

HDI ramp yields attractive valuation

Hong Kong Electronics

Daisho Microline (567 HK, HK\$3.46)

Not Rated

Daisho Microline (Daisho), a high-end printed circuit board (PCB) manufacturer, focusing on high density interconnect (HDI) PCBs announced its 1H FY3/07F results. Key takeaways are as follows:

- Turnover rose 82.5% YoY to HK\$458.9m, gross profit up 138.6% YoY to HK\$217.4m. Operating profit was surged 286.1% YoY to HK\$117.4m while net profit came in at HK\$97.7m, jumping 271.0% YoY. The impressive growth was the result of a combination of continuing ramp up in HDI production, improving yields and shift in product mix to favour the higher-end HDI products.
- Since Daisho is still in a ramp up mode, we prefer to compare the results on a HoH basis. In this respect, turnover, gross profit and net profit rose 23.5%, 16.2% and 17.3% HoH respectively, despite a seasonally slower 1H.
- Gross margin fell 2.9 pcp HoH to 47.4%. Though the company was negatively impacted by price increases in raw materials such as copper foil and laminates, the cost pressures were partially alleviated by a 13% YoY increase in ASPs.
- Daisho reduced its proportion of revenue derived from the handset sector from 90% for FY3/06 to 85% in 1H FY3/07. The company has been expanding into other consumer electronics sectors, mainly in the area of digital cameras. Management targets PCBs for digital cameras to account for around 20% of revenues in around 1 year time.
- The company sells its HDI PCBs to international handset manufacturers through Taiwan/Japan/US/European electronic manufacturing services (EMS) companies in China. Daisho typically negotiates pricing and obtains product approvals with handset brand owners and settles through EMS. The company does not supply to Chinese handset brand owners.
- Though growth of the handset industry is expected to moderate from an estimated 21% in 2006 to just over 10% in 2007 according to Gartner, we expect Daisho to be able to sustain growth through: 1) continuing shift of high-end PCB production to China and 2) consumer electronics such as handsets trending to smaller/slimmer form factors. Handset market share leader Nokia recently unveiled their first thin form factor handset to compete with similar types of handset offered by Motorola and Samsung.
- The main risk of Daisho remains the transparency of the company, as well as increasing competition going forward. We note that other PCB plays, such as Hannstar (667 HK, HK\$1.88, NR) is in the process of installing HDI production capacity.
- We estimate that the company is on track for a full year FY3/07F net profit of HK\$193.9m (EPS: HK\$0.407), implying that the counter is currently trading at an undemanding 8.5x FY3/07F P/E. International handset component manufacturers are trading at around 13x forward earnings based on market consensus. In our view, a fair valuation for the stock should be around 10x FY3/07F P/E, after incorporating a valuation discount for the lack of transparency of the company.

Table 1: 1H results

6 months to Sep	Turnover (HK\$m)	Gross profit (HK\$m)	Gross margin (%)	Operating profit (HK\$m)	Tax rate (%)	Net profit (HK\$m)	Basic EPS (HK\$)
1H07	458.9	217.4	47.4	117.4	14.7	97.7	0.205
1H06	251.5	91.1	36.2	30.4	11.9	25.8	0.055
YoY (%)	82.5	138.6		286.1		279.0	271.0

Source: Company data

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