

## China Textile Monthly

### Demand for quality cotton remains high

	Ticker	Rec	Mkt cap (HKD bn)	Ccy	Price	PT	Up/ dn (%)	PER 1-yr fwd	2-yr fwd	PBR 1-yr fwd	Dividend yield (%)	ROIC (%)
Texhong Textile	2678 HK	Hold	9.4	HKD	10.3	11.3	10.1	7.1	6.0	1.3	4.3	15.7
Weiqiao Textile	2698 HK	NR	6.7	HKD	5.6	N/A	N/A	N/A	N/A	N/A	5.1	4.7
Fountain Set	420 HK	NR	1.2	HKD	1.0	N/A	N/A	N/A	N/A	1.0	5.2	N/A
Pacific Textiles	1382 HK	Buy	12.5	HKD	8.6	11.4	32.1	13.0	12.4	3.7	8.1	20.8
Best Pacific	2111 HK	Buy	6.7	HKD	6.5	7.3	12.0	13.0	10.8	3.0	2.0	13.5
Taiwan Paiho	9938 TT	NR	8.2	HKD	27.5	N/A	N/A	17.5	15.1	3.6	N/A	11.9
Texwinca	321 HK	Hold	7.3	HKD	5.3	5.1	(3.8)	13.7	13.4	1.2	8.7	14.1
Shenzhou International	2313 HK	Buy	68.8	HKD	49.2	53.5	8.7	18.0	14.8	3.5	1.7	16.2
Regina Miracle	2199 HK	Hold	7.3	HKD	6.0	6.6	10.0	50.2	25.2	2.5	0.9	8.1
Nameson	1982 HK	Buy	3.4	HKD	1.6	2.0	22.0	10.3	8.0	2.1	3.4	13.1
Win Hanverky	3322 HK	NR	1.5	HKD	1.2	N/A	N/A	8.4	8.4	N/A	9.8	9.7
Eagle Nice	2368 HK	NR	1.1	HKD	2.2	N/A	N/A	N/A	N/A	N/A	12.2	9.9

Source: Company, Bloomberg, CSCI Research estimates

- The drop in the purchase rate in China Cotton Reserve Auction recently has created negative sentiment in the cotton spot market. However, we believe it was mainly driven by a decline in the quality of the cotton being auctioned, whereas the demand for quality cotton remains high, as our channel checks showed that customers are now required to pay upfront for their cotton orders. This has also raised textile mills' capital requirement, whereby smaller mills are finding it increasingly difficult to survive.
- The CC328 Index remained strong in March, gaining 33.9% YoY, despite a softening on a MoM basis, falling 0.3% in March to RMB15,916/tonne from RMB15,961/tonne in February. The domestic synthetic and polyester yarn prices also started to soften in March, but still rising by a HDD percentage YoY.
- For those HK-listed textile stocks which have reported FY16 results saw substantial growth in their net profits. Shenzhou (2313 HK, BUY) and Best Pacific (2111 HK, BUY) posted net profit growth of between 25-30% YoY, benefiting from strong sportswear sales and optimisation of their clients' portfolios, whilst upstream players such as Texhong (2678 HK, HOLD) saw net profit surged by >100% YoY, riding on lower cotton cost. We expect the strong earnings growth for mid-stream players can be sustained in 2017E, but we are less optimistic on upstream players due to higher raw material cost pressure in 2017.

**Demand for quality cotton remains high, despite a drop in the purchase rate from the cotton reserve auction.** This year's China Cotton Reserve Auction started two months earlier on 6 Mar, compared to last year's auction which began on 2 May. For this year's auction, the target is to sell c.30k tpd (tons per day) until the end of Aug-17. A total of 2.6mn tons of cotton were sold in 2016's auction. As of 10 Apr, China has offered a total of 764,900 tonnes cotton for auctioning in the market and 561,300 tonnes were sold, representing an average purchase rate of 73.4%. These cotton were sold at an average price of RMB14,861/tonne (price range RMB13,360-16,500/tonne), c.7% discount compared to RMB15,910/tonne under the CC Index 328 during the same period. However, the weekly purchase rate started to weaken in the week of 10 Apr to 55%, compared with 79% in the week of 20 Mar. This created negative sentiment in the spot cotton market, leading to a softening in the CC328 Index from RMB15,965/tonne at the beginning of Mar to RMB15,848 on 7 Apr. However, we believe the lower purchase rate was due to a decline in the quality of the cotton being auctioned and a relatively high initial bidding price driving away the bidders.

**Growing capital pressure for mills.** Our channel checks suggested that textile mills are encountering growing capital pressure, as cotton traders required them to pay upfront for their cotton orders in order to lock up the market cotton price and secure supply. Hence, we believe the demand for quality cotton remains high in China, thus supporting the cotton price.

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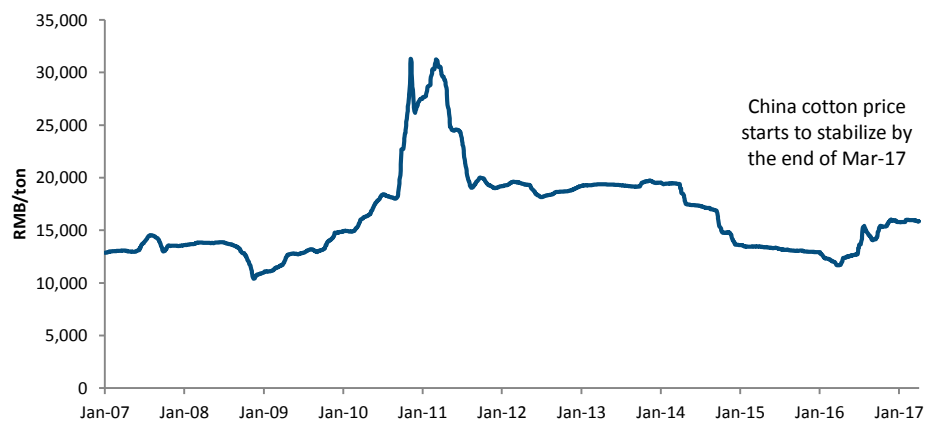
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## Textile commodity update – Mar 2017

**China's domestic cotton prices softened by the end of Mar, following the weakened purchase rate in the China Cotton Reserve Auction.** The expectations on the China Cotton Reserve Auction, which began on 6 Mar this year, had initially lent support to the domestic cotton price in the spot market. However, it failed to sustain an uptrend following a decline in the auction's purchase rate by the end of Mar. The China Cotton 328 (CC328) Index softened to RMB15,863/tonne level by the end of Mar, after reaching its peak of RMB15,975/tonne on 9 Mar (see Figure 1).

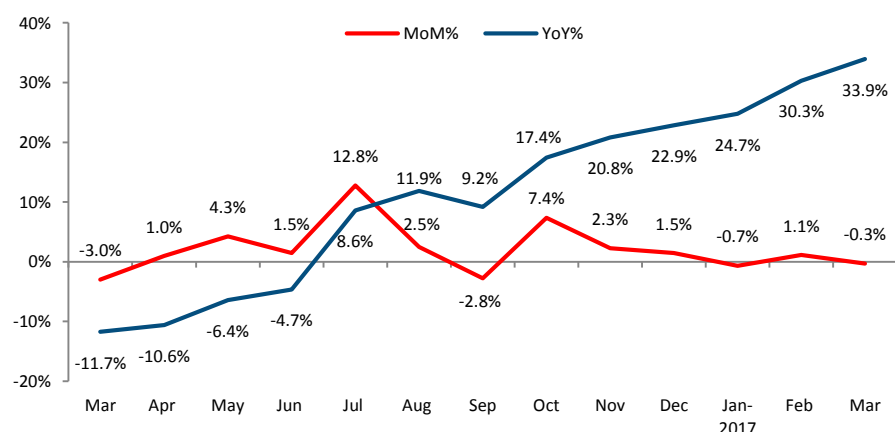
**The rising momentum is weakening on a MoM basis.** The CC328 Index remained strong on a YoY basis in Mar, gaining 33.9% YoY. However, the rising momentum is weakening on a MoM basis, with the monthly average down 0.3% in March to RMB15,916/tonne, compared to RMB15,961/tonne in Feb. Moreover, the MoM growth momentum has continued to decelerate since Oct-16 (see Figure 2).

**Figure 1: China Cotton Price Index 328 (CC 328 Index) (2007- Mar-17)**



Source: Wind, CSCI Research

**Figure 2: China Cotton 328 Index (Mar-16 – Mar-17, MoM% YoY%)**



Source: Wind, CSCI Research

**Figure 3: Performance of Major Indices (YoY %)**

Major indices	2016												2017		
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec	Jan	Feb	Mar
CC328 Index (China domestic cotton)	-6.5%	-8.9%	-11.7%	-10.6%	-6.4%	-4.7%	8.6%	11.9%	9.2%	17.4%	20.8%	22.9%	24.7%	27.3%	29.8%
CotLook A Index	7.3%	9.2%	-5.7%	0.7%	7.6%	2.4%	12.0%	17.2%	19.7%	19.4%	14.0%	23.7%	19.7%	23.2%	26.7%
FC Index (Foreign import cotton)	-3.9%	-9.1%	-10.3%	-7.3%	-7.1%	-3.2%	4.5%	8.1%	9.7%	8.9%	11.6%	11.5%	16.8%	20.1%	23.6%
China Cotton Yarn Index	-6.4%	-6.1%	-6.2%	-6.4%	-6.0%	-6.2%	-0.3%	7.1%	8.0%	10.3%	13.1%	13.1%	16.4%	17.9%	19.1%
China Synthetic Yarn Index	-12.5%	-11.8%	-10.0%	-7.5%	-13.4%	-11.8%	-9.8%	-6.6%	-0.7%	1.5%	5.7%	20.4%	30.2%	32.2%	24.7%
China Polyester Cotton Yarn (32S · 65/35) Index	-9.0%	-9.7%	-9.8%	-10.6%	-11.9%	-11.3%	-7.6%	-0.9%	-0.8%	-0.9%	-0.5%	2.3%	10.4%	13.0%	13.6%

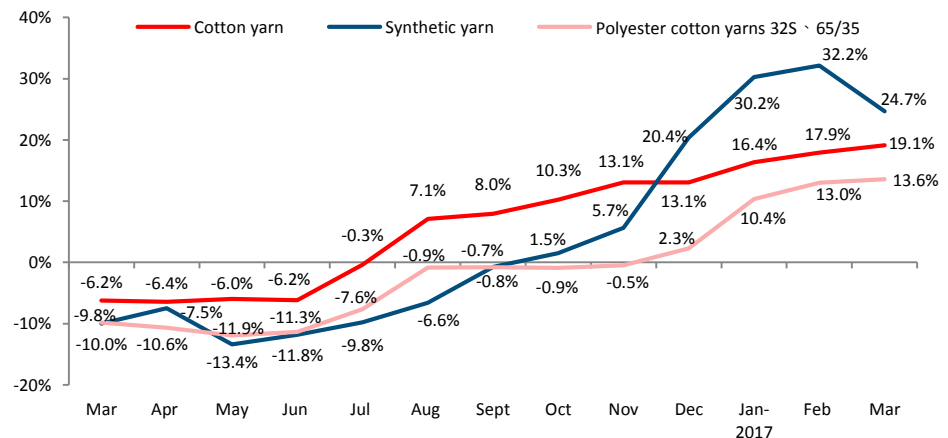
Source: Wind, CSCI Research

**China's synthetic yarn prices softened in Mar, following the retreat in global crude oil prices.** The China synthetic yarn index rose 24.7% YoY in Mar, a deceleration compared with an increase of 32.2% YoY in Feb. Meanwhile, the China polyester cotton yarn (32S \ 65/35) index continued to increase on a MoM basis, though it also started to soften, rising only 13.6% YoY in Mar, versus 13.0% in Feb. On the contrary, the China cotton yarn index continued its strong uptrend, gaining 19.1% YoY in Mar, compared with a 17.9% jump in Feb (see Figure 3-4).

**The spread between China's cotton and yarn prices continued to widen in Mar.** The increase in China's yarn prices (both cotton yarn and polyester cotton yarn) continued to lag behind the domestic cotton price, with the spread between the YoY changes in the CC328 Index and China Cotton Yarn Index widening to 10.6% in Mar from 9.4% in Feb (see Figure 5). Likewise, the spread for the China Polyester Cotton Yarn Index also widened to 16.2% in Mar from 14.3% in Feb (see Figure 6). The rise in yarn prices, which has continued to lag behind that of cotton suggests a relatively weak end-demand market (apparel & garment) and intensifying margin pressure faced by the upstream yarn producers.

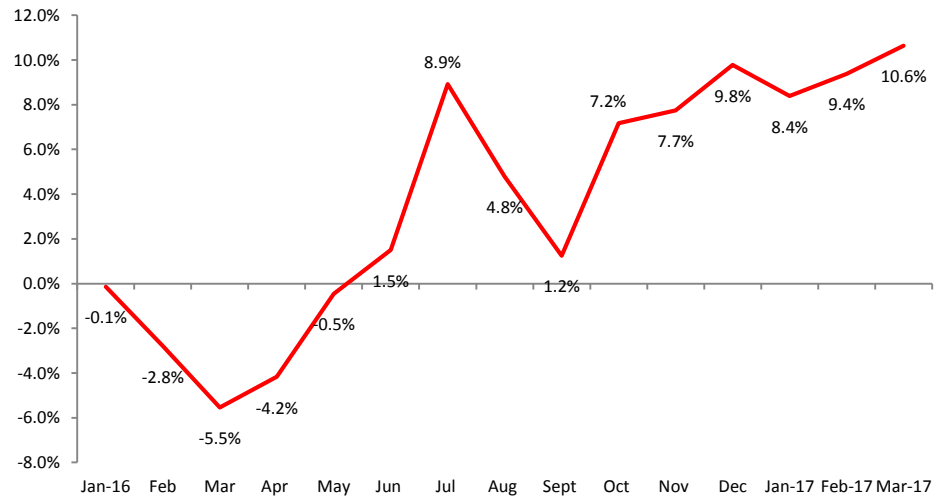
**ICA's cotton forecast for 2016/17 (as of 1 Mar 2017).** China's total cotton stocks, including those in the private sector are forecast to reach 9.3mn tons at the end of 2016/17, accounting for 53% of world stocks. On the contrary, the world ending stocks are expected to decline by 7% to 17.9mn tons in 2016/17. In 2017/18, world cotton consumption is estimated to exceed production by 1.2mn tons and stocks are expected to drop for the third consecutive season to 16.7mn tons, whilst China's ending stocks are anticipated to drop by 19% to 7.5mn tons, accounting for 45% of the world stocks at the end of 2017/18.

**Figure 4: China yarn prices – by categories (Mar-16 – Mar-17, YoY%)**



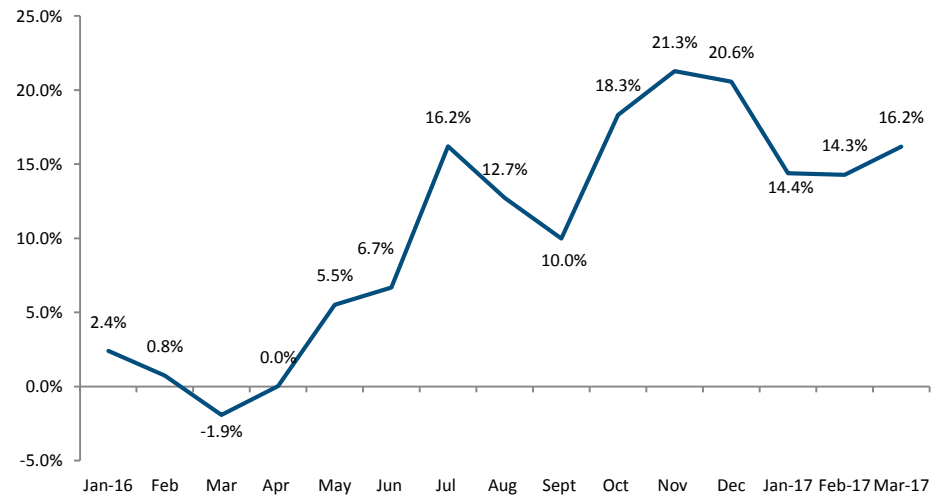
Source: Wind, CSCI Research

**Figure 5: CC328 v. China Cotton Yarn Index YoY % Spread (Jan-16 – Mar-17)**



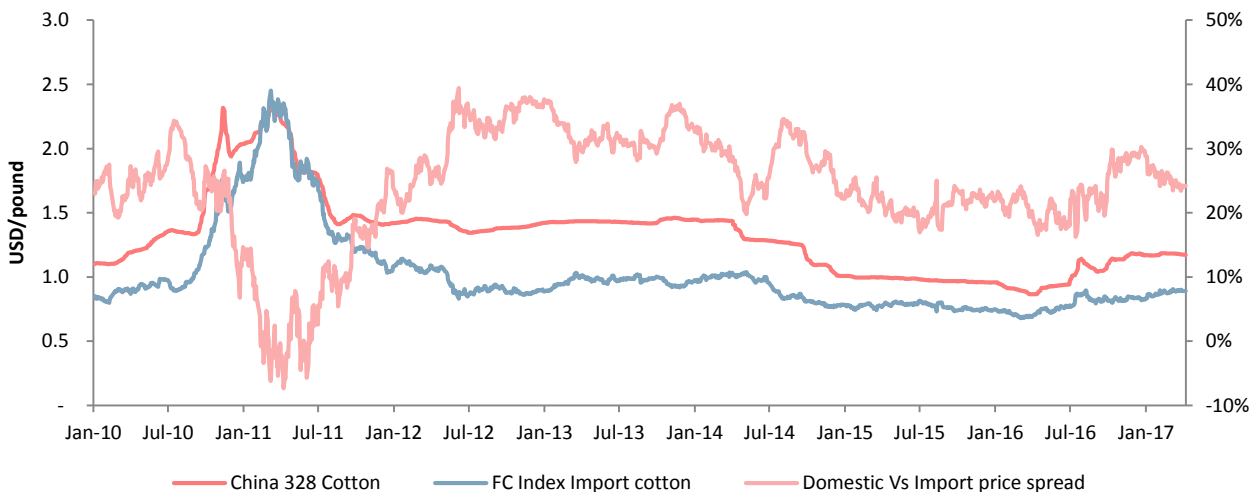
Source: Wind, CSCI Research

**Figure 6: CC328 v. China Polyester Cotton Yarn (32S \ 65/35) Index YoY % Spread (Jan-16 – Mar-17)**



Source: Wind, CSCI Research

**Figure 7: Cotton prices: domestic vs. import (2010- Mar-17)**



Source: Wind, CSCI Research

## Inventory/sales trend for major global brands

**Figure 8: Inv/sales (x) – (as of 3 Feb-17)**
**Figure 9: Inv/sales (x) – (as of 12 Apr-17)**

Company	Ticker	FYE	Inv/sales			ppt.	Company	Ticker	FYE	Inv/sales			ppt.	
			Latest financial quarter	Historical avg. for the same quarter (past two years)	YoY%					Latest financial quarter	Historical avg. for the same quarter (past two years)	YoY%		
Adidas	ADS GR	Dec	3Q16	0.59x	0.61x	-3.4%	(0.02) Adidas	ADS GR	Dec	4Q16	0.80x	0.72x	11.1%	0.08
Fast Retailing	9983 JP	Aug	1Q17	0.52x	0.52x	0.0%	(0.00) Fast Retailing	9983 JP	Aug	1Q17	0.52x	0.52x	0.0%	(0.00)
Hanesbrands	HBI US	Jan	4Q16	1.17x	1.14x	2.8%	0.03 Hanesbrands	HBI US	Jan	4Q16	1.17x	1.14x	2.8%	0.03
L Brands	LB US	Jan	4Q17	0.24x	0.26x	-7.7%	(0.02) L Brands	LB US	Jan	4Q17	0.24x	0.26x	-7.7%	(0.02)
Nike	NKE US	May	2Q17	0.56x	0.55x	1.8%	0.01 Nike	NKE US	May	3Q17	0.58x	0.57x	1.8%	0.01
PVH	PVH US	Feb	3Q17	0.59x	0.57x	3.5%	0.02 PVH	PVH US	Feb	4Q17	0.63x	0.62x	1.6%	0.01
Under Armour	UA US	Dec	4Q16	0.60x	0.46x	30.4%	0.14 Under Armour	UA US	Dec	4Q16	0.60x	0.46x	30.4%	0.14
Lululemon	LULU US	Jan	3Q17	0.75x	0.55x	36.4%	0.20 Lululemon	LULU US	Jan	4Q17	0.38x	0.37x	2.7%	0.01
Skechers	SKX US	Dec	4Q16	0.92x	0.86x	7.0%	0.06 Skechers	SKX US	Dec	4Q16	0.92x	0.86x	7.0%	0.06
Puma	PUMGY	Dec	4Q16	0.75x	0.75x	0.0%	- Puma	PUMGY	Dec	4Q16	0.75x	0.75x	0.0%	-

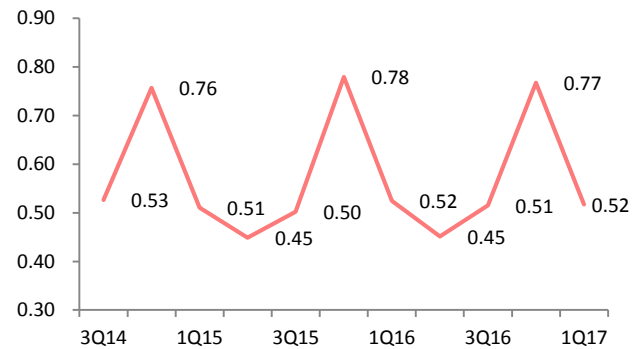
Source: Bloomberg, CSCI Research

Source: Bloomberg, CSCI Research

Majority of the global apparel brands recorded a higher inventory/sales ratio for the latest fiscal quarter. A drop in the inventory/sales ratio of retailers is usually accompanied by acceleration in their inventory replenishment in the near future, hence, favourable to their OEM suppliers and vice versa. In the latest fiscal quarter, such a ratio has declined YoY for the L Brands (LB US: 4Q17: -7.7%) only when compared with the historical average for the same quarter in the past two years. Although, Lululemon (LULU US) inventory/sales ratio continued to increase in 4Q17 by 2.7% but it is an improvement compared with a 36.4% YoY rise in 3Q17. PVH shared a similar trend in 4Q17, where inventory/sales ratio rose 1.6%, smaller than the increase of 3.5% in 3Q17. On the contrary, Adidas (AD US) inventory/sales ratio increased by 11.1% in 4Q16 versus a drop of 3.4% in 3Q16. (see Figure 8-9).

**Figure 10: Inventory/ sales (x), Adidas (ADS GR)**
**Figure 11: Inventory/ sales (x), Fast Retailing (9983 JP)**

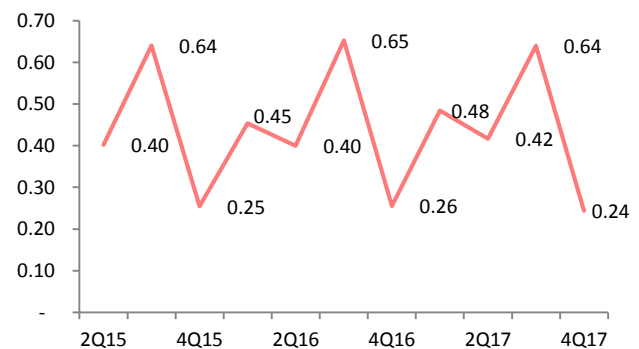

Source: Bloomberg, CSCI Research



Source: Bloomberg, CSCI Research

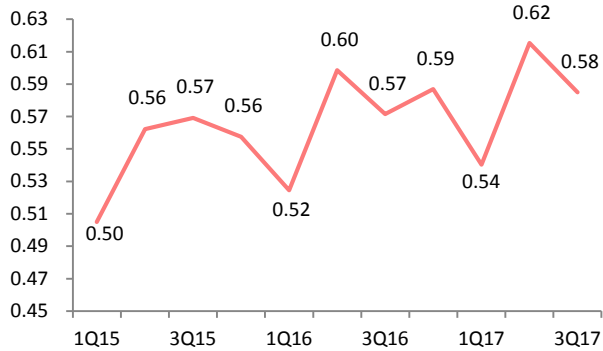
**Figure 12: Inventory/ sales (x), Hanesbrands (HBI US)**
**Figure 13: Inventory/ sales (x), L Brands (LB US)**


Source: Bloomberg, CSCI Research



Source: Bloomberg, CSCI Research

**Figure 14: Inventory/ sales (x), Nike (NKE US)**



Source: Bloomberg, CSCI Research

**Figure 15: Inventory/ sales (x), PVH (PVH US)**



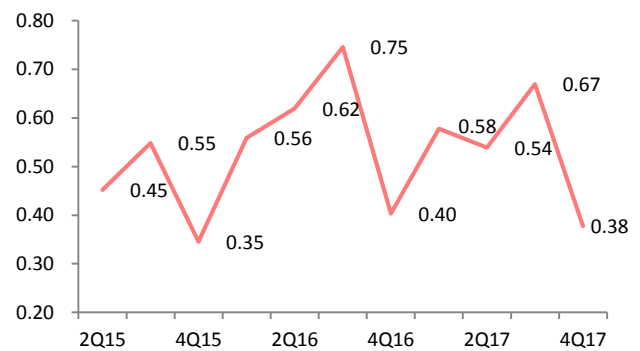
Source: Bloomberg, CSCI Research

**Figure 16: Inventory/ sales (x), Under Armour (UA US)**



Source: Bloomberg, CSCI Research

**Figure 17: Inventory/ sales (x), Lululemon (LULU US)**



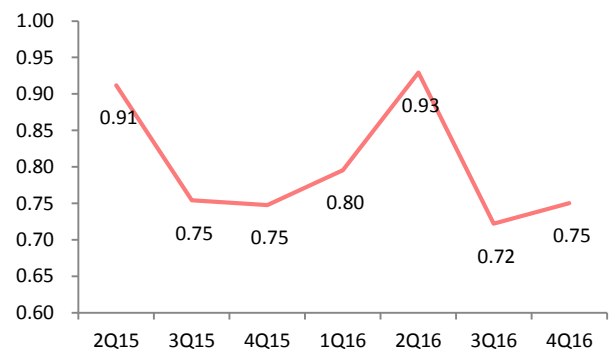
Source: Bloomberg, CSCI Research

**Figure 18: Inventory/ sales (x), Sketchers (SKX US)**



Source: Bloomberg, CSCI Research

**Figure 19: Inventory/ sales (x), Puma (PUM US)**



Source: Bloomberg, CSCI Research



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## Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index; Time Horizon: 12 months

<b>Buy</b>	12-month absolute total return: $\geq 10\%$
<b>Hold</b>	12-month absolute total return: $> -10\%$ but $< 10\%$
<b>Sell</b>	12-month absolute total return: $\leq -10\%$

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