

2H14F to improve sequentially

US/Europe markets to cushion slowing China

Manufacturing order trends in CY14F: US > Europe > China and Japan

Our discussions with apparel and footwear manufacturers point to strong brand ODM/OEM orders, in general, in the US market in CY14, and a pick-up in Europe, especially in 2H, while China and Japan are likely to be relatively weak. While many of supply chain players guide for low to mid single-digit volume growth for the full year, we see potential for upside if the positive momentum in the US and Europe continues. Product wise, the fashion category looks set to outperform casual on a low base. Sportswear also stands to benefit from more new product launches in 2H.

Top picks: Shenzhou (2313 HK, Buy) and Stella (1836 HK, Buy)

We believe Shenzhou and Stella offer the best fundamentals in the supply chain space, where only a few can tap into the growth that key customers see from new product launches. For Shenzhou, we believe Nike's *Flyknit* applications and World Cup-related products will boost sales growth to the mid-teens level in its interim results in late August. Stella will post 2Q updates later this week and we expect a positive pick-up in sales (vs -7.2% in 1Q14). We have a non-consensus Buy call on Stella with 11% upside to our TP.

Most potential upside: Texhong (2678 HK, Buy)

Among the supply chain players we cover, Texhong has been one of the most disliked names over the past year, resulting in a correction in 12m forward P/E to 5x. With its utilisation still at 100% and cotton yarn prices having stabilised and likely to pick up in August, we see the most potential upside at Texhong. A potential risk, albeit a likely minor one, is the potential sale of more of China government's cotton reserves which would likely cap the yarn price recovery.

Pacific Textiles (1382 HK, Buy) a steady dividend play; Yue Yuen (551 HK, Neutral) – wait for interim

We expect Pacific Textiles shares to hold up well before the ex-dividend date (12 Aug) with forecasted dividend yield at 10% (7% for 2H and 10% FY14). Yue Yuen's retail business is recovering as price markdowns shrink (to 25-30% in 1Q14, from ~50% in 2H13) and the inventory level normalises. However, we believe continuing production relocation and the potential hike in employee benefit payments in China (other than Dongguan's Gaobu factory, which we estimate to be another USD60-70mn) may disappoint the consensus estimates by interim reporting. We maintain Neutral.

Fig. 1: Stocks for action

Company	Ticker	Nomura Rating	Target Price (HKD)	Price 8-July 2014 (HKD)	Potential Upside	PE Ratio 12m fwd	EPS growth CY14-15F CAGR	Dividend Yield CY14F
Shenzhou Int'l	2313 HK	Buy	32.2 ↑	27.0	19.3%	12.6	18.0%	3.3%
Pacific Textiles	1382 HK	Buy	10.8 ↓	9.8	10.7%	12.6	4.5%	7.2%
Texhong Textile	2678 HK	Buy	8.3 ↓	6.2	33.9%	5.0	-5.8%	5.2%
Yue Yuen	551 HK	Neutral	25.8 ↓	26.3	-1.9%	12.2	6.0%	3.8%
Stella	1836 HK	Buy	24.0 ↑	21.6	11.4%	14.5	11.8%	4.5%

Source: Bloomberg, Nomura estimates. Note: ↑ Upgrading, ↓ Downgrading

Global Markets Research

10 July 2014

Anchor themes

Market wise, we prefer those names with more exposure to the US/Europe markets than to China/Japan in CY14F. Product wise, the fashion and sportswear categories will likely outperform casual products.

Nomura vs consensus

The worst may be over for Pacific Textiles and Texhong, but it is not yet over for Yue Yuen, in our contrarian view.

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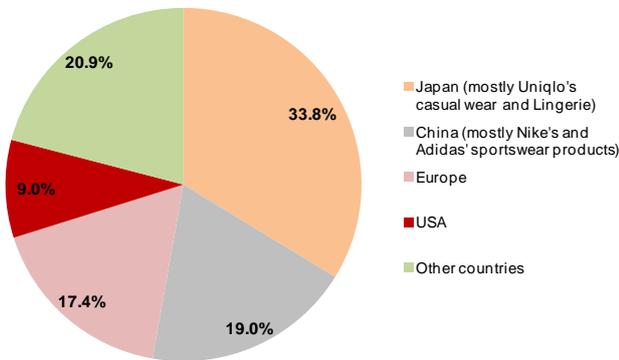
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In the aftermath of the Vietnam riots, manufacturers likely to allocate more resources to improving production efficiency of China factories

The Vietnam riots in May have since driven manufacturers to revisit their capacity expansion plans in the country. Although most of the existing projects will likely be unaffected, these manufacturers will likely accelerate plans to diversify their facilities in other locations such as Myanmar. Meanwhile, manufacturers will likely increase capex in China, with an aim to reduce headcount while increasing or at least maintaining output via measures such as upgrading machines, adopting more automation applications and/or improving production flow. For manufacturers, China is likely to remain a critical production base but to become more capital intensive than before, in our view.

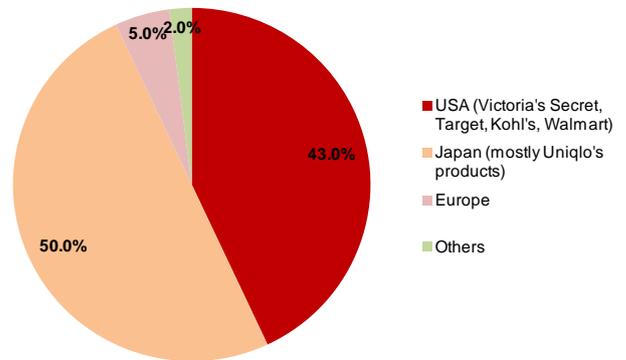
Supply chain player revenue exposure by geography

Fig. 2: Shenzhou: FY13 revenue breakdown by region
Sportswear 55%, Casual wear 29%, Lingerie 14%, Other 2%



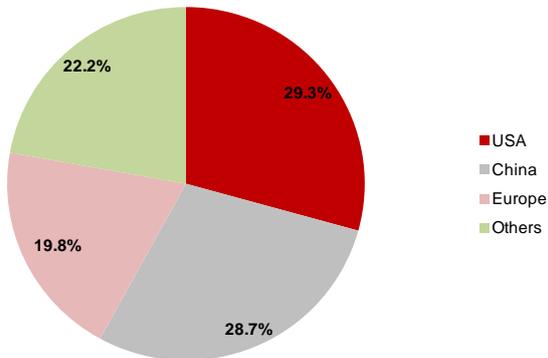
Source: Company data, Nomura research

Fig. 3: Pacific Textiles: FY14 revenue breakdown by region
Revenue breakdown by brand buyers' country of origin



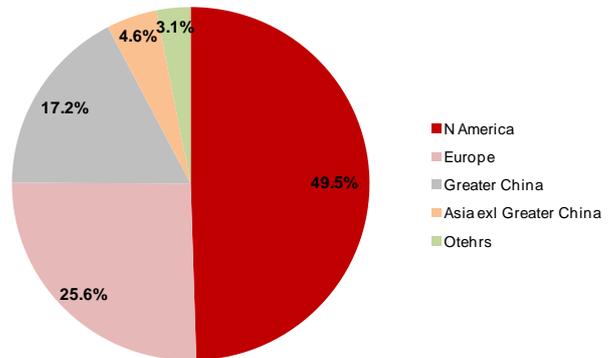
Source: Company data, Nomura research

Fig. 4: Yue Yuen: FY13 revenue breakdown by region
Athletic shoes 48%, Casual shoes 20%, Retail 25%, Other 7%



Source: Company data, Nomura research

Fig. 5: Stella: FY13 revenue breakdown by region
Fashion 48%, Casual 44%, Retail 8%



Source: Company data, Nomura research

Shenzhou International Group

2313.HK 2313 HK

EQUITY: CONSUMER RELATED

Margin expansion underestimated by market

More new product launches scheduled for 2H

Action: Maintain Buy on strong demand from brand customers

We think the market's concern with regard to whether Shenzhou can fill orders of its aggressive capacity expansion (fabrics capacity will increase 70% by end-2016 vs end-2013) has muted its performance YTD. However, we are positive on the expansion as growth prospects of its core customers (Uniqlo's lingerie, Adidas' and Nike's apparel) remain strong, as per these companies. Specifically, Shenzhou's collaboration with customers' innovative products should help it defend orders and improve margins. Maintain Buy.

Catalysts: Brand customers' new product launches in 2H14; fabrics capacity in Vietnam comes online in late 2014

We expect North America (20% y-y), Japan (18% y-y) and non-China Asian countries (20% y-y) to be key growth drivers for Shenzhou in FY14F, aided by Nike's Flyknit products and new apparel offerings, Adidas' product launch pipeline in 2H and Uniqlo's lingerie product launches. China should mirror the growth the company saw in FY13 (7.5% y-y), while Europe may remain flat. In addition, as fabrics capacity will add 60 tons/day in Vietnam by late 2014 (vs currently 280 tons/day), Shenzhou would thus have a greater allocation to new product categories such as golf-related products and some others.

Valuation: Issuance of CB prepares war chest and also helps FX hedge; Valuation is attractive concerning growth potential and dividends

Shenzhou's convertible bond issuance (redemption rate at 3.8% premium for five years, coupon rate 0.5% p.a.) will be used in developments of production facilities, which, in our view, can resolve its capacity limitation and hedge its accounts receivable (80% in USD). In light of the potential secular growth once capacity expansion project is completed, the current valuation looks undervalued (12.6x 12m fwd P/E of CNY1.65) vs 2-year average of 14x, given Shenzhou is relatively resilient amidst the weak global economy.

Year-end 31 Dec	FY13		FY14F		FY15F		FY16F	
Currency (CNY)	Actual	Old	New	Old	New	Old	New	
Revenue (mn)	10,047	11,374	11,401	12,833	12,896	14,690	14,858	
Reported net profit (mn)	1,767	2,109	2,150	2,415	2,462	2,796	2,863	
Normalised net profit (mn)	1,767	2,109	2,150	2,415	2,462	2,796	2,863	
FD normalised EPS	1.26	1.54	1.54	1.77	1.76	2.05	2.05	
FD norm. EPS growth (%)	4.4	19.4	21.7	14.5	14.5	15.8	16.3	
FD normalised P/E (x)	16.9	N/A	13.6	N/A	11.8	N/A	10.2	
EV/EBITDA (x)	10.4	N/A	8.4	N/A	7.3	N/A	5.9	
Price/book (x)	2.9	N/A	2.5	N/A	2.2	N/A	2.0	
Dividend yield (%)	2.8	N/A	3.3	N/A	3.8	N/A	4.9	
ROE (%)	19.2	19.2	19.6	19.6	19.9	20.1	20.4	
Net debt/equity (%)	net cash							

Source: Company data, Nomura estimates

Key company data: See page 2 for company data and detailed price/index chart

Global Markets Research

10 July 2014

Rating	Buy
Remains	
Target price	HKD 32.20
Increased from 31.70	
Closing price	HKD 27.00
8 July 2014	
Potential upside	+19.3%

Anchor themes

Integration across the value chain and acquiring design capabilities will continue to be the key theme across the sector. Relocation outside China will drive near-term market segmentation.

Nomura vs consensus

Our FY14F and FY15F margins are 80bp higher than consensus as we build in better margin expansions gained from key customers' new products.

Research analysts

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Key data on Shenzhou International Group

Relative performance chart



Source: Thomson Reuters, Nomura research

Notes:

Performance

(%)	1M	3M	12M		
Absolute (HKD)	-0.6	9.0	23.9	M cap (USDm)	4,873.9
Absolute (USD)	-0.5	9.1	24.0	Free float (%)	34.1
Rel to MSCI China	-4.0	5.4	6.2	3-mth ADT (USDm)	5.6

Income statement (CNYmn)

Year-end 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
Revenue	8,938	10,047	11,401	12,896	14,858
Cost of goods sold	-6,393	-7,209	-8,120	-9,149	-10,508
Gross profit	2,545	2,839	3,281	3,747	4,350
SG&A	-509	-627	-642	-726	-836
Employee share expense					
Operating profit	2,035	2,211	2,640	3,022	3,514
EBITDA	2,397	2,618	3,049	3,476	4,008
Depreciation	-343	-386	-387	-432	-473
Amortisation	-19	-21	-22	-22	-21
EBIT	2,035	2,211	2,640	3,022	3,514
Net interest expense	-30	-10	0	0	0
Associates & JCEs					
Other income					
Earnings before tax	2,005	2,201	2,640	3,022	3,514
Income tax	-384	-397	-488	-559	-650
Net profit after tax	1,621	1,804	2,151	2,463	2,864
Minority interests	-1	-1	-1	-1	-1
Other items	-11	-36	0	0	0
Preferred dividends					
Normalised NPAT	1,609	1,767	2,150	2,462	2,863
Extraordinary items					
Reported NPAT	1,609	1,767	2,150	2,462	2,863
Dividends	-755	-825	-968	-1,108	-1,432
Transfer to reserves	854	942	1,183	1,354	1,432

Valuations and ratios

Reported P/E (x)	18.0	16.5	13.6	11.8	10.2
Normalised P/E (x)	18.0	16.5	13.6	11.8	10.2
FD normalised P/E (x)	18.0	16.9	13.6	11.8	10.2
Dividend yield (%)	2.6	2.8	3.3	3.8	4.9
Price/cashflow (x)	16.8	36.2	12.1	15.7	8.7
Price/book (x)	3.6	2.9	2.5	2.2	2.0
EV/EBITDA (x)	12.2	10.4	8.4	7.3	5.9
EV/EBIT (x)	14.3	12.3	9.7	8.4	6.8
Gross margin (%)	28.5	28.3	28.8	29.1	29.3
EBITDA margin (%)	26.8	26.1	26.7	27.0	27.0
EBIT margin (%)	22.8	22.0	23.2	23.4	23.7
Net margin (%)	18.0	17.6	18.9	19.1	19.3
Effective tax rate (%)	19.1	18.0	18.5	18.5	18.5
Dividend payout (%)	46.9	46.7	45.0	45.0	50.0
ROE (%)	22.7	19.2	19.6	19.9	20.4
ROA (pretax %)	36.8	26.9	29.5	30.4	32.4

Growth (%)

Revenue	-1.2	12.4	13.5	13.1	15.2
EBITDA	-1.8	9.2	16.5	14.0	15.3
Normalised EPS	1.2	7.1	18.7	14.5	16.3
Normalised FDEPS	na	4.4	21.7	14.5	16.3

Source: Company data, Nomura estimates

Cashflow statement (CNYmn)

Year-end 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
EBITDA	2,397	2,618	3,049	3,476	4,008
Change in working capital	-153	-1,291	-149	-1,066	7
Other operating cashflow	-521	-499	-488	-559	-650
Cashflow from operations	1,723	828	2,412	1,850	3,365
Capital expenditure	-650	-792	-800	-800	-600
Free cashflow	1,073	36	1,612	1,050	2,765
Reduction in investments	1	3	0	0	0
Net acquisitions	-2				
Dec in other LT assets	159	103	0	0	0
Inc in other LT liabilities		0	0	0	0
Adjustments					
CF after investing acts	1,230	142	1,612	1,050	2,765
Cash dividends	-540	-755	-825	-968	-1,108
Equity issue					
Debt issue					
Convertible debt issue			3,100		
Others	424	1,077	200	0	0
CF from financial acts	-116	322	2,475	-968	-1,108
Net cashflow	1,115	464	4,087	83	1,657
Beginning cash	1,030	2,144	2,609	6,696	6,778
Ending cash	2,144	2,609	6,696	6,779	8,435
Ending net debt	-1,358	-2,609	-3,596	-3,678	-5,335

Balance sheet (CNYmn)

As at 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
Cash & equivalents	2,144	2,609	6,696	6,778	8,435
Marketable securities	131	227	27	27	27
Accounts receivable	1,728	1,728	2,177	2,240	2,849
Inventories	1,924	2,425	2,247	3,368	2,966
Other current assets	0	3	0	0	0
Total current assets	5,928	6,993	11,147	12,413	14,276
LT investments					
Fixed assets	3,314	3,518	3,931	4,299	4,426
Goodwill					
Other intangible assets	105	102	95	89	84
Other LT assets	548	704	688	673	657
Total assets	9,895	11,317	15,862	17,474	19,444
Short-term debt	786	0	0	0	0
Accounts payable	829	923	1,056	1,174	1,387
Other current liabilities	158	63	49	49	49
Total current liabilities	1,773	986	1,104	1,222	1,435
Long-term debt	0	0	3,100	3,100	3,100
Convertible debt					
Other LT liabilities	0	0	0	0	0
Total liabilities	1,773	986	4,204	4,322	4,535
Minority interest	35	15	16	16	17
Preferred stock					
Common stock	137	142	142	142	142
Retained earnings	7,196	9,349	10,532	11,886	13,317
Proposed dividends	755	825	968	1,108	1,432
Other equity and reserves					
Total shareholders' equity	8,087	10,316	11,642	13,136	14,891
Total equity & liabilities	9,895	11,317	15,862	17,474	19,444

Liquidity (x)

Current ratio	3.34	7.09	10.09	10.16	9.95
Interest cover	67.9	220.9	na	na	na

Leverage

Net debt/EBITDA (x)	net cash				
Net debt/equity (%)	net cash				

Per share

Reported EPS (CNY)	1.21	1.30	1.54	1.76	2.05
Norm EPS (CNY)	1.21	1.30	1.54	1.76	2.05
FD norm EPS (CNY)	1.21	1.26	1.54	1.76	2.05
BVPS (CNY)	6.08	7.37	8.32	9.39	10.64
DPS (CNY)	0.57	0.59	0.69	0.79	1.02

Activity (days)

Days receivable	55.4	62.8	62.5	62.5	62.7
Days inventory	110.7	110.1	105.0	112.0	110.3
Days payable	25.3	44.4	44.5	44.5	44.6
Cash cycle	140.7	128.5	123.0	130.0	128.4

Source: Company data, Nomura estimates

Fig. 6: Key estimates changes

	FY14F		FY15F	
	Old	New	Old	New
Revenues	11,374	11,401	12,833	12,896
Gross Profits	3,274	3,281	3,730	3,747
<i>GPM</i>	<i>28.8%</i>	<i>28.8%</i>	<i>29.1%</i>	<i>29.1%</i>
Operating Profits	2,634	2,640	3,008	3,022
<i>OPM</i>	<i>23.2%</i>	<i>23.2%</i>	<i>23.4%</i>	<i>23.4%</i>
Net Profits	2,145	2,150	2,450	2,462
<i>NPM</i>	<i>18.9%</i>	<i>18.9%</i>	<i>19.1%</i>	<i>19.1%</i>

Source: Nomura estimates

Valuation methodology

We continue to value Shenzhou by using a blended valuation of DCF and P/E, but roll over six months forward to arrive at our new TP of HKD32.2. For DCF, we assume WACC of 10% and the terminal growth rate of 2% with discounted cash flow back to CY14F. For the P/E multiple, we use the company's one-year average of 14x of 12m forward EPS of CNY1.65 as the company has re-rated with its customers over the past year.

Pacific Textiles Holdings

1382.HK 1382 HK

EQUITY: CONSUMER RELATED

A steady dividend play

FY15F bottom-line growth relies on improved production efficiency

Action: Challenging FY15F; 2H may improve sequentially from 1H, Buy

Although Pacific Textiles' orders from Uniqlo were down 15% y-y in 2H14, they had already narrowed to a high-single-digit decline y-y in 1Q15 and management expects further improvements in 2H15F. As per management, part of the spare capacity could be filled by some other US customers, as momentum of the US market is currently strong. Hence, utilisation in FY15F can still sustain at 85-88% (vs. 90% in FY14). Buy on the stable dividends.

Catalysts: Improved production efficiency should help protect margins; first phase facility in Vietnam to commence operations in March 2015

While rising labour costs and chemical input costs could squeeze GP margins in FY15F, we believe the company will be able to minimise any negative impact by optimising its production flow, which could lead to a headcount reduction while still generating positive volume growth (in FY14, the number of employees reduced by 3% but sales volumes rose 5% y-y). As per management, the company will also continue to invest in equipment and machine upgrades. Our FY15/16F OPM are 30/60bp above consensus, which we believe could bring an upside surprise to the Street.

In our view, a longer-term catalyst would be the company's first-phase capacity (15% incremental capacity) in Vietnam commencing operations in March 2015, and the second phase (another >20% incremental capacity) coming online one year later, if China-Vietnam tensions do not escalate.

Valuation: Dividend yield of 6% to be supportive to stock price

The stock trades at 12.6x 12m fwd P/E (EPS: HKD0.75), in line with its two-year average but 8% below the one-year average. We believe the positive surprise on dividend payout ratio for the past three years (exceeding 100% due to special dividends), will underpin the stock price. As well, the stock should hold up well before the ex-dividend date (12 Aug).

Year-end 31 Mar	FY14		FY15F		FY16F		FY17F	
Currency (HKD)	Actual	Old	New	Old	New	Old	New	
Revenue (mn)	7,423	8,748	7,569	9,582	8,647		9,702	
Reported net profit (mn)	1,112	1,264	1,042	1,381	1,214		1,325	
Normalised net profit (mn)	1,112	1,264	1,042	1,381	1,214		1,325	
FD normalised EPS	76.91c	87.57c	72.07c	95.73c	83.99c		91.67c	
FD norm. EPS growth (%)	14.8	14.3	-6.3	9.3	16.5		9.1	
FD normalised P/E (x)	12.7	N/A	13.5	N/A	11.6	N/A	10.6	
EV/EBITDA (x)	8.5	N/A	8.9	N/A	7.7	N/A	6.8	
Price/book (x)	3.6	N/A	3.7	N/A	3.4	N/A	3.2	
Dividend yield (%)	10.8	N/A	5.5	N/A	6.5	N/A	7.0	
ROE (%)	28.1	28.6	26.8	29.1	30.4		30.8	
Net debt/equity (%)	net cash		net cash					

Source: Company data, Nomura estimates

Key company data: See page 2 for company data and detailed price/index chart

Global Markets Research

10 July 2014

Rating Remains	Buy
Target price Reduced from 12.30	HKD 10.80
Closing price 8 July 2014	HKD 9.76
Potential upside	+10.7%

Anchor themes

Integration across the value chain and acquiring design capabilities should continue to be the key theme across the sector. Relocation outside China is likely to drive near-term market segmentation.

Nomura vs consensus

Our FY15F/FY16F operating margin are 30/60bp higher than consensus, if we exclude outdated numbers, as we assume a more positive improvement in production efficiency.

Research analysts

China Consumer Related

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Key data on Pacific Textiles Holdings

Relative performance chart



Source: Thomson Reuters, Nomura research

Notes:

Performance

(%)	1M	3M	12M		
Absolute (HKD)	0.0	-4.7	8.6	M cap (USDm)	1,821.6
Absolute (USD)	0.0	-4.6	8.6	Free float (%)	31.0
Rel to MSCI China	-3.5	-8.3	-9.1	3-mth ADT (USDm)	1.7

Income statement (HKDmn)

Year-end 31 Mar	FY13	FY14	FY15F	FY16F	FY17F
Revenue	6,649	7,423	7,569	8,647	9,702
Cost of goods sold	-5,468	-6,062	-6,275	-7,090	-7,936
Gross profit	1,182	1,361	1,294	1,556	1,766
SG&A	-113	-73	-98	-156	-233
Employee share expense					
Operating profit	1,069	1,289	1,196	1,401	1,533
EBITDA	1,259	1,448	1,407	1,664	1,857
Depreciation	-189	-158	-210	-262	-323
Amortisation	-1	-1	-1	-1	-1
EBIT	1,069	1,289	1,196	1,401	1,533
Net interest expense	15	7	7	7	7
Associates & JCEs	26	16	36	36	36
Other income	0	0	0	0	0
Earnings before tax	1,111	1,311	1,239	1,444	1,576
Income tax	-186	-197	-198	-231	-252
Net profit after tax	924	1,114	1,041	1,213	1,324
Minority interests	1	3	1	1	1
Other items	42	-5	0	0	0
Preferred dividends					
Normalised NPAT	967	1,112	1,042	1,214	1,325
Extraordinary items					
Reported NPAT	967	1,112	1,042	1,214	1,325
Dividends	-1,153	-1,519	-781	-911	-994
Transfer to reserves	-186	-407	260	304	331

Valuations and ratios

Reported P/E (x)	14.5	12.7	13.5	11.6	10.6
Normalised P/E (x)	14.5	12.7	13.5	11.6	10.6
FD normalised P/E (x)	14.6	12.7	13.5	11.6	10.6
Dividend yield (%)	8.2	10.8	5.5	6.5	7.0
Price/cashflow (x)	13.8	9.1	10.3	9.9	7.6
Price/book (x)	3.6	3.6	3.7	3.4	3.2
EV/EBITDA (x)	9.6	8.5	8.9	7.7	6.8
EV/EBIT (x)	11.3	9.5	10.4	9.1	8.1
Gross margin (%)	17.8	18.3	17.1	18.0	18.2
EBITDA margin (%)	18.9	19.5	18.6	19.2	19.1
EBIT margin (%)	16.1	17.4	15.8	16.2	15.8
Net margin (%)	14.5	15.0	13.8	14.0	13.7
Effective tax rate (%)	16.8	15.0	16.0	16.0	16.0
Dividend payout (%)	119.3	136.6	75.0	75.0	75.0
ROE (%)	24.4	28.1	26.8	30.4	30.8
ROA (pretax %)	31.5	37.0	32.9	33.2	32.7

Growth (%)

Revenue	3.6	11.6	2.0	14.2	12.2
EBITDA	3.9	15.0	-2.8	18.3	11.6
Normalised EPS	-3.5	14.4	-6.3	16.5	9.1
Normalised FDEPS	-3.9	14.8	-6.3	16.5	9.1

Source: Company data, Nomura estimates

Cashflow statement (HKDmn)

Year-end 31 Mar	FY13	FY14	FY15F	FY16F	FY17F
EBITDA	1,259	1,448	1,407	1,664	1,857
Change in working capital	-240	103	-35	-243	1
Other operating cashflow					
Cashflow from operations	1,019	1,550	1,372	1,421	1,858
Capital expenditure	-111	-250	-500	-600	-400
Free cashflow	908	1,300	872	821	1,458
Reduction in investments	41	9	0	0	0
Net acquisitions					
Dec in other LT assets	4	-29	33	0	0
Inc in other LT liabilities	13	12	0	0	0
Adjustments					
CF after investing acts	966	1,292	905	821	1,458
Cash dividends	-1,005	-1,157	-781	-911	-994
Equity issue					
Debt issue					
Convertible debt issue					
Others	-60	-152	-495	-188	-209
CF from financial acts	-1,065	-1,309	-1,276	-1,099	-1,203
Net cashflow	-100	-17	-371	-277	255
Beginning cash	1,893	1,793	1,776	1,404	1,127
Ending cash	1,793	1,777	1,405	1,127	1,382
Ending net debt	-1,746	-1,729	-1,306	-1,079	-1,335

Balance sheet (HKDmn)

As at 31 Mar	FY13	FY14	FY15F	FY16F	FY17F
Cash & equivalents	1,793	1,776	1,404	1,127	1,382
Marketable securities	0	0	0	0	0
Accounts receivable	1,024	905	1,107	1,239	1,393
Inventories	994	1,131	1,035	1,373	1,279
Other current assets	93	70	70	70	70
Total current assets	3,904	3,882	3,616	3,809	4,124
LT investments	210	201	201	201	201
Fixed assets	1,159	1,237	1,509	1,845	1,921
Goodwill	0	0	0	0	0
Other intangible assets					
Other LT assets	4	33	0	0	0
Total assets	5,277	5,353	5,325	5,855	6,246
Short-term debt	0	0	50	0	0
Accounts payable	1,146	1,231	1,279	1,557	1,618
Other current liabilities	65	78	50	50	50
Total current liabilities	1,211	1,309	1,379	1,607	1,668
Long-term debt	48	48	48	48	48
Convertible debt					
Other LT liabilities	46	58	58	58	58
Total liabilities	1,304	1,415	1,485	1,713	1,773
Minority interest	6	4	3	2	0
Preferred stock					
Common stock	1	1	1	1	1
Retained earnings	3,964	3,934	3,836	4,140	4,471
Proposed dividends					
Other equity and reserves					
Total shareholders' equity	3,966	3,935	3,838	4,141	4,472
Total equity & liabilities	5,277	5,353	5,325	5,855	6,246

Liquidity (x)

Current ratio	3.22	2.97	2.62	2.37	2.47
Interest cover	na	na	na	na	na

Leverage

Net debt/EBITDA (x)	net cash				
Net debt/equity (%)	net cash				

Per share

Reported EPS (HKD)	67.23c	76.91c	72.07c	83.99c	91.67c
Norm EPS (HKD)	67.23c	76.91c	72.07c	83.99c	91.67c
FD norm EPS (HKD)	67.00c	76.91c	72.07c	83.99c	91.67c
BVPS (HKD)	2.75	2.72	2.65	2.86	3.09
DPS (HKD)	0.80	1.05	0.54	0.63	0.69

Activity (days)

Days receivable	55.5	47.4	48.5	49.6	49.5
Days inventory	63.3	64.0	63.0	62.2	61.0
Days payable	81.1	71.5	73.0	73.2	73.0
Cash cycle	37.7	39.8	38.5	38.6	37.5

Source: Company data, Nomura estimates

Fig. 7: Key estimate changes

	FY15F		FY16F	
	Old	New	Old	New
Revenues	8,748	7,569	9,582	8,647
Gross Profits	1,645	1,294	1,801	1,556
<i>GPM</i>	<i>18.8%</i>	<i>17.1%</i>	<i>18.8%</i>	<i>18.0%</i>
Operating Profits	1,470	1,196	1,610	1,401
<i>OPM</i>	<i>16.8%</i>	<i>15.8%</i>	<i>16.8%</i>	<i>16.2%</i>
Net Profits	1,263	1,042	1,380	1,214
<i>NPM</i>	<i>14.4%</i>	<i>13.8%</i>	<i>14.4%</i>	<i>14.0%</i>

Source: Nomura estimates

Valuation methodology

We continue to value Pacific Textiles by using a blended valuation of DCF and P/E, but roll-over six months forward to arrive at our TP of HKD10.8. For DCF, we assume a WACC of 10.5% and a terminal growth rate of 2% with cash flows discounted back to CY14F. For P/E multiple, we use the company's two-year average of 12x of 12m forward EPS of HKD0.75 as the company has re-rated with its key customers over the past two years.

Texhong Textile Group

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EQUITY: CONSUMER RELATED

Light at the end of the tunnel

August may be the turning point for cotton yarn prices

Action: Utilisation remains 100%, while earnings hit by weak yarn price; worst looks over, reaffirm Buy

China's domestic cotton price fell to CNY17,300/tonne in late-June (vs CNY19,500/tonne in Jan 2014), thus shrinking the premium to only ~5% vs. international levels. Meanwhile, Texhong's raw materials inventory (stocked at higher cotton prices) has already reduced to 2-3 months (vs. 4-5 months early this year). We see limited potential downside, as we believe Texhong's long-term growth will bode well, spurred by lower input costs (cotton), a stabilising CNY and still strong orders with 100% utilisation. We maintain our Buy rating.

Catalysts: Cotton yarn prices set to pick up in Aug (start of peak season); capacity expansion of 17% in 1H14 vs FY13 to contribute to growth

As per data compiled by China Textile Materials Exchange Center, the y-y downtrend in cotton yarn selling prices have already stabilised in June. We don't think the cotton yarn selling prices will deteriorate further; instead, we believe the prices are set to pick up in August when the peak season begins. However, a potential, but likely minor, risk is if China's government decides to sell more reserve cotton, thus capping domestic yarn price recovery.

Close to trough valuation with a likely turnaround ahead

Texhong trades at 5x of 12m forward P/E (EPS: CNY0.99), which is close to its historical trough, given that our numbers are even more conservative than consensus (our FY14F and FY15F earnings are in line and 3% lower, respectively). We find the valuation attractive because of a slim likelihood of cotton yarn prices falling. Specifically, some of Texhong's end customers have a good exposure to the US market where we expect a decent momentum. As Texhong's sales volumes remain solid and reached a record high in May, we believe its margins and earnings will be back on the growth track again, once cotton yarn selling prices ramp up in China.

Year-end 31 Dec	FY13		FY14F		FY15F		FY16F	
Currency (CNY)	Actual	Old	New	Old	New	Old	New	
Revenue (mn)	8,229	11,762	11,400	13,280	13,028	14,732	14,846	
Reported net profit (mn)	1,148	1,020	733	1,196	1,019	1,267	1,290	
Normalised net profit (mn)	1,148	1,020	733	1,196	1,019	1,267	1,290	
FD normalised EPS	1.30	1.15	82.82c	1.35	1.15	1.43	1.46	
FD norm. EPS growth (%)	136.0	-11.2	-36.2	17.3	39.1	5.9	26.6	
FD normalised P/E (x)	3.8	N/A	5.8	N/A	4.2	N/A	3.3	
EV/EBITDA (x)	3.8	N/A	4.6	N/A	3.2	N/A	2.7	
Price/book (x)	1.3	N/A	1.1	N/A	0.9	N/A	0.7	
Dividend yield (%)	7.6	N/A	5.2	N/A	7.2	N/A	9.1	
ROE (%)	38.7	26.9	20.1	25.8	23.7	23.0	25.0	
Net debt/equity (%)	55.3	54.8	61.1	33.4	34.5	28.9	30.3	

Source: Company data, Nomura estimates

Key company data: See page 2 for company data and detailed price/index chart

Global Markets Research

10 July 2014

Rating Remains	Buy
Target price Reduced from 9.10	HKD 8.30
Closing price 8 July 2014	HKD 6.20
Potential upside	+33.9%

Anchor themes

Integration across the value chain and acquiring design capabilities should continue to be the key themes across the sector. Relocation outside China is likely to drive near-term market segmentation.

Nomura vs consensus

Our FY14F earnings are basically in line with the consensus while FY15F earnings are 3% below as we factor in the tax rate normalisation.

Research analysts

China Consumer Related

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Key data on Texhong Textile Group

Relative performance chart



Notes:

Performance

(%)	1M	3M	12M		
Absolute (HKD)	1.8	-27.0	-47.8	M cap (USDm)	707.7
Absolute (USD)	1.8	-26.9	-47.8	Free float (%)	27.8
Rel to MSCI China	-1.6	-30.6	-65.5	3-mth ADT (USDm)	1.8

Income statement (CNYmn)

Year-end 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
Revenue	7,341	8,229	11,400	13,028	14,846
Cost of goods sold	-6,217	-6,645	-9,706	-10,905	-12,285
Gross profit	1,124	1,583	1,694	2,123	2,561
SG&A	-448	-226	-695	-782	-891
Employee share expense					
Operating profit	677	1,357	999	1,341	1,670
EBITDA	881	1,625	1,426	1,811	2,177
Depreciation	-201	-262	-418	-460	-498
Amortisation	-4	-6	-9	-9	-9
EBIT	677	1,357	999	1,341	1,670
Net interest expense	-123	-122	-160	-160	-174
Associates & JCEs	4	5	4	4	4
Other income					
Earnings before tax	557	1,240	842	1,185	1,500
Income tax	-71	-114	-109	-166	-210
Net profit after tax	486	1,126	733	1,019	1,290
Minority interests	0	0	0	0	0
Other items	0	22	0	0	0
Preferred dividends					
Normalised NPAT	487	1,148	733	1,019	1,290
Extraordinary items					
Reported NPAT	487	1,148	733	1,019	1,290
Dividends	-192	-329	-220	-306	-387
Transfer to reserves	294	819	513	713	903

Valuations and ratios

Reported P/E (x)	9.1	3.8	5.8	4.2	3.3
Normalised P/E (x)	9.1	3.8	5.8	4.2	3.3
FD normalised P/E (x)	9.1	3.8	5.8	4.2	3.3
Dividend yield (%)	4.3	7.6	5.2	7.2	9.1
Price/cashflow (x)	5.0	3.9	11.5	1.8	9.2
Price/book (x)	1.7	1.3	1.1	0.9	0.7
EV/EBITDA (x)	6.4	3.8	4.6	3.2	2.7
EV/EBIT (x)	8.3	4.6	6.6	4.3	3.5
Gross margin (%)	15.3	19.2	14.9	16.3	17.2
EBITDA margin (%)	12.0	19.8	12.5	13.9	14.7
EBIT margin (%)	9.2	16.5	8.8	10.3	11.2
Net margin (%)	6.6	14.0	6.4	7.8	8.7
Effective tax rate (%)	12.8	9.2	13.0	14.0	14.0
Dividend payout (%)	39.5	28.6	30.0	30.0	30.0
ROE (%)	46.5	38.7	20.1	23.7	25.0
ROA (pretax %)	37.4	20.8	12.1	15.0	17.1

Growth (%)

Revenue	6.8	12.1	38.5	14.3	13.9
EBITDA	163.4	84.4	-12.3	27.0	20.2
Normalised EPS	0.6	136.0	-36.2	39.1	26.6
Normalised FDEPS	0.6	136.0	-36.2	39.1	26.6

Source: Company data, Nomura estimates

Cashflow statement (CNYmn)

Year-end 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
EBITDA	881	1,625	1,426	1,811	2,177
Change in working capital	-22	104	-507	339	-756
Other operating cashflow	23	-611	-551	180	-959
Cashflow from operations	882	1,118	368	2,329	462
Capital expenditure	-656	-968	-372	-331	-293
Free cashflow	226	151	-4	1,999	168
Reduction in investments	0	16	0	0	0
Net acquisitions	11	10	0	0	0
Dec in other LT assets					
Inc in other LT liabilities					
Adjustments					
CF after investing acts	237	177	-4	1,999	168
Cash dividends	-192	-326	-220	-306	-387
Equity issue					
Debt issue	-212	927	-167	-167	-181
Convertible debt issue					
Others	234	-389	-131	-748	305
CF from financial acts	-170	212	-518	-1,221	-263
Net cashflow	67	389	-523	778	-95
Beginning cash	463	530	919	397	1,174
Ending cash	530	920	397	1,175	1,080
Ending net debt	1,240	1,870	2,393	1,615	1,710

Balance sheet (CNYmn)

As at 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
Cash & equivalents	530	919	397	1,174	1,079
Marketable securities	22	27	27	27	27
Accounts receivable	1,049	1,315	1,746	1,752	2,234
Inventories	1,422	2,280	1,974	2,507	2,541
Other current assets	0	13	0	0	0
Total current assets	3,023	4,555	4,144	5,461	5,881
LT investments	51	56	56	56	56
Fixed assets	2,494	4,199	4,572	4,902	5,196
Goodwill	0	0	0	0	0
Other intangible assets					
Other LT assets	57	135	135	135	135
Total assets	5,625	8,944	8,905	10,553	11,267
Short-term debt	206	166	166	166	166
Accounts payable	1,174	2,405	2,081	2,959	2,718
Other current liabilities	64	115	43	43	43
Total current liabilities	1,444	2,686	2,290	3,168	2,927
Long-term debt	1,564	2,623	2,623	2,623	2,623
Convertible debt					
Other LT liabilities	59	254	76	76	76
Total liabilities	3,067	5,564	4,989	5,867	5,626
Minority interest	0	0	0	0	0
Preferred stock					
Common stock	94	94	94	94	94
Retained earnings	2,083	2,902	3,414	4,097	4,970
Proposed dividends	192	195	220	306	387
Other equity and reserves	189	189	189	189	189
Total shareholders' equity	2,558	3,380	3,917	4,686	5,640
Total equity & liabilities	5,625	8,944	8,905	10,553	11,267

Liquidity (x)

Current ratio	2.09	1.70	1.81	1.72	2.01
Interest cover	5.5	11.2	6.2	8.4	9.6

Leverage

Net debt/EBITDA (x)	1.41	1.15	1.68	0.89	0.79
Net debt/equity (%)	48.5	55.3	61.1	34.5	30.3

Per share

Reported EPS (CNY)	55.00c	1.30	82.82c	1.15	1.46
Norm EPS (CNY)	55.00c	1.30	82.82c	1.15	1.46
FD norm EPS (CNY)	55.00c	1.30	82.82c	1.15	1.46
BVPS (CNY)	2.89	3.82	4.43	5.30	6.38
DPS (CNY)	0.22	0.37	0.25	0.35	0.44

Activity (days)

Days receivable	36.1	52.4	49.0	49.0	49.1
Days inventory	79.5	101.7	80.0	75.0	75.2
Days payable	40.1	98.3	84.3	84.3	84.6
Cash cycle	75.5	55.8	44.7	39.7	39.8

Source: Company data, Nomura estimates

Fig. 8: Key estimate changes

	FY14F		FY15F	
	Old	New	Old	New
Revenues	11,762	11,400	13,280	13,028
Gross Profits	2,046	1,694	2,291	2,123
<i>GPM</i>	17.4%	14.9%	17.3%	16.3%
Operating Profits	1,328	999	1,547	1,341
<i>OPM</i>	11.3%	8.8%	11.6%	10.3%
Net Profits	1,020	733	1,196	1,019
<i>NPM</i>	8.7%	6.4%	9.0%	7.8%

Source: Nomura estimates

Valuation methodology

We continue to value Texhong using a blended valuation of DCF and P/E, but roll-over six months forward to arrive at our new TP of HKD8.3. For DCF, we assume a WACC of around 12% and a terminal growth rate of 2%, with cash flows discounted back to CY14F. For P/E multiple, we use 6x 12m forward EPS of CNY0.99.

Key downside risks include: 1) a more serious margin squeeze than expected; and 2) if the Chinese government continues to sell more reserve cotton, which may drag down the recovery and lead to a subdued cotton yarn selling price.

Yue Yuen Industrial Holdings

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EQUITY: CONSUMER RELATED

Wait after the interim

Employee benefit costs may still be a swing factor

Action: Manufacturing remains uncertain, retail to pick up, but employee benefit payments could be key swing factor; Neutral, TP cut to HKD25.8

We believe Yue Yuen's volume-dependent manufacturing unit (75% of overall sales) will be fragile if the economic growth in China weakens. Specifically, the company is undergoing a capacity relocation which may drag the utilization rate in China (below 80%) where most of its high-end products are manufactured. In our view, the pick-up may still take a few quarters. On the retail front (25% of total sales), although we may see a recovery this year as price markdowns shrink (25-30% in 1Q14 vs. ~50% in 2H13) and inventory levels normalise, its joint ventures in other retail business may still remain subdued due to higher exposure to Chinese local brands. More importantly, we believe the additional employee benefit costs for other employees in China other than Dongguan's Gaobu factory, which we estimate to be another USD60-70mn, may cap its recovery in the near term. Maintain Neutral.

Risks: Stronger-than-expected orders in the US and Europe could provide upside potential, while employee benefit payments and loss on financial derivatives could put downward pressure

Valuation: 10% ROE and ~4% dividend yield; fair valuation

Yue Yuen is currently trading at 12.2x 12m forward P/E, which is about 6% above its three-year average. We believe it is fairly valued as the current 10% ROE and 4% dividend yield are also in line with the past three years. However, we flag a downside risk to consensus earnings estimates if the fair value changes in financial derivatives (posted in 1Q14 results) do not recover. In addition, we think consensus has over-estimated the retail pick-up while it has not yet built in all effects from employee benefit payments, which may trigger a correction after 1H14 results. We suggest investors sit on the sidelines and wait for a better entry point.

Year-end 31 Dec	FY13		FY14F		FY15F		FY16F	
Currency (USD)	Actual	Old	New	Old	New	Old	New	
Revenue (mn)	7,582	8,117	8,117	8,754	8,754	9,347	9,347	
Reported net profit (mn)	435	462	429	513	489	563	538	
Normalised net profit (mn)	435	462	429	513	489	563	538	
FD normalised EPS	24.97c	26.53c	24.63c	29.49c	28.06c	32.35c	30.92c	
FD norm. EPS growth (%)	-7.1	6.3	-1.3	11.1	13.9	9.7	10.2	
FD normalised P/E (x)	13.6	N/A	13.7	N/A	12.0	N/A	10.9	
EV/EBITDA (x)	8.3	N/A	9.6	N/A	8.6	N/A	7.9	
Price/book (x)	1.3	N/A	1.2	N/A	1.2	N/A	1.1	
Dividend yield (%)	4.2	N/A	3.8	N/A	4.4	N/A	4.8	
ROE (%)	10.4	10.4	9.6	10.9	10.4	11.3	10.9	
Net debt/equity (%)	net cash	2.0	2.6	3.6	4.4	2.7	3.7	

Source: Company data, Nomura estimates

Key company data: See page 2 for company data and detailed price/index chart

Global Markets Research

10 July 2014

Rating Remains	Neutral
Target price Reduced from 27.20	HKD 25.80
Closing price 8 July 2014	HKD 26.30
Potential downside	-1.9%

Anchor themes

Integration across the value chain and acquiring design capabilities should continue to be the key theme across the sector. Relocation outside China is likely to drive near-term market segmentation.

Nomura vs consensus

Our FY14F/FY15F earnings are 3%/6% lower than consensus, as we are more cautious about a potential hike in employee benefit costs.

Research analysts

China Consumer Related

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Key data on Yue Yuen Industrial Holdings

Relative performance chart



Source: Thomson Reuters, Nomura research

Notes:

Performance

(%)	1M	3M	12M		
Absolute (HKD)	8.5	3.1	34.9	M cap (USDmn)	5,595.7
Absolute (USD)	8.5	3.2	35.0	Free float (%)	46.1
Rel to MSCI China	5.0	-0.4	17.2	3-mth ADT (USDmn)	6.8

Income statement (USDmn)

Year-end 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
Revenue	7,281	7,582	8,117	8,754	9,347
Cost of goods sold	-5,621	-5,936	-6,364	-6,844	-7,290
Gross profit	1,660	1,647	1,753	1,909	2,056
SG&A	-1,209	-1,225	-1,299	-1,401	-1,495
Employee share expense					
Operating profit	451	422	455	509	561
EBITDA	692	670	619	694	758
Depreciation	-232	-240	-154	-175	-186
Amortisation	-9	-8	-11	-10	-11
EBIT	451	422	455	509	561
Net interest expense	-36	-24	-22	-21	-21
Associates & JCEs	87	49	18	26	26
Other income	-30	8	0	0	0
Earnings before tax	472	454	450	514	567
Income tax	-23	-25	-27	-31	-34
Net profit after tax	449	429	423	483	533
Minority interests	18	6	6	6	6
Other items					
Preferred dividends					
Normalised NPAT	468	435	429	489	538
Extraordinary items					
Reported NPAT	468	435	429	489	538
Dividends	-213	-233	-214	-244	-269
Transfer to reserves	255	202	214	244	269

Valuations and ratios

Reported P/E (x)	12.0	12.9	13.0	11.4	10.4
Normalised P/E (x)	12.0	12.9	13.0	11.4	10.4
FD normalised P/E (x)	12.6	13.6	13.7	12.0	10.9
Dividend yield (%)	3.8	4.2	3.8	4.4	4.8
Price/cashflow (x)	11.7	19.4	13.5	11.4	9.6
Price/book (x)	1.4	1.3	1.2	1.2	1.1
EV/EBITDA (x)	8.1	8.3	9.6	8.6	7.9
EV/EBIT (x)	11.7	12.7	12.9	11.6	10.6
Gross margin (%)	22.8	21.7	21.6	21.8	22.0
EBITDA margin (%)	9.5	8.8	7.6	7.9	8.1
EBIT margin (%)	6.2	5.6	5.6	5.8	6.0
Net margin (%)	6.4	5.7	5.3	5.6	5.8
Effective tax rate (%)	4.8	5.6	6.0	6.0	6.0
Dividend payout (%)	45.5	53.6	50.0	50.0	50.0
ROE (%)	12.2	10.4	9.6	10.4	10.9
ROA (pretax %)	9.1	7.8	7.6	8.0	8.3

Growth (%)

Revenue	3.6	4.1	7.1	7.8	6.8
EBITDA	0.7	-3.2	-7.6	12.0	9.2
Normalised EPS	12.5	-7.1	-1.3	13.9	10.2
Normalised FDEPS	24.9	-7.1	-1.3	13.9	10.2

Source: Company data, Nomura estimates

Cashflow statement (USDmn)

Year-end 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
EBITDA	692	670	619	694	758
Change in working capital	-190	-366	-184	-176	-145
Other operating cashflow					
Cashflow from operations	503	304	435	517	612
Capital expenditure	-305	-184	-400	-400	-350
Free cashflow	198	120	35	117	262
Reduction in investments		25	3	0	0
Net acquisitions					
Dec in other LT assets		-9	17	0	0
Inc in other LT liabilities		-2	-1	0	0
Adjustments					
CF after investing acts	198	134	55	117	262
Cash dividends	-213	-233	-214	-244	-269
Equity issue					
Debt issue					
Convertible debt issue					
Others	120	216	6	2	2
CF from financial acts	-93	-17	-208	-242	-267
Net cashflow	105	117	-153	-125	-5
Beginning cash	704	809	926	773	648
Ending cash	809	926	773	648	643
Ending net debt	290	-7	116	211	187

Balance sheet (USDmn)

As at 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
Cash & equivalents	809	926	773	648	643
Marketable securities	9	3	0	0	0
Accounts receivable	1,325	1,465	1,478	1,688	1,692
Inventories	1,208	1,240	1,376	1,437	1,559
Other current assets	10	13	0	0	0
Total current assets	3,361	3,647	3,626	3,773	3,894
LT investments	1,082	1,062	1,062	1,062	1,062
Fixed assets	1,929	1,825	2,071	2,296	2,460
Goodwill	274	274	274	274	274
Other intangible assets	134	118	108	118	127
Other LT assets	57	66	49	49	49
Total assets	6,836	6,993	7,190	7,572	7,866
Short-term debt	734	519	469	419	369
Accounts payable	1,252	1,256	1,278	1,423	1,453
Other current liabilities	0	20	0	0	0
Total current liabilities	1,987	1,795	1,747	1,842	1,823
Long-term debt	365	400	420	440	460
Convertible debt					
Other LT liabilities	63	61	61	61	61
Total liabilities	2,415	2,256	2,227	2,343	2,343
Minority interest	419	398	410	432	456
Preferred stock					
Common stock	53	53	53	53	53
Retained earnings	3,950	4,285	4,500	4,744	5,013
Proposed dividends					
Other equity and reserves					
Total shareholders' equity	4,003	4,339	4,553	4,797	5,067
Total equity & liabilities	6,836	6,993	7,190	7,572	7,866

Liquidity (x)

Current ratio	1.69	2.03	2.08	2.05	2.14
Interest cover	12.4	17.2	20.5	23.7	27.1

Leverage

Net debt/EBITDA (x)	0.42	net cash	0.19	0.30	0.25
Net debt/equity (%)	7.2	net cash	2.6	4.4	3.7

Per share

Reported EPS (USD)	28.37c	26.37c	26.01c	29.63c	32.65c
Norm EPS (USD)	28.37c	26.37c	26.01c	29.63c	32.65c
FD norm EPS (USD)	26.86c	24.97c	24.63c	28.06c	30.92c
BVPS (USD)	2.43	2.63	2.76	2.91	3.07
DPS (USD)	0.13	0.14	0.13	0.15	0.16

Activity (days)

Days receivable	63.7	67.2	66.2	66.0	66.2
Days inventory	74.5	75.2	75.0	75.0	75.2
Days payable	72.1	77.1	72.6	72.0	72.2
Cash cycle	66.1	65.3	68.5	69.0	69.2

Source: Company data, Nomura estimates

Fig. 9: Key estimate changes

	FY14F		FY15F	
	Old	New	Old	New
Revenues	8,117	8,117	8,754	8,754
Gross Profits	1,753	1,753	1,909	1,909
<i>GPM</i>	<i>21.6%</i>	<i>21.6%</i>	<i>21.8%</i>	<i>21.8%</i>
Operating Profits	455	455	509	509
<i>OPM</i>	<i>5.6%</i>	<i>5.6%</i>	<i>5.8%</i>	<i>5.8%</i>
Net Profits	462	429	513	489
<i>NPM</i>	<i>5.7%</i>	<i>5.3%</i>	<i>5.9%</i>	<i>5.6%</i>

Source: Nomura estimates

Valuation methodology

We continue to value Yue Yuen by using a blended valuation of DCF and P/E, but roll over six months forward to arrive at our new target price of HKD25.8. For DCF, we assume a WACC of 9% and a terminal growth rate of 2% with cash flows discounted back to CY14F. For P/E multiple, we use the company's five-year average of 11x of the 12m fwd EPS of USD0.26.

Brands to restock in 2H14F

Handbag business acquisition would attract eyeballs in 2H

Action: Manufacturing to pick up in 2Q with further improvement in 2HF; Reiterate Buy

Aided by a recovering US market and relative low base last year, we look for Stella's manufacturing to pick up in 2QF and accelerate in 2HF. Meanwhile, over half of Stella's annual shoes production (51mn pairs) is catered to new products, thus giving it an edge vs. peers in prototype developments. We believe footwear brands' efforts to broaden their premium product offerings have magnified the quality of orders for Stella, increasing its potential to gain more new customers. Reiterate Buy.

Catalysts: Existing key customers expect uptrend in 2H14 and 2015; new orders from quality brands likely continue to increase

We believe the upcoming re-stocking cycle in 2H14F will drive growth, especially for boot products. Some of Stella's top customers have revised up FY14F top-line guidance post strong 1Q (UGG to 11% from previously 9%; Timberland to 12% from 10%) and expect the momentum to continue. New orders from some growth names (eg, Tory Burch and Michael Kors) should also hold up Stella's margins and utilization rate (recover to 90%+).

Valuation: Handbag business yet reflected in P&L; its ~20% EBIT margin offers potential upside and a cushion to Stella's lukewarm retail

Stella's handbag business has ~20% EBIT margin, similar to its retail category and higher than OEM's/ODM's 10-15%. We look for the handbag business to add USD7-8mn to our FY14F operating profit, providing a cushion to the slowing retail business (only 8% of the Group's sales). If we build in the business in FY14-15F, the 12m fwd P/E is trading at 13.8x (EPS of HKD1.55), which is 10% lower than its one year average. Valuation appears attractive given Stella's dividend yield is ~5%. We suggest investors to accumulate.

Year-end 31 Dec	FY13		FY14F		FY15F		FY16F	
Currency (USD)	Actual	Old	New	Old	New	Old	New	
Revenue (mn)	1,541	1,630	1,648	1,739	1,773	1,859	1,912	
Reported net profit (mn)	124	132	141	145	155	160	169	
Normalised net profit (mn)	124	132	141	145	155	160	169	
FD normalised EPS	15.66c	16.64c	17.76c	18.37c	19.55c	20.14c	21.33c	
FD norm. EPS growth (%)	-19.5	6.2	13.4	10.4	10.1	9.6	9.1	
FD normalised P/E (x)	17.8	N/A	15.6	N/A	14.2	N/A	13.0	
EV/EBITDA (x)	11.3	N/A	9.7	N/A	8.8	N/A	8.0	
Price/book (x)	2.4	N/A	2.3	N/A	2.1	N/A	2.0	
Dividend yield (%)	4.4	N/A	4.5	N/A	4.9	N/A	5.4	
ROE (%)	13.4	13.9	14.8	14.8	15.5	15.6	16.1	
Net debt/equity (%)	net cash							

Source: Company data, Nomura estimates

Key company data: See page 2 for company data and detailed price/index chart

Global Markets Research

10 July 2014

Rating Remains	Buy
Target price Increased from 21.60	HKD 24.00
Closing price 8 July 2014	HKD 21.55
Potential upside	+11.4%

Anchor themes

Integration across the value chain and acquiring design capabilities are likely to continue to be key themes across the sector. Relocation outside China should drive near-term market segmentation.

Nomura vs consensus

Our FY14F and FY15F earnings are 5% and 3% higher than consensus, respectively, as we see potential upsides in the US/Europe markets where Stella has 75%+ sales exposure.

Research analysts

China Consumer Related

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Key data on Stella International

Relative performance chart



Source: Thomson Reuters, Nomura research

Notes:

Performance

(%)	1M	3M	12M		
Absolute (HKD)	4.1	17.1	2.6	M cap (USDmn)	2,208.9
Absolute (USD)	4.1	17.1	2.7	Free float (%)	59.2
Rel to MSCI China	0.7	13.5	-15.1	3-mth ADT (USDmn)	1.4

Income statement (USDmn)

Year-end 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
Revenue	1,550	1,541	1,648	1,773	1,912
Cost of goods sold	-1,175	-1,188	-1,261	-1,353	-1,456
Gross profit	375	353	387	420	455
SG&A	-209	-216	-233	-251	-270
Employee share expense					
Operating profit	166	137	154	169	185
EBITDA	194	173	201	218	234
Depreciation	-27	-35	-47	-49	-49
Amortisation					
EBIT	166	137	154	169	185
Net interest expense	0	0	0	0	0
Associates & JCEs	1	0	0	0	0
Other income	0	0	0	0	0
Earnings before tax	167	137	154	169	185
Income tax	-14	-15	-13	-14	-16
Net profit after tax	153	123	141	155	169
Minority interests	1	0	0	0	0
Other items	1	1	0	0	0
Preferred dividends					
Normalised NPAT	154	124	141	155	169
Extraordinary items					
Reported NPAT	154	124	141	155	169
Dividends	-107	-97	-98	-108	-118
Transfer to reserves	47	27	42	46	51

Valuations and ratios

Reported P/E (x)	14.3	17.8	15.6	14.2	13.0
Normalised P/E (x)	14.3	17.8	15.6	14.2	13.0
FD normalised P/E (x)	14.3	17.8	15.6	14.2	13.0
Dividend yield (%)	4.9	4.4	4.5	4.9	5.4
Price/cashflow (x)	10.2	11.7	12.6	10.9	10.2
Price/book (x)	2.4	2.4	2.3	2.1	2.0
EV/EBITDA (x)	10.1	11.3	9.7	8.8	8.0
EV/EBIT (x)	11.7	14.3	12.7	11.4	10.2
Gross margin (%)	24.2	22.9	23.5	23.7	23.8
EBITDA margin (%)	12.5	11.2	12.2	12.3	12.2
EBIT margin (%)	10.7	8.9	9.3	9.6	9.7
Net margin (%)	9.9	8.1	8.5	8.7	8.8
Effective tax rate (%)	8.7	10.6	8.5	8.5	8.5
Dividend payout (%)	69.7	78.4	70.0	70.0	70.0
ROE (%)	17.3	13.4	14.8	15.5	16.1
ROA (pretax %)	19.5	14.9	16.0	16.8	17.8

Growth (%)

Revenue	3.7	-0.6	6.9	7.6	7.8
EBITDA	6.3	-10.8	16.3	8.7	7.2
Normalised EPS	0.2	-19.5	13.4	10.1	9.1
Normalised FDEPS	0.2	-19.5	13.4	10.1	9.1

Source: Company data, Nomura estimates

Cashflow statement (USDmn)

Year-end 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
EBITDA	194	173	201	218	234
Change in working capital	22	16	-27	-18	-18
Other operating cashflow					
Cashflow from operations	216	189	174	201	216
Capital expenditure	-53	-82	-60	-50	-40
Free cashflow	163	107	114	151	176
Reduction in investments	5	6	0	0	0
Net acquisitions	-31	-15	-15	-15	-15
Dec in other LT assets		7	-1	0	0
Inc in other LT liabilities		0	0	0	0
Adjustments					
CF after investing acts	136	105	98	136	161
Cash dividends	-100	-108	-116	-103	-113
Equity issue					
Debt issue					
Convertible debt issue					
Others	-48	-1	18	-5	-6
CF from financial acts	-148	-109	-98	-108	-119
Net cashflow	-12	-3	0	27	42
Beginning cash	264	252	249	249	277
Ending cash	252	249	249	276	318
Ending net debt	-252	-249	-249	-277	-319

Balance sheet (USDmn)

As at 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
Cash & equivalents	252	249	249	277	319
Marketable securities	52	29	30	30	30
Accounts receivable	311	326	333	367	387
Inventories	179	178	202	206	217
Other current assets	64	44	50	50	50
Total current assets	857	827	864	929	1,003
LT investments					
Fixed assets	248	313	326	327	318
Goodwill	0	0	0	0	0
Other intangible assets					
Other LT assets	54	47	48	48	48
Total assets	1,159	1,187	1,238	1,304	1,369
Short-term debt					
Accounts payable	201	202	213	232	246
Other current liabilities	41	51	50	50	50
Total current liabilities	242	253	262	282	296
Long-term debt	0	0	0	0	0
Convertible debt					
Other LT liabilities					
Total liabilities	242	253	262	282	296
Minority interest	1	1	1	1	1
Preferred stock					
Common stock	10	10	10	10	10
Retained earnings	906	923	965	1,011	1,062
Proposed dividends					
Other equity and reserves					
Total shareholders' equity	916	933	975	1,021	1,072
Total equity & liabilities	1,159	1,187	1,238	1,304	1,369

Liquidity (x)

Current ratio	3.54	3.27	3.29	3.29	3.39
Interest cover	1,342.0	579.6	na	na	na

Leverage

Net debt/EBITDA (x)	net cash				
Net debt/equity (%)	net cash				

Per share

Reported EPS (USD)	19.46c	15.66c	17.76c	19.55c	21.33c
Norm EPS (USD)	19.46c	15.66c	17.76c	19.55c	21.33c
FD norm EPS (USD)	19.45c	15.66c	17.76c	19.55c	21.33c
BVPS (USD)	1.16	1.18	1.23	1.29	1.35
DPS (USD)	0.14	0.12	0.12	0.14	0.15

Activity (days)

Days receivable	67.2	75.5	73.0	72.0	72.2
Days inventory	56.2	54.8	55.0	55.0	53.1
Days payable	53.8	61.9	60.0	60.0	60.2
Cash cycle	69.6	68.4	68.0	67.0	65.2

Source: Company data, Nomura estimates

Fig. 10: Key estimates changes

	FY14F		FY15F	
	Old	New	Old	New
Revenues	1,630	1,648	1,739	1,773
Gross Profits	375	387	405	420
<i>GPM</i>	23.0%	23.5%	23.3%	23.7%
Operating Profits	144	154	159	169
<i>OPM</i>	8.8%	9.3%	9.1%	9.6%
Net Profits	132	141	145	155
<i>NPM</i>	8.1%	8.5%	8.3%	8.7%

Source: Nomura estimates

Valuation methodology

We continue to value Stella by using a blended valuation of DCF and P/E, but roll over six months forward to arrive at our new target price of HKD24. For DCF, we assume WACC of around 9% and the terminal growth rate of 2% with discounted cash flow back to CY14F. For P/E multiple, we use the company's five-year average of 14x of 12m fwd EPS of USD0.19.

Appendix A-1

Analyst Certification

I, George Hsu, hereby certify (1) that the views expressed in this Research report accurately reflect my personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of my compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

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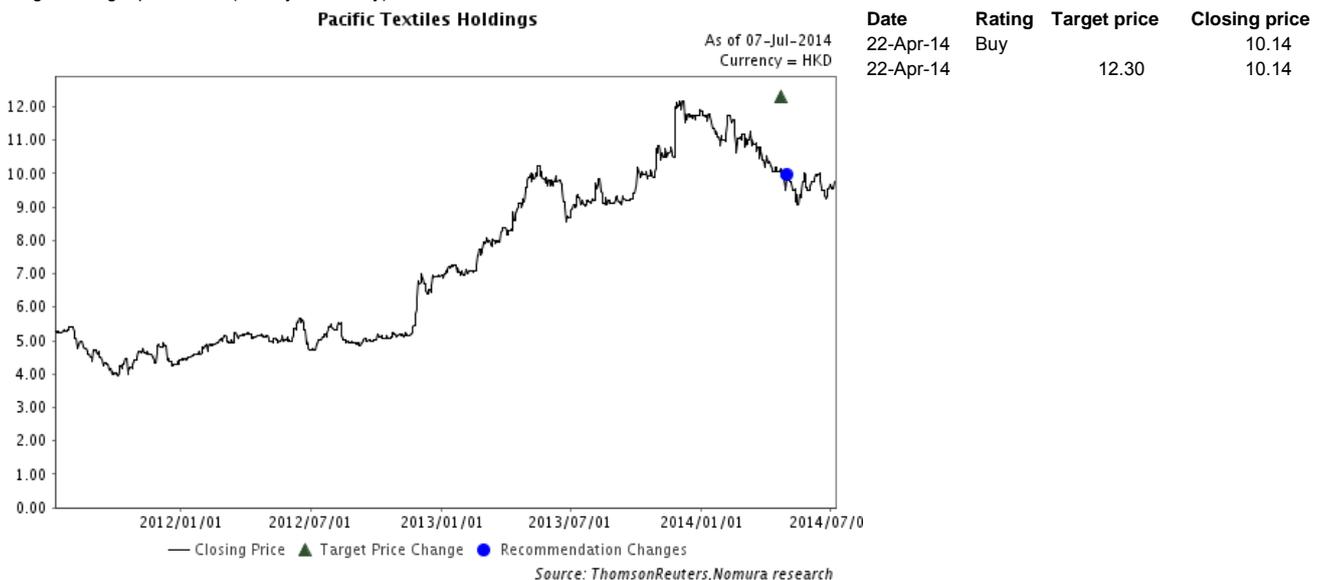
Materially mentioned issuers

Issuer	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Pacific Textiles Holdings	1382 HK	HKD 9.69	09-Jul-2014	Buy	N/A	
Stella International	1836 HK	HKD 21.70	09-Jul-2014	Buy	N/A	
Shenzhou International Group	2313 HK	HKD 27.00	09-Jul-2014	Buy	N/A	
Texhong Textile Group	2678 HK	HKD 6.22	09-Jul-2014	Buy	N/A	
Yue Yuen Industrial Holdings	551 HK	HKD 26.45	09-Jul-2014	Neutral	N/A	

Pacific Textiles Holdings (1382 HK)

HKD 9.69 (09-Jul-2014) Buy (Sector rating: N/A)

Rating and target price chart (three year history)



For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We value Pacific Textiles by using a blended valuation of DCF and P/E, but roll-over six months forward to arrive at our TP of HKD10.8. For DCF, we assume a WACC of 10.5% and a terminal growth rate of 2% with cash flows discounted back to CY14F. For P/E multiple, we use the company's two-year average of 12x of 12m forward EPS of HKD0.75 as the company has re-rated with its key customers over the past two years. The benchmark index for this stock is MSCI HK.

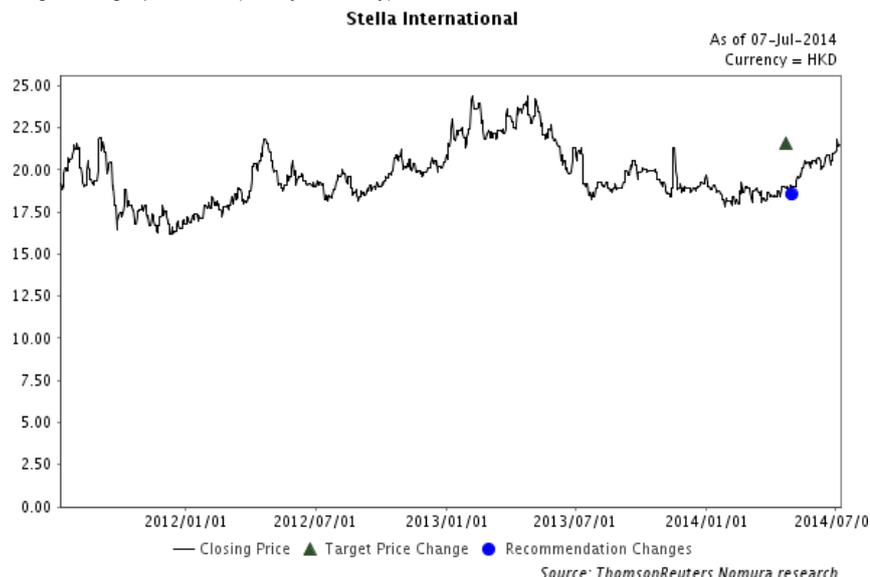
Risks that may impede the achievement of the target price A downside risk is slowing orders from key customers (Uniqlo, Victoria's Secret, Triumph, Walmart, Gap, etc). China's policy on cotton reserves may also affect the company's input costs.

Stella International (1836 HK)

HKD 21.70 (09-Jul-2014) Buy (Sector rating: N/A)

Rating and target price chart (three year history)

Date	Rating	Target price	Closing price
22-Apr-14	Buy		18.887
22-Apr-14		21.60	18.887



For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We value Stella by using a blended valuation of DCF and P/E to arrive at our target price of HKD24. For DCF, we assume WACC of around 9% and the terminal growth rate of 2% with discounted cash flow back to CY14F. For P/E multiple, we use the company’s five-year average of 14x of 12m fwd EPS of USD0.19. The benchmark index for this stock is MSCI HK.

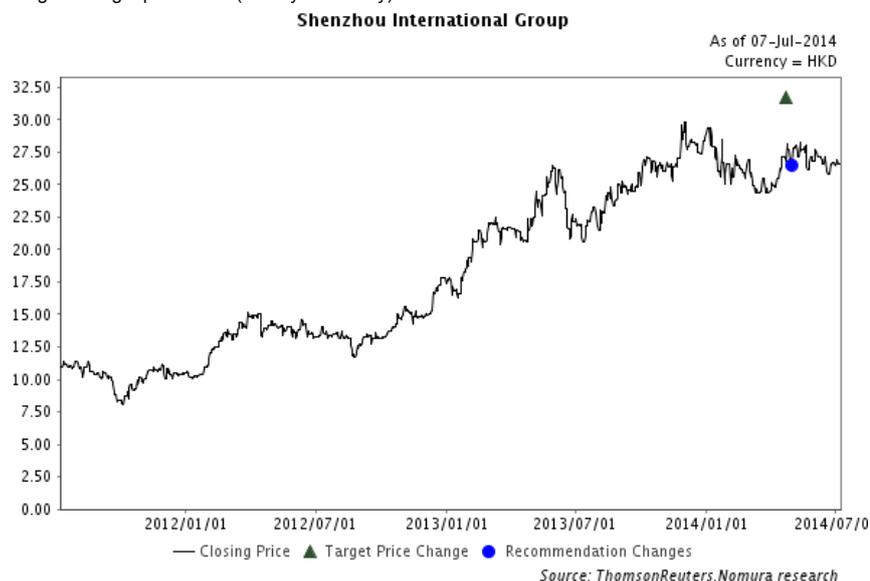
Risks that may impede the achievement of the target price The downside risk is the slowing orders from key customers, such as Timberland, Wolverine, Deckers, etc. The retail business is also an overhang in the short term.

Shenzhou International Group (2313 HK)

HKD 27.00 (09-Jul-2014) Buy (Sector rating: N/A)

Rating and target price chart (three year history)

Date	Rating	Target price	Closing price
22-Apr-14	Buy		26.955
22-Apr-14		31.70	26.955



For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We value Shenzhou by using a blended valuation of DCF and P/E to arrive at our target price of HKD32.2. For DCF, we assume WACC of 10% and the terminal growth rate of 2% with discounted cash flow back to CY14F. For P/E multiple, we use the company’s one-year average of 14x of 12m forward EPS of CNY1.65 as the company has re-rated with its customers over the past year. The benchmark index for this stock is MSCI HK.

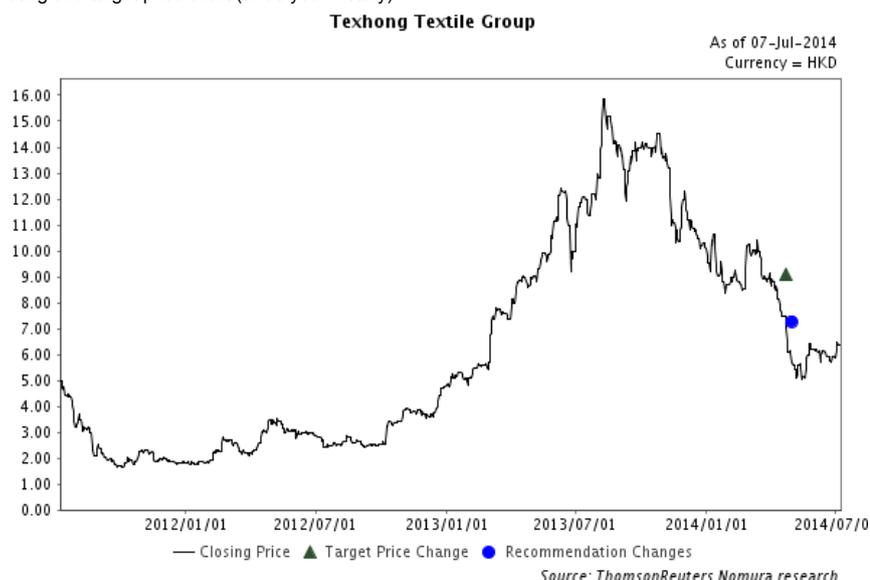
Risks that may impede the achievement of the target price The key downside risk should be slowing orders from its key customers (Uniqlo, Nike, Adidas, Puma) and a delay in completion of its factories in Vietnam.

Texhong Textile Group (2678 HK)

HKD 6.22 (09-Jul-2014) Buy (Sector rating: N/A)

Rating and target price chart (three year history)

Date	Rating	Target price	Closing price
22-Apr-14	Buy		7.50
22-Apr-14		9.10	7.50



For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We value Texhong using a blended valuation of DCF and P/E, but roll-over six months forward to arrive at our TP of HKD8.3. For DCF, we assume a WACC of around 12% and a terminal growth rate of 2%, with cash flows discounted back to CY14F. For P/E multiple, we use 6x of the 12m forward EPS of CNY0.99.

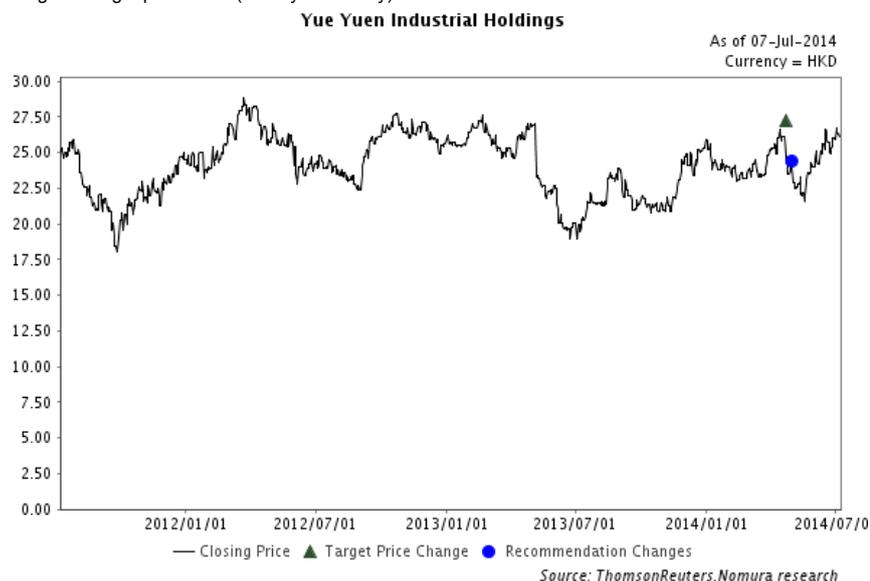
Risks that may impede the achievement of the target price Key downside risks include: 1) a more serious margin squeeze than expected; and 2) if the Chinese government continues to sell more reserve cotton, which may drag down the recovery and lead to a subdued cotton yarn selling price.

Yue Yuen Industrial Holdings (551 HK)

HKD 26.45 (09-Jul-2014) Neutral (Sector rating: N/A)

Rating and target price chart (three year history)

Date	Rating	Target price	Closing price
22-Apr-14	Neutral		24.80
22-Apr-14		27.20	24.80



For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We value Yue Yuen by using a blended valuation of DCF and P/E to arrive at our target price of HKD25.8. For DCF, we assume WACC of 9% and terminal growth rate of 2% with cash flows discounted back to CY14F. For P/E multiple, we use the company's five-year average of 11x of the 12m fwd EPS of USD0.26. The benchmark index for this stock is MSCI HK.

Risks that may impede the achievement of the target price A downside risk is slowing orders from key customers Nike, Adidas and Puma. Also, the rising cost may erode margins if the company is unable to tame the pressure. An upside risk is the better-than-expected retail business.

Rating and target price changes

Issuer	Ticker	Old stock rating	New stock rating	Old target price	New target price
Pacific Textiles Holdings	1382 HK	Buy	Buy	HKD 12.30	HKD 10.80
Stella International	1836 HK	Buy	Buy	HKD 21.60	HKD 24.00
Shenzhou International Group	2313 HK	Buy	Buy	HKD 31.70	HKD 32.20
Texhong Textile Group	2678 HK	Buy	Buy	HKD 9.10	HKD 8.30
Yue Yuen Industrial Holdings	551 HK	Neutral	Neutral	HKD 27.20	HKD 25.80

Important Disclosures

Online availability of research and conflict-of-interest disclosures

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As at 30 June 2014. *The Nomura Group as defined in the Disclaimer section at the end of this report.

Explanation of Nomura's equity research rating system in Europe, Middle East and Africa, US and Latin America, and Japan and Asia ex-Japan from 21 October 2013

The rating system is a relative system, indicating expected performance against a specific benchmark identified for each individual stock, subject to limited management discretion. An analyst's target price is an assessment of the current intrinsic fair value of the stock based on an appropriate valuation methodology determined by the analyst. Valuation methodologies include, but are not limited to, discounted cash flow analysis, expected return on equity and multiple analysis. Analysts may also indicate expected absolute upside/downside relative to the stated target price, defined as (target price - current price)/current price.

STOCKS

A rating of '**Buy**', indicates that the analyst expects the stock to outperform the Benchmark over the next 12 months. A rating of '**Neutral**', indicates that the analyst expects the stock to perform in line with the Benchmark over the next 12 months. A rating of '**Reduce**', indicates that the analyst expects the stock to underperform the Benchmark over the next 12 months. A rating of '**Suspended**', indicates that the rating, target price and estimates have been suspended temporarily to comply with applicable regulations and/or firm policies. Securities and/or companies that are labelled as '**Not rated**' or shown as '**No rating**' are not in regular research coverage. Investors should not expect continuing or additional information from Nomura relating to such securities and/or companies. Benchmarks are as follows: **United States/Europe/Asia ex-Japan**: please see valuation methodologies for explanations of relevant benchmarks for stocks, which can be accessed at: <http://go.nomuranow.com/research/globalresearchportal/pages/disclosures/disclosures.aspx>; **Global Emerging Markets (ex-Asia)**: MSCI Emerging Markets ex-Asia, unless otherwise stated in the valuation methodology; **Japan**: Russell/Nomura Large Cap.

SECTORS

A '**Bullish**' stance, indicates that the analyst expects the sector to outperform the Benchmark during the next 12 months. A '**Neutral**' stance, indicates that the analyst expects the sector to perform in line with the Benchmark during the next 12 months. A '**Bearish**' stance, indicates that the analyst expects the sector to underperform the Benchmark during the next 12 months. Sectors that are labelled as '**Not rated**' or shown as '**N/A**' are not assigned ratings. Benchmarks are as follows: **United States**: S&P 500; **Europe**: Dow Jones STOXX 600; **Global Emerging Markets (ex-Asia)**: MSCI Emerging Markets ex-Asia. **Japan/Asia ex-Japan**: Sector ratings are not assigned.

Explanation of Nomura's equity research rating system in Japan and Asia ex-Japan prior to 21 October 2013

STOCKS

Stock recommendations are based on absolute valuation upside (downside), which is defined as (Target Price - Current Price) / Current Price, subject to limited management discretion. In most cases, the Target Price will equal the analyst's 12-month intrinsic valuation of the stock,

based on an appropriate valuation methodology such as discounted cash flow, multiple analysis, etc. A **'Buy'** recommendation indicates that potential upside is 15% or more. A **'Neutral'** recommendation indicates that potential upside is less than 15% or downside is less than 5%. A **'Reduce'** recommendation indicates that potential downside is 5% or more. A rating of **'Suspended'** indicates that the rating and target price have been suspended temporarily to comply with applicable regulations and/or firm policies in certain circumstances including when Nomura is acting in an advisory capacity in a merger or strategic transaction involving the subject company. Securities and/or companies that are labelled as **'Not rated'** or shown as **'No rating'** are not in regular research coverage of the Nomura entity identified in the top banner. Investors should not expect continuing or additional information from Nomura relating to such securities and/or companies.

SECTORS

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Target Price

A Target Price, if discussed, reflects in part the analyst's estimates for the company's earnings. The achievement of any target price may be impeded by general market and macroeconomic trends, and by other risks related to the company or the market, and may not occur if the company's earnings differ from estimates.

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