

## Tongda Group

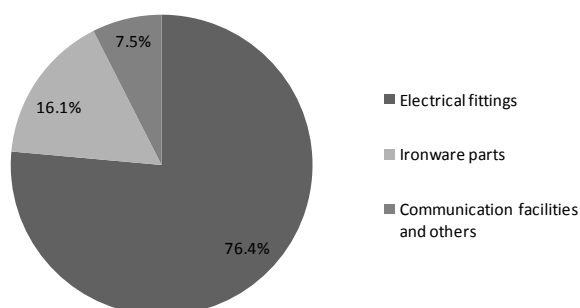
### New products lead growth

to summarize...

- With patented in-mould lamination (IML) technology, the company is the largest supplier of IML plastic casings for consumer electronics in the world.
- IML product can be more scratch proof. Industry momentum is anticipated to remain strong.
- Driven by increasing demand for IML products, top line went up 53% in 1H FY12/10A to HK\$1,039m.
- New LED light guide plate business commenced operation this year, which is expected to generate additional HK\$936m revenue in FY12/11F.
- Earnings will increase from HK\$102m in FY12/09A to HK\$174m in FY12/10F and then reach HK\$235-278m in FY12/11F, which puts the counter at undemanding 6.6-7.9x FY12/11F P/E.

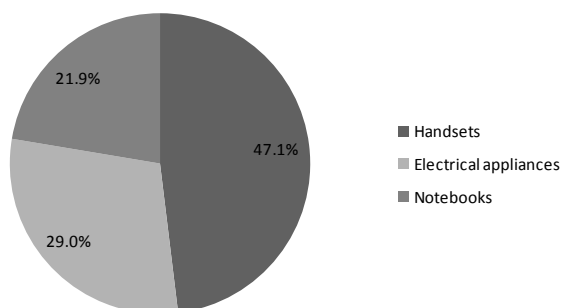
**Business summary.** Established in 1988, Tongda Group (TDG) is an IML specialist with self-developed and patented technology. According to the management, it is the largest supplier of IML products in the world (e.g. it has 50%+ market share for notebook IML plastic casing). The company manufactures mainly plastic casings for consumer electronics such as notebook, handset and electrical appliances, which, called electrical fittings segment, accounted for 76% of the total revenue in 1H FY12/10A. Other products include ironware parts and digital satellite TV receiver.

Chart 1. Sales breakdown 1H FY12/10A



Source: Company data

Chart 2. Breakdown of electrical fittings segment 1H FY12/10A



Source: Company data

| Ticker                 | 0698 HK     |
|------------------------|-------------|
| Rating                 | Not Rated   |
| Price (HK\$)           | 0.405       |
| Target Price (HK\$)    | n.a.        |
| 12m Price Range (HK\$) | 0.220-0.420 |
| Market cap. (US\$m)    | 236.2       |
| Daily t/o (US\$m)      | 0.4         |
| Free float (%)         | 43.8        |

#### Financial summary

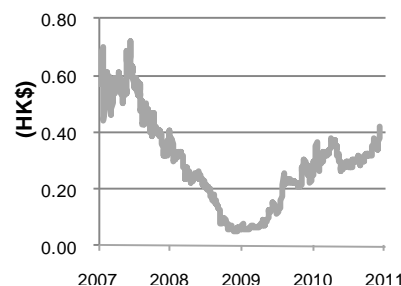
| Year to Dec        | 07A   | 08A   | 09A   |
|--------------------|-------|-------|-------|
| Turnover (HK\$m)   | 1,140 | 1,394 | 1,800 |
| Net Profit (HK\$m) | 1745  | 65    | 102   |
| EPS (HK\$)         | 0.044 | 0.016 | 0.025 |
| P/E (x)            | 9.2   | 24.7  | 16.1  |
| P/B (x)            | 1.43  | 1.37  | 1.21  |
| EV/EBITDA (x)      | 12.5  | 38.1  | 27.3  |
| Yield (%)          | 4.0   | 1.5   | 2.1   |
| ROE (%)            | 15.4  | 5.6   | 8.1   |
| ROCE (%)           | 14.6  | 6.5   | 7.7   |
| N. Gear. (%)       | cash  | 15.5  | 6.7   |

Source: SBI E2-Capital

|                           | 10F   | 11F  | 12F   |
|---------------------------|-------|------|-------|
| Consensus EPS (HK\$)      | 0.043 | 0.55 | 0.060 |
| Previous earnings (HK\$m) | -     | -    | -     |
| Previous EPS (HK\$)       | -     | -    | -     |

#### Price performance

| Year to Dec              | 1m    | 3m    | 12m   |
|--------------------------|-------|-------|-------|
| Relative to HSI (%)      | +20.0 | +25.4 | +51.7 |
| Actual price changes (%) | +11.0 | +37.3 | +58.8 |



Source: Bloomberg

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**IML technology.** Different from in-mould decoration (IMD) technology, which simply prints designs onto a certain surface (e.g. casing), IML covers the patterns with a protective layer so that the finished product is much more scratch proof. Meanwhile, IML has better operation flexibility and can be used for short-run production. However, IML-made product is thicker and more expensive, which affects the technology's market acceptance (e.g. for notebook plastic casings, IML accounts for ~10% of total outputs, versus IMD's ~80%). Nevertheless, the two major setbacks (i.e. thickness and cost) have been largely resolved. Now, the covering sheet can be as thin as 0.075mm while the cost gap between IML and IMD has been narrowed to single digit. Thus, IML is observed to be increasingly adopted.

**1H review.** TDG's revenue surged 53% in 1H FY12/10A from HK\$678m to HK\$1,039m backed by the rising demand for IML technology. Segment wise, the growth largely came from notebook casing and electrical appliances divisions. Launched in 2008, the prior is still in its early fast expansion stage. The latter, meanwhile, was mainly boosted by China's "Home Appliances to Countryside" (HAC) programme, which stimulated the country's demand for home appliances. Under the top line, gross margin improved 1pcp to 18.1% thanks to internal cost control and release of new products. Net profit almost doubled from HK\$41m to HK\$81m.

**Table 1. 1H results highlight**

| Year to Dec (HK\$m)                 | 1H 09A       | 2H 09A         | 1H 10A         | YoY growth (%) |
|-------------------------------------|--------------|----------------|----------------|----------------|
| <b>Revenue</b>                      | <b>678.1</b> | <b>1,122.2</b> | <b>1,039.5</b> | <b>53.3</b>    |
| Electrical fittings                 | 461.3        | 844.4          | 794.4          | 72.2           |
| Handsets                            | 297.0        | 333.0          | 374.0          | 25.9           |
| Electrical appliances               | 94.0         | 351.0          | 230.0          | 144.7          |
| Notebooks                           | 66.0         | 159.0          | 174.0          | 163.6          |
| Ironware parts                      | 163.5        | 174.6          | 167.2          | 2.3            |
| Communication facilities and others | 53.3         | 103.2          | 77.9           | 46.1           |
| Gross profit                        | 115.6        | 186.8          | 188.1          | 62.7           |
| Net profit                          | 41.0         | 61.1           | 81.4           | 98.6           |
| Gross margin                        | 17.1         | 16.6           | 18.1           |                |
| Net margin                          | 6.0          | 5.4            | 7.8            |                |

Source: Company data

**Major drivers.** For time being, we identified two major drivers for TDG:

- Industry momentum – although growth from home appliance sector will probably moderate due to a higher comparison basis, both notebook PC and mobile handset are expected to have some double-digit growth in 2011. Plus, for each product category, IML will likely further expand its occupancy, which is regarded as a general trend, according to the management
- Tongda Optical (TDO) – TDO is a 55:45 JV between TDG and Matsushita Shokai, producing LED light guide plate (LGP), a core component used in LED TV backlight module. Operation launched this year. TDO is the only LGP plant on the mainland so far.

**TDO estimates.** Matsushita Shokai is a major LGP supplier in Japan. It provides necessary technology and industry connections (e.g. sourcing raw plate from Chimei. Raw plate supply is tight now) to the JV. As the local partner, TDG has extensive experiences in printing and laminating, which is helpful during LGP processing. According to the management, TPO's annual capacity will be 1.5m pieces in 2010 and 6m next year. ASP and gross margin is guided at US\$20 per piece and 20%+, respectively. Accordingly, we calculate the JV may contribute HK\$936m turnover and HK\$187m+ gross profit in FY12/11F.

**Preliminary forecast.** According to the management, the company's business stays in good shape in 2H. Assuming a YoY flat top line in 2H, full FY12/10F revenue will reach HK\$2,162m, up 20% YoY. With steady margins and effective tax rate (HoH), we estimate TDG's net profit will increase 70% to HK\$174m. For FY12/11F, TDO's impact will be substantial. When its sales contribution is more or less certain, capped by production capacity, gross margin is subject to operation conditions (e.g. economy of scale) and sales mix (e.g. large-size LPG's gross margin exceeds 30%). Therefore, a simple sensitivity test was done, which suggests each 1pcp change in TDO's gross margin will result in HK\$4.3m variation (1.7%) in TDG's net profit.

**Table 2. TDO FY12/11F estimates and sensitivity test**

| Gross margin assumption (%)        | 20.0  | 22.5  | 25.0  | 27.5  | 30.0  |
|------------------------------------|-------|-------|-------|-------|-------|
| Sales volume (pieces m)            | 6.0   | 6.0   | 6.0   | 6.0   | 6.0   |
| ASP (US\$/piece)                   | 20.0  | 20.0  | 20.0  | 20.0  | 20.0  |
| Revenue (HK\$m)                    | 936.0 | 936.0 | 936.0 | 936.0 | 936.0 |
| Gross profit (HK\$m)               | 187.2 | 210.6 | 234.0 | 257.4 | 280.8 |
| Net profit (HK\$m)                 | 92.8  | 112.4 | 132.1 | 151.7 | 171.4 |
| Profit attributable to TDG (HK\$m) | 51.0  | 61.8  | 72.7  | 83.5  | 94.3  |

Source: SBI E2-Capital

Table 3. Preliminary forecasts

| Year to Dec (HK\$m)                 | 1H 10A         | 2H 10F         | 10F            | 11F            |                |                |
|-------------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|
|                                     |                |                |                | TDO's GP@20%   | TDO's GP@25%   | TDO's GP@30%   |
| <b>Revenue</b>                      | <b>1,039.5</b> | <b>1,122.2</b> | <b>2,161.6</b> | <b>3,172.1</b> | <b>3,172.1</b> | <b>3,172.1</b> |
| Electrical fittings                 | 794.4          | 844.4          | 1,638.8        | 1,704.2        | 1,704.2        | 1,704.2        |
| Handsets                            | 374.0          | 333.0          | 707.0          | 742.4          | 742.4          | 742.4          |
| Electrical appliances               | 230.0          | 351.0          | 581.0          | 595.5          | 595.5          | 595.5          |
| Notebooks                           | 174.0          | 159.0          | 333.0          | 366.3          | 366.3          | 366.3          |
| Ironware parts                      | 167.2          | 174.6          | 341.8          | 341.8          | 341.8          | 341.8          |
| Communication facilities and others | 77.9           | 103.2          | 181.0          | 190.1          | 190.1          | 190.1          |
| LED light guide plate               | minor          | minor          | minor          | 936.0          | 936.0          | 936.0          |
| Gross profit                        | 188.1          | 203.1          | 391.2          | 591.8          | 638.6          | 685.4          |
| Operating profit                    | 106.1          | 120.1          | 226.1          | 357.2          | 404.0          | 450.8          |
| Net profit                          | 81.4           | 92.5           | 173.9          | 234.7          | 256.3          | 277.9          |

Source: SBI E2-Capital

**Balance sheet.** At end-Jun 10, the company had HK\$175m cash in hand (net debt: HK\$70m). Capex is estimated at HK\$150m for each of FY12/10F and FY12/11F. Considering the enlarged net profit from this year, operating cash inflow should be able to cover the capex requirement, although the management will consider external fund raising at due course.

**Valuation.** Based on our preliminary forecasts, the counter is trading at 10.6x FY12/ P/E or 6.6-7.9x two year forward which is at the middle of HK-listed peers.

Table 4. Preliminary forecasts

| Company         | Ticker  | FY end  | Market cap<br>(US\$m) | Historical PER |                | P/BV (x) | ROE (%) |      |
|-----------------|---------|---------|-----------------------|----------------|----------------|----------|---------|------|
|                 |         |         |                       | (x)            | 1-year PER (x) |          |         |      |
| RMIH            | 1997 HK | 12/2009 | 505.1                 | 7.0            | 6.8            | 4.9      | 2.1     | 27.8 |
| Great Wall Tech | 74 HK   | 12/2009 | 578.9                 | 7.7            | n.a.           | n.a.     | 0.8     | 9.6  |
| TPV             | 903 HK  | 12/2009 | 1,467.7               | 8.2            | 9.8            | 8.6      | 0.9     | 9.8  |
| Foxconn         | 2038 HK | 12/2009 | 5,180.2               | n.a.           | n.a.           | 60.5     | 1.5     | 1.1  |
| Ju Teng         | 3336 HK | 12/2009 | 456.1                 | 4.9            | 5.5            | 4.6      | 0.8     | 20.8 |
| BYD Electronic  | 285 HK  | 12/2009 | 1,175.7               | 8.7            | 9.3            | 8.3      | 1.1     | 12.2 |
| Tongda Group    | 698 HK  | 12/2009 | 236.2                 | 11.6           | 9.4            | 7.4      | 1.3     | 8.1  |

Source: Bloomberg

**Risk.** Existing operation bears market risk. As a brand new business, TDO suffers quite high execution uncertainty.

Table 5. Key financial figures

| Year to Dec (HK\$m)                     | 07A     | 08A     | 09A     | 1H 10A  |
|-----------------------------------------|---------|---------|---------|---------|
| Revenue                                 | 1,139.5 | 1,393.8 | 1,800.3 | 1,039.5 |
| Gross profit                            | 243.4   | 217.9   | 302.4   | 188.1   |
| Operating profit                        | 191.5   | 111.1   | 151.6   | 106.1   |
| Net profit                              | 174.8   | 65.3    | 102.1   | 81.4    |
| Fixed assets                            | 523.7   | 752.8   | 822.3   | 863.5   |
| Inventories                             | 167.7   | 305.9   | 369.2   | 442.8   |
| Receivables                             | 686.0   | 690.2   | 706.1   | 800.9   |
| Payables                                | 301.4   | 360.3   | 496.3   | 594.8   |
| Cash                                    | 160.7   | 199.0   | 257.5   | 174.9   |
| Short-term debt                         | 112.8   | 170.9   | 248.2   | 195.3   |
| Long-term debt                          | 0.0     | 211.2   | 99.1    | 50.0    |
| Shareholders' fund                      | 1,133.0 | 1,181.7 | 1,333.5 | 1,441.4 |
| Total equity                            | 1,138.4 | 1,215.3 | 1,380.8 | 1,480.6 |
| Net cash from operating activities      | 52.9    | 47.7    | 259.8   | 91.6    |
| Net cash used in investing activities   | (195.8) | (266.2) | (130.2) | (94.5)  |
| Net cash from financing activities      | 180.1   | 221.7   | (51.7)  | (84.8)  |
| Net change in cash and cash equivalents | 37.2    | 3.2     | 77.9    | (87.7)  |

Source: Company data

Table 6. P&amp;L

| Year to Dec (HK\$m)              | 07A     | 08A       | 09A       | 1H 10A  |
|----------------------------------|---------|-----------|-----------|---------|
| Revenue                          | 1,139.5 | 1,393.8   | 1,800.3   | 1,039.5 |
| Cost of sales                    | (896.1) | (1,175.9) | (1,497.9) | (851.4) |
| Gross profit                     | 243.4   | 217.9     | 302.4     | 188.1   |
| Other income and gain, net       | 66.2    | 52.4      | 25.0      | 9.8     |
| Selling and distribution costs   | (33.4)  | (39.0)    | (49.0)    | (21.7)  |
| Administrative expenses          | (69.3)  | (97.6)    | (108.1)   | (65.0)  |
| Change in fair value of warrants | 0.0     | 0.0       | 0.0       | (5.1)   |
| Other expenses, net              | (15.4)  | (22.5)    | (18.6)    | (0.0)   |
| Profit from operations           | 191.5   | 111.1     | 151.6     | 106.1   |
| Finance costs                    | (14.9)  | (27.3)    | (16.7)    | (8.3)   |
| Share of profits and losses of   |         |           |           |         |
| Associates                       | 3.8     | 2.7       | 3.1       | 2.0     |
| A jointly-controlled entity      | 18.5    | 3.6       | -         | -       |
| Profit before tax                | 198.9   | 90.1      | 138.1     | 99.8    |
| Income tax                       | (28.9)  | (18.7)    | (24.2)    | (16.0)  |
| Profit for the period            | 170.0   | 71.3      | 113.8     | 83.8    |
| Attributable to:                 |         |           |           |         |
| Owners of the Company            | 174.8   | 65.3      | 102.1     | 81.4    |
| Minority interests               | (4.8)   | 6.0       | 11.7      | 2.4     |
| EPS - Basic (HK\$)               | 0.044   | 0.016     | 0.025     | 0.018   |
| EPS - Diluted (HK\$)             | 0.044   | 0.016     | 0.025     | 0.018   |

Source: Company data

Table 7. Shareholding structure

| Shareholders  | Interest (%) |
|---------------|--------------|
| Wong Brothers | 53.19        |
| Atlantis      | 4.33         |
| Others        | 42.48        |

Source: Bloomberg

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