

Fundamentals well in place

Hong Kong Textiles

Texwinca (321 HK, HK\$5.12)

BUY (unchanged)

Target price: HK\$6.0 (+17%)

We believe all the fundamentals are well in place for a full-blown recovery in FY3/07. Although we expect cotton cost to be lower in 2H FY3/07F, ASP will still manage to rise by at least 4% in FY3/07F buoyed by strong demand. The retail segment will contribute positively to the Group, we conservatively assume an operating margin of 2% in FY3/07F.

Softening cotton price since Sept 2006. The weather has turned favourable in the cotton growing regions. A good harvest is confirmed for 2006/2007 as guided earlier by the management. According to China Cotton Association (CCA), the cotton production of 2006/2007 season will reach a new record of 6.41m tons, up 12.5% compared with that of last season. As a result, the China Cotton Index (CCI 328) began to drop since Sept. On 30th Sept, the CCI 328 was RMB13,624/ton compared to RMB14,070/ton on 1st Sept, representing a drop of 3.3%. A softening in cotton price affects Texwinca's margin in two ways: 1) it will benefit Texwinca with lower raw material costs but 2) it will also lower its ASP since customers are charged on a cost-plus basis.

Strong volume increase to ease a potential softening in ASP. While, we are certain that lower cotton costs can benefit Texwinca but whether ASP will fall in tandem with lower cotton costs hinges on other factors, such as the demand and supply of fabrics in China. Apart from strong industry growth, Texwinca's sales are buoyed by a shift in orders from those textile producers who failed to comply with the environmental requirements in China in the wake of an industry crackdown since mid 2006. The supply of fabrics has been disrupted by the crackdown to a certain extent. With full compliance to the environmental requirements, Texwinca's bargaining power has increased, which has led to a 10% ASP hike since July. However, we believe the benefit of higher ASP from the disruption is rather short-lived since downstream garment manufacturers can adjust their fabric sourcing geographically. That well explained Texwinca's expansion in yarn spinning, which is aimed to fill higher-margin rush orders to mitigate the impact from lower ASP in the future. Accounting for 1) lower cotton cost and 2) the ease of demand and supply mismatch, we expect ASP in 2H to be lower than that of 1H FY3/07F. Nevertheless, we forecast a 4% ASP and 18% volume increase and an operating margin of 12.5% for the full-year FY3/07F.

Higher operating efficiency for the retail segment. The retail segment has already turned profitable with an operating profit of HK\$35m in 2H FY3/06A. The management is looking at same-store-sales growth of 3% and 4.5-5% in PRC and H.K. respectively in FY3/07F. After rapid expansion over the past few years, management will focus on improving the operating efficiency in the near-term, maintaining the current number of c.3,500 POS. After Texwinca's acquisition of the Baleno brand in 1996, it has successfully grown its portfolio and penetrate into different market segments. Apart from "Baleno", Texwinca's retail business consist of six other brands, including "Baleno: attitude", "Baleno kids", "Samuel & Kevin", "IPZone", "eBase" and "Bambini".

Table 1: Financial summary

Year to	Net profit	EPS	EPS	P/E	P/B	EV/EBITDA	Yield	ROE	ROCE	N. Gearing
Mar	HK\$m	HK\$	Δ %	x	x	x	%	%	%	%
05A	461.8	0.345	8.8	15.5	2.69	9.8	3.9	16.8	15.2	1.4
06A	480.3	0.351	1.6	15.3	2.60	15.1	1.9	17.2	7.5	1.1
07F	629.9	0.460	31.2	11.6	2.38	7.3	5.4	22.1	21.2	1.3
08F	759.3	0.555	20.5	9.6	2.16	6.1	6.4	24.2	23.1	Cash
09F	869.9	0.656	18.3	8.2	1.95	5.0	7.4	25.2	24.4	Cash

SBI E2-Capital is a dedicated small/mid cap investment banking/ stockbrokerage house. If you would like to access our research reports and know more about our services, please contact Raymond Jook, Head of Research, on (852) 2533 3715 or raymondjook@softbank.com.hk. Find our research on: sbie2capital.com, thomsononeanalytics.com and multex.com

Investors should assume that SBI E2-Capital is seeking or will seek investment banking or other primary businesses with the companies in this report.

Analyst certification: the views expressed in this report accurately reflects the analyst's personal views of the subject securities and that the analyst has not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

Disclaimer: the information and opinions in this report were prepared by SBI E2-Capital Securities Limited. SBI E2-Capital Securities Limited does not undertake to advise you of changes in its opinion or information. SBI E2-Capital Securities Limited and others associated with it may have positions in and effect transactions in securities of companies mentioned and may also perform or seek to perform investment banking services for those companies. This memorandum is based on information available to the public. No representation is made that it is accurate or complete. This memorandum is not an offer to buy or sell the securities mentioned.

According to a latest research of the casual wear market in PRC by Li & Fung, “Baleno” captured the largest market share, followed by “Jeanwest” and “Crocodile”, while “Giordano” is fourth in 2006.

Good shopping atmosphere. Texwinca owns two buildings located in major shopping areas in Shanghai and Tianjin. Its retail brands filled up the whole building space, creating a good atmosphere for shopping with heavy traffic flows. We revised up our operating margin forecast for the retail segment to 2% in FY3/07F against our previous forecast of 1%.

Valuations. We have revised our earnings forecast upwards by 7% - 17% for FY3/07-09F to reflect a higher ASP and stronger order growth in the textile segment, as well as a higher operating margin of the retail segment. We believe fundamentals are well in place for a full-blown recovery in FY3/07. Our sum-of-the-parts valuation for suggests a fair value of HK\$6.0 (prev. HK\$5.8), equivalent to a blended 13.0x FY3/07F P/E.

Table 2: Peer comparisons

Company Name	Ticker	Price (HK\$)	Mkt cap. (US\$m)	FY06F P/E	FY07F P/E	ROA %	ROE %
Textile							
Texhong Textile	2678	1.50	165.5	5.1	4.3	15.2	27.2
Texwinca	321	5.18	870.6	10.5	8.7	9.5	17.5
Fountain Set	420	2.33	234.1	6.0	7.2	2.6	6.0
Victory City	539	2.65	218.7	5.3	4.5	8.1	19.1
Weiqiao Textile	2698	9.97	1,512.9	8.1	7.3	6.1	15.6
Shenzhou Int'l	2313	3.36	542.7	10.2	8.5	13.8	23.6
Top Form	333	1.70	231.8	10.8	9.2	16.0	25.7
Luen Thai	311	1.24	156.5	5.1	4.9	3.4	6.7
Hembly Int'l	3989	2.25	72.8	6.5	5.1	15.9	56.7
China Ting	3398	2.13	553.3	10.5	9.0	25.1	40.5
Tack Fat	928	1.09	243.7	7.0	5.9	7.4	17.4
Average				7.7	6.8	11.2	23.3
Retail							
Li Ning	2331	9.59	1,203.1	35.6	26.6	12.2	17.2
Bossini	592	0.52	104.6	6.5	5.7	12.5	18.3
Giordano	709	4.08	772.1	16.4	14.9	14.3	19.9
Glorious Sun	393	3.51	473.3	13.6	11.9	7.5	15.5
Sasa Int'l	178	2.75	474.2	17.9	15.6	13.5	20.3
Average				18.0	14.9	12.0	18.2

Source: SBI E2-Capital

Chart 1: Baleno



Source: www.inbase.com.cn

Chart 2: Baleno: attitude



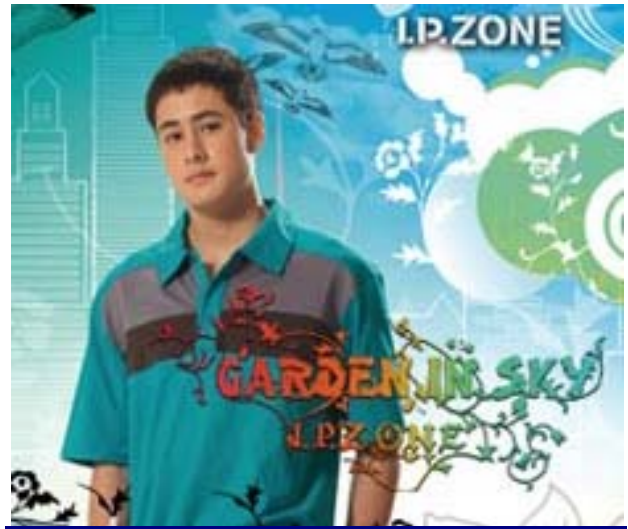
Source: www.inbase.com.cn

Chart 3: Bambini



Source: www.inbase.com.cn

Chart 4: IPZone



Source: www.inbase.com.cn

Chart 5: ebase



Source: www.inbase.com.cn

Chart 6: ebase



Source: www.inbase.com.cn

Chart 7: Samuel & Kevin



Source: www.inbase.com.cn

Chart 8: Samuel & Kevin



Source: www.inbase.com.cn