Corporate Snippet

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A full rebound in FY3/07F — Hong Kong Textile

Texwinca (321 HK, HK$5.35) — BUY (unchanged)

Target price: HK$5.8 (+8.4%)

Results summary:

FY3/06 net profit came in below our expectation by 10% to HK$480m, representing an increase of 4% YoY. Sales rose 6% YoY to HK$7.7b. EPS amounted to HK$0.362. A final DPS of HK$0.11 was declared, bringing the full-year DPS to HK$0.22, equivalent to a payout ratio of 61% and a dividend yield of 4.3%. The shortfall to our earnings forecast attributed to a larger-than-expected full-year ASP decline and higher interest costs. Nonetheless, we believe Texwinca's fundamentals are well in place for a strong year ahead.

Results highlights:

Textile business

- **Stabilizing ASP.** Since Texwinca charges its customer on a cost-plus-basis, the decrease in raw material price led to 4% sales growth despite a 20% increase in sales volume. This implied a c.15% decline in ASP for FY3/06. However, ASP began to stabilize in 2H. ASP dropped c.5% in 2H, compared to 10% in 1H. On the back of a stabilizing raw material supply, ASP is expected to experience a mild increase in FY3/07F.
- **Higher utilization rate.** Operating profit margin for textile segment improved to 12.1% in FY3/06 from 10.3% in FY3/05 despite increase in operating costs such as fuel prices and wages. We believe the improvement mainly came from a higher utilization rate of c.92% compared to c.85% earlier.

Retail business

- **Small operating profit in 2H.** Sales grew 9% YoY and operating losses narrowed from HK$86.2m in 1H to HK$51m in 2H FY3/06, which reflected an operating profit of c.HK$35.2m in 2H. The shop revamping exercise has been successful. There were a net addition of c.310 stores mainly in the PRC in FY3/06.

Outlook & valuation

- Going forward, the catalysts lie on 1) capacity expansion in yarn spinning; 2) ASP improvement from stabilizing raw material prices and 3) improved order flows. Texwinca will expand its yarn spinning production capacity by 20% in FY3/07. As a result of a more stringent requirement in compiling to environmental policies, there is a shift of orders to Texwinca from other manufacturers. This will benefit its order flows and utilization rate.
- Nonetheless, we have revised down our forecast by 9%-13% for FY3/07-08F based on a more conservative ASP assumptions, higher effective tax rate and interest cost. We maintain our BUY recommendation and

Table 1: Financial summary

Year to Mar	Net profit HK$m	FD EPS HK$	EPS Δ%	P/E x	P/B X	EV/EBITDA x	Yield %	ROE %	ROCE %	N. Gearing %
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	0.8
07F	587.2	0.429	22.3	12.5	2.39	7.9	5.1	20.6	19.5	1.7
08F	739.7	0.540	26.0	9.9	2.18	6.3	6.3	23.8	22.6	Cash
09F	867.2	0.654	21.0	8.2	1.97	5.0	7.3	25.2	25.0	Cash

target price of HK$5.8, equivalent to 13.5x FY3/07F P/E.

Major risks. 1) Large fluctuation in raw material prices; 2) RMB appreciation and 3) Higher interest rate.