<b>0.787</b>	<b>0.904</b>
<b>EPS (adjusted fully-diluted)(HKD)</b>	<b>0.569</b>	<b>0.644</b>	<b>0.773</b>	<b>0.700</b>	<b>0.712</b>	<b>0.714</b>	<b>0.787</b>	<b>0.903</b>
<b>DPS (HKD)</b>	<b>0.700</b>	<b>0.803</b>	<b>1.051</b>	<b>0.800</b>	<b>0.800</b>	<b>0.714</b>	<b>0.787</b>	<b>0.904</b>
<b>EBIT</b>	<b>961</b>	<b>1,069</b>	<b>1,289</b>	<b>1,111</b>	<b>1,159</b>	<b>1,159</b>	<b>1,280</b>	<b>1,475</b>
<b>EBITDA</b>	<b>1,215</b>	<b>1,259</b>	<b>1,448</b>	<b>1,262</b>	<b>1,314</b>	<b>1,349</b>	<b>1,494</b>	<b>1,702</b>

### Cash flow (HKDm)

Year to 01 Apr	2012	2013	2014	2015	2016	2017E	2018E	2019E
Profit before tax	974	1,111	1,311	1,220	1,295	1,185	1,306	1,498
Depreciation and amortisation	254	190	159	151	155	191	213	227
Tax paid	(190)	(139)	(196)	(236)	(172)	(154)	(170)	(195)
Change in working capital	763	(262)	27	117	(149)	86	(119)	(203)
Other operational CF items	(229)	(67)	29	(273)	(70)	(63)	(62)	(61)
<b>Cash flow from operations</b>	<b>1,572</b>	<b>833</b>	<b>1,331</b>	<b>980</b>	<b>1,058</b>	<b>1,245</b>	<b>1,168</b>	<b>1,266</b>
Capex	(162)	(113)	(262)	(418)	(350)	(500)	(300)	(300)
Net (acquisitions)/disposals	100	51	18	7	0	0	0	0
Other investing CF items	117	0	0	0	0	0	0	0
<b>Cash flow from investing</b>	<b>55</b>	<b>(62)</b>	<b>(244)</b>	<b>(411)</b>	<b>(350)</b>	<b>(500)</b>	<b>(300)</b>	<b>(300)</b>
Change in debt	(9)	0	0	1,085	(301)	0	0	0
Net share issues/(repurchases)	1	50	12	0	0	0	0	0
Dividends paid	(846)	(1,005)	(1,157)	(1,519)	(1,157)	(1,033)	(1,139)	(1,308)
Other financing CF items	48	14	8	4	4	(9)	(12)	(15)
<b>Cash flow from financing</b>	<b>(805)</b>	<b>(942)</b>	<b>(1,136)</b>	<b>(429)</b>	<b>(1,454)</b>	<b>(1,043)</b>	<b>(1,151)</b>	<b>(1,322)</b>
Forex effect/others	0	0	0	0	0	0	0	0
<b>Change in cash</b>	<b>821</b>	<b>(171)</b>	<b>(49)</b>	<b>140</b>	<b>(746)</b>	<b>(297)</b>	<b>(283)</b>	<b>(357)</b>
Free cash flow	1,409	720	1,069	562	708	745	868	966

Source: FactSet, Daiwa forecasts

## Financial summary continued ...

### Balance sheet (HKDm)

As at 01 Apr	2012	2013	2014	2015	2016	2017E	2018E	2019E
Cash & short-term investment	1,899	1,797	1,778	2,028	1,452	1,156	910	592
Inventory	903	994	1,131	966	1,016	963	1,068	1,249
Accounts receivable	927	953	845	800	935	791	877	1,026
Other current assets	144	160	128	173	141	141	141	141
<b>Total current assets</b>	<b>3,872</b>	<b>3,904</b>	<b>3,882</b>	<b>3,967</b>	<b>3,545</b>	<b>3,051</b>	<b>2,997</b>	<b>3,007</b>
Fixed assets	1,231	1,159	1,237	1,410	1,560	1,870	1,956	2,030
Goodwill & intangibles	0	0	0	0	0	0	0	0
Other non-current assets	258	214	234	350	326	416	453	491
<b>Total assets</b>	<b>5,362</b>	<b>5,277</b>	<b>5,353</b>	<b>5,727</b>	<b>5,431</b>	<b>5,337</b>	<b>5,406</b>	<b>5,528</b>
Short-term debt	0	0	0	988	686	700	700	700
Accounts payable	929	783	839	747	783	672	744	870
Other current liabilities	391	428	469	341	436	436	436	436
<b>Total current liabilities</b>	<b>1,319</b>	<b>1,211</b>	<b>1,309</b>	<b>2,076</b>	<b>1,906</b>	<b>1,808</b>	<b>1,881</b>	<b>2,006</b>
Long-term debt	47	48	48	144	144	150	150	150
Other non-current liabilities	33	46	58	12	29	29	29	29
<b>Total liabilities</b>	<b>1,400</b>	<b>1,304</b>	<b>1,415</b>	<b>2,233</b>	<b>2,080</b>	<b>1,987</b>	<b>2,059</b>	<b>2,185</b>
Share capital	1	1	1	1	1	1	1	1
Reserves/R.E./others	3,953	3,964	3,934	3,495	3,359	3,359	3,359	3,359
<b>Shareholders' equity</b>	<b>3,955</b>	<b>3,966</b>	<b>3,935</b>	<b>3,497</b>	<b>3,360</b>	<b>3,360</b>	<b>3,360</b>	<b>3,360</b>
Minority interests	7	6	4	(2)	(8)	(10)	(13)	(17)
<b>Total equity &amp; liabilities</b>	<b>5,362</b>	<b>5,277</b>	<b>5,353</b>	<b>5,727</b>	<b>5,431</b>	<b>5,337</b>	<b>5,406</b>	<b>5,528</b>
EV	12,948	13,090	13,115	13,922	14,176	14,453	14,659	14,935
<b>Net debt/(cash)</b>	<b>(1,851)</b>	<b>(1,749)</b>	<b>(1,730)</b>	<b>(896)</b>	<b>(622)</b>	<b>(306)</b>	<b>(60)</b>	<b>258</b>
<b>BVPS (HKD)</b>	<b>2.760</b>	<b>2.762</b>	<b>2.722</b>	<b>2.417</b>	<b>2.323</b>	<b>2.323</b>	<b>2.323</b>	<b>2.323</b>

### Key ratios (%)

Year to 01 Apr	2012	2013	2014	2015	2016	2017E	2018E	2019E
Sales (YoY)	(10.6)	3.6	11.6	(7.0)	0.3	(0.7)	10.9	16.9
EBITDA (YoY)	(12.9)	3.6	15.0	(12.8)	4.1	2.7	10.7	13.9
Operating profit (YoY)	(12.0)	11.2	20.6	(13.8)	4.4	(0.1)	10.5	15.2
Net profit (YoY)	(7.0)	13.5	20.7	(9.4)	1.8	0.3	10.2	14.8
Core EPS (fully-diluted) (YoY)	(7.0)	13.3	19.9	(9.5)	1.8	0.3	10.2	14.8
Gross-profit margin	17.1	17.8	18.3	17.1	18.8	18.6	18.7	18.7
EBITDA margin	18.9	18.9	19.5	18.3	19.0	19.6	19.6	19.1
Operating-profit margin	15.0	16.1	17.4	16.1	16.7	16.8	16.8	16.5
Net profit margin	12.7	13.9	15.0	14.7	14.9	15.0	14.9	14.7
ROAE	21.0	23.4	28.3	27.2	30.1	30.8	33.9	38.9
ROAA	15.3	17.4	21.0	18.3	18.5	19.2	21.2	23.9
ROCE	23.8	26.6	32.2	25.8	26.3	27.6	30.5	35.2
ROIC	31.6	41.1	49.4	40.5	37.7	34.9	35.2	37.3
Net debt to equity	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	7.7
Effective tax rate	16.2	16.8	15.0	12.3	13.3	13.0	13.0	13.0
Accounts receivable (days)	57.9	51.6	44.2	43.5	45.7	45.8	39.9	38.9
Current ratio (x)	2.9	3.2	3.0	1.9	1.9	1.7	1.6	1.5
Net interest cover (x)	n.a.	n.a.	n.a.	n.a.	n.a.	125.9	108.3	99.8
Net dividend payout	112.3	124.6	136.0	107.7	102.8	100.0	100.0	100.0
Free cash flow yield	9.4	4.8	7.1	3.7	4.7	5.0	5.8	6.4

Source: FactSet, Daiwa forecasts

## Company profile

Pacific Textiles Holdings manufactures customised knitted fabrics with a focus on complex, value-added fabrics. The company's products are used in a broad range of garments, such as men's, women's, and children's clothing, sportswear, swimwear, and innerwear. It works closely with many leading brands, including UNIQLO, Calvin Klein, Nike, Adidas, and Victoria's Secret, and has strong relationships with garment manufacturers.

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#### Disclosure of investment ratings

Rating	Percentage of total
Buy*	65.8%
Hold**	21.8%
Sell***	12.4%

Source: Daiwa

Notes: data is for single-branded Daiwa research in Asia (ex Japan) and correct as of 30 June 2016.

\* comprised of Daiwa's Buy and Outperform ratings.

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