

# China / Hong Kong Company Update

## Texhong Textile Group

Bloomberg: 2678 HK EQUITY | Reuters: 2678.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

17 Mar 2022

### BUY

Last Traded Price (17 Mar 2022): HK\$9.70 (HSI : 21,501)  
Price Target 12-mth: HK\$23.80 (145% upside) (Prev HK\$20.00)

#### Analyst

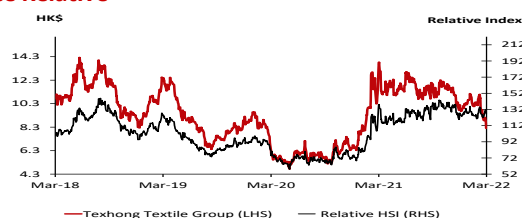
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#### What's New

- Record high FY2021 earnings beating profit alert expectation
- Expect GP margin to come off from record high but volume growth to offset the lower GP margin expectation
- Potential spinoff of mid-downstream business and overseas yarn businesses could trigger re-rating for the company
- Revised up FY22 earnings by 35% to reflect stronger sales volume expectation and more margin stability; Maintain BUY with higher TP at HK\$23.8

#### Price Relative



#### Forecasts and Valuation

FY Dec (RMBm)	2020A	2021A	2022F	2023F
Turnover	19,577	26,521	30,281	31,211
EBITDA	1,782	4,364	4,384	4,585
Pre-tax Profit	681	3,340	3,203	3,313
Net Profit	517	2,685	2,588	2,679
Net Profit Gth (Pre-ex) (%)	(41.5)	419.3	(3.6)	3.5
EPS (RMB)	0.57	2.93	2.83	2.93
EPS (HK\$)	0.70	3.61	3.48	3.60
EPS Gth (%)	(41.5)	419.3	(3.6)	3.5
Diluted EPS (HK\$)	0.70	3.61	3.48	3.60
DPS (HK\$)	0.21	1.08	1.05	1.09
BV Per Share (HK\$)	10.58	13.50	15.92	18.45
PE (X)	13.9	2.7	2.8	2.7
P/Cash Flow (X)	2.2	4.2	1.9	2.0
P/Free CF (X)	2.7	nm	4.5	4.7
EV/EBITDA (X)	6.8	2.8	2.7	2.4
Net Div Yield (%)	2.2	11.2	10.9	11.2
P/Book Value (X)	0.9	0.7	0.6	0.5
Net Debt/Equity (X)	0.5	0.4	0.3	0.2
ROAE (%)	6.7	30.0	23.7	21.0
Earnings Rev (%)			35	New
Consensus EPS (RMB)		2.28	2.53	n.a.
Other Broker Recs:		B:6	S:0	H:0

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

### Potential spinoff to trigger re-rating

#### Investment Thesis

Texhong is misunderstood by the market, trading at below a c.3x FY22F PE (-1SD of its five-year mean). Due to Texhong's volatile margins and higher gearing, we concur a discount is warranted, but the current level is excessive. We argue that the market has failed to recognise 1) the structural increase in scale throughout the years, 2) long-term GP margin consistency, and 3) its ability to maintain a healthy financial position through the COVID situation

**Downstream business will contribute to a more stable GP margin and catalyse a re-rating.** Texhong's margins have always hinged on fluctuations in raw material prices. As such, its foray into the downstream fabric and jeans business is important in terms of margin stability and could be crucial catalyst to trigger a re-rating. We expect the higher margin downstream business to stabilise GP margin moving forward.

**Potential for spinoff of mid-downstream business and overseas yarn businesses** (excluding China and Vietnam). Texhong has been exploring the possibility of a spinoff and separate listing of the group's overseas yarn operations together with the vertically integrated garment fabric and trading businesses. The spin-off would benefit Texhong in term of its valuation, business operation and geographical advantage and trigger re-rating

#### Valuation:

Our TP of HK\$23.8 is pegged to a lowered multiple of 7x FY22F PE, which we think is justified due to its strong performance in FY21, multi-year low net gearing ratio, and stabler gross margin. We have lowered our PE multiple due to the low-risk appetite in HK market

#### Where we differ:

We are more positive about Texhong's gross margin in FY22/23F. We also think the spinoff of the downstream business will help crystallise some of the value

#### Key Risks to Our View:

Texhong's margins are highly dependent on cotton price movements. New forays into the downstream garment and fabric segment could be a new risk due to relative unfamiliarity.

#### At A Glance

Issued Capital (m shrs)	918
Mkt Cap (HK\$m/US\$m)	7,932 / 1,014
Major Shareholders (%)	
Hong (Tianzhu)	43.4
Trade Partner Investments Ltd.	16.5
Wisdom Grace Investments Ltd	7.4
Hui (Ching Lau)	7.0
Free Float (%)	25.7
3m Avg. Daily Val. (US\$m)	1.05
GICS Industry: Consumer Discretionary / Consumer Durables & Apparel	



Watchlist the stock on Insights Direct to receive prompt updates



## WHAT'S NEW

### **FY2021 earnings results beat profit alert; potential for spinoff of mid-downstream business and overseas yarn businesses (ex. China & Vietnam)**

#### **FY2021 earnings results better than profit alert**

**expectation.** Net profit increased to RMB2.69bn, up 419.3% y-o-y, better than the profit alert expectation. Revenue increased by 35.5%, to RMB26.5bn, thanks to strong demand, return of overseas orders, and the increase in ASP. The gross profit margin increased by 8.3ppt to 22.1%, close to its historical high. Net gearing improved to 0.45, vs. 0.52 as at 31 Dec 2020. The board declared a final dividend of HK\$0.57 per share with a steady payout ratio of 30% (2020: HK\$0.20).

#### **Injecting Jeanswear business to JV should further cement margin stability**

Texhong reached an agreement with its existing joint venture partner of garment company Hualida Group at the end of 2021. The 15 jeanswear production lines are sold to the Hualida Group. Although jeanswear's gross margin improved from 9.4% to 13.3% in 2021, we think the group's decision and its focus on the garment fabric business will further cement its stability and the higher gross margin moving forward.

#### **Potential for spinoff of mid-downstream business and overseas yarn businesses (ex. China & Vietnam).**

Texhong has been exploring different management restructuring options, including the possibility of a spinoff and separate listing of the group's overseas yarn operations (excluding China and Vietnam) together with the vertically integrated garment fabric and trading businesses. Nicaragua, Turkey, and Mexico contributed. The mid-downstream business contributed 27% of FY21 sales, while the overseas yarn operations (excluding China and Vietnam) are equivalent to 6% of the total yarn capacity. Exact details of the restructuring options have yet been determined.

#### **Spin-off into "China Yarn" and "Non-China fabrics".**

We think the spin-off will benefit Texhong in term of its valuation, business operation and geographical advantage. We think that Texhong is trading at this low valuation mainly due to the volatile margins and high gearing. The spinoff will completely separate the mid-downstream business to form a vertical integrated company, without the most fluctuated margin of the yarn businesses. It will likely attract investors and improve the company's valuation. Moreover, the garment fabrics are served mostly US customers. A spin off will completely target non-China customers and it will avoid US-China trade tariff or any

further negative developments. A vertically integrated operation is also likely to command higher margins and higher valuations. That said we think the potential spinoff could trigger a re-rating for the company.

#### **Expect gross profit margin to come off from historical high and maintain at 20% in 2022 and 2023.**

We expect the GP margin to lower slightly but remain high vs historical level, at 20% in FY22, thanks to 1) the continuous rise in both domestic and overseas cotton prices, which will continue to provide strong support to the GP margin of the yarn business; 2) the improvement of the downstream business and its increasing contribution to the company's earnings, which will bring stability and a higher margin for Texhong; 3) the removal of its lower margin jeanswear business; and 4) the commencement of the new garment fabric factory in Vietnam. In addition, we expect Texhong's GP margin to slightly drop to 19.6% in 2023. We expect begin to normalise afterwards but offset by the improving GP margin of the mid-downstream businesses.

#### **However, expect volume growth to offset the lower GP margin and drive future growth.**

In Jan-Feb 2022, the company enjoyed a similar business environment to that of 2H21, amid the inflationary environment and strong demand as the world is stepping out of the pandemic. We expect ASP to remain at the current strong level. We expect the company to achieve its sales target of 880,000 tonnes of yarn, 180m metres of woven garment fabrics, and 28,000 tonnes of knitted garment fabrics, which represent a growth of 7.6%, 31.4%, and 57.8%, compared to the sales volumes of 2021. We believe disruptions from lockdowns in Vietnam like last year are unlikely, as the country has already lifted its zero-COVID policy.

#### **Expect total of RMB2.2bn CAPEX in FY22.**

The CAPEX will be for improving old machinery and equipment for the yarn and garment businesses and purchases of new machines and equipment for the new Vietnam factory. The spending of capex in upgrading the equipment will help lower reliance on labour costs and eventually raise margins. We expect Texhong to further reduce its net gearing ratio to 0.3-0.4 in FY22 and achieve a more stable and low-risk profit growth.

## Texhong Textile Group

Revised up earnings by 35% for FY22F. Overall, we have adjusted our earnings estimate to reflect the better-than-expected earnings in FY21. We expect earnings to drop 3.6% following the lowered GP margin expectation in FY22. Moving into FY23, we expect earnings to growth 3.7% backed by the expected volume growth. That said, we revise up our TP to HK\$23.8, pegged to a lower multiple (reflect recent market de-risking) of 7x FY22F PE, which we think is justified due to its strong performance in FY21, multi-year low net gearing ratio, and stabler gross margin.

### Company Background

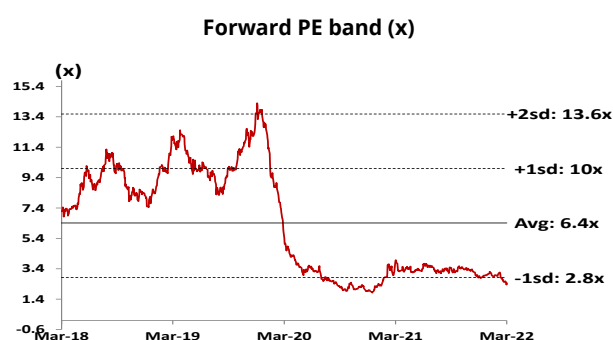
Texhong Textile Group Limited (Texhong) manufactures and sells yarn and grey fabrics. The company's main focus is promoting and selling spandex stretch yarn and spandex stretch grey fabrics.

### Income Statement (RMB m)

FY Dec	2020A	2021A	% cha yoy
Revenue	19,577	26,521	35.5
Cost of Goods Sold	(16,870)	(20,669)	22.5
<b>Gross Profit</b>	<b>2,707</b>	<b>5,852</b>	<b>116.2</b>
Other Opng (Exp)/Inc	(1,851)	(2,429)	31.2
<b>Operating Profit</b>	<b>856</b>	<b>3,423</b>	<b>300.1</b>
Other Non Opng (Exp)/Inc	0	0	nm
Associates & JV Inc	45	40	(12.2)
Net Interest (Exp)/Inc	(220)	(123)	44.2
Exceptional Gain/(Loss)	0	0	nm
<b>Pre-tax Profit</b>	<b>681</b>	<b>3,340</b>	<b>390.6</b>
Tax	(151)	(599)	297.7
Minority Interest	(13)	(56)	(324.8)
<b>Net Profit</b>	<b>517</b>	<b>2,685</b>	<b>419.3</b>
Net Profit before Except.	517	2,685	419.3
EBITDA	1,782	4,364	145.0
<b>Margins &amp; Ratio</b>			
Gross Margins (%)	13.8	22.1	
Opg Profit Margin (%)	4.4	12.9	
Net Profit Margin (%)	2.6	10.1	

Source: Company, DBS HK

### Historical PE and PB band



Source: Thomson Reuters, DBS HK

## Texhong Textile Group

### Key Assumptions

FY Dec	2019A	2020A	2021A	2022F	2023F
Sales growth	14.9	(11.0)	35.5	14.2	3.1
Gross margin	13.6	13.8	22.1	19.9	19.6
Opex/Sales	(4.8)	(4.8)	(4.8)	(4.8)	(4.8)
Effective Tax Rate	(17.2)	(22.1)	(17.9)	(17.9)	(17.8)
Payout	30.3	30.8	30.3	30.3	30.3

Source: Company, DBS HK

### Segmental Breakdown (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
<b>Revenues (RMB m)</b>					
Yarn	16,714	15,202	20,400	21,254	20,667
Grey fabrics	710	497	588	887	819
Garment fabrics	3,595	3,136	3,612	5,215	5,788
Jeans	983	680	672	976	1,143
Non Woven Fabrics	0	62	123	162	2,632
Trading	0	0	1,125	1,787	162
	N/A	N/A	N/A	N/A	N/A
<b>Total</b>	<b>22,003</b>	<b>19,577</b>	<b>26,521</b>	<b>30,281</b>	<b>31,211</b>
<b>Gross Profit (RMB m)</b>					
Yarn	2,257	2,030	4,752	4,251	4,082
Grey fabrics	122	64	175	248	213
Garment fabrics	573	527	760	1,181	962
Jeans	53	37	89	137	369
Non Woven Fabrics	0	(26)	(15)	(16)	160
Trading	0	0	138	220	324
<b>Total</b>	<b>3,006</b>	<b>2,632</b>	<b>5,900</b>	<b>6,021</b>	<b>6,109</b>
<b>Gross Profit Margins (%)</b>					
Yarn	13.5	13.4	23.3	20.0	19.8
Grey fabrics	17.2	12.9	29.7	28.0	26.0
Garment fabrics	15.9	16.8	21.1	22.7	16.6
Jeans	5.4	5.4	13.3	14.0	32.3
Non Woven Fabrics	N/A	(41.9)	(12.4)	(10.0)	6.1
Trading	N/A	N/A	12.3	12.3	199.6
<b>Total</b>	<b>13.7</b>	<b>13.4</b>	<b>22.2</b>	<b>19.9</b>	<b>19.6</b>

Source: Company, DBS HK

## Texhong Textile Group

### Income Statement (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Revenue	22,003	19,577	26,521	30,281	31,211
Cost of Goods Sold	(19,010)	(16,870)	(20,669)	(24,261)	(25,094)
<b>Gross Profit</b>	<b>2,993</b>	<b>2,707</b>	<b>5,852</b>	<b>6,021</b>	<b>6,117</b>
Other Opng (Exp)/Inc	(1,359)	(1,851)	(2,429)	(2,581)	(2,580)
<b>Operating Profit</b>	<b>1,634</b>	<b>856</b>	<b>3,423</b>	<b>3,440</b>	<b>3,537</b>
Other Non Opng (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	28	45	40	15	15
Net Interest (Exp)/Inc	(548)	(220)	(123)	(251)	(239)
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
<b>Pre-tax Profit</b>	<b>1,115</b>	<b>681</b>	<b>3,340</b>	<b>3,203</b>	<b>3,313</b>
Tax	(192)	(151)	(599)	(574)	(591)
Minority Interest	(39)	(13)	(56)	(42)	(43)
Preference Dividend	0	0	0	0	0
<b>Net Profit</b>	<b>884</b>	<b>517</b>	<b>2,685</b>	<b>2,588</b>	<b>2,679</b>
Net Profit before Except.	884	517	2,685	2,588	2,679
EBITDA	2,521	1,782	4,364	4,384	4,585
<b>Growth</b>					
Revenue Gth (%)	14.9	(11.0)	35.5	14.2	3.1
EBITDA Gth (%)	(5.6)	(29.3)	145.0	0.4	4.6
Opg Profit Gth (%)	(13.7)	(47.6)	300.1	0.5	2.8
Net Profit Gth (%)	(24.0)	(41.5)	419.3	(3.6)	3.5
<b>Margins &amp; Ratio</b>					
Gross Margins (%)	13.6	13.8	22.1	19.9	19.6
Opg Profit Margin (%)	7.4	4.4	12.9	11.4	11.3
Net Profit Margin (%)	4.0	2.6	10.1	8.5	8.6
ROAE (%)	12.4	6.7	30.0	23.7	21.0
ROA (%)	4.4	2.5	12.0	10.1	9.7
ROCE (%)	8.7	4.0	16.4	14.8	13.8
Div Payout Ratio (%)	30.3	30.8	30.0	30.3	30.3
Net Interest Cover (x)	3.0	3.9	27.9	13.7	14.8

Source: Company, DBS HK

### Interim Income Statement (RMB m)

FY Dec	1H2019	2H2019	1H2020	2H2020	1H2021
Revenue	10,191	11,811	8,214	11,363	12,526
Cost of Goods Sold	(8,811)	(10,199)	(7,277)	(9,592)	(9,674)
<b>Gross Profit</b>	<b>1,381</b>	<b>1,613</b>	<b>937</b>	<b>1,770</b>	<b>2,853</b>
Other Oper. (Exp)/Inc	(579)	(780)	(620)	(1,231)	(1,185)
<b>Operating Profit</b>	<b>801</b>	<b>833</b>	<b>317</b>	<b>539</b>	<b>1,668</b>
Other Non Opng (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	0	28	30	16	(15)
Net Interest (Exp)/Inc	(237)	(311)	(324)	104	(22)
Exceptional Gain/(Loss)	0	0	0	0	0
<b>Pre-tax Profit</b>	<b>565</b>	<b>550</b>	<b>23</b>	<b>658</b>	<b>1,631</b>
Tax	(79)	(113)	(4)	(146)	(309)
Minority Interest	(15)	(24)	(8)	(5)	(34)
<b>Net Profit</b>	<b>471</b>	<b>413</b>	<b>10</b>	<b>507</b>	<b>1,288</b>
Net profit bef Except.	471	413	10	507	1,288
<b>Growth</b>					
Revenue Gth (%)	15.7	14.2	(19.4)	(3.8)	52.5
Opg Profit Gth (%)	(9.2)	(15.6)	(60.5)	(35.3)	426.8
Net Profit Gth (%)	(21.8)	(22.7)	(97.8)	22.8	12,192.3

### Margins

Gross Margins (%)	13.5	13.7	11.4	15.6	22.8
Opg Profit Margins (%)	7.9	7.1	3.9	4.7	13.3
Net Profit Margins (%)	4.6	3.5	0.1	4.5	10.3

Source: Company, DBS HK

## Texhong Textile Group

### Balance Sheet (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Net Fixed Assets	9,616	9,062	9,393	10,664	11,631
Invts in Associates & JVs	243	290	321	336	351
Other LT Assets	1,515	1,478	1,680	1,680	1,680
Cash & ST Invts	2,118	2,795	2,561	3,372	4,123
Inventory	5,100	3,796	7,152	6,425	6,646
Debtors	2,561	2,477	3,146	3,942	4,063
Other Current Assets	21	261	190	190	190
<b>Total Assets</b>	<b>21,175</b>	<b>20,157</b>	<b>24,443</b>	<b>26,609</b>	<b>28,684</b>
ST Debt	3,360	3,837	3,832	3,832	3,832
Creditors	3,834	3,464	5,480	5,249	5,429
Other Current Liab	390	709	778	1,340	1,309
LT Debt	4,925	3,226	3,383	3,383	3,383
Other LT Liabilities	567	448	369	369	369
Shareholder's Equity	7,473	7,863	10,038	11,832	13,714
Minority Interests	626	609	563	604	647
<b>Total Cap. &amp; Liab.</b>	<b>21,175</b>	<b>20,157</b>	<b>24,443</b>	<b>26,609</b>	<b>28,684</b>
Non-Cash Wkg. Capital	3,459	2,359	4,230	3,968	4,161
Net Cash/(Debt)	(6,166)	(4,268)	(4,654)	(3,843)	(3,092)
Debtors Turn (avg days)	45.1	47.0	38.7	42.7	46.8
Creditors Turn (avg days)	81.3	83.3	82.6	83.9	81.0
Inventory Turn (avg days)	103.7	101.5	101.1	106.2	99.1
Asset Turnover (x)	1.1	0.9	1.2	1.2	1.1
Current Ratio (x)	1.3	1.2	1.3	1.3	1.4
Quick Ratio (x)	0.6	0.7	0.6	0.7	0.8
Net Debt/Equity (X)	0.8	0.5	0.4	0.3	0.2
Net Debt/Equity ex MI (X)	0.8	0.5	0.5	0.3	0.2
Capex to Debt (%)	23.4	9.3	31.0	30.5	27.7
Z-Score (X)	2.1	1.6	2.0	2.2	2.2

Source: Company, DBS HK

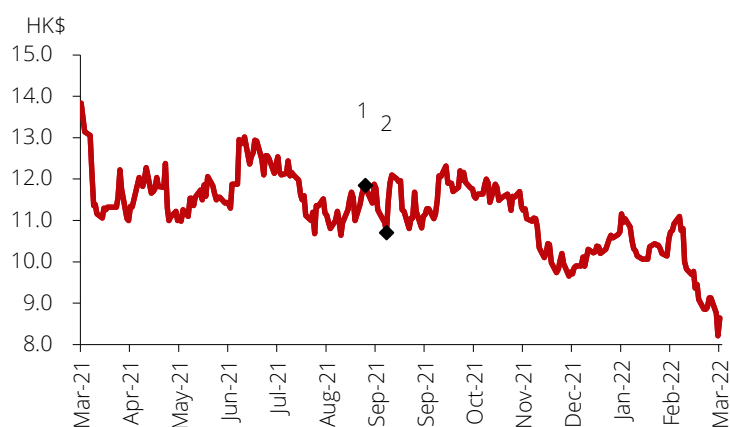
### Cash Flow Statement (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Pre-Tax Profit	1,115	681	3,340	3,203	3,313
Dep. & Amort.	859	881	901	929	1,033
Tax Paid	(165)	(177)	(480)	(12)	(622)
Assoc. & JV Inc/(loss)	(28)	(45)	(40)	(15)	(15)
(Pft)/Loss on disposal of FAs	0	0	0	0	0
Chg in Wkg. Cap.	12	1,019	(2,009)	(300)	(161)
Other Operating CF	487	943	0	0	0
<b>Net Operating CF</b>	<b>2,279</b>	<b>3,301</b>	<b>1,713</b>	<b>3,805</b>	<b>3,547</b>
Capital Exp. (net)	(1,939)	(660)	(2,235)	(2,200)	(2,000)
Other Invts. (net)	(87)	24	92	0	0
Invts in Assoc. & JV	0	0	0	0	0
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	87	59	(239)	0	0
<b>Net Investing CF</b>	<b>(1,939)</b>	<b>(578)</b>	<b>(2,382)</b>	<b>(2,200)</b>	<b>(2,000)</b>
Div Paid	(337)	(267)	(536)	(795)	(796)
Chg in Gross Debt	1,157	(1,222)	152	0	0
Capital Issues	0	0	0	0	0
Other Financing CF	(384)	(381)	875	0	0
<b>Net Financing CF</b>	<b>436</b>	<b>(1,870)</b>	<b>491</b>	<b>(795)</b>	<b>(796)</b>
Currency Adjustments	0	0	0	0	0
Chg in Cash	776	853	(178)	811	751
Opg CFPS (RMB)	2.48	2.49	4.07	4.49	4.05
Free CFPS (RMB)	0.37	2.89	(0.57)	1.75	1.69

Source: Company, DBS HK

## Texhong Textile Group

### Target Price & Ratings History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	26-Aug-21	HK\$11.78	HK\$20.00	Buy
2:	7-Sep-21	HK\$10.94	HK\$20.00	Buy

Source: DBS HK

Analyst: Dennis Lam

Byron Lam

DBS HK recommendations are based on an Absolute Total Return\* Rating system, defined as follows:

**STRONG BUY** (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

**BUY** (>15% total return over the next 12 months for small caps, >10% for large caps)

**HOLD** (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

**FULLY VALUED** (negative total return, i.e., > -10% over the next 12 months)

**SELL** (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

\*Share price appreciation + dividends

Completed Date: 17 Mar 2022 19:48:37 (HKT)

Dissemination Date: 17 Mar 2022 19:54:00 (HKT)

Sources for all charts and tables are DBS HK unless otherwise specified.

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