

IPE: Solid foundation for future growth

Recommendation: Not Rated

Hong Kong Industrials

Price	HK\$1.35	Yield (12/05A)	1.04%
12 mth range	HK\$1.16-2.18	ROE (12/05A)	16.54%
Market cap.	US\$128.06m	Net gearing (1H FY12/06)	20.0%
No. shares o/s	723.8m	Net debt/sh. (1H FY12/06)	HK\$0.34
Daily t/o, 3 mth	<US\$0.15m	BV/sh. (1HFY12/06)	HK\$0.81
Free float %	38.83%	Consensus EPS	
Major shareholder	Tottenham Ltd.- 48.70%	- 12/06F	HK\$0.14
Ticker	0929.HK/ 929 HK	- 12/07F	HK\$0.21

Key points:

- Achieved an interim profit growth of 27% YoY for FY12/06, driven by robust sales growth of HDD and hydraulic components.
- Annual production capacity increased c.50% to 600m pieces.
- Sales of pivot shafts and pivot housings position the company as a major global player with more than 20% global market share.
- Automotive components will become the next growth driver (from 0.6% to one third of total sales by 2009) as the company has received more certifications from customers.
- Dividend payout ratio is set at 30%.

Background. IPE is principally engaged in the manufacture and sale of high precision metal components. IPE serves a broad range of business through various business segments. The group has three major business segments—hard disk drivers (HDD) components, automotive components and hydraulic components segment. The group produces pivot shafts, pivot housings, hydraulic equipment, fiber optic connectors, automobile parts and other industrial products and office equipments. All products manufactured by IPE Group are sold on project basis to well known international manufacturers of HDD components, hydraulic products and automotive parts. The five largest customers of IPE are Seiko Instrument Thailand Limited (SIT), Nidec Precision Thailand, Micro Precision (MSP), ISC Micro Precision and NTN-Nidec, accounting for 70-80% of sales in 1H FY12/06.

Interim results summary. Turnover increased by 54.6% YoY to HK\$275m, thanks to the high demand for HDD components and hydraulic equipment components in 1H FY12/06. Gross profit rose by 51.6% to HK\$89m and net profit grew by 27.3% to HK\$39m. CAPEX incurred during 1H06 was HK\$112m. Interim dividend of HK\$0.015 per ordinary share was declared. EPS climbed from HK\$0.059 to HK\$0.060. EPS was relatively flat YoY due to the dilution effect caused by its top-up placement exercise in April 06 (placed 120m shares at HK\$1.87). Depreciation charges were higher due to its aggressive expansion in China (IPE uses straight line depreciation method). Driven by continuous demand of HDD in computer and consumer electronics market, sales of HDD pivot and spindle motor components rose by 57.3% YoY. Hydraulic components' sales surged by 55.4% YoY due to the implementation of more new projects with existing customers. The strength of hydraulic business is contributed by greater outsourcing by existing customers. As for automotive components segment, the launch of new projects leads to a 292.3% YoY increase in sales. Management expects stronger growth in this segment when more projects are launched in late 2006 and early 2007. Siemens VDO will be the biggest customer of IPE next year.

Industry overview:

- **HDD components.** Global HDD shipments typically enjoy a 10-15% YoY growth. For HDD market, NMB accounted for 60% of market share and NSK, Nidec and SIT together accounted for 40% of the market share,

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in which 70-80% of HDD pivots are supplied by IPE. Most of the global players such as Nidec, NSK, and SIT outsource their production to third parties such as IPE. The market for HDD is on an upward trend. IPE accounted for c.6.8% of the HDD spindle motor component world market, as it is the largest supplier to Nidec who owned a 67.7% market share. NMB (Minebea) accounted for 14.3%, PSEC Panasonic accounted for 11.2% and JVC accounted for 6.8% of spindle motor component market. Being the second largest global pivot maker, IPE accounted for around 25-30% of the HDD pivot world market share after NMB (Minebea) who owned around 50-60% of market share.

- ❑ **Hydraulic components.** The major market for hydraulic is North America. Global hydraulic industry grows steadily at 3% to 5% each year. Currently, IPE's customers are expanding their assembling business in China, selling more hydraulic device to domestic China market and outsourcing more assembled parts to China components manufacturers. This market has higher entry barriers because generally hydraulic component vendors need to take longer time to become a qualified vendor and each project usually lasts for 3 to 5 years after kick off.
- ❑ **Automotive components.** Many global automobile manufacturers favour outsourcing production to China, the group can gain benefit from this trend.

Raw materials. Raw materials accounted for 30% of sales in 1H06. One of the major materials is stainless steel, accounting for 40% of total cost. Other raw materials are alloy steel (accounted for 40%), aluminium (accounted for 10%) and copper (accounted for 10%).

Source and price of raw materials. The price of special steel increased around 10% in 2H 06 and is expected to increase more by year-end. The group purchases most of the stainless steel from Japan (approximately 90%); alternatively it will source the material from Taiwan and Korea. As for automotive components material, IPE will purchase the materials from Europe and US. The price for aluminium has stabilized, so the upward pressure remains on stainless steel.

Future plans:

- ❑ **HDD components.** IPE will try to maintain its leading position in terms of technology and capacity in the international marketplace. As the HDD segment has become a cash cow business, IPE will not invest a lot in this segment.
- ❑ **Hydraulic components.** IPE will diversify its focus on the turned parts, die-casting components and complete subassemblies.
- ❑ **Automotive components.** IPE hopes to increase the sales of this segment to one-third of the group's total turnover from the current 0.6% in 1H FY12/06. The management expects the growth of this segment will accelerate in the 2H 06 when it commences mass production for the Siemens VDO new orders. Management also expects that the automotive components segment will grow faster than the HDD components segment.

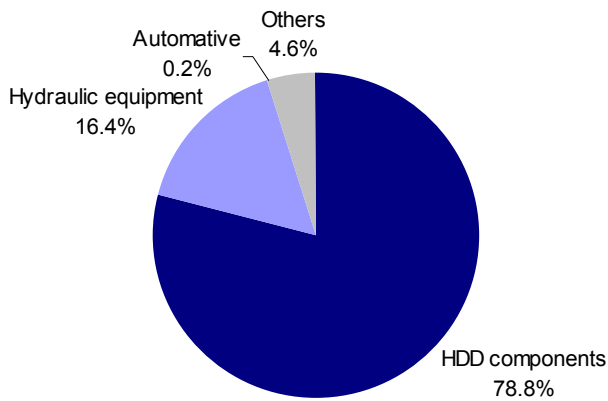
Long-term development. Management expects to increase CAPEX to HK\$1m in 2007 and invest more new machines to improve production capacity. IPE expects 2H06 turnover will be slightly better than that of 1H06.

Table 1: Peer comparisons

Company	Ticker	Currency	Share Price	Market Cap (US\$m)	P/E(x)		
					Last Year	FY1	FY2
Innovalues Precision Limited	IP SP	SGD	0.79	78.64	12.3	8.4	6.6
Unisteel Technology Limited	USTL SP	SGD	2.05	412.74	15.8	13.8	11.5
MMI Holdings Limited	MMI SP	SGD	0.98	367.31	12.9	7.0	6.0
Seksun Corporation Limited	SEK SP	SGD	0.39	91.80	13.4	7.6	6.7
Magnecomp Precision Technology	MPT TB	THB	2.10	116.76	6.6	-	10.4
Calcomp Electronics	CCET TB	THB	3.92	409.35	8.0	7.2	6.6
IPE Group Limited	929 HK	HKD	1.46	135.71	13.8	10.1	7.1

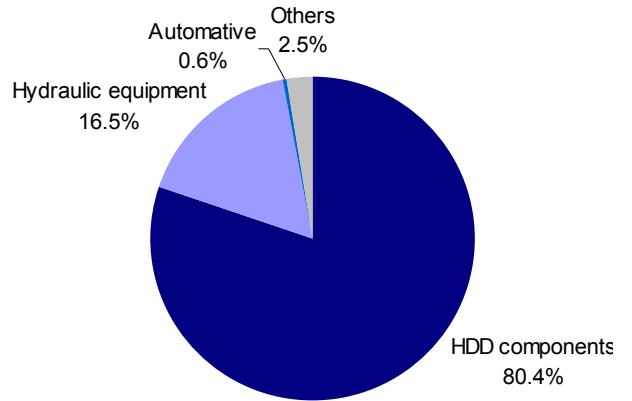
Source: Bloomberg

Chart 1: Revenue Breakdown 1H FY05



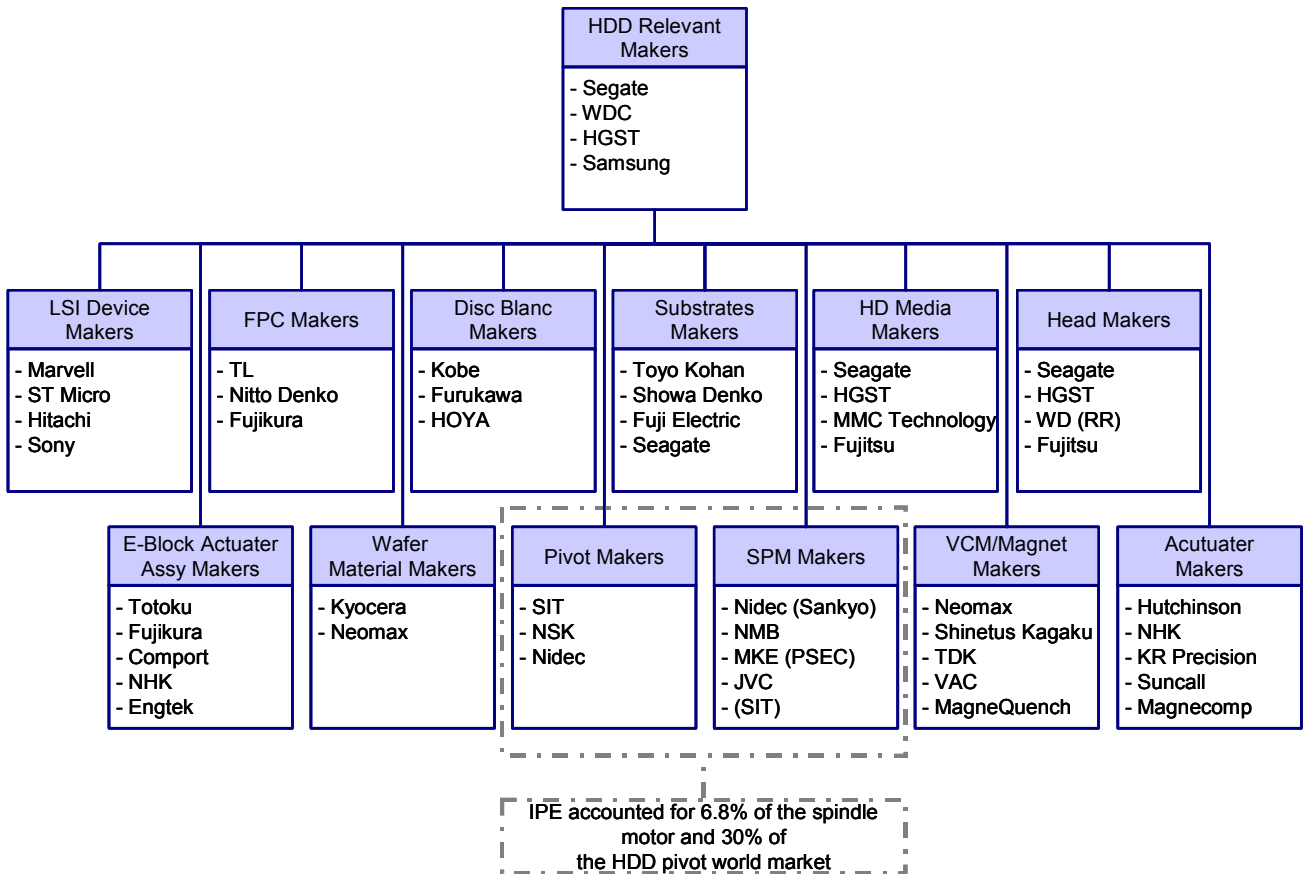
Source: Company data

Chart 2: Revenue Breakdown 1H FY06



Source: Company data

Chart 3: HDD relevant makers



Source: SBI E2-Capital

P & L (HK\$m)	03A	04A	05A	Cash Flow (HK\$m)	04A	05A
Year to Dec				Year to Dec		
Turnover	208.3	281.8	406.0	EBIT	61.7	73.1
% chg	-	35.3	44.1	Depre./amort.	24.5	46.1
Gross profit	86.4	94.6	123.6	Net int. paid	(4.2)	(5.9)
				Tax paid	(3.3)	(4.3)
EBITDA	49.5	86.2	119.2	Dividends received	-	-
Depre./amort.	(18.3)	(24.5)	(46.1)	Gross cashflow	78.7	109.0
EBIT	31.2	61.7	73.1	Chgs. in working cap.	(79.5)	(36.8)
Net int. income/(exp.)	(3.8)	(4.2)	(5.9)	Operating cashflow	(0.8)	72.2
Exceptionals	-	-	-	Capex	(82.5)	(199.3)
Associates	-	-	-	Free cashflow	(83.3)	(127.1)
Jointly-controlled entit.	-	-	-	Dividends paid	(11.1)	(19.8)
Pre-tax profit	27.4	57.5	67.2	Net distribution to MI	-	-
Tax	(5.4)	(4.3)	(2.8)	Investments	0.0	0.0
Minority interests	0.2	(0.0)	-	Disposals	4.0	0.0
Net profit	22.2	53.2	64.4	New shares	71.8	112.3
% chg	-	139.6	21.1	Others	(0.7)	(88.3)
Dividends	(5.0)	(15.1)	(21.8)	Net cashflow	(19.3)	(122.9)
Retained earnings	17.2	38.1	42.6	Net (debt)/cash - Beg.	(59.2)	(78.5)
				Net (debt)/cash - End.	(78.5)	(201.4)
EPS (HK\$) - Basic	0.114	0.135	0.114	Interim Results (HK\$m)	04A	05A
EPS (HK\$) - F.D.	-	0.134	0.106	Six months ended 30 Jun		
DPS (HK\$)	-	0.018	0.030	Turnover	131.4	178.0
No. sh.s o/s (m) - W.A.	-	393.8	567.1	% chg		275.0
No. sh.s o/s (m) - Y.E.	-	500.0	601.1	Profit from operations	26.22	37.4
No. sh.s o/s (m) - F.D.	-	394.7	606.0	Interest expenses	(2.1)	(3.7)
				Associates	-	-
Margins (%)				Jointly-controlled entit.	-	-
Gross	41.5	33.6	30.4	Pre-tax profit	24.1	33.7
EBITDA	23.8	30.6	29.4	Tax	(2.0)	(3.0)
EBIT	15.0	21.9	18.0	Minority interests	0.0	-
Pre-tax	13.2	20.4	16.5	Net profit	22.1	30.7
Net	10.7	18.9	15.9	% chg	-	38.9
				EPS (HK\$) - Basic	0.061	0.059
				DPS (HK\$)	-	0.015
						0.015
Balance Sheet (HK\$m)	03A	04A	05A	Shareholding Structure	Shares o/s (m)	%
Year to Dec				Tottenham Limited	352.50	48.70
Fixed assets	235.3	337.3	680.0	Invesco Hong Kong Limited	50.47	6.97
Intangible assets	(26.8)	(25.3)	-	JP Morgan Chase & Co.	47.81	6.61
Other LT assets	1.5	34.7	35.6	Public	273.04	37.72
Cash	6.3	52.2	158.4	Total	723.82	100.00
Accounts receivable	63.4	77.5	124.7			
Other receivables	13.6	16.1	7.3			
Inventories	30.3	54.0	127.0			
Due from related co.s	-	-	-			
Other current assets	11.8	11.5	1.2			
Total assets	335.4	558.0	1,134.2			
Accounts payable	(24.7)	(83.8)	(83.1)	Background		
Other payable	(30.4)	(44.1)	(200.0)	IPE Group is a leading manufacturer of high precision metal components.		
Tax payable	(2.9)	(1.6)	(1.8)	The group has three major business segments- hard disk drivers (HDD)		
Due to related co.s	-	-	-	components, automotive components and hydraulic components segments.		
ST debts	(37.7)	(59.1)	(115.2)	All products manufactured by IPE Group are sold on project basis to well		
Other current liab.	(21.8)	-	(2.9)	known international manufacturers of HDD components, hydraulic products		
LT debts	(27.8)	(71.6)	(244.6)	and automotive parts.		
Other LT liabilities	(29.2)	(4.0)	(1.9)			
Total liabilities	(174.5)	(264.2)	(649.5)			
Share capital	0.0	50.0	60.1	Key Ratios	03A	04A
Reserves	160.9	243.7	424.5	Net gearing (%)	Cash	Cash
Shareholders' funds	160.9	293.7	484.6	Net ROE (%)	13.8	23.4
Minority interest	0.01	0.02	-	EBIT ROCE (%)	9.1	19.0
Total	161.0	293.7	484.6	Dividend payout (%)	22.5	28.4
Capital employed	226.5	424.4	844.4	Effective tax rate (%)	19.7	7.5
Net (debt)/cash	(59.2)	(78.5)	(201.4)	Net interest coverage (x)	8.2	14.7
				A/R turnover (days)	111.1	91.3
				A/P turnover (days)	43.3	70.3
				Stock turnover (days)	90.7	82.2
						117.0