Equity Research l China l Textile OEM

9 June 2017

China Textile Monthly

A warmer global apparel market

Company	Ticker	Rec	Mkt. cap. (HKD bn)	Cur	Last Price (HKD)	PT (HKD)	Up/ dn (%)	PER (x) 1-yr fwd	PER (x) 2-yr fwd	PBR (x) 1-yr fwd	Dividend yield (%)	ROIC (%)
Texhong Textile	2678 HK	HOLD	8.9	HKD	9.7	11.3	16.7	8.2	7.4	1.7	4.6	15.6
Weiqiao Textile	2698 HK	NR	6.7	HKD	5.6	n.a.	n.a.	n.a.	n.a.	n.a.	5.2	4.7
Fountain Set	420 HK	NR	1.2	HKD	1.0	n.a.	n.a.	n.a.	n.a.	1.0	5.3	n.a.
Pacific Textiles	1382 HK	BUY	12.8	HKD	8.8	11.4	29.3	14.7	13.5	4.3	7.9	20.8
Best Pacific	2111 HK	BUY	7.3	HKD	7.1	7.3	2.8	17.5	15.1	3.6	2.4	18.0
Taiwan Paiho	9938 TT	NR	7.8	TWD	26.3	n.a.	n.a.	17.5	15.1	3.6	n.a.	11.7
Texwinca	321 HK	HOLD	6.0	HKD	4.3	5.1	18.1	13.7	13.4	1.2	10.6	14.1
Shenzhou International	2313 HK	BUY	79.0	HKD	53.2	58.9	10.7	21.2	16.9	4.3	1.6	16.2
Regina Miracle	2199 HK	HOLD	6.9	HKD	5.7	6.6	16.4	61.0	18.7	6.4	1.0	8.1
Nameson	1982 HK	BUY	3.2	HKD	1.6	2.0	28.2	9.9	7.3	2.1	3.4	13.1
Win Hanverky	3322 HK	NR	1.5	HKD	1.2	n.a.	n.a.	11.6	7.7	n.a.	9.9	9.7
Eagle Nice	2368 HK	NR	1.1	HKD	2.3	n.a.	n.a.	9.2	9.2	n.a.	11.5	9.9

Source: Company, Bloomberg, CSCI Research estimates

- **More global apparel retailers have reported a decline in their inventory/sales ratio in their latest quarterly results, with Fast Retailing (9983 JP) and Puma (PUM GY) posting the most prominent declines. The overall downward trend indicates potential acceleration in inventory restocking in the near term, which bodes well for their major suppliers, such as Shenzhou (2313 HK, BUY) and Nameson (1982 HK, BUY).**
- **Although the CC328 Index has continued on an uptrend in May-17, gaining 28.2% YoY, the pace of growth has started to decelerate since its peak growth rate of 33.9% YoY in Mar-17.**
- **Hence, we believe the CC328 Index has most likely reached its peak growth in Mar-17, increasing 33.9% YoY. As such, we expect China's domestic cotton price will remain stable going forward, which is most favourable to the textile and garment manufacturers.**

Global apparel brands' inventory/sales ratio continued to improve in their latest quarter. More brands have reported a declining inventory/sales ratio in their latest quarterly results, which is an indication of potential acceleration in inventory restocking in the near term. Fast Retailing (9983 JP) posted the most prominent drop of 7.2% in 2Q17, followed by Puma (PUM GY) and Hanesbrands (HBI US) with a 5.1% and -4.0% decline respectively in 1Q17 and PVH (PVH US) with a 3.1% drop in 1Q18. Although Under Armour's (UA US) inventory/sales ratio has risen 6.6% in 4Q17, it has eased slightly from the 30.4% growth recorded for 4Q16. (see Figure 9-10) Shenzhou's (2313 HK, BUY) major clients include Uniqlo (under Fast Retailing) and Puma, whereas Regina Miracle's (2199 HK, HOLD) clients include HBI, PVH and UA.

China's domestic cotton price growth might have peaked in Mar-17. Although the CC328 Index has continued to increase in May-17, gaining 28.2% YoY to an average of RMB16,034/tonne, the pace of acceleration has started to slow down since its peak growth rate of 32.3% YoY in Apr. The CC328 Index has most likely reached its peak growth in Mar-17, increasing 33.9% YoY (*see Figure 1-2*). According to the latest report by United States Department of Agriculture (USDA) in May, despite China's aggressive sales of state cotton reserves and a continuing recovery in consumption, the ending stocks in China is expected to continue to remain high with the ending stocks-to-use ratio above 100% for the sixth consecutive year. Hence, we expect China's domestic cotton price will remain stable, which is most favourable to the textile and garment manufacturers.

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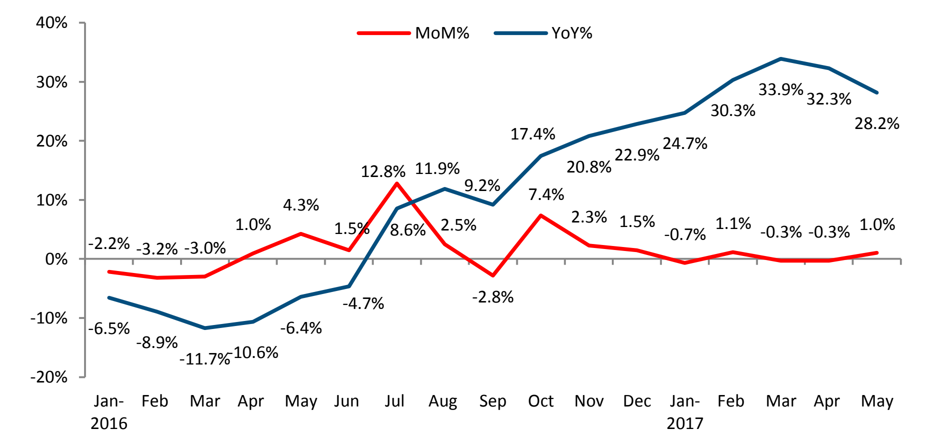
Textile commodity update – May 2017

China's domestic cotton price continued to rise in May, albeit a slower pace. The CC328 Index has increased by 28.2% YoY to RMB16,034/tonne in May-17. Despite a double-digit percentage increase, the pace of growth has continued to decelerate from the 32.3% and 33.9% YoY upsurge in April and Mar respectively. We believed the spot market prices may be negatively impacted by a declining purchase rate from the State cotton auction. The purchase rate in the week of 24 May has fallen to 53%from 60% in the prior week, as the base bidding price has continued to rise, which has discouraged bidders, coupled with a tepid demand for downstream products (i.e. cotton yarn).

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

Source: Wind, CSCI Research

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

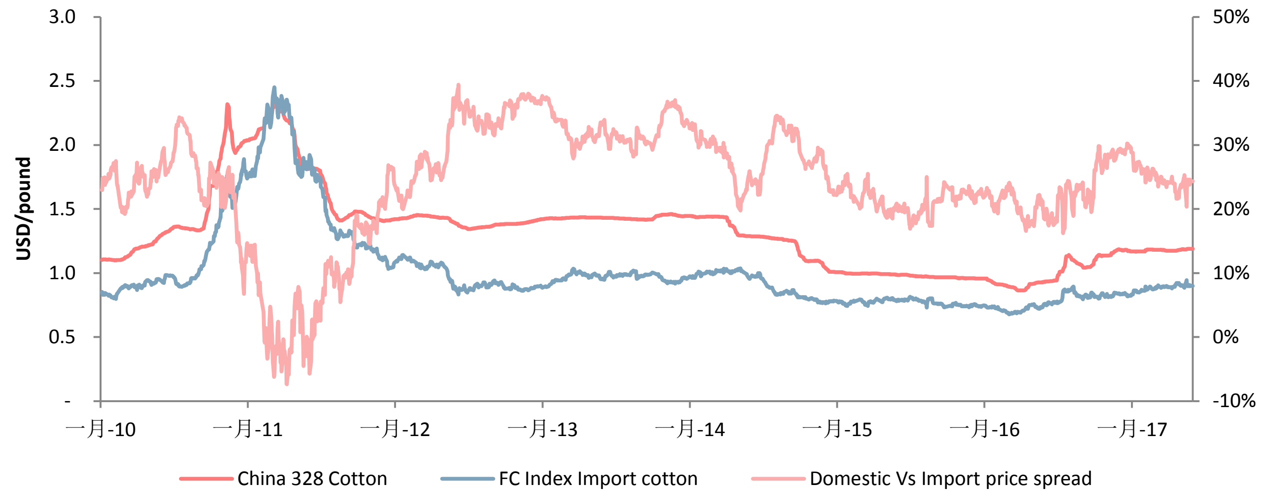


Source: Wind, CSCI Research

USDA forecasts 2017/18 world cotton inventories to rise, except China. According to the USDA, China's cotton stocks are forecast to fall for the third consecutive year as a result of the state cotton reserve auction. Nevertheless, China's cotton inventory will remain very high with the ending stocks-to-use ratio above 100% for the sixth consecutive year. And since China aims to reduce the cotton State reserves, it will unlikely raise the import quotas substantially in 2017/18, in our view. On the contrary, USDA expects global production (ex-China) will increase by c.7% YoY in 2017/18, resulting in the highest global production levels outside of China in the past six years. Global consumption is expected to remain above production, yielding the third consecutive year of declining global stocks, albeit a much smaller reduction than in the previous two years. Also, global consumption is expected to grow at a faster rate than within China, primarily coming from Vietnam and Bangladesh (*see Figure 4)*.

China's domestic cotton price to remain stable. Hence, we believe the CC328 Index may well have already reached its peak growth rate in Mar-17, increasing 33.9% YoY. We expect China's domestic cotton price will remain stable going forward, which is most favourable to the textile and garment manufacturers.

Figure 3: Cotton prices: domestic vs. import (2010- May-17)



Source: Wind, CSCI Research

Figure 4: Cotton World Supply, Use, and Trade (Season Beginning August 1)

(units: 1,000 MT)	2012/13	2013/14	2014/15	2015/16	2016/17	2016/17 (May)
Production:						
India	6,205	6,750	6,423	5,748	5,770	6,096
China	7,620	7,131	6,532	4,790	4,953	5,117
United States	3,770	2,811	3,553	2,806	3,738	4,180
Pakistan	2,025	2,068	2,308	1,524	1,676	1,851
Brazil	1,306	1,742	1,524	1,285	1,481	1,524
Australia	1,002	893	501	621	958	1,045
Turkey	577	501	697	577	697	806
Other	4,473	4,315	4,420	3,717	3,779	4,033
TOTAL	26,978	26,211	25,958	21,068	23,052	24,652
USE Dom. Consumption:						
China	7,838	7,512	7,403	7,620	8,056	8,165
India	4,736	5,062	5,334	5,280	5,171	5,225
Pakistan	2,341	2,264	2,308	2,243	2,243	2,264
Bangladesh	1,023	1,154	1,263	1,328	1,415	1,502
Turkey	1,317	1,372	1,393	1,448	1,372	1,426
Vietnam	490	697	893	958	1,154	1,285
United States	762	773	778	751	718	740
Other	5,101	5,063	4,882	4,588	4,517	4,595
TOTAL	23,608	23,897	24,254	24,216	24,646	25,202
Imports:						
Bangladesh	1,089	1,154	1,252	1,350	1,361	1,524
Vietnam	525	697	931	980	1,176	1,350
China	4,426	3,075	1,804	959	1,045	1,089
Turkey	804	924	800	918	686	740
Indonesia	683	651	728	640	697	697
Pakistan	392	261	207	718	588	566
India	258	147	267	233	544	381
Other	2,201	2,068	1,869	1,863	1,848	1,847
TOTAL	10,378	8,977	7,858	7,661	7,945	8,194
Exports:						
United States	2,836	2,293	2,449	1,993	3,157	3,048
India	1,690	2,016	914	1,255	914	980
Australia	1,343	1,056	523	621	827	936
Brazil	938	486	851	939	631	697
Uzbekistan	697	588	533	544	327	370
Burkina	261	278	229	283	250	272
Mali	174	196	185	218	239	261
Other	2,175	2,038	2,002	1,832	1,700	1,629
TOTAL	10,114	8,951	7,686	7,685	8,045	8,193
Ending Stocks:						
China	10,965	13,653	14,570	12,671	10,603	8,632
India	2,568	2,495	2,936	2,383	2,611	2,884
Brazil	1,263	1,670	1,640	1,341	1,597	1,760
United states	827	512	795	827	697	1,089
Australia	522	393	396	366	577	710
Pakistan	590	539	629	569	542	613
Turkey	286	295	347	345	296	356
Other	3,040	2,924	3,016	2,571	2,569	2,930
TOTAL	20,061	22,481	24,329	21,073	19,492	18,974

Source: USDA, CSCI Research

Figure 5: Performance of Major Indices

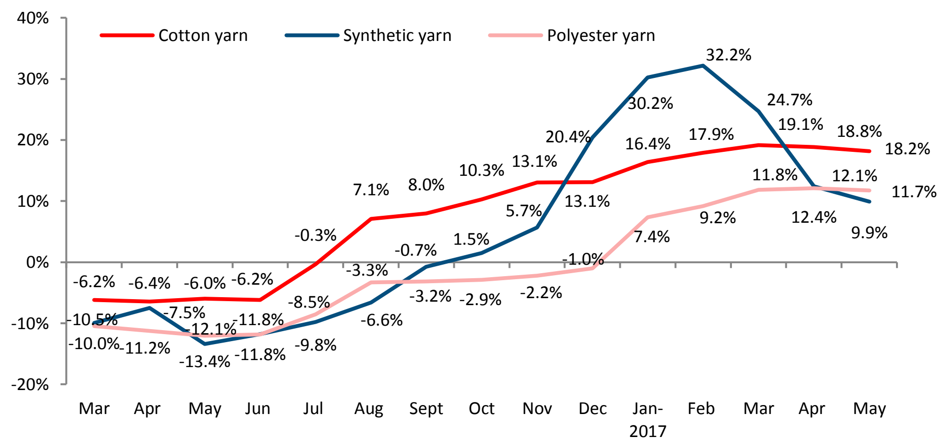
	2016											2017				
Major indices	**Jan**	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sept**	**Oct**	**Nov**	**Dec**	**Jan**	**Feb**	**Mar**	**Apr**	**May**
CC328 Index (China domestic cotton)	-6.5%	-8.9%	-11.7%	-10.6%	-6.4%	-4.7%	8.6%	11.9%	9.2%	17.4%	20.8%	22.9%	24.7%	30.3%	33.9%	32.3%	28.2%
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%	27.2%	32.4%	26.3%	25.7%
FC Index (Foregin 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%	24.0%	29.4%	23.4%	22.3%
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%	18.8%	18.2%
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%	12.4%	9.9%
China Polyester Yarn Index	-9.1%	-9.0%	-10.5%	-11.2%	-12.1%	-11.8%	-8.5%	-3.3%	-3.2%	-2.9%	-2.2%	-1.0%	7.4%	9.2%	11.8%	12.1%	11.7%

Source: Wind, CSCI Research

Growth in synthetic yarn price continued to decelerate in May-17. Due to a weaker global crude oil price, the growth rate of China's synthetic yarn index decelerated further to 9.9% YoY in May from a 32.2% YoY increase in Feb and 12.4% rise in Apr. On the contrary, the growth in cotton and polyester yarn prices remained strong, rising by 18.2% and 11.7% YoY in May, as compared to the 18.8% and 12.1% growth in Apr, respectively (*See Fig. 6*).

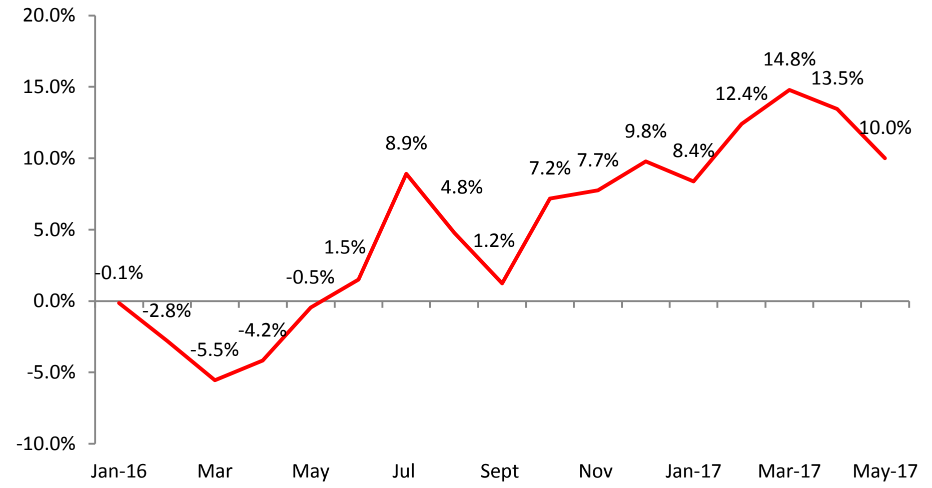
The spread between CC328 vs China cotton and polyester yarn indices narrowed. The spread between the CC328 Index and China cotton yarn index has narrowed to 10.0% in May, down from 13.5% in Apr and 14.8% in Mar (*see Fig.7*).Meanwhile, the spread between the CC328 Index and China polyester yarn index showed a similar trend, narrowing to 16.5% in May from 20.2% in Apr and 22.1% in Mar (*see Fig.8*). This was attributable to a deceleration in China's cotton price growth. We believe such development is positive to the upstream yarn producers as margin pressure (from higher raw material cotton cost) might start to alleviate going forward. Nevertheless, we still need to monitor whether the growth in the yarn price will be sustainable in the coming months before we turn bullish on the upstream yarn producers.

Figure 6: China yarn prices – by categories (Mar-16 – May-17, YoY%)



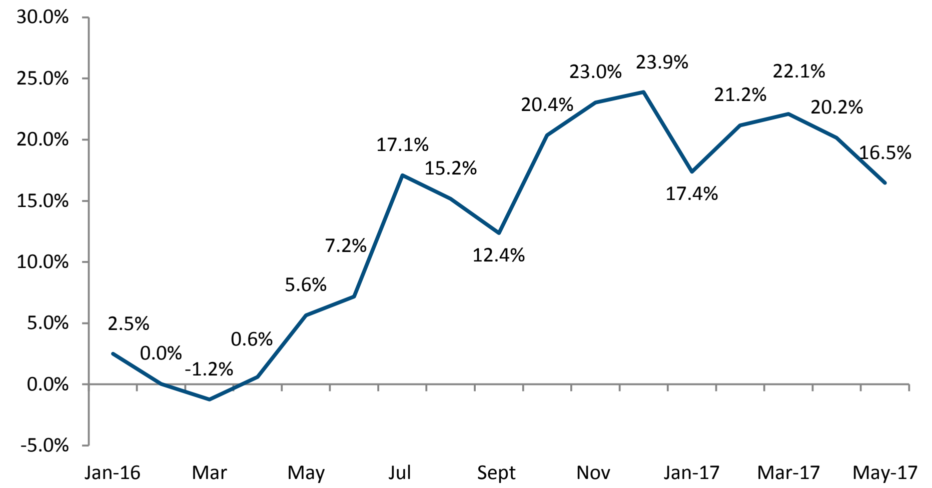
Source: Wind, CSCI Research

Figure 7: CC328 v. China Cotton Yarn Index YoY % Spread (Jan-16 – May-17)



Source: Wind, CSCI Research

Figure 8: CC328 v. China Polyester Yarn Index YoY % Spread (Jan-16 – Mar-17)



Source: Wind, CSCI Research

Inventory/sales trend for major global brands

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

Company	Ticker	FYE		Inv/sales Latest financial quarter	Historical avg. for the same quarter (past two years)	YoY%	ppt.
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)
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)
Nike	NKE US	May	3Q17	0.58x	0.57x	1.8%	0.01
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
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
Puma	PUM GY	Dec	4Q16	0.75x	0.75x	0.0%	-

Source: Bloomberg, CSCI Research

Figure 10: Inv/sales (x) – (as of 2 Jun-17)

Company	Ticker	FYE		Inv/sales Latest financial quarter	Historical avg. for the same quarter (past two years)	YoY%	ppt.
Adidas	ADS GR	Dec	1Q17	0.64x	0.62x	3.2%	0.02
Fast Retailing	9983 JP	Aug	2Q17	0.48x	0.52x	-7.2%	(0.04)
Hanesbrands	HBI US	Jan	1Q17	1.45x	1.51x	-4.0%	(0.06)
L Brands	LB US	Jan	1Q18	0.47x	0.47x	0.4%	0.00
Nike	NKE US	May	3Q17	0.58x	0.57x	1.8%	0.01
PVH	PVH US	Feb	1Q18	0.63x	0.65x	-3.1%	(0.02)
Under Armour	UA US	Dec	1Q18	0.81x	0.76x	6.6%	0.05
Lululemon	LULU US	Jan	4Q17	0.38x	0.37x	2.7%	0.01
Skechers	SKX US	Dec	1Q17	0.55x	0.51x	7.8%	0.04
Puma	PUM GY	Dec	1Q17	0.75x	0.79x	-5.1%	(0.04)

Source: Bloomberg, CSCI Research

Global apparel brands' inventory/sales ratio continued to improve in their latest quarter. More brands have reported a drop in their inventory/sales ratio in their latest quarterly results, with Fast Retailing (9983 JP) posting the most prominent decline of 7.2% in 2Q17, followed by Puma (PUM GY) and Hanesbrands (HBI US) with a 5.1% and 4.0% decline respectively in 1Q17 and PVH (PVH US) with a 3.1% drop in 1Q18. Although Under Armour's (UA US) inventory/sales ratio has risen by 6.6% in 4Q17, it has eased slightly from the 30.4% growth recorded for 4Q16 (see Fig.1). Shenzhou (2313 HK, BUY)'s major clients include Uniqlo (under Fast Retailing) and Puma, whereas Regina Miracle's (2199 HK, HOLD) clients include HBI, PVH and UA.

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Company Rating Definition

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

Buy	12-month absolute total return: >=10%
Hold	12-month absolute total return: >-10% but <10%
Sell	12-month absolute total return: <=-10%

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