

Growth to remain strong in 2017

- Shenzhou (SZ)'s sales order growth remained intact in 3Q16, despite fewer rush orders due to product seasonality, while the preliminary sales order growth outlook of its sportswear clients for 2017E continued to be solid at 25% YoY, with the only bottleneck coming from production capacity constraints.
- Concerns over rising cotton cost that will cap SZ's GPM growth is irrelevant, as SZ's major raw materials are cotton yarn and synthetic yarn and their prices fell 1.2%/8.4% YoY respectively for Jan-Oct 2016 (see Figure 1).
- We have trimmed our sales/net profit estimates for FY16E and FY17E by 2.1%/1.8% and 3.0%/2.8% respectively, on lower rush orders. Accordingly, we have cut our PT to HKD53.5 (prev HKD56.7), which is still based on 1.0x PEG. SZ currently trades at 15.9x FY17E PER. The recent price consolidation provides a better re-entry point to this quality OEM play, given a core net profit 3-yr CAGR of 23.6%.

Sales orders stable in 3Q16. SZ's sportswear clients' sales orders remained solid in 3Q16, whereas that of casualwear and lingerie were stable. However, the percentage of rush orders (i.e. 1 month delivery) in 2H16 was slightly lower than the 2-3% registered in 1H16, due to product seasonality. Hence, we have trimmed our 2H16E overall sales growth forecast by 4.5ppt to 19.3% (1H16: +24.6%).

Capacity growth of 12-15% for FY17E. The order plans of SZ's clients for the new financial year would normally have been finalised in November of each year, though there might be target adjustments based on the orders they actually receive. The preliminary sales order growth outlook of its sportswear clients (Nike and Adidas combined) for FY17E is robust at +25% YoY, whereas that of casual wear remains stable. This compares with SZ's production capacity growth target of 12-15% for FY17E. We believe the capacity constraints can be resolved by either adding capacity or raising production efficiency.

Flyknit sales target intact. SZ reiterated its sales target of +70%/50%/50% YoY for FY16/17/18E. It has installed 2,000 Flyknit machines in the PRC and it will install another 2,000 machines in VN. The VN capacity will be launched in 2Q17E.

Valuation and earnings revision. We have trimmed our sales/net profit estimates for FY16E and FY17E by 2.1%/1.8% and 3.0%/2.8% respectively on lower rush orders. Accordingly, we have cut our PT to HKD53.5 (prev HKD56.7), which is still based on 1.0x PEG and a core net profit 3-yr CAGR of 23.6% (prev. 24.5%). SZ currently trades at 15.9x FY17E PER.

Shenzhou International (2313 HK)

Buy

(unchanged)

Price Target	HKD53.5
(Revision)	(-5.6%)
(upside)	(11.5%)

EPS	2016E	2017E
revision	-1.8%	-2.8%

Close price	HKD48.0
-------------	---------

Market cap.	HKD67.2bn
-------------	-----------

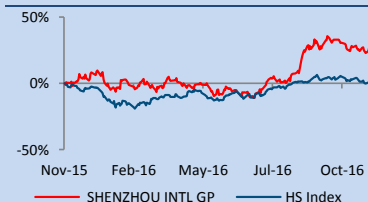
Free float	40.1%
------------	-------

52-week range	HKD34.7 – 56.0
---------------	----------------

3-mth ave. T/O	HKD170mn
----------------	----------

Price as of 21 November 2016

Stock rel HSI performance (%)



Analysts

SO Lai Shan, Jennifer

(CE No.: AHA295)

jenniferso@csci.hk +852 3465 5781

Cost synergies expected in 2H17E from the VN fabric plant. The production capacity of the VN fabric plant is expected to be ramped up to 200 tpd (tons per day) in 2017E from the current level of 120 tpd. Meanwhile, the company has already recruited 7k workers for the VN fabric plant and plans to increase the plant's total workforce to 11k by the end of 2017E. Although the labour cost in VN is c.50% lower than in the PRC, their efficiency is lower compared to the PRC. Hence, cost synergies (on GPM enhancement) from the VN expansion are expected to be gradually realised in 2H17E.

GPM growth intact. We expect GPM in 2H16 to rise 0.3ppt YoY to 31.9% or to be flat HoH, benefiting from RMB depreciation, further production efficiency improvement and product structure optimisation. Concerns over rising cotton price that will cap SZ's GPM growth is irrelevant, as SZ's major raw materials are cotton yarn and synthetic yarn, instead of raw cotton. Although the cotton price index in China (CC328 Index) has gained 0.5% YoY in Jan-Oct, compared with an 8.2% YoY decline in Jan-Jun, cotton yarn prices did not rise in tandem. According to the China Cotton Yarn Index, cotton yarn prices have slipped 1.2% YoY in Jan-Oct and 6.2% YoY in Jan-Jun (see Figure 1). The rebound in the cotton yarn price has lagged behind that of raw cotton was primarily due to an oversupply of cotton yarn in the market in China as well as the speculative activities on raw cotton. Besides, the ratio of synthetic to cotton yarn is expected to rise to 45:55 in 2017E from 40:60 in 1H16, which will also be favourable to GPM enhancement going forward.

Figure 1: Raw material price indices changes, 2016

2016	YoY %	YoY %	YoY %	YoY %	YoY %
Major indices	Jan-Oct	Jan-Sep	Jan-Aug	Jan-Jul	Jan-Jun
CC328 Index (China domestic cotton)	0.5%	-2.0%	-3.3%	-5.7%	-8.2%
CotLook A Index	9.0%	7.6%	6.2%	4.4%	3.1%
FC Index (Foreign import cotton)	-0.1%	-2.0%	-3.3%	-5.1%	-6.8%
China Cotton Yarn Index	-1.2%	-2.4%	-3.8%	-5.3%	-6.2%
China Synthetic Yarn Index	-8.4%	-9.5%	-10.5%	-11.0%	-11.3%
China Polyester Cotton Yarn (32S - 65/35) Index	-7.3%	-7.9%	-8.9%	-9.9%	-10.4%

Source: Wind data, CSCI research

Earnings revision

We have trimmed net profit estimates for FY16/17/18E by 1.8%/2.8%/2.3%, on lower rush orders after adjusting downwards our sales growth estimates by 2.1%/3.0%/2.3% respectively (see Figure 2).

Figure 2: Major assumption changes

	Previous estimates			Changes			Revised estimates		
	FY2016E	FY2017E	FY2018E	FY2016E	FY2017E	FY2018E	FY2016E	FY2017E	FY2018E
Revenue growth (YoY %)									
By segment:									
- Sports wear	25.0%	25.0%	20.0%	-1.0 ppt	-2.0 ppt	0.0 ppt	24.0%	23.0%	20.0%
- Casual wear	27.0%	10.0%	5.0%	-7.0 ppt	0.0 ppt	3.0 ppt	20.0%	10.0%	8.0%
- Lingerie	11.0%	3.0%	0.0%	0.0 ppt	0.0 ppt	0.0 ppt	11.0%	3.0%	0.0%
- Other knitting products	0.0%	0.0%	0.0%	0.0 ppt	0.0 ppt	0.0 ppt	0.0%	0.0%	0.0%
TOTAL Revenue	24.2%	19.0%	14.7%	-2.6 ppt	-1.2 ppt	0.8 ppt	21.6%	17.8%	15.5%

Source: CSCI research estimates

Figure 3: Peers valuation

Name	Rating	PT	Ticker	Mkt Cap (bn HK\$)	Currency	Last Price	FYE	1-yr fwd PER (x)	2-yr fwd PER (x)	1-yr fwd PBR (x)	Sales growth (%)	Op Profit Margin (%)	Cap Ex/Sales (x)	ROIC (%)	ROA (%)	Dvd Yield (%)	EV/EBITDA (x)
HK listed																	
Upstream: yarn/fabric																	
Tiehong Textile	BUY	12.4	2678 HK	11.3	HKD	12.4	12/2015	8.2	7.4	1.7	1.0	11.8	10.5	14.5	6.9	2.4	7.2
Weiqiao Textile	NR	N/A	2698 HK	6.1	HKD	5.1	12/2015	4.6	3.5	0.3	(12.9)	18.3	3.8	4.7	3.5	5.6	1.4
Fountain Set	NR	N/A	420 HK	1.2	HKD	1.0	12/2015	N/A	N/A	N/A	(3.5)	2.4	1.9	N/A	2.6	N/A	N/A
Pacific Textiles	BUY	12.5	1382 HK	13.3	HKD	9.2	03/2016	14.7	13.5	4.3	0.3	16.7	5.1	22.9	20.2	8.7	9.5
Best Pacific	BUY	7.2	2111 HK	6.7	HKD	6.5	12/2015	17.5	15.1	3.6	10.1	19.9	6.0	13.5	12.0	2.0	11.1
Sub-Average				7.7				11.3	9.9	2.5	(1.0)	13.8	5.4	13.9	9.0	4.7	7.3
Up-mid stream: fabric & garment																	
Tewinca	HOLD	5.1	321 HK	7.5	HKD	5.5	03/2016	11.9	11.7	1.1	0.2	12.8	2.2	14.1	9.6	8.4	3.4
Shenzhou International	BUY	53.5	2313 HK	67.2	HKD	48.0	12/2015	21.2	17.1	4.3	13.5	22.6	16.1	16.0	14.7	1.6	18.1
Victory City	NR	N/A	539 HK	0.9	HKD	0.3	03/2016	N/A	N/A	N/A	(4.4)	8.3	15.7	3.7	2.3	15.9	4.9
Esprit	NR	N/A	1476 TT	20.2	TWD	75.1	12/2015	23.3	18.7	N/A	22.4	19.0	2.4	25.4	20.1	N/A	14.7
Sub-Average-excl. Shenzhou				9.5				17.6	15.2	1.1	6.1	13.3	6.8	14.4	10.7	12.2	7.7
Mid-stream: garment																	
Regina Miracle	BUY	8.4	2199 HK	9.3	HKD	7.6	03/2016	34.6	18.7	N/A	21.2	12.6	17.9	15.9	11.5	0.7	12.1
Nameson	BUY	1.7	1982 HK	3.3	HKD	1.6	03/2016	9.9	7.3	2.1	7.7	10.3	7.0	13.1	11.0	-	8.6
Win Haverly	NR	N/A	3322 HK	1.7	HKD	1.3	12/2015	6.7	6.7	0.7	7.5	7.0	5.9	9.7	6.9	8.6	2.8
Eagle Nice	NR	N/A	2368 HK	1.2	HKD	2.4	03/2016	9.3	8.3	1.1	1.2	10.9	1.6	10.2	8.0	9.7	5.2
Makalot	NR	N/A	1477 TT	5.8	TWD	27.9	12/2015	13.6	14.1	N/A	11.8	11.3	2.0	19.6	13.8	N/A	8.7
Sub-Average				4.3				14.8	11.0	1.3	9.9	10.4	6.9	13.7	10.2	4.8	7.5
Average of all - excl. Shenzhou				6.8				14.0	11.4	1.9	4.8	12.4	6.3	13.9	9.9	6.2	7.5

Source: CSCI research, Bloomberg

Income statement (RMBm)

Year end: Dec	2014	2015	2016E	2017E	2018E
Revenue	11,132	12,639	15,374	18,115	20,931
COGS	(7,905)	(8,790)	(10,469)	(12,131)	(13,767)
Gross profit	3,227	3,849	4,905	5,983	7,163
Selling & distribution costs	(249)	(255)	(342)	(402)	(465)
General & administrative expenses	(792.9)	(962.1)	(1,185.6)	(1,396.9)	(1,614.1)
Other income	(15.3)	(104.2)	(126.7)	(149.3)	(172.5)
Other losses - net	294.7	237.0	303.6	357.7	413.3
EBITDA	2,908	3,286	4,190	5,141	6,190
Depreciation & Amortization	443	522	635	749	865
EBIT	2,465	2,764	3,555	4,392	5,325
Net interest expenses/ (income)	(79)	(124)	(45)	(64)	(98)
Non-recurring items	(3)	(6)	-	-	-
JVs and associates	(1)	(1)	(1)	(1)	(1)
Pretax profit	2,541	2,882	3,600	4,456	5,424
Taxation	(477)	(532)	(663)	(817)	(978)
Minority interests	(1)	(0)	(0)	(0)	(0)
Net profit	2,064	2,350	2,936	3,640	4,446
Net profit (*adjusted)	2,068	2,359	2,936	3,640	4,446
Basic EPS (RMB)	1.48	1.68	2.10	2.60	3.18
Basic EPS (RMB) - (adjusted)	1.48	1.69	2.10	2.60	3.18
Diluted EPS (RMB)	1.45	1.62	2.00	2.42	2.96
Diluted EPS (RMB) - (adjusted)	1.42	1.57	1.96	2.42	2.96
DPS (RMB)	0.79	0.90	1.08	1.34	1.64

Balance sheet (RMBm)

Year end: Dec	2014	2015	2016E	2017E	2018E
Cash	1,428	1,816	3,036	3,578	4,134
Short term investments	3,447	3,064	3,064	3,064	3,064
Accounts receivables	1,643	2,002	2,139	2,527	2,920
Inventory	2,607	3,233	3,386	3,935	4,465
Other current assets	84	126	127	128	130
Total current assets	9,209	10,240	11,752	13,232	14,713
PP&E	4,184	5,550	5,914	5,966	5,801
Intangible Assets	103	109	109	109	109
Associates and JVs	6	5	4	3	2
Other long term assets	2,442	2,458	2,862	3,220	3,589
Total long term assets	6,734	8,121	8,889	9,299	9,501
TOTAL ASSETS	15,943	18,361.6	20,642	22,530	24,214
Short term debt	47	657	1,479	1,453	859
Accounts payables	468	679	624	725	823
Other current liabilities	749	817	1,021	1,213	1,411
Total current liabilities	1,263	2,153	3,124	3,391	3,093
Long term debt	2,865	3,117	3,117	3,117	3,117
Deferred tax	2	-	-	-	-
Convertible bonds	-	-	-	-	-
Other long term liabilities	2	2	2	2	2
Total long term liabilities	2,868	3,119	3,119	3,119	3,119
TOTAL LIABILITIES	4,132	5,272	6,243	6,510	6,213
Shareholders' funds	11,796	13,074	14,382	16,004	17,985
Minority Interests	16	16	16	16	16
TOTAL LIAB AND EQUITY	15,943	18,361.6	20,642	22,530	24,214
Net cash / (debt)	(1,483)	(1,958)	(1,560)	(992)	158

Source: CSCI research estimates

Cash flow statement (RMBm)

Year end: Dec	2014	2015	2016E	2017E	2018E
EBIT	2,465	2,764	3,555	4,392	5,325
Depreciation & amortisation	(443)	(522)	(635)	(749)	(865)
Net interest expenses/ (income)	79	124	45	64	98
Taxes paid	(477)	(532)	(663)	(817)	(978)
Changes in working capital	(1,129)	(617)	(547)	(1,004)	(997)
Others	887	1,043	1,271	1,497	1,730
Cash flow from operations	1,383	2,259	3,025	3,385	4,314
Capex	(666)	(1,366)	(1,000)	(800)	(700)
Acquisitions	(3,965)	(258)	-	-	-
Disposals	(22)	(7)	-	-	-
Others	-	(1)	-	-	-
Cash flow from investing	(4,652)	(1,631)	(1,000)	(800)	(700)
Dividends	(825)	(1,104)	(1,627)	(2,017)	(2,464)
Issue of shares	-	-	-	-	-
Change in debt	2,911	862	823	(26)	(594)
Others	2	0	-	-	-
Cash flow from financing	2,088	(241)	(804)	(2,043)	(3,058)
Change in cash	(1,181)	388	1,221	541	556
Cash and cash equivalents at Beg. of the year	2,609	1,428	1,816	3,036	3,578
Cash and cash equivalents at End of the year	1,428	1,816	3,036	3,578	4,134
Free cash flow	540	812	1,981	2,521	3,516

Year end: Dec	2014	2015	2016E	2017E	2018E
Operating ratios					
Gross margin	29.0	30.5	31.9	33.0	34.2
EBIT margin (%)	22.1	21.9	23.1	24.2	25.4
EBITDA margin (%)	26.1	26.0	27.3	28.4	29.6
Effective tax rate (%)	18.8	18.5	18.4	18.3	18.0
Revenue growth (%)	10.8	13.5	21.6	17.8	15.5
Net income growth (%)	14.5	13.9	25.0	24.0	22.2
Net income (adjusted) growth (%)	14.5	14.1	24.5	24.0	22.2
Basic EPS growth adj (%)	11.7	14.1	24.5	24.0	22.2
DPS growth (%)	1.1	13.6	20.9	24.0	22.2
Efficiency ratios					
ROE (%)	17.5	18.0	20.4	22.7	24.7
ROCE (%)	16.8	17.1	20.3	22.9	25.2
Asset turnover (x)	0.7	0.7	0.7	0.8	0.9
Op cash / EBIT (x)	0.6	0.8	0.9	0.8	0.8
Depreciation / CAPEX (x)	(0.7)	(0.4)	(0.6)	(0.9)	(1.2)
Inventory turnover days	115.9	120.9	118.4	118.4	118.4
Accounts receivable days	49.3	52.5	50.9	50.9	50.9
Accounts payable days	19.8	23.8	21.8	21.8	21.8
Leverage ratios					
Net debt/ equity (%)	12.6	15.0	10.8	6.2	(0.9)
Net debt / EBITDA (x)	0.5	0.6	0.4	0.2	(0.0)
Interest cover (x)	(31.2)	(22.3)	n.a.	(68.6)	(64.2)
Current ratio (x)	7.3	4.8	3.8	3.9	4.8
Valuation					
PER (x)	28.0	24.5	19.7	15.9	13.0
PER (x) - fully-diluted and adj. EPS	29.1	26.3	21.2	17.1	14.0
EV/EBITDA (x)	20.4	18.1	14.1	11.4	9.3
PBR (x)	4.9	4.4	4.0	3.6	3.2
Dividend yield (x)	1.6	1.9	2.3	2.8	3.4



Research

LIU Taisheng, Steven
TMT
(852) 3465 5652
stevenliu@csci.hk

SO Lai Shan, Jennifer
Consumer
(852) 3465 5781
jenniferso@csci.hk

CHAN Ka Yeung, Duncan
Commodity
(852) 3465 5654
duncanchan@csci.hk

TIAN Yang
Automotive
(852) 3465 5775
tianyong@csci.hk

SUN Lingxiao, Roger
Industrials
(852) 3465 5785
rogersun@csci.hk

XU Bo, Albert
Financials
(852) 3465 5789
albertxu@csci.hk

ZHU Kexin
Renewable energy
(852) 3465 5653
zhukexin@csci.hk

Institutional Sales & Trading

XIANG Xinrong, Ron
(852) 3465 5633
ronxiang@csci.hk

CAO Xiaogang, Glen
(852) 3465 5658
caoxiaogang@csci.hk

ZHANG Meng, Maurice
(852) 3465 5656
mauricezhang@csci.hk

HO Wen Hao, Jack
(852) 3465 5685
jackho@csci.hk

WANG Zhuo, Gary
(852) 3465 8655
wangzhuo@csci.hk

HO Hung Wei
(852) 3465 5687
hohungwei@csci.hk

LEE Ying Ju, Rose
(852) 3465 5707
roselee@csci.hk

LI Jiageng, Mike
(852) 3465 5636
mikeli@csci.hk

XIA Tian
(852) 3465 5670
xiatian@csci.hk

XU Xiaowei, Vincent
(852) 3465 5795
vincentxu@csci.hk

LI Tianyi, Miranda
(852) 3465 8653
mirandali@csci.hk

Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index; Time Horizon: 12 months

Buy	12-month absolute total return: $\geq 10\%$
Hold	12-month absolute total return: $> -10\%$ but $< 10\%$
Sell	12-month absolute total return: $\leq -10\%$

Disclosure of Interests

As of the date of this report,

- The research analysts primarily responsible for the preparation of all or part of this report hereby certify that:
 - the views expressed in this research report accurately reflect the personal views of each such analyst about the subject securities and issuers; and
 - no part of the analyst's compensation was, is, or will be directly or indirectly, related to the specific recommendations or views expressed in this research report.
- The research analysts primarily responsible for the preparation of all or part of this report, or his/her associate(s), do not have any interest (including any direct or indirect ownership of securities, arrangement for financial accommodation or serving as an officer) in any company mentioned in this report,
- This report has been produced in its entirety by China Securities (International) Brokerage Company Limited ("China Securities (International)") (CE Number: BAU373, regulated by the Securities and Futures Commission in Hong Kong)
- China Securities (International) and each of its group companies that carry on a business in Hong Kong in investment banking, proprietary trading or agency broking in relation to securities have no financial interest, in aggregate, equal to or more than 1% of the market capitalization in the stocks reviewed in this report.
- China Securities (International) and each of its group companies that carry on a business in Hong Kong in investment banking, proprietary trading or agency broking in relation to securities may receive compensation from or mandates for investment banking services in the past 12 months from listed corporations whose stocks are being reviewed by China Securities (International) in this report.
- China Securities (International) and each of its group companies that carry on a business in Hong Kong in investment banking, proprietary trading or agency broking in relation to securities do not have any individual employed by or associated with them serving as an officer of a listed corporation whose stocks are being reviewed by China Securities (International) in this report.
- China Securities (International) and each of its group companies that carry on a business in Hong Kong in investment banking, proprietary trading or agency broking in relation to securities may act as the market makers in the stocks reviewed by China Securities (International) in this report.

Disclaimer

This report is for information purposes only and should not be construed as an offer to sell or to solicitation of an offer to buy or sell any securities in any jurisdiction. The securities referred to in this research report may not be eligible for sale in some jurisdictions. This information contained in this report has been compiled by China Securities (International) from sources that it believes to be reliable and the opinions, analysis, forecasts, projections and expectations contained in this report are based on such information and are expressions of belief only and no representation, warranty or guarantee is made or given by China Securities (International) or any person for its accuracy or completeness. All opinions and estimates expressed in this report are (unless otherwise indicated) entirely those of China Securities (International) as of the date of this report only and are subject to change without notice. Such opinions and estimates may be different from or contrary to the opinions presented by the other business departments, units or affiliates of China Securities (International), as different assumptions and standards, different views and analytical methods may be adopted in the preparation of such other materials, and China Securities (International) is under no obligation to bring such other materials to the attention of any recipient of this report. Neither China Securities (International) nor its holding companies and affiliates accept any liability whatsoever for any direct or consequential loss arising from any use of material contained in this report or otherwise arising in connection therewith.

Any investment referred to herein may involve significant risk, may be illiquid and may not be suitable for all investors. The value of or income from any investment referred to herein may fluctuate and be affected by changes in exchange rates. Past performance is not indicative of future results. This report does not take into account the investment objectives, financial situation or particular needs of any particular person. Investors are expected to make their own investment decision without relying on this publication. Before entering into any transactions in any securities referred to in this research report investor should consider their own individual investment objectives and financial situation and seek professional financial, tax and legal advice, as necessary.

This report is strictly confidential to the recipient. It is being supplied to you solely for your information and may not be reproduced, redistributed or passed on, directly or indirectly, to any other person or published, in whole or in part, for any purpose. The distribution of this report in other jurisdictions may be restricted by law, and persons into whose possession this report comes should inform themselves about, and observe, any such restrictions. By accepting this report you agree to be bound by the foregoing instructions.

China Securities (International) Research

18/F, Two Exchange Square, Central, Hong Kong

Tel: (852) 34655600 Fax: (852) 21809495

Bloomberg: CSCR <Go>