

Better days in 2H06

Hong Kong Electronics

TPV (903 HK, HK\$7.45)

BUY (unchanged)

Target price: HK\$9.0 (+21%)

Mixed results in 2Q FY12/06. TPV reported a net profit of US\$38.9m in 2Q FY12/06, up 1.7% YoY and 10.7% QoQ. While the bottom line was in line with market expectations, we believe the market has somewhat concerned about the dollar margin decline for the LCD TV. The dollar margin for LCD TV declined to US\$4.71 (or gross margin of 1.1%) in 2Q FY12/06 (cf. US\$15.6 in 1Q FY12/06) due to a sharp decline in LCD TV panel price and high production costs of new product rollouts during the period. As a result, gross margin dropped slightly to 5.2% in 2Q FY12/06 (cf. 5.7% in 1Q FY12/06 and 6.4% in 2Q FY12/05). The company proposed to pay an interim dividend of US\$0.8 per share (cf. US\$0.72 in same period last year), which represent a payout of 20%.

Table 1: Quarterly results comparisons

(US\$m)	2Q06	2Q05	YoY (%)	1Q06	QoQ (%)
Revenue	1,713	1,005	70.5	1,538	11.3
Gross profit	90	65	38.6	87	2.7
Operating profit	53	43	23.7	50	5.2
Pre-tax profit	44	41	7.2	40	8.6
Net profit	39	38	1.7	35	10.7
Gross margin (%)	5.2	6.4		5.7	
Operating margin (%)	3.1	4.2		3.3	
Net margin (%)	2.3	3.8		2.3	

Source: Company data and SBI E2-Capital

Shipments of LCD TVs showed the strongest growth. In 2Q FY12/06, the company shipped around 6.5m units of LCD monitors (cf. 5.3m in 1Q FY12/06) and 516k units of flat panel TVs (cf. 374k in 1Q FY12/06). Meanwhile, TPV shipped around 3.3m units of CRT monitors (cf. 3.4m units in 1Q06). LCD monitors accounted for around 70% of revenue in 2Q FY12/06, followed by CRT monitors (16%) and LCD TVs (13%). The contribution from LCD TV was only 3% in the same period last year. Currently, TPV commands around 5.3% in global market share in the LCD TV arena.

Financials. Inventory, AR and AP turnover days all improved slightly in 2Q FY12/06 compared with 1Q FY12/06, we note that the company reported negative free operating cash flow in 2Q FY12/06. Inventory turnover was 47.9 days in June 06 (cf. 50.4% in March 06), AR was 64.7 days (cf. 68.5 days) and AP was 76.7

Table 2: Financial summary

Year to Dec	Net profit US\$m	EPS HK\$	EPS Δ %	P/E x	P/B x	EV/EBITDA x	Yield %	ROE %	ROCE %	N. Gearing %
04A	108.3	0.38	55.7	20.4	4.2	13.4	1.7	28.9	37.2	Cash
05A	149.6	0.53	38.1	14.8	2.4	8.5	2.4	26.1	14.5	18.9
06F	187.4	0.66	25.3	11.8	2.7	5.2	2.7	19.7	22.4	37.0
07F	241.2	0.85	28.7	9.2	2.2	4.5	3.4	17.6	25.3	28.4
08F	292.3	1.03	21.2	7.6	1.6	4.5	4.0	16.3	19.5	23.1

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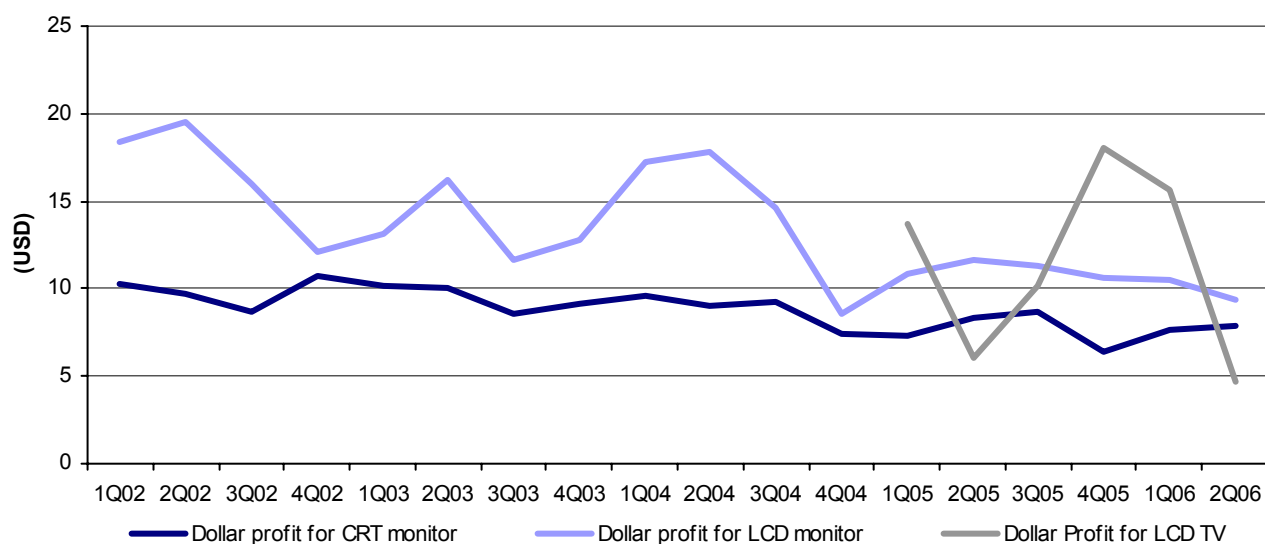
days (cf. 82.3 days). Net gearing was 20% at the end of 2Q06.

Table 3: Shipments for TPV

(k units)	1Q05	2Q05	3Q05	4Q05	1Q06	2Q06	2003	2004	2005	2006F
TFT-LCD monitor	3,017	3,895	4,437	6,319	5,273	6,504	4,508	9,365	17,668	29,227
CRT monitor	2,350	2,316	2,630	3,915	3,402	3,309	10,262	11,965	11,211	11,981
Flat TV	27	69	246	362	374	516	0	51	704	2,690
Total	5,394	6,280	7,313	10,596	9,049	10,329	14,770	21,381	29,583	43,898

Source: SBI E2-Capital

Chart 1: Dollar profit trends for TPV



Source: Company data

Second half outlook remains upbeat. Management is quite positive about the shipments sales in 2H FY12/06, which is in line with our expectations. The company expects monitor shipments to grow 15~20% QoQ in 3Q FY12/06, while shipments of LCD TV to grow over 50% HoH in 2H FY12/06 as significant decline in selling price is expected. In short, revenue is expected to grow 15~20% HoH in 2H FY12/06. TPV also expects the dollar profit to improve to double digit in 2H FY12/06 for LCD TV. We believe the profit improvement is likely for LCD TVs, given that panel prices for LCD TVs of below 32" has already stabilized. However, the company indicated that dollar margin for LCD monitors may stay at current levels in 3Q FY12/06, as the company will have to bear some of the costs of the sudden price hike in monitor panels that incurred in July of this year.

Eastern Europe production is on the way. Given the fact that Europe is charging a high import tariff (14%) for imported LCD TVs from outside of EU countries, TPV decided to finalize its production plan in Poland. Details of the new plant will be released next month with a total investment of US\$40~50m. Management claims that it would be more cost effective to produce >20" LCD TVs in Eastern Europe than in China. We consider this a good move for TPV, as the company is currently sub-contracting out some of its TVs orders (from Philips) to Eastern Europe, thus reducing the level of profitability on those orders. We expect the Eastern Europe factory could help to boost TPV's LCD TV margin going forward. We reckon that BenQ and Hon Hai also have plants in Eastern Europe to bypass the high import tariff.

LCD TV shipments could surprise the market. We like TPV based on the LCD TV growth story. We believe the theme is still valid. Panel price for 32" TV panel has already reached US\$350 in Sept., suggesting that the retail price for leading brands could be around US\$1,000 before Christmas selling season. With such attractive pricing, we believe TPV's shipment target of 2.5m units of LCD TVs for the whole of FY12/06 (almost 900k in 1H FY12/06) is highly achievable and may even surprise the market on the upside. In 1H FY12/06, TPV commanded just 5.3% global market share of LCD TVs (cf. 3.5% in 2005). One would expect the company to continue to gain more market share just like it did in the monitor arena. TPV accounted for 36% global market share of CRT monitor shipments and 21.7% for LCD monitor shipments in 1H FY12/06.

Valuation. The stock is currently trading at 9.2x FY12/07F P/E. While the valuation does not look too cheap, we believe the strong sales momentum in 2H FY12/06 could push up the share price. We reiterate our BUY rating for the counter and raised up our target price slightly to HK\$9.0 (10.5x FY12/07F P/E).