Corporate Visit

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Jackin Int'l: A premium recycle play

Recommendation: Not Rated **Hong Kong Industrials**

Price	**HK$0.71**	**Yield (12/06A)**	na
12 mth range	HK$0.81-0.091	**ROE (12/06A)**	26.8%
Market cap.	US$52.5m	**Net gearing (12/06A)**	75.4%
No. shares o/s	694.3m	**Net debt/sh. (12/06A)**	HK$0.266
Daily t/o, 3 mth	US$0.91m	**BV/sh. (12/06A)**	HK$0.40
Free float %	46.9%	**Consensus EPS**	
Major shareholder	Helena Ho & Jacky Ho – 30.0%	**- 12/07F**	0.047
Ticker	0630.HK/ 630 HK	**- 12/08F**	0.069

Key points:

- Jackin's 100%-owned AFEX was the eight largest among the world's 50 cartridge recyclers.
- One of China's three cartridge recycle manufacturers, with two out of the country's five limited licences to import and remanufacture used toner cartridges.
- Able to recycle most parts of toner cartridges including primary charge rollers and mag rollers.
- Set to benefit from the emerging recycling industry.
- In talks to produce floppy disks for one of the world largest US based manufacturer, making it the world's main floppy disk supplier.
- On preliminary estimates put Jackin's net profit at between HK$30.0m-35.0m in FY12/07F, translating to a FY12/07F P/E of 14.0-16.3x.

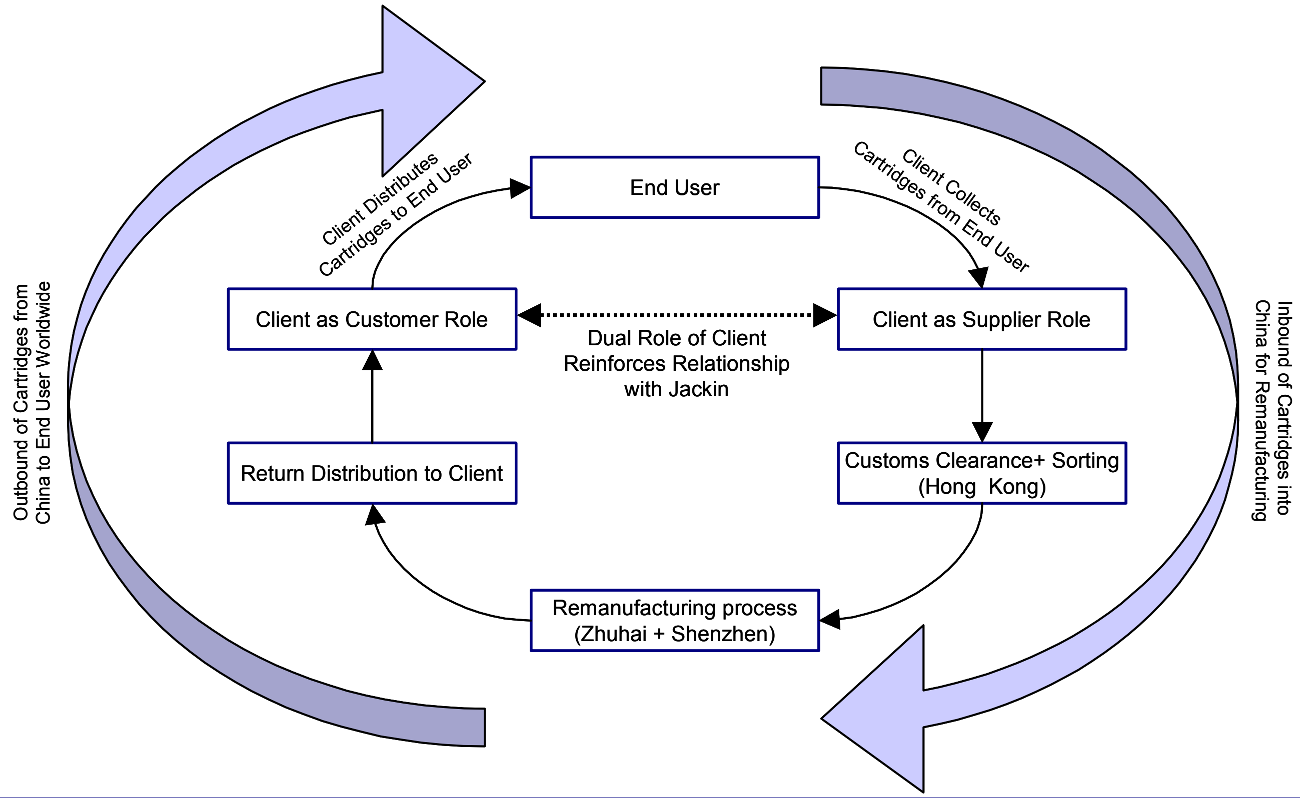
Company background. Listed in 1996, Jackin is engaged in three lines of business: 1) remanufacturing and sales of computer printing and imaging products; 2) manufacturing and sales of data media products such as floppy disk and 3) distribution and sales of data media products.

Cartridge recycler. AFEX, its wholly-owned subsidiary, engaged in remanufacturing of toner cartridges at its two plants in Zhuhai and Shenzhen, with a current production capacity of 100,000 per month. The company holds two out of China's five limited licenses to import and remanufacture used toner cartridges. Jackin's recycled toners cartridges are carried by major stationery channels.

Core business and main growth driver. Set up in 2004, AFEX is the eight largest among the world's 50 cartridge recyclers and Asia's second OEM, a testament to the company's strong execution ability. Last year, its sales of recycled toner cartridges increased 34.3% YoY to HK$133.1m, accounting for 38.5% of the total turnover. Its major market is the US (31.0% of the total), followed by Asia Pacific, including Australia (48.0%) and Europe (21.0%).

Unique relationship with customers. Clients are both suppliers and customers of AFEX's printer cartridge remanufacturing business. It relies on clients for upstream cartridge collection and after remanufacturing delivers cartridges to clients downstream, who in turn distribute them to end users. In effect, AFEX's clients are key channel partners, reinforcing the inter-dependent relationship and creating a win-win situation for all parties. The remanufacturing process is labour intensive and currently AFEX employs 550 production workers.

Chart 1: Jackin's supply chain for printer cartridge remanufacturing



Source: SBI E2-Capital

Product portfolio. AFEX's products can be divided into several grades – super premium, premium, premium standard, standard and test grade. The grade is determined by the composite of new and used materials used in the cartridge. In super premium cartridges, most of the materials are new but in standard or test grade cartridges most are recycled components. As AFEX is able to re-use most of cartridge parts such as toners, primary charge rollers and mag rollers, only a small portion (c.10.0%) of disassembled components needed to be disposed of, reducing material costs by 35.0% and the BOM/turnover ratio to 41.0% currently (from 67.0% in FY12/05A). The company now makes more than 180 monochrome and 60 color recycled laser toner cartridges, which are used in printers manufactured by HP, Epson, Canon, Lexmark, Xerox and Konica. The company estimates that around 80% of its recycled laser toner cartridges are used in HP branded printers.

China's cost advantage vs. high entry barriers. China, with its abundant cheap labour, is an ideal location for such a labour intensive operation. However, the need to secure a large amount of working capital and steady supply of used cartridges and to set up the whole supply chain represents high entry barriers. Also, to engage in this business, a company has to obtain licences from the commercial affairs department, customs and environmental protection department, which became more difficult after the tightening of import licences for used laser toner cartridges in 2005. Jackin is one of China's three manufacturers licensed to offer cartridge recycling services.

Benefits from consolidation. Three out of the world's 50 cartridge recyclers are based in China. The industry has been consolidating over the last few years. We believe that this trend will reinforce Jackin's prominent position in the sector. With its sufficient manufacturing capabilities, we expect its potential M&A targets to be upstream clients/suppliers and asset-light companies, to lower the risk.

Encouraging sell through rate. AFEX sold c.0.5m units of cartridges in FY12/06A and c.0.2m in 1Q07. It aims to sell 1.0m units in FY12/07F, which we think is achievable as in 2H07, the company will start to distribute cartridges to smaller, low-end customers.

Macro and micro drivers:

- *Favourable environmental regulations and policies.* The tightening of import licences for laser toner cartridges has favoured Jackin. Besides, in recent years, the Chinese government started encouraging recycling and many Western countries have begun to implement regulations requiring manufacturers to recycle their products and encouraging consumers to use recycled products.
- *Shortening replacement cycle.* Nowadays, many printer manufacturers focus on improving the quality of printing which in turn shortens the replacement cycle as fewer pages are produced per cartridge. Due to "the

smaller the better" trend, manufacturers find it difficult to sell big cartridges, which leads to an increase in demand for replacement cartridges.

- *Growing consumption of recycled cartridges.* Demand for laser printers, photocopiers and all-in-one equipment is increasing and with it demand for replacements. According to a Lyra research report, the recycled toner cartridge market in the US is worth US$11.0b and in Europe US$5.0b. The consumption of recycled toner cartridges has been rising as customers discover that they offer the same quality as new cartridges but at a lower price (by c.30-40% price) and are environmentally friendly.
- *Consolidation of cartridge suppliers.* Most parts of the cartridges have been standardized with only a few players (especially HP) in the whole toner cartridge industry. This favours the remanufacturing business models such as that of AFEX.
- *Strengthening business model.* By leveraging the existing value chain, Jackin plans to distribute cartridges to low-end customers. Currently, premium and standard grade products account for c. 60.0% of its total sales. To balance the product mix, Jackin will start to sell standard and test grade cartridges to countries such as Africa, India and some underdeveloped areas of China. This will drive costs down as they are made of used parts.

Floppy disk business. Jackin is in talks to produce disks for one of the world largest US based manufacturer, which by 4Q07 plans to close down all of its production facilities and start outsourcing in 1H07. Jackin has a fully automated floppy disk plant in Shenzhen with a capacity of 20m per month. With additional orders from this US customer, we believe that the segment's turnover will increase this year. On the downside, the global demand for floppy disks is declining with a shift towards CD-Rs, USB memory devices and optical disks. According to the Japan Recording-Media Industries Association, it will fall at an average of 24.0% in the next three years. Thus, the benefits of this deal are relatively short term.

Distribution and sales of data media products. In December 2001, Jackin started distributing data media products for Sony in China, with sales of HK106.9m, up 2.7% from FY12/05A. The company expects to continue to benefit from the appreciation of RMB, as its distribution revenue is mainly generated in China.

FY12/06A results. Jackin's turnover rose 4.8% YoY to c. HK$345.6m from HK$329.8m in FY12/06A. Including its net gain from a legal claim, net profit reached HK$65.0m (or HK$17.9m ex-gain).

Table 1: Turnover breakdown

Year to end Dec	2006(HK$m)	% of total	2005 (HK$m)	% of total	*% change*
Remanufacture and sale of cartridges	133.1	38.5	98.8	30.0	*34.7*
Manufacture and sale of data media products	105.6	30.6	126.9	38.5	*(16.8)*
Distribution and sale of data media products	106.9	30.9	104.1	31.6	*2.7*
Total	345.6	100.0	329.8	100.0	*4.8*

Source: Company data, SBI E2-Capital

Preliminary estimate and valuation. With robust growth in toner cartridges and orders for floppy disks, we expect net profit to increase to between HK$30.0-35.0m in FY12/07F. We believe that the recycled cartridge business to be the sole contributor and driver of Jackin's business going forward. This counter is trading at current fully diluted historical P/E of 27.7x (excluding one-off gain on legal claim). Based on our preliminary estimate, the counter is trading at P/E of 14.0-16.3x for FY12/07F.

Corporate governance. Jackin was listed on the Hong Kong Stock Exchange in 1996. The company has changed its auditors several times over the last few years. It replaced Deloitte with Grant Thornton in 2004 and reappointed Deloitte in 2005. In 2006, it replaced Deloitte with KPMG. The company's major shareholders, Helena and Jacky Ho, hold 30.0%, Art-Tech Enterprises Limited 9.3% and Martin Currie 7.4% and Nestor 6.4%. Public shareholders account for c. 46.9%.

Risk. (1) Substantial capital outlay for business expansion; (2) high working capital requirements; (3) ability to secure supply of used cartridges and (4) changes in government regulations.

Table 2: P&L

Year end Dec (HK$m)	04A	05A	06A
Turnover	**363.8**	**329.7**	**345.6**
Cost of good sold	(274.4)	(259.4)	(233.4)
Gross profit	89.4	70.3	112.2
Other revenue	7.3	4.5	8.2
Other net (loss)/income	0.0	0.3	(0.1)
Distribution costs	(15.8)	(22.8)	(22.4)
Administrative expenses	(50.6)	(51.1)	(51.8)
Other operating expenses	0.0	(119.8)	-
Operating profit/ (loss)	**30.3**	**(118.6)**	**45.9**
Finance costs	(10.5)	(15.4)	(23.3)
Gain on disposal of a subsidiary	0.6	-	-
Gain from legal claim	-	-	47.1
Before tax profit/ (loss)	**20.4**	**(134.0)**	**69.7**
Income tax	(0.3)	(1.2)	(4.8)
Profit/ (loss) attributable to equity shareholder	**20.1**	**(135.2)**	**65.0**
Dividends	-	-	-
EPS - Basic (HK$)	0.040	(0.198)	0.095
EPS - Diluted (HK$)	-	-	0.093

Source: Company data