

Sector: Textile & Apparel

Shanghai Shuixing Home Textile (603365)

Performance Rating

A	Profitability & Growth
A	Use of Capital
A	Valuation
B	Stock Liquidity
C	Institutional Holdings

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Investment Highlights

(We had made three visits to the company headquarters and main factory since Aug 1, 2019. Our analysts had discussed and interviewed with the Shanghai Shuixing's board secretary, managing director (CEO) and securities affairs representative.)

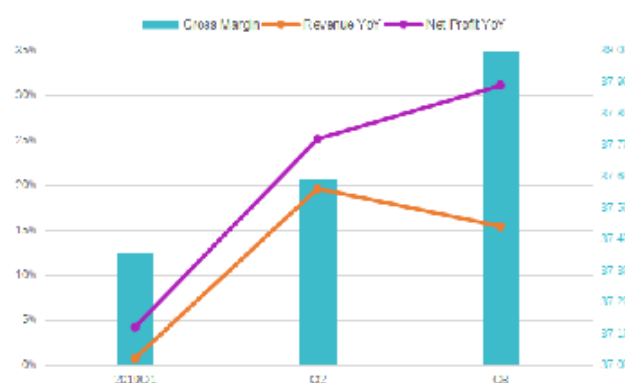
- Ranked 1st in terms of bedding products' online sales on Singles Day (Nov, 11)**
 Shanghai Shuixing topped the chart on Tmall's online sales platform on the Singles Day's sales spree. Overall its online sales on the online shopping festival amounted to RMB 266 mln, up more than 10% YoY. It had beaten rivals including Luolai, Fuanna and Mendale.
- Shuixing's aggressive move into e-commerce gains tractions**
 As one of the earliest bedding & home furnishing companies to embrace ecommerce, its online business has developed rapidly this year. The company optimizes its layout of online products, and actively entered new e-commerce platforms including Pinduoduo, yunjiglobal.com, beidian.com and large online retailers. This has boosted the development of new products. At present, the efforts have seen remarkable results. It is expected that the growth of its online market in Q4 to continue on strong momentum and drive expansion.
- Consolidate lower-tier markets, high quality 'star items' offers**
 Shuixing emphasizes and focuses on lower-tier markets where penetration is low; and presents ample growth opportunities. It has built solid relations and cooperation with local franchisers to optimize its layout of offline stores in order to effectively upgrade to higher quality home textile products at affordable prices. Because of its continuous optimization of their store structure, plus reducing cost of raw materials, its profit margin has improved significantly. Since 2015, the company has actively developed and promoted its "star items", which have the features of mass market popularity, outstanding function and high quality, this plays a significant role in driving the sales of other products. In addition, its sales volume in spring and summer in 2020 is expected to have strong growth impact, which could lift the company's financial performance.
- Meeting evolving consumers' needs, rapid R&D to marketplace delivery**
 The demand of Chinese consumers for the beddings is not limited to keeping warm and comfortable, but evolve rapidly to more sophisticated requirements on quality of materials and functions. In addition, consumers there pay more attention to the health wellness, designs and eco-friendliness of the products. Shuixing has relentlessly improved its information system and digitization, and increased product R&D to capture changing consumers' taste and evolving need. With these systems in place it could calibrate and optimize their supplies and production structure, accelerates the market response and ensuring the rapid development of new products to meet diversified markets.
- Incentivize employees to stay ahead of competition, 3 years plan**
 On Oct 28, Shuixing issued its first draft of employees' equity incentive plan, covering about 50 key employees. The total amount of funds to be raised is about RMB 34 mln, with a duration of 3 years and a lockup period of 1 year. The stocks used in the incentive plan are to be obtained from its shares buyback in the open market. (These buybacks in total amounted to 20.86 mln. In Sep 2019, the company had registered buybacks of 1.26 mln shares at an average price of RMB 16.62. Shuixing has set a quota of RMB 60-100 mln for shares buyback.)

1 Profitability & Growth

Indicator (RMB)	2019 H1	H1 Change YoY	2019 Q3	Q3 Change YoY
Operating Income	1.28bln	9.93%	2.02bln	11.89%
Operating Cost	1.15bln	11.16%	1.80bln	11.33%
Sales Expenditure	0.26bln	28.22%	0.39bln	31.63%
Gross Margin (%)	37.59%	△ 3.18%	38.09%	△ 1.72%
Net Profits Attributed to Main Shareholders	0.14bln	12.47%	0.22bln	18.78%
EPS	0.50	11.11%	0.80	17.65%

Source: Shanghai Stock Exchange, China Knowledge Online, Annual Report, Corporate Announcements

In Q3 Shuixing continued its strong growth. In the first three quarters of 2019, its total operating revenue registered RMB 2.02 bln, up 11.89% YoY. Its net profit attributed to shareholders was RMB 215 mln, up 18.78% YoY, and EPS at RMB 0.80. According to the company's announced results, its YoY growth rate of revenue from Q1 to Q3 was 0.76%, 19.64% and 15.43% respectively, and net profit growth rate attributed to shareholders was 4.22%, 25.17% and 31.14% respectively. The low growth rate of Q1 revenue was mainly due to relatively high figures in Q4 2018. Once the adjustment was in place, revenue began to accelerate in Q2. The increase in the net profit attributed to shareholders is mainly because of the large increase in gross margin, with H1 gross margin increasing by 3.18 percent point YoY.



Source: China Knowledge Online

Note: Net profit is attributable to main shareholders.

The company's revenue derives mainly from stable expansion of retail outlets – both self-operated and through franchising, accounting for 65%, as well as its rapidly growing **ONLINE BUSINESS** (accounting for 35%). Of these figures its online's sales growth has been increasing since Q1, and reached 30% in Q2, and is expected to further accelerate to 38%. Based on its excellent performance on Tmall and Vip.com during the Singles Day shopping spree on 11 Nov, Shuixing garnered RMB 266 mln of sales with a YoY growth of 12% - beating its rivals Luolai, Fuanna and Nanjids. In addition, through more than one year's preparation, it has also entered into online sales agreement with Pinduoduo, Yunjiglobal.com, Beidian.com and other social commerce platforms. With advantage of low prices, these platforms create an impact on the traditional platforms' sales such as Alibaba, JD, VipShop, which have also launched their new sub-platforms corresponding to the new competitions.

As of Q3 2019

Company	Stock Code	Avg Price of Online Product (RMB)	Overall Gross Margin	E-commerce Business	No. of Stores
Shuixing	603365	350	38.09%	35%	2,756
Luolai Lifestyle	002293	527	43.44%	20.28%	2,663
Fuanna	002327	353	51.78%	16.42%	1,800
Mendale	002397	460	40.41%	7.23%	3,181

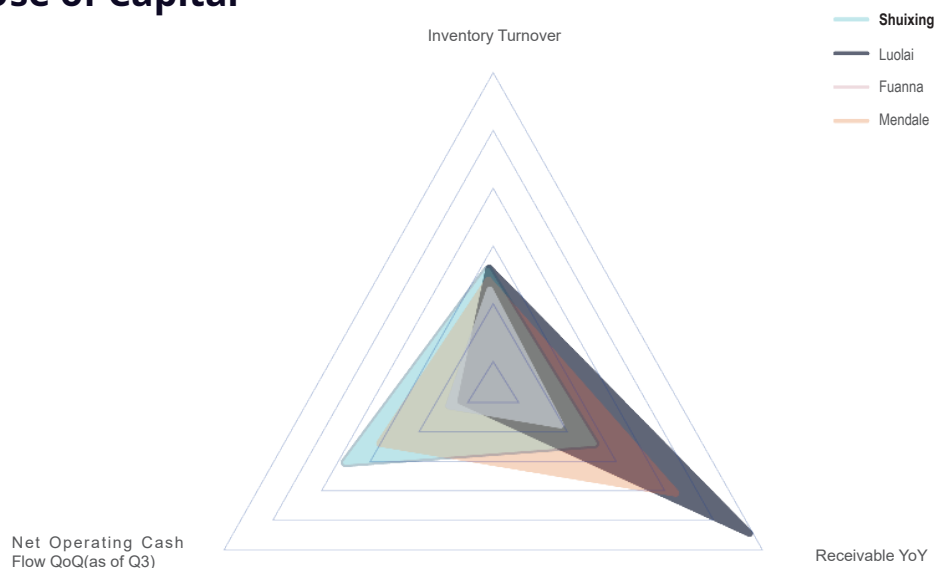
Source: Shanghai Stock Exchange, China Knowledge Online, Annual Report, Company Announcements

OFFLINE MARKET has contributed more to the increase of profit margin than online business. Due to store optimization and lower raw materials costs such as cotton fabric, its profitability has improved significantly. Since 2015, every year Shuixing has developed one or two “star items” at higher price value, and now there are five of them, contributing 20% of its revenue. Overall, the unit price of products in the store outlets is higher by RMB 1,000 (online products’ prices are mostly in the range of RMB 300-600). With growing demand for better quality and higher priced bedding products, rapid urbanization of lower-tier cities, and extensive local franchisees network, it has rapidly penetrate 60% of all Chinese cities. Its current 2,700 stores ranked Shuixing second place among its peers. The untapped cities will see Shuixing presence, with their market strategy targeting higher store density, creating strong growth potential in the long term.



The company has also increased its expenditure on branding and marketing, which directly led to a substantial growth in both online and offline sales. Moreover, the endorsement of celebrities with huge fan base has effectively expanded its customers to younger generations. To sum up, an "A" is allocated for its profitability in coming quarters.

2 Use of Capital



Shuixing's optimum **INVENTORY** control has improved its cash flow. The inventory of Q3 2019 was RMB 898 mln, up 7.86% YoY, mainly due to the stocking of 'Bliss' products for Nov 11 Singles Day's online shopping spree. **RECEIVABLES** increased by 17.60% YoY to RMB 184 mln, mainly because e-commerce platform usually has a payment time lag. Overall, the company's operation is relatively stable. In terms of **CASH FLOW**, Q3 net operating cash flow increased from negative RMB 3.65 mln in Q2 to positive RMB 5.91 mln, showing a significant improvement. From the first three quarters, this figure increased by 31.65% YoY, and with the expected sales peak in Q4, we anticipate the annual operating cash flow will continue to improve.

Indicators	2019H1	2019Q3	Industry's Average
Asset-liability Ratio (%)	16.26	18.23	25.47
Liquidity Ratio	4.92	4.35	2.99
Quick Ratio	2.56	2.23	1.56
ROE (%)	6.15	9.79	6.20

Source: China Knowledge Online, Corporate Annual Report

Note: The industry's average is based on the data from the comparable companies, namely, Luolai Lifestyle (002293), Funanna (002327), Mendale (002397), Dohia (002761).

Shuixing has managed debt asset ratio lower than its peers in the first three quarters. At the same time, the company's current ratio and quick ratio are also higher than the peers. Based on these data, it displays excellent solvency, superior asset liquidity and business sustainability.

Accordingly, we rate Shuixing an "A" in terms of capital utilization.

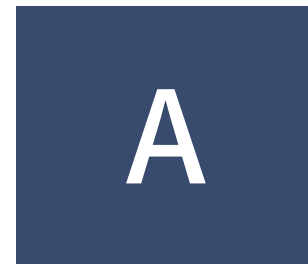
3 Valuation

Financial Summary (RMB)	2019H1	2019Q3	2019E	2020E	2021E
Revenue	1,275 mln	2,018 mln	3,026 mln	3,341 mln	3,778 mln
Net Profit	135 mln	215 mln	321 mln	372 mln	434 mln
EPS	0.50	0.80	1.22	1.43	1.66
PE	17.92	15.55	12.32	10.51	9.05

Source: China Knowledge Online, Corporate Annual Report

Note: The closing dates of PE are the last days of Q2 and Q3 2019.

Net profit is attributable to main shareholders.



We expect Shuixing's annual revenue to reach RMB 3.03 bln, 3.34 bln and 3.78 bln respectively from 2019-2021, corresponding to EPS of RMB 1.22, RMB 1.43 and RMB 1.66, respectively.

Company Name	Stock Code	Mkt Cap (RMB bln)	PE(TTM)	EPS (RMB)	Revenue YoY	Gross Margin Rate (%)
Shuixing	603365	4.01	12.6	0.80	11.89%	38.09%
Luolai	002293	7.27	14.1	0.43	-1.64%	43.44%
Fuanna	002327	5.79	11.6	0.29	-4.88%	51.78%
Mendale	002397	3.84	44.3	0.12	16.71%	40.41%

Source: China Knowledge Online, Corporate Annual Report

Note: Mkt Cap and PE is as of 21 Nov, 2019. Other indicators are based on the Q3 report of listing companies.

In terms of profitability, its gross margin of 38.09% ranks the bottom among its peers compare above, mainly because of their differences of online/offline layouts. Shuixing's offline business account the most at 65% of its overall revenue. In addition, the continuous expansion of cities coverage through offline market will also drive the revenue growth rate.

Comparing the PE level, Shuixing reports a ratio 12.6 times, lower than the industry average. Hence, a bargain among its peers. Based on the positive performance presented above, we think the company is undervalued.

To sum up, in terms of valuation, Shuixing home textile is rated "A".

4 Stock Liquidity

21 Oct - 20 Nov

Name	Stock Code	Amihud Liquidity Measure (10 ¹⁰)
Shuixing	603365	0.2
Luolai	002293	0.2
Fuanna	002327	0.1
Mendale	002397	0.1

Source: China Knowledge Online

According to the Amihud liquidity measurement which is a widely used liquidity proxy in finance literature that uses the absolute value of the daily volume-to-return ratio to capture price impact. The larger the number, the more liquid the stock is.

Accordingly, Shuixing's liquidity proxy is 0.2, slightly higher than the industry average, but still lower than that of other industries. The improvement of its liquidity is still of necessity. Therefore, we rate a "B".



5 Institutional Holdings

Holders' Name	Holding Shares ('000)		
	2019Q2	2019Q3	Change
Shanghai Zanjia Mgt Consulting Co., Ltd.	3,700	3,700	-
Shenzhen East Tonda Assets Mgt Co - No.10 Private Equities Investment Fund	1,224.8	1353.0	10.47%
CPIC Desheng Selective Funds	450.1	-	Exited
CPIC Flexible Securities Investment Funds	150.0	-	Exited
HSBCJT Duo Strategic Securities Investment Funds	87.7	-	Exited
CIFM-JP Morgan Key Growth Securities Investment Funds	80.0	-	Exited
CPIC Value-oriented Selective Securities Investment Funds	15.0	-	Exited
GFS-CSI Open-Index Securities Investment Funds	10.6	-	Exited
SSE Social Responsibility Securities Investment Funds	5.6	-	Exited
AEGON CSI300 Listed Open-Ended Fund	2.1	-	Exited
GFS-CSI Open-index Securities Investment Funds Sponsored Connect Funds	0.2	-	Exited
CCB-SSE Social Responsibility Securities Investment Connect Funds	0.2	-	Exited
Shuixing Home Textile Securities Account for Shares Buyback	-	1,255.5	New

Source: China Knowledge Online, Corporate Annual Report

Compare Q3 with Q1 & Q2, most of the institutional investors reduced or withdrew their holdings. However, due to negligible holding value, the outflows had no negative price impact. With the company's accelerated growth in coming quarters we believe it will usher in more domestic and foreign institutional investors.

Therefore, in terms of institutional shareholding, Shuixing is rated "C".



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