

## Ka Shui: A leading die casting play

**E Wuen Tan**  
(852) 2533 5697  
ewuantan@sbie2capital.com

**Recommendation: Not Rated**

**Hong Kong Industrials**

<b>Price</b>	<b>HK\$0.56</b>	<b>Yield (12/06A)</b>	<b>13.6%</b>
<b>12 mth range</b>	<b>HK\$0.46-1.61</b>	<b>ROE (12/06A)</b>	<b>65.9%</b>
<b>Market cap.</b>	<b>US\$63.2m</b>	<b>Net gearing (12/06A)</b>	<b>39.6%</b>
<b>No. shares o/s</b>	<b>880.0m</b>	<b>Net debt/sh. (12/06A)</b>	<b>HK\$0.098</b>
<b>Daily t/o, 3 mth</b>	<b>US\$0.3m</b>	<b>BV/sh. (12/06A)</b>	<b>HK\$0.24</b>
<b>Free float %</b>	<b>31%</b>	<b>Consensus EPS</b>	
<b>Major shareholder</b>	<b>Lee Yuet Fat – 69%</b>	<b>- 12/07F</b>	<b>HK\$0.109</b>
<b>Ticker</b>	<b>0822.HK/ 822 HK</b>	<b>- 12/08F</b>	<b>HK\$0.278</b>

### Key points:

- One of China's leading die casters, positioning itself as a one-stop solution provider.
- Long-term relationships with well-known customers built on good quality, reputation and execution.
- Increasing capacity to meet to growing demand.
- "First mover" advantage in the burgeoning magnesium alloy die casting market.
- Growth to come from: 1) expansion into higher-margin components; 2) new products, 3) new orders and 4) potential JV.
- Trading at an attractive 5.1x FY12/07F P/E and 2.0x FY12/08F P/E.

**China's leading die-caster.** Ka Shui is principally engaged in the manufacture and sale of zinc (Zn), magnesium (Mg) and aluminum (Al) alloy die casting components. The company has over 25 years of experience in the industry and it is one of China's largest die-casters. It sells to customers in the household, 3C (computers, communications and consumer electronics) and automotive industries.

**Table 1: Products**

<b>Category</b>	<b>Description</b>
Zinc alloy	High ductility, high impact strength, easy for plating - used in small daily use objects such as household products.
Magnesium alloy	Good stiffness, thin wall rigidity and high strength-to-weight ratio, lightweight - widely used in portable products such as 3C.
Aluminum alloy	Lightweight, good tolerance to high operating temperatures, good corrosion resistance and heat dissipation - widely used in precision parts for cars.

Source: Company data

**One-stop service provider.** The company offers extensive solutions from design conceptualization through production to final delivery. Providing more value added service such as die design, die manufacturing, does not just gives the company a competitive advantage against its rivals but also helps it to win more orders and helps it to build quality client base.

**Table 2: Turnover breakdown**

	2004		2005		2006		1H07	
	HK\$m	%	HK\$m	%	HK\$m	%	HK\$m	%
Zinc alloy die casting components	330.3	87.9	310.8	89.2	541.2	83.8	272.7	77.3
Magnesium alloy die casting components	37.2	9.9	23.9	6.9	67.2	10.4	50.8	14.4
Aluminum alloy die casting components	8.2	2.2	13.6	3.9	37.1	5.7	29.2	8.3
<b>Total</b>	<b>375.7</b>	<b>100.0</b>	<b>348.4</b>	<b>100.0</b>	<b>645.6</b>	<b>100.0</b>	<b>352.7</b>	<b>100.0</b>

Source: Company data

**Quality client base.** Kai Shui's customers include IKEA (for more than 10 years) and Schick (over 20 years). In FY12/06A, IKEA was its largest customer, contributing c.35.0% of total sales, ahead of Schick (15.0% of total sales). The long-term relationship with such well-known customers is a testimony to the company's stringent product requirements, quality, reputation and execution ability.

**Capacity expansion.** The company has two production bases in Pinghu, Shenzhen, with annual production capacity of 13,200 tonnes. It is also building a new plant, with designated capacity of 9,800 tonne on land acquired in 2006 in Daya Bay, Huizhou. The new facility, to be launched this July, will focus on the application of new alloys, automotive components, 3C products and precision moulds.

**Table 3: Interim results**

Six months to Jun	Turnover (HK\$m)	Gross profit (HK\$m)	Gross margin (%)	Pre-tax profit (HK\$m)	Tax rate (%)	Net profit (HK\$m)	EPS (HK\$)	DPS (HK\$)
1H FY06	286.4	79.9	27.9	50.1	9.0	44.5	0.067	-
1H FY07	352.7	83.7	23.7	48.4	10.5	43.3	0.065	0.012
YoY (%)	23.1	4.8		(3.4)		(2.8)		

Source: Company data

**Hong Kong's first magnesium alloy manufacturer.** According to the Hong Kong Productivity Council (HKPC), Ka Shui is China's first magnesium alloy die casting manufacturer. Launched in 2000, the operation is well positioned to capitalize on China's growing magnesium alloy die casting market driven by the growing application of magnesium alloy on 3C products.

**China's die casting industry.** With its abundant cheap labour, low input costs and rapid development of the household products industry, 3C products industry and automobile industry, China is an ideal outsourcing and production base. Its non-ferrous metal casting industry grew at the CAGR of 14.5% from 1996 to 2005, compared with the global rate of 6.4%. Currently, China is the world's second largest die casting producer after the US. According to the HKPC, its die casting output is forecast to grow at a CAGR of c. 15.7% from 2005 to 2010.

**Keen competition.** China about 3,000 die casting companies, mostly smaller players with an annual capacity of less than 1,000 tonnes. Ka Shui is among 30 die casters with an annual production capacity exceeding 5,000 tonnes. Most of the country's die casters (c. 2000 players) are based in Guangdong province.

**Taking on Taiwanese giants.** When Ka Shui successfully secured orders from Lenovo to provide computer casings 2006, it started competing with Taiwanese giants such as Foxconn (2354 TT, TWD180.0, NR) and Catchers (2474 TT, TWD94.6, NR). Currently, Ka Shui supplies about 50.0% of Lenovo's casings and Foxconn the rest.

**Growth through JVs.** Apart from growing organically, the company plans to form JVs with upstream suppliers or downstream vendors, especially with expertise in (1) product design and development; (2) advanced mould and die manufacturing and precision machining technologies; (3) magnesium and other non-ferrous metal processing technologies; (4) alloy smelting; (5) advanced plastic injection moulding technologies and (6) surface finishing treatment.

**Growth drivers.** The company is well-positioned to expand its market coverage because of:

- ❑ Ability to offer substitutes to expensive zinc alloy - Ka Shui has been actively promoting to its customers the use of magnesium and aluminium alloy as substitutes. We expect these alloy components to become the major sales contributor going forward. Its expansion into higher margin magnesium die casting components and the substitution of magnesium and aluminium for zinc alloy is likely to keep gross margins widening.
- ❑ Rapid car sector development – China's buoyant economic growth, increasing GDP and disposable incomes are fuelling demand for cars and auto parts, which Ka Shui's aluminium alloy die casting business will benefit from.
- ❑ Steady growth from customers - IKEA and Lenovo remain bullish on their business prospects and both increased their orders to Ka Shui by 20.0% in 2008.

- ❑ New products in the pipeline- electric kettles, computer disk drives and motorcycle wheels. We expect the launch in 2008 to boost the company's top line growth.

**Valuation.** The counter is currently trading at 5.1x FY12/07F P/E and 2.0x FY12/08F P/E, compared with the industry average of 11.7x and 10.1x, respectively.

**Table 4: Peer comparison**

Company name	Ticker	Market Cap (US\$m)	P/E (x)		ROA	ROE
			Current	1-yr forward		
Eva Precision Industrial	838 HK	198.8	9.3	6.0	14.2	27.0
China Metal International	319 HK	329.7	10.9	8.6	9.0	12.5
Nissei Corp	6271 JP	325.9	22.3	21.5	3.8	4.3
Ahresty Corp	5852 JP	299.7	8.0	6.7	8.1	19.2
Ryobi Ltd	5851 JP	711.3	8.6	8.3	5.2	14.0
Foxconn Tech	2354 TT	4,269.7	15.5	12.1	20.2	30.3
Catcher Tech	2474 TT	1,601.3	7.5	7.3	37.7	42.8
<i>Average</i>			<i>11.7</i>	<i>10.1</i>		

Source: Bloomberg, SBI E2-Capital

**Corporate governance.** Ka Shui was listed on the Hong Kong Stock Exchange in Jun 2007. The company appointed RSM Nelson Wheeler as its auditor. Its major shareholder, Lee Yuen Fat, holds 69.2% and the public 30.8%.

**Table 5: P&L**

Year to Dec (HK\$m)	2004	2005	2006
<b>Turnover</b>	<b>375.7</b>	<b>348.4</b>	<b>645.6</b>
Cost of sales	(275.9)	(282.1)	(464.7)
<b>Gross profit</b>	<b>99.8</b>	<b>66.3</b>	<b>180.9</b>
Other income	0.5	2.2	4.6
Selling and distribution expenses	(5.6)	(6.7)	(7.8)
General and administrative expenses	(32.5)	(41.6)	(47.4)
<b>Operating profit</b>	<b>62.2</b>	<b>20.1</b>	<b>130.4</b>
Finance cost	(1.4)	(4.5)	(8.0)
Share of (loss)/ profit of an associate	-	(0.5)	0.3
<b>Before tax profit</b>	<b>60.7</b>	<b>15.1</b>	<b>122.8</b>
Taxation	(6.1)	(2.0)	(11.3)
Minority interest	(0.9)	(0.1)	(1.9)
<b>Net profit</b>	<b>53.6</b>	<b>13.0</b>	<b>109.6</b>
Dividends	18.0	-	50.0

Source: Company data