

Best Pacific International

2111 HK

Target (HKD): 4.90 → 4.40

Upside: 26.4%

17 Mar price (HKD): 3.48

- 1 Buy (unchanged)
- 2 Outperform
- 3 Hold
- 4 Underperform
- 5 Sell

Long-term thesis intact

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- Lace business ramp-up slower than our expectations
- But expansion into sportswear materials progressing well
- Lowering target price to HKD4.40; reaffirming Buy(1)

■ What's new

Best Pacific has announced its first full-year results since its IPO in May 2014. The top and bottom lines were within 1-3% of our estimates, with the variance mainly due to a much slower ramp-up of its lace business than we anticipated. Nonetheless, we believe the company's weak lace order flow is simply a timing issue, as Best Pacific is yet to receive an order from its largest customer, Victoria's Secret (VS), which we expect to come through during 2015.

Given the slower ramp-up of its lace business (a key gross-margin driver for the company) and a faster-than-expected expansion into the sportswear market (a lower-gross-margin business), we now see limited room for gross-margin improvement in 2015.

■ What's the impact

Best Pacific generated HKD42m in lace revenue in 2014, up 111% YoY but substantially below our estimate of HKD74m. The company is

currently waiting for VS (its largest customer for elastic fabrics and webbing) to submit its first lace order. We believe this lace order is essential because: 1) we expect it to be sizeable, since VS is among the largest buyers of lace globally, and 2) VS' purchase would serve as a testimony of the company's lace production capabilities, which may help it win orders from other brands. Management remains confident that its first order from VS should come through in 2015.

While Best Pacific's lace business has lagged our expectations, the second leg to our investment thesis – Best Pacific's expansion into sportswear – is intact, given that the company recorded 130% YoY growth in sportswear fabric sales in 2014, contributing 8.5% of total sales (up from c.5% in 2013). We believe Best Pacific's sportswear business is poised to grow alongside its key sportswear customers, Lululemon Athletica, Under Armour, VSX Sport and PINK, all of which we expect will grow in revenue by at least double-digit percentages in 2015.

Overall, we have reduced our 2015-16E revenue estimates by 10% on the slower ramp of Best Pacific's lace business and lower fabric ASPs. This, along with lower-than-expected gross margins, has led to a 9-10% drop in our 2015-16E EPS. We also introduce our 2017 revenue and EPS estimates of HKD3.0bn and HKD0.52, respectively.

■ What we recommend

We reiterate our Buy (1) call, but lower our 12-month target price to HKD4.40 (formerly 6-month TP of HKD4.90), on an unchanged PER of 13x (a 10% discount to the average trading PERs of China textile peers) applied to our revised 2015E

earnings. While one of the legs to our two-pronged thesis appears to be playing out more slowly than expected (see [Initiation: hidden allure](#) published on 27 November 2014), we believe our long-term thesis is fully intact. The key risk to our call: a further slowdown in the ramp-up of its lace business.

■ How we differ

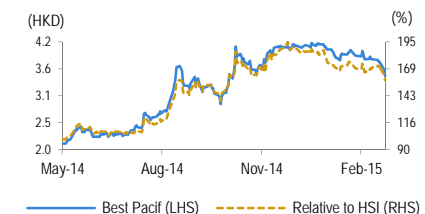
Our net-profit forecasts for 2015-16 are 1-7% below consensus, which we attribute to our more conservative view of the company's ramp-up of its lace business.

Forecast revisions (%)

Year to 31 Dec	15E	16E	17E
Revenue change	(9.7)	(11.1)	(8.9)
Net profit change	(10.6)	(9.8)	(7.7)
Core EPS (FD) change	(10.2)	(8.1)	(3.6)

Source: Daiwa forecasts

Share price performance



12-month range	2.12-4.13
Market cap (USDbn)	0.46
3m avg daily turnover (USDm)	0.41
Shares outstanding (m)	1,019
Major shareholder	Yuquang Lu (62.6%)

Financial summary (HKD)

Year to 31 Dec	15E	16E	17E
Revenue (m)	2,190	2,646	2,992
Operating profit (m)	387	515	604
Net profit (m)	345	462	548
Core EPS (fully-diluted)	0.337	0.451	0.534
EPS change (%)	19.4	33.9	18.6
Daiwa vs Cons. EPS (%)	(7.5)	(0.3)	n.a.
PER (x)	10.3	7.7	6.5
Dividend yield (%)	2.9	3.9	4.6
DPS	0.102	0.136	0.161
PBR (x)	1.9	1.6	1.4
EV/EBITDA (x)	6.3	4.5	3.4
ROE (%)	19.8	22.7	22.9

Source: FactSet, Daiwa forecasts

Financial summary

■ Key assumptions

Year to 31 Dec	n.a.	2011	2012	2013	2014	2015E	2016E	2017E
Elastic fabric sales volume (million meters)	-	23.2	22.5	27.5	32.4	37.5	44.4	49.6
Elastic fabric ASP (HKD/meter)	-	40.5	41.2	39.1	37.0	37.3	37.7	38.1
Elastic webbing sales volume (million meters)	-	525.8	521.0	608.4	642.6	738.8	853.2	929.0
Elastic webbing ASP (HKD/meter)	-	0.9	0.9	0.9	1.0	1.0	1.0	1.0
Lace sales volume (million meters)	-	0.0	0.0	1.2	2.5	4.0	7.5	9.8
Lace ASP (HKD/meter)	-	0.0	21.4	16.7	17.2	17.3	17.5	17.9

■ Profit and loss (HKDm)

Year to 31 Dec	n.a.	2011	2012	2013	2014	2015E	2016E	2017E
Elastic fabric	-	938	929	1,076	1,198	1,400	1,674	1,891
Elastic webbing	-	457	474	564	621	721	841	925
Other Revenue	-	0	1	20	42	70	131	176
Total Revenue	-	1,396	1,404	1,659	1,861	2,190	2,646	2,992
Other income	-	0	0	0	0	0	0	0
COGS	-	(948)	(955)	(1,137)	(1,292)	(1,521)	(1,805)	(2,028)
SG&A	-	(141)	(154)	(166)	(193)	(221)	(259)	(287)
Other op. expenses	-	(21)	(37)	(45)	(75)	(61)	(67)	(72)
Operating profit	-	285	259	312	301	387	515	604
Net-interest inc./(exp.)	-	(40)	(45)	(35)	(18)	8	20	35
Assoc/forex/extraord./others	-	(1)	26	25	33	30	33	35
Pre-tax profit	-	244	240	301	316	425	568	674
Tax	-	(38)	(42)	(57)	(57)	(80)	(107)	(127)
Min. int./pref. div./others	-	(26)	(23)	(30)	0	0	0	0
Net profit (reported)	-	180	174	215	259	345	462	548
Net profit (adjusted)	-	180	174	215	259	345	462	548
EPS (reported)(HKD)	-	0.240	0.232	0.286	0.284	0.338	0.453	0.537
EPS (adjusted)(HKD)	-	0.240	0.232	0.286	0.284	0.338	0.453	0.537
EPS (adjusted fully-diluted)(HKD)	-	0.240	0.232	0.286	0.282	0.337	0.451	0.534
DPS (HKD)	-	0.000	0.000	0.080	0.085	0.102	0.136	0.161
EBIT	-	285	259	312	301	387	515	604
EBITDA	-	346	344	416	417	525	661	754

■ Cash flow (HKDm)

Year to 31 Dec	n.a.	2011	2012	2013	2014	2015E	2016E	2017E
Profit before tax	-	244	240	301	316	425	568	674
Depreciation and amortisation	-	61	86	105	117	138	145	150
Tax paid	-	(19)	(64)	(42)	(57)	(80)	(107)	(127)
Change in working capital	-	(202)	74	(53)	5	(8)	(97)	(82)
Other operational CF items	-	61	35	35	27	2	(15)	(32)
Cash flow from operations	-	144	370	345	407	477	496	583
Capex	-	(139)	(142)	(217)	(189)	(219)	(93)	(51)
Net (acquisitions)/disposals	-	(60)	0	2	72	0	0	0
Other investing CF items	-	118	(83)	193	139	39	56	77
Cash flow from investing	-	(80)	(225)	(22)	22	(180)	(37)	25
Change in debt	-	66	59	(120)	(136)	69	139	100
Net share issues/(repurchases)	-	0	0	0	578	0	0	0
Dividends paid	-	0	0	(60)	(78)	(103)	(138)	(164)
Other financing CF items	-	(91)	(181)	(197)	(134)	(26)	(31)	(38)
Cash flow from financing	-	(25)	(122)	(376)	230	(60)	(31)	(102)
Forex effect/others	-	0	0	0	0	0	0	0
Change in cash	-	39	23	(53)	659	237	428	507
Free cash flow	-	6	228	128	218	257	403	532

Source: FactSet, Daiwa forecasts

Financial summary continued ...

■ Balance sheet (HKDm)

As at 31 Dec	n.a.	2011	2012	2013	2014	2015E	2016E	2017E
Cash & short-term investment	-	126	149	98	745	982	1,411	1,918
Inventory	-	231	231	318	348	388	450	500
Accounts receivable	-	393	383	454	419	522	638	738
Other current assets	-	238	318	114	120	96	115	128
Total current assets	-	988	1,080	983	1,631	1,988	2,613	3,284
Fixed assets	-	758	890	1,033	1,106	1,181	1,127	1,029
Goodwill & intangibles	-	45	45	44	43	49	50	51
Other non-current assets	-	90	88	109	33	40	48	54
Total assets	-	1,882	2,103	2,169	2,813	3,258	3,839	4,417
Short-term debt	-	733	845	346	402	502	502	502
Accounts payable	-	206	243	310	357	388	450	500
Other current liabilities	-	454	358	198	154	238	284	320
Total current liabilities	-	1,392	1,445	853	912	1,128	1,236	1,322
Long-term debt	-	20	16	452	259	228	367	467
Other non-current liabilities	-	51	33	32	25	33	37	42
Total liabilities	-	1,463	1,495	1,337	1,196	1,389	1,641	1,831
Share capital	-	0	0	0	10	10	10	10
Reserves/R.E./others	-	361	527	725	1,607	1,859	2,188	2,575
Shareholders' equity	-	361	527	726	1,617	1,869	2,198	2,586
Minority interests	-	58	80	107	0	0	0	0
Total equity & liabilities	-	1,882	2,103	2,169	2,813	3,258	3,839	4,417
EV	-	4,230	4,338	4,352	3,462	3,294	3,004	2,597
Net debt/(cash)	-	627	712	700	(84)	(252)	(542)	(949)
BVPS (HKD)	-	0.481	0.703	0.967	1.771	1.834	2.158	2.538

■ Key ratios (%)

Year to 31 Dec	n.a.	2011	2012	2013	2014	2015E	2016E	2017E
Sales (YoY)	-	n.a.	0.6	18.2	12.1	17.7	20.8	13.1
EBITDA (YoY)	-	n.a.	(0.4)	20.9	0.2	25.7	25.9	14.0
Operating profit (YoY)	-	n.a.	(9.3)	20.6	(3.5)	28.6	33.2	17.2
Net profit (YoY)	-	n.a.	(3.2)	23.1	20.7	33.2	33.9	18.6
Core EPS (fully-diluted) (YoY)	-	n.a.	(3.2)	23.1	(1.5)	19.4	33.9	18.6
Gross-profit margin	-	32.1	32.0	31.5	30.5	30.5	31.8	32.2
EBITDA margin	-	24.8	24.5	25.1	22.4	24.0	25.0	25.2
Operating-profit margin	-	20.4	18.4	18.8	16.2	17.7	19.5	20.2
Net profit margin	-	12.9	12.4	12.9	13.9	15.7	17.4	18.3
ROAE	-	n.a.	38.5	34.0	21.1	19.8	22.7	22.9
ROAA	-	n.a.	8.7	10.0	10.4	11.4	13.0	13.3
ROCE	-	n.a.	19.6	20.1	15.4	15.9	18.2	18.2
ROIC	-	23.0	18.0	17.8	16.1	19.9	25.6	29.8
Net debt to equity	-	173.7	135.0	96.4	n.a.	n.a.	n.a.	n.a.
Effective tax rate	-	15.5	17.6	18.8	18.0	18.8	18.8	18.8
Accounts receivable (days)	-	n.a.	100.9	91.9	85.5	78.4	80.0	83.9
Current ratio (x)	-	0.7	0.7	1.2	1.8	1.8	2.1	2.5
Net interest cover (x)	-	7.1	5.8	8.8	16.8	n.a.	n.a.	n.a.
Net dividend payout	-	0.0	0.0	28.0	30.0	30.0	30.0	30.0
Free cash flow yield	-	0.2	6.4	3.6	6.1	7.3	11.4	15.0

Source: FactSet, Daiwa forecasts

■ Company profile

Founded in 2003, Best Pacific International is a leading global manufacturer of lingerie materials. The company produces elastic fabrics, elastic webbing and lace materials. Its major clients include some of the world's top lingerie brands, such as Victoria's Secret, Calvin Klein, Triumph and Wacoal. The company also supplies fabric for sports brands such as Lululemon Athletica and Under Armour.

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