

## Jackin Int'l: Moving the right direction

### Recommendation: BUY (unchanged)

### Hong Kong Industrials

Price	HK\$0.34	Year to	Net profit	EPS	EPS	P/E	P/B	EV/EBITDA	Yield	ROE	ROCE	N. Gear.
Target price	HK\$0.80 (+135%)	Dec	HK\$m	HK\$	Δ %	x	x	x	%	%	%	%
12 mth range	HK\$0.104-0.81	05A	(135.2)	(0.198)	Na	(1.7)	1.1	2.3	Na	(51.3)	(36.5)	90.6
Market cap.	US\$32.7m	06A	64.9	0.093	Na	3.7	0.8	3.9	Na	26.7	14.8	69.2
Daily t/o, 3 mth	US\$0.4m	07F	41.5	0.046	(50.7)	7.4	0.7	4.2	Na	12.0	8.2	31.7
Free float %	55.9%	08F	62.6	0.069	50.8	4.9	0.6	3.2	Na	13.9	11.0	15.9
Ticker	0630.HK/630 HK	09F	85.3	0.094	36.4	3.6	0.5	2.6	Na	16.0	13.8	2.2

Relative to Hang Seng Index (1 mth, 3 mth, 12 mth): -44.7%, -48.5%, 85.1%

Actual price changes (1 mth, 3 mth, 12 mth): -36.0%, -37.3%, 190.9%

Consensus EPS (07F-09F): HK\$0.047, HK\$0.069

Previous forecasts (07F-09F): HK\$39.2m (\$0.043), HK\$60.6m (\$0.067), HK\$83.8m (\$0.093)

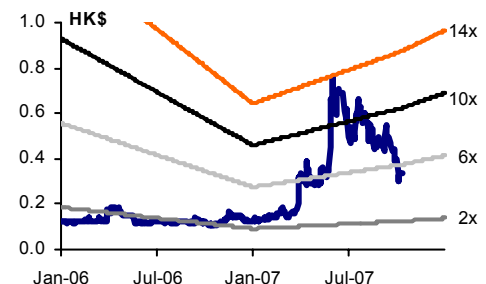
### Key points:

- Jackin plans to leverage its expertise in remanufacturing to horizontally broaden into e-waste recycling.
- Rapid technology changes, shorter product life cycles and new environmental regulations are fuelling the demand for e-waste recycling.
- The Chinese government is expected to limit the issue of e-waste recycling licenses. If Jackin is successful in securing a license, it will give the company access to an industry with high entry barriers.
- After the recent 1H FY12/07A results, we have revised our net profit estimates up slightly to HK\$41.5m for FY12/07F and HK\$62.6m for FY12/08F.
- Plans to sell low-end cartridges in the Middle East and China by 4Q FY12/07, will further boost top line growth and improve margins in FY12/08F.
- Growth to come from: 1) growing number of colour toner cartridges; 2) sales of low-end cartridges and 3) better margins. We believe growth in remanufacturing will offset gradual declines in the floppy disk and data media segments.
- Our bullish outlook remains intact. Maintain BUY with a target price of HK\$0.80, representing 11.6x FY12/08F P/E (on a fully-diluted basis). The counter is currently deeply undervalued, trading at 7.4x FY12/07F P/E and 4.9x FY12/08F P/E.

**Planning horizontal expansion into e-waste business.** In a recent meeting with the company, we understand that Jackin plans to horizontally diversified its into electronics recycling. To prevent China from becoming a dumping ground, we expect the Chinese government to limit the issue of e-waste recycling licences. The company is lobbying to obtain its license and set up a plant in Dandong, Liaoning, to take advantage of the province's cheap labour costs. Liaoning is a relatively a poor province with a low employment rate. Jackin expects to get full support from the local government, as its new business will be in line with central government policy to develop the environmental industry whilst helping boost employment. Thus, the success of obtaining such licence will give Jackin instant leadership position in this emerging industry with high entry barriers.

**Right direction to a potentially lucrative industry.** We believe Jackin's expansion into e-waste recycling is a good move. The industry is in its infancy but is growing and gaining popularity as rapid technology changes,

Chart 1: P/E bands



Source: SBI E2-Capital

shorter product life cycles and new environmental regulations lead to increases in the amount of waste, fuelling demand for recycling. According to a 2005 survey by the International Association of Electronics Recyclers (IAER), electronics recycling companies in the US generated more than US\$1.5b in sales. The amount is expected to increase four to five times by 2010. The global electronics recycling industry was worth US\$7.0b in 2004 and should reach US\$20.0b within the next decade. We believe Jackin is well positioned to capitalize on the industry's prospects.

**Securing new suppliers relieves capital resources.** On the recent trip to a trade show in the US, Jackin was able to secure new suppliers and hence a sufficient and stable supply of empties. Hence, the previous M&A activities planned by the management is now less urgent. This will free up capital resources for the company to pursue its plans to broaden into the e-waste recycling industry.

**Recent 1H FY12/07A net profit beats expectations.** Jackin's net profit amounted to HK\$22.5m in 1H FY12/07A, compared with HK\$67.3m in the year-earlier period, which included a one-off gain of HK\$58.6m. Excluding the one-off gain, net profit increased 161.6% to HK\$22.5m in 1H07. Turnover rose 7.0% to HK\$179.9m, below our estimate of HK\$220.6m, mainly due to faster-than-expected drop in the sales of its low margin distribution business. Gross profit increased 21.1% YoY to HK\$63.1m and gross margin widened 3.9pcp to 35.1%.

**Table 1: Turnover breakdown**

Six months to Jun	1H07A (HK\$m)	% of total	1H06A (HK\$m)	% of total	% change (YoY)
Remanufacture and sale of cartridges	102.3	56.9	62.6	37.4	63.4
Manufacture and sale of data media products	52.6	29.3	54.9	32.8	(4.2)
Distribution and sale of data media products	24.8	13.8	50.1	29.9	(50.5)
	<b>179.7</b>	<b>100.0</b>	<b>167.6</b>	<b>100.0</b>	<b>7.2</b>

Source: SBI E2-Capital

**Toner cartridge remanufacturing is the current core driver.** Since its official launch in 2004, toner cartridge remanufacturing has become the company's core business and main growth driver. In 1H FY12/07A, the sales of remanufactured toner cartridges rose 63.4% to HK\$102.3m, accounting for 56.9% of total turnover. Of the 0.4m of toner cartridges sold in 1H, about 90.0% were monochrome and the remainder colour toners. The major markets are the US, Asia Pacific (including Australia) and Europe, which contributed 44.0%, 37.0% and 19.0% of sales, respectively. Currently, the company remanufactures more than 250 different models of toner cartridges for major brands such as Hewlett-Packard, Canon, Xerox, Brothers and Samsung.

**Floppy disk business and data media products.** Floppy disks sales fell 4.1% to HK\$52.6m and distribution business sales declined 50.5% to HK\$24.8m. Both segments represented 43.1% of total turnover. We expect demand for floppy disks to remain stable in the short term but to dwindle away eventually, as the focus shifts to substitutes such as CD-Rs, USB memory devices and optical disks. We believe remanufacturing growth will offset gradual declines in contributions from the floppy disk and data media segments.

**Expanding global reach.** One of Jackin's key competitive advantages is its ability to refurbish, in-house, most parts of toner cartridges such as OPC drums, magnetic and charging rollers, toners and wiper blades. This allows the company to save costs and lengthen its product line by introducing low-grade cartridge products to utilize refurbished materials. These products (known as standard and test grades) are aimed at low-end customers and will be sold in the Middle East and China by 4Q FY12/07. Their margins are relatively high as most of their parts are remanufactured. In China, Jackin plans to capitalize on its well-established distribution network to sell recycled toner cartridges.

**Forecasts lifted.** So far, the cartridge shipments are on track. With robust growth in toner cartridges and orders for floppy disks, we have slightly revised up our net profit forecasts to HK\$41.5m for FY12/07F and HK\$62.6m for FY12/08F. We expect the remanufacturing business to drive growth and boost margins. Turnover should increase 47.7% to HK\$510.3m in FY12/07F and 6.1% to HK\$541.5m in FY12/08F, while the gross margin of the remanufacturing business should widen to 39.9% by FY12/08F, thanks to changes in the company's product mix and lower production costs. Our current estimates do not include Jackin's planned expansion into e-waste recycling.

**Bullish outlook intact - maintain BUY.** We remain bullish on this company's long-term prospects. Growth should come from: 1) product mix changes - introduction of low-end cartridges and growing proportion of colour toners, 2) margin improvement and 3) horizontal expansion into new businesses. We maintain our BUY call with a target price of HK\$0.80, representing 11.6x FY12/08F P/E (on a fully diluted basis). Trading at 7.4x FY12/07F

P/E and 4.9x FY12/08F P/E, the stock is deeply undervalued compared with its peers' current P/E of 17.8x and one-year forward P/E of 14.9x and with recycling peers' current P/E of 15.9x and one-year forward P/E of 14.3x.

**Table 2: Peer comparison**

Company name	Ticker	Market Cap (US\$m)	Historical	P/E (x)		ROA (%)	ROE (%)
				Current	1-yr forward		
Industrial sector							
Lexmark International	LXK US	3,824.7	12.4	19.4	15.8	11.0	27.5
Ricoh Company	7752 JP	15,823.6	16.4	14.7	13.3	5.2	11.0
Canon Finetech Inc	6421 JP	700.0	12.4	11.8	10.1	5.7	10.7
Riso Kagaku Corporation	6413 JP	537.4	21.1	16.1	14.4	2.5	4.3
Hybrid Service Company	2743 JP	15.9	7.1	na	na	3.6	15.7
Seiko Epson Corporation	6724 JP	5,006.9	na	18.1	14.9	na	na
Brother Industries Limited	6448 JP	3,484.9	14.1	15.9	12.8	7.7	14.8
General Plastic Industrial	6128 TT	68.2	na	na	na	16.9	20.3
OCE NV	OCE NA	1,885.7	24.3	15.8	13.9	2.5	4.3
GMP Company	018290 KS	68.0	24.3	15.8	13.9	0.6	2.6
Inktec Corporation Limited	049550 KS	53.4	na	na	na	2.4	3.4
Average			23.6	17.8	14.9		
Recycling sector							
Waste Management Inc	WMI US	19,954.5	18.3	18.3	16.9	5.5	18.6
Allied Waste Industries Inc	AW US	4,737.8	38.7	17.0	14.7	0.9	4.3
Advance Sct Ltd	ASCT SP	184.8	41.2	12.4	12.4	4.9	16.4
Centillion Env & Recycling	CENR SP	229.9	7.5	na	na	25.0	na
Enviro-Hub Holdings Ltd	ENVH SP	242.5	137.5	10.6	8.1	1.0	2.0
Super Dragon Technology Co.	9955 TT	284.0	48.3	na	na	13.4	16.2
Asahi Pretec Corp	5855 JP	1,169.9	23.7	21.3	19.2	14.6	19.3
Average			45.0	15.9	14.3		

Source: Bloomberg and SBI E2-Capital

**Table 3: P&L**

Year to Dec (HK\$m)	2005A	2006A	2007F	2008F	2009F
<b>Turnover</b>					
Cartridge recycler	98.8	133.1	292.8	373.3	444.3
Floppy disc	126.9	105.6	137.5	103.1	77.3
Distribution and sales of data media	104.1	106.9	80.0	65.0	55.0
	<b>329.8</b>	<b>345.6</b>	<b>510.3</b>	<b>541.5</b>	<b>576.6</b>
Cost of sales	(259.4)	(233.5)	(356.3)	(363.2)	(370.2)
<b>Gross profit</b>	<b>70.4</b>	<b>112.1</b>	<b>154.0</b>	<b>178.3</b>	<b>206.4</b>
Other revenue	4.5	8.2	8.2	8.2	8.2
Other net (loss)/income	0.3	(0.1)	-	-	-
Selling and distribution costs	(22.8)	(22.4)	(40.8)	(43.3)	(46.1)
Administrative expenses	(51.1)	(51.8)	(40.8)	(43.3)	(46.1)
Other operating expenses	(199.8)	0.0	0.0	0.0	0.0
Depreciation & amortisation	(22.0)	(20.5)	(18.1)	(18.9)	(19.6)
<b>Operating profit</b>	<b>(118.6)</b>	<b>45.9</b>	<b>62.4</b>	<b>80.9</b>	<b>102.8</b>
Financial costs	(15.4)	(23.3)	(16.3)	(11.4)	(8.0)
Gain from a legal claim	-	47.1	-	-	-
<b>Pre-tax profit</b>	<b>(134.0)</b>	<b>69.7</b>	<b>46.1</b>	<b>69.5</b>	<b>94.8</b>
Tax	(1.2)	(4.8)	(4.6)	(7.0)	(9.5)
Minority interests	-	-	-	-	-
<b>Net profit</b>	<b>(135.2)</b>	<b>64.9</b>	<b>41.5</b>	<b>62.6</b>	<b>85.3</b>
EPS (HK\$) - Basic	(0.198)	0.095	0.053	0.080	0.109
EPS (HK\$) - F.D.	(0.198)	0.093	0.046	0.069	0.094

Source: SBI E2-Capital

**Disclosure of interests: SBI E2-Capital Securities Ltd and/or its affiliates beneficially own(s) more than one percent of the ordinary shares of Jackin International Holdings Limited.**

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