

# Pacific Textiles

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DBS Group Research . Equity

27 Jun 2022

## BUY

Last Traded Price (27 Jun 2022): HK\$3.35 (HSI : 22,230)  
Price Target 12-mth: HK\$4.46 (33% upside) (Prev HK\$6.80)

### Analyst

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### What's New

- FY22A earnings miss due to distortion of one-off gain in disposal and worse-than-expected GP margin
- Expect margin pressures to ease moving forward as the raw material price hikes slow down
- Revised down FY23 earnings by 26% to reflect a more conservative order flow and weaker-than-expected GP margin
- Maintain BUY with a lower TP of HK\$4.46 for steady dividend play at 9%+ yield; the stock is too cheap to ignore

## Sustainable 9%+ dividend yield play

### Investment Thesis

Offering 9%+ dividend yield on normalising operations. Although Pacific Textile's share price is under pressure due to rising raw material prices and economic uncertainties, it offers an attractive and sustainable dividend yield of 9%+. The stock, at c.8x FY23 PE, trades substantially below industry bellwether Shenzhou; 35x PE.

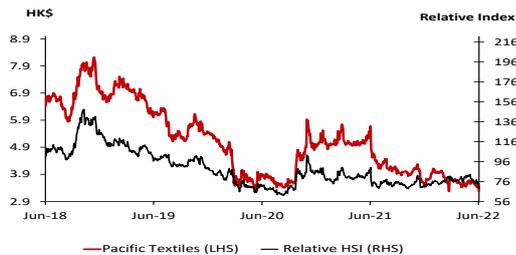
**Expect GP margin to improve from 1HFY23 onward.** Expect margin contraction to ease, as cotton yarn prices dropped YTD. We think PT's margin has already faced its worst and its GP margin to gradually improve when ASP hikes and raw material prices narrow. We expect margin pressures to ease, as the raw material price hikes slow down, and rebound to the 14.5% level in FY24.

**Expansion in Vietnam will be key driver of PT's growth.** Major US customers have requested PT to increase its production capacity in Vietnam. PT expects to ramp up its existing Vietnam capacity by 30% to meet the strong demand from US customers. Phase 1 is expected to commence in 1HFY23 and phase 2 is likely to be built in FY24. Vietnam's capacity will then contribute 1/3 of total capacity. Vietnam factories will ride on overseas customers' demand.

### Valuation:

We maintain our BUY call with a new TP of HK\$4.46, pegged to 10.7x (previously 12x) FY23F PE, which is its five-year average. We are optimistic that PT should be able to gradually improve ASP to match the higher yarn price in FY23F.

### Price Relative



### Forecasts and Valuation

FY Mar (HK\$m)	2021A	2022A	2023F	2024F
Turnover	5,385	6,066	6,068	6,442
EBITDA	1,010	835	820	991
Pre-tax Profit	838	646	684	834
Net Profit	721	573	588	717
Net Profit Gth (Pre-ex) (%)	(3.0)	(20.6)	2.6	21.9
EPS (HK\$)	0.51	0.41	0.42	0.51
EPS Gth (%)	(0.7)	(20.6)	2.6	21.9
Diluted EPS (HK\$)	0.51	0.41	0.42	0.51
DPS (HK\$)	0.44	0.35	0.31	0.36
BV Per Share (HK\$)	2.37	2.34	2.48	2.65
PE (X)	6.6	8.3	8.0	6.6
P/Cash Flow (X)	6.5	9.1	4.3	6.1
P/Free CF (X)	12.6	14.5	6.8	11.0
EV/EBITDA (X)	4.5	5.9	5.5	4.5
Net Div Yield (%)	13.1	10.4	9.3	10.7
P/Book Value (X)	1.4	1.4	1.4	1.3
Net Debt/Equity (X)	CASH	0.0	CASH	CASH
ROAE (%)	22.8	17.2	17.3	19.8
Earnings Rev (%)			(26)	NEW
Consensus EPS (HK\$)			0.54	0.59
Other Broker Recs:		B:3	S:0	H:1

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

### Where we differ:

PT is viewed as a good company which lacks growth. While we agree that earnings growth has been unexciting and its Vietnam's ramp-up is slower than peers, its very stable cash flows is remarkable. Share price has retraced to a level where we think that the relatively low growth is very much priced in. The stock is too cheap to ignore.

### Key Risks to Our View:

Any hiccups or poorer sales for Uniqlo (accounts for c.50% of PT's sales) will have a negative impact on PT's share price. Drastic changes to US trade policies are also a key concern.

### At A Glance

Issued Capital (m shrs)	1,411
Mkt Cap (HKm/US\$m)	4,727 / 602
Major Shareholders (%)	
Toray Industries Inc	28.7
Lam (Wing Tak)	6.0
Free Float (%)	65.3
3m Avg. Daily Val. (US\$m)	0.60
GICS Industry: Consumer Discretionary / Consumer Durables & Apparel	



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## Pacific Textiles

### WHAT'S NEW

#### FY22 earnings results below expectations due to margin erosion

**FY22 earnings results below expectations due to margin erosion.** Pacific Textiles (PT) recorded a 20.6% y-o-y drop in net profit to HK\$572m, missing market expectations. Excluding the distortion from the one-off gain on disposal of property, plant, and equipment from last year, net profit dropped 7.9% y-o-y. The earnings miss was mainly due to the margin contraction, from 16% in FY21 to 12.8% in FY22, implying a GP margin of 10.8% recorded in 2HFY22 – this is because raw material prices, such as of yarn and coal, increased significantly during the period. The average selling price (ASP) increased 9.6%, however, the hike was not enough to offset the rising raw material prices. PT proposed a final dividend of HK\$14 cents per share with an 86% payout ratio (2HFY21: HK\$22 cents).

**Expect PT's margin pressure to ease in 1HFY23F and gradually improve in the next couple of years.** The major cause of the worse-than-expected GP margin in 2HFY22 was the rapid hike in cotton yarn prices in early October 2021. Cotton yarn prices have been slowing down in China YTD. We expect PT's GP margin to rebound from 10.8% in 2HFY22 to 12.5% in 1HFY23F, where the difference between average selling price hikes and rising raw material prices narrow. We expect PT to hike its ASP by 9.6% more, to HK\$40.3 per pound in FY23F. We expect the GP margin to improve to 12.8% in FY23F and return to the 14.5% level in FY24F, when we think the inflation environment should ease.

**Expect a 10% drop in sales volume due to more conservative orders from customers.** Due to the uncertainties from the rising interest rates, recession risk in advanced countries, and the Russia-Ukraine war, US customers have become more conservative in ordering from PT. For instance, US customers' usual practice was to order half its orders in the beginning of each year. Nowadays, however, customers prefer smaller orders at a time to minimise their stock inventories. Management expects a 10% drop in sales volume in FY23F. For instance, the drop is mainly from US customers, while we expect Japan customers' orders to be flat in growth, while Chinese companies are likely to see 20%-30% growth in sales. The increasing GP margin and ASP are unlikely to offset the drop in sales volume. As a result, we expect a flat growth in FY23F revenue

**Expect utilisation rate to be weaker in Panyu but stronger in Vietnam.** The utilisation rate in Panyu was at the 70%-80% level in FY22, while Vietnam's factor dropped to 60%-70%. This is due to the higher number of workers who left for the Chinese New Year holiday while PT saw more conservative orders from US customers. Moving into FY23F, the economic outlook will continue to impact sales orders from all customers. We expect Panyu's utilisation rate to reduce to 60%-70% while Vietnam has a better rate of 70%-80% due to the commencement of Vietnam's phase 1 factory in 2HFY23F.

**Revised down FY23 earnings by 26% and expect a 2.6%/21.9% growth in FY23/24F.** The earnings revision in FY23F is mainly due to (1) lower sales volume expectations due to economic uncertainties, (2) the revision of GP margin expectations due to weaker-than-expected results in 2HFY22, and (3) the lower anticipation on the utilisation rate in China moving forward.

**New Vietnam factory to be key driver for PT's earnings growth moving forward.** PT's capital expenditure was at HK\$130m in FY22. We expect capex to be HK\$500/600m in FY22/23, respectively, due to the new factories in Vietnam. Phase 1 of the new Vietnam factory is expected to commence in 1HFY23 and add 600,000 pounds per month to PT's total capacity. Looking ahead of FY24, phase 2 of Vietnam's new factory, which is likely to be built in 2025, will be a positive catalyst for the company. As more and more customers prefer production to shift away from China, the total of two phases are expected to bring 3m in volume per month to the company. Vietnam will contribute one-third of the company's total capacity if/when phase 2 commences.

**Maintain BUY for steady dividend play at 9%+ yield.** We continue to like PT, as it offers an attractive and sustainable dividend yield of 9%+. Despite the COVID-19 mayhem and margin contraction in the past years, the company commits to keep its dividend payout ratio at 80%-90%. The share price has retraced to a level where we think that the relatively low growth is very much priced in. The stock is too cheap to ignore. We maintain our BUY call with a lower TP of HK\$4.46, pegged to 10.7x FY22F PE, which is its five-year average.

## Pacific Textiles

### Company Background

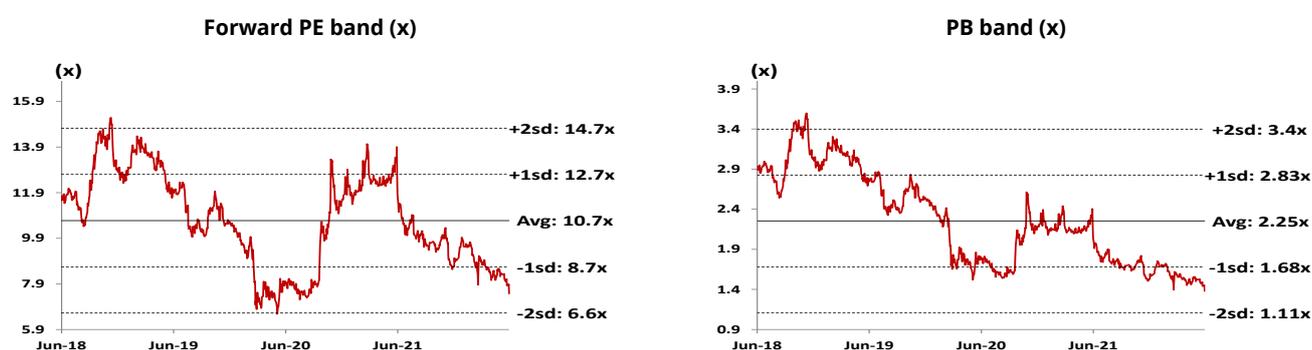
Pacific Textiles (PT) manufactures customised knitted fabrics. The company's fabrics are used in a broad range of apparels, including men's, women's, and children's clothing, sportswear, swimwear, and inner wear. Uniqlo accounts for c.50% of PT's revenue.

### Income Statement (HK\$ m)

FY Mar	2021A	2022A	% chg vov
Revenue	5,385	6,066	12.7
Cost of Goods Sold	(4,523)	(5,290)	17.0
<b>Gross Profit</b>	<b>862</b>	<b>776</b>	<b>(9.9)</b>
Other Opng (Exp)/Inc	(261)	(252)	(3.3)
<b>Operating Profit</b>	<b>601</b>	<b>524</b>	<b>(12.8)</b>
Other Non Opg (Exp)/Inc	188	93	(50.6)
Associates & JV Inc	41	35	(14.2)
Net Interest (Exp)/Inc	9	(6)	nm
Exceptional Gain/(Loss)	0	0	nm
<b>Pre-tax Profit</b>	<b>838</b>	<b>646</b>	<b>(22.9)</b>
Tax	(103)	(67)	(35.1)
Minority Interest	(14)	(7)	52.6
<b>Net Profit</b>	<b>721</b>	<b>573</b>	<b>(20.6)</b>
Net Profit before Except.	721	573	(20.6)
EBITDA	1,010	835	(17.3)
<b>Margins &amp; Ratio</b>			
Gross Margins (%)	16.0	12.8	
Opg Profit Margin (%)	11.2	8.6	
Net Profit Margin (%)	13.4	9.4	

Source: Company, DBS HK

### Historical PE and PB band



Source: Thomson Reuters, DBS HK

## Pacific Textiles

### Key Assumptions

FY Mar	2020A	2021A	2022A	2023F	2024F
Total effective capacity (m pounds)	253.2	253.2	253.2	253.2	253.2
Sales volume (m pounds)	131.1	160.3	164.8	150.6	147.9
ASP (HK\$/pound)	41.8	33.6	36.8	40.3	43.6
Gross profit (HK\$/pound)	7.1	5.4	4.7	5.1	6.3

Source: Company, DBS HK

### Income Statement (HK\$ m)

FY Mar	2020A	2021A	2022A	2023F	2024F
Revenue	5,476	5,385	6,066	6,068	6,442
Cost of Goods Sold	(4,552)	(4,523)	(5,290)	(5,293)	(5,508)
<b>Gross Profit</b>	<b>925</b>	<b>862</b>	<b>776</b>	<b>774</b>	<b>933</b>
Other Opng (Exp)/Inc	(254)	(261)	(252)	(254)	(268)
<b>Operating Profit</b>	<b>671</b>	<b>601</b>	<b>524</b>	<b>521</b>	<b>665</b>
Other Non Opg (Exp)/Inc	149	188	93	80	80
Associates & JV Inc	37	41	35	35	35
Net Interest (Exp)/Inc	14	9	(6)	49	54
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
<b>Pre-tax Profit</b>	<b>871</b>	<b>838</b>	<b>646</b>	<b>684</b>	<b>834</b>
Tax	(103)	(103)	(67)	(83)	(102)
Minority Interest	(24)	(14)	(7)	(13)	(16)
Preference Dividend	0	0	0	0	0
<b>Net Profit</b>	<b>743</b>	<b>721</b>	<b>573</b>	<b>588</b>	<b>717</b>
Net Profit before Except.	743	721	573	588	717
EBITDA	1,015	1,010	835	820	991
<b>Growth</b>					
Revenue Gth (%)	(10.5)	(1.7)	12.7	0.0	6.2
EBITDA Gth (%)	(13.8)	(0.5)	(17.3)	(1.8)	20.9
Opg Profit Gth (%)	(16.5)	(10.4)	(12.8)	(0.7)	27.8
Net Profit Gth (%)	(13.7)	(3.0)	(20.6)	2.6	21.9
<b>Margins &amp; Ratio</b>					
Gross Margins (%)	16.9	16.0	12.8	12.8	14.5
Opg Profit Margin (%)	12.2	11.2	8.6	8.6	10.3
Net Profit Margin (%)	13.6	13.4	9.4	9.7	11.1
ROAE (%)	23.7	22.8	17.2	17.3	19.8
ROA (%)	15.9	14.4	10.4	9.8	11.3
ROCE (%)	15.3	12.9	10.1	8.9	10.9
Div Payout Ratio (%)	85.6	86.1	86.2	74.4	70.9
Net Interest Cover (x)	NM	NM	89.6	NM	NM

Source: Company, DBS HK

## Pacific Textiles

### Interim Income Statement (HK\$ m)

FY Mar	2H2020	1H2021	2H2021	1H2022	2H2022
Revenue	2,451	2,453	2,932	3,163	2,903
Cost of Goods Sold	(2,066)	(2,023)	(2,501)	(2,701)	(2,589)
<b>Gross Profit</b>	<b>384</b>	<b>430</b>	<b>432</b>	<b>462</b>	<b>314</b>
Other Oper. (Exp)/Inc	(130)	(122)	(139)	(123)	(129)
<b>Operating Profit</b>	<b>255</b>	<b>308</b>	<b>293</b>	<b>339</b>	<b>185</b>
Other Non Opg (Exp)/Inc	120	116	72	35	58
Associates & JV Inc	17	13	28	15	20
Net Interest (Exp)/Inc	(3)	(11)	20	(1)	(5)
Exceptional Gain/(Loss)	0	0	0	0	0
<b>Pre-tax Profit</b>	<b>389</b>	<b>426</b>	<b>413</b>	<b>388</b>	<b>258</b>
Tax	(47)	(40)	(63)	(35)	(31)
Minority Interest	(11)	(10)	(4)	(5)	(2)
<b>Net Profit</b>	<b>331</b>	<b>376</b>	<b>346</b>	<b>348</b>	<b>225</b>
Net profit bef Except.	331	376	346	348	225

### Growth

Revenue Gth (%)	(9.8)	(18.9)	19.6	29.0	(1.0)
Opg Profit Gth (%)	(16.1)	(25.9)	15.0	10.1	(36.9)
Net Profit Gth (%)	(8.0)	(8.8)	4.4	(7.4)	(35.0)

### Margins

Gross Margins (%)	15.7	17.5	14.7	14.6	10.8
Opg Profit Margins (%)	10.4	12.6	10.0	10.7	6.4
Net Profit Margins (%)	13.5	15.3	11.8	11.0	7.7

Source: Company, DBS HK

### Balance Sheet (HK\$ m)

FY Mar	2020A	2021A	2022A	2023F	2024F
Net Fixed Assets	1,410	1,433	1,443	1,659	1,797
Invts in Associates & JVs	323	347	359	359	359
Other LT Assets	179	288	322	322	322
Cash & ST Invts	929	957	1,441	1,822	1,862
Inventory	1,134	1,223	1,237	1,092	1,160
Debtors	742	864	946	822	873
Other Current Assets	96	98	92	92	92
<b>Total Assets</b>	<b>4,813</b>	<b>5,211</b>	<b>5,840</b>	<b>6,168</b>	<b>6,465</b>
ST Debt	737	645	1,454	1,454	1,454
Creditors	646	719	593	715	760
Other Current Liab	231	261	215	215	215
LT Debt	125	125	126	126	126
Other LT Liabilities	78	108	126	126	126
Shareholder's Equity	2,986	3,338	3,304	3,496	3,733
Minority Interests	11	16	22	36	52
<b>Total Cap. &amp; Liab.</b>	<b>4,813</b>	<b>5,211</b>	<b>5,840</b>	<b>6,168</b>	<b>6,465</b>
Non-Cash Wkg. Capital	1,096	1,206	1,467	1,076	1,150
Net Cash/(Debt)	67	187	(139)	242	282
Debtors Turn (avg days)	49.3	54.4	54.4	53.2	48.0
Creditors Turn (avg days)	50.4	57.3	46.9	46.7	50.8
Inventory Turn (avg days)	86.4	99.1	87.9	83.2	77.6
Asset Turnover (x)	1.2	1.1	1.1	1.0	1.0
Current Ratio (x)	1.8	1.9	1.6	1.6	1.6
Quick Ratio (x)	1.0	1.1	1.1	1.1	1.1
Net Debt/Equity (X)	CASH	CASH	0.0	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	0.0	CASH	CASH
Capex to Debt (%)	17.6	45.4	12.2	25.3	22.2
Z-Score (X)	4.3	4.2	4.3	4.2	NA

Source: Company, DBS HK

## Pacific Textiles

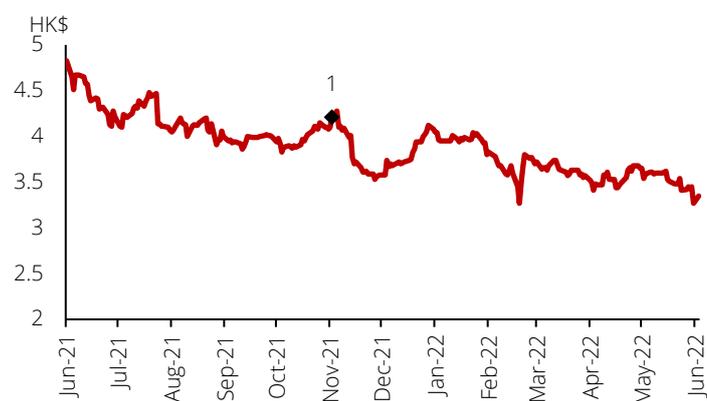
### Cash Flow Statement (HK\$ m)

FY Mar	2020A	2021A	2022A	2023F	2024F
Pre-Tax Profit	871	838	646	684	834
Dep. & Amort.	158	180	183	185	211
Tax Paid	(103)	(103)	(67)	(83)	(102)
Assoc. & JV Inc/(loss)	(37)	(41)	(35)	(35)	(35)
(Pft)/ Loss on disposal of FAs	0	0	0	0	0
Chg in Wkg.Cap.	(87)	(140)	(215)	391	(74)
Other Operating CF	(14)	(9)	6	(49)	(54)
<b>Net Operating CF</b>	<b>788</b>	<b>726</b>	<b>518</b>	<b>1,093</b>	<b>781</b>
Capital Exp.(net)	(152)	(350)	(192)	(400)	(350)
Other Invt.(net)	0	0	0	0	0
Invt in Assoc. & JV	(3)	(24)	(12)	0	0
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	4	44	9	54	59
<b>Net Investing CF</b>	<b>(151)</b>	<b>(330)</b>	<b>(195)</b>	<b>(346)</b>	<b>(291)</b>
Div Paid	(738)	(571)	(607)	(395)	(480)
Chg in Gross Debt	416	(91)	809	0	0
Capital Issues	(142)	(96)	0	0	0
Other Financing CF	34	390	(42)	30	30
<b>Net Financing CF</b>	<b>(429)</b>	<b>(368)</b>	<b>160</b>	<b>(366)</b>	<b>(450)</b>
Currency Adjustments	0	0	0	0	0
Chg in Cash	208	29	483	381	40
Opg CFPS (HK\$)	0.61	0.61	0.52	0.50	0.61
Free CFPS (HK\$)	0.44	0.27	0.23	0.49	0.31

Source: Company, DBS HK

**Pacific Textiles**

**Target Price & Ratings History**



S.No.	Date	Closing Price	Target Price	Rating
1	26-Nov-21	HK\$4.10	HK\$6.80	BUY

Source: DBS HK

Analyst: Byron Lam

Dennis Lam

## Pacific Textiles

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

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

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