

1Q results in line

Hong Kong Industrial

Karrie Int'l (1050 HK, HK\$2.43)

HOLD (unchanged)

Target price: HK\$2.59 (+7%)

- Turnover declined 8% to HK\$753.2m while net profit fell 12% to HK\$33.3m for 1Q FY3/07 (for the period of April to Jun 2006), in line with our full year view of a 19% profit decline. Sales split between Metal & Plastic and EMS was 48:52 for the quarter compared with 39:61 a year ago, resulting in a stable gross margin of 9.8% as the later commands lower margins.
- Unaudited July 06 sales were HK\$275m, compared with HK\$280m a year ago.
- Nonetheless, management is more upbeat about the outlook for 2H FY3/07, guiding a better performance over that of 1H.
- In addition, the company will raise its capex from HK\$70m to HK\$100m for FY3/07 as a result of the confidence on the future.
- Hence, the company announced a change in dividend policy from no less than a 50% payout to a more flexible ratio dependent on a combination of net profit, cash flow and capex requirements. This new policy will take effect from the final results of FY3/07 while the old policy is still applicable for the upcoming interim results. As such, we have tuned down our dividend payout assumption to 46%, 43% and 39% for FY3/07 to FY3/09 (from >50%).
- In any case, the company continued to generate robust operating and free cash inflow of HK\$80m and HK\$31.5m for the quarter, respectively. Net debt was also reduced to just HK\$34.8m from HK\$111.6m as of end of last quarter. Despite this, management expect net gearing will rise to 30% (from current 6%) as the company reaches peak shipment season in the 2H of the calendar year, which in general requires more working capital, in addition to payment of the FY3/06 final dividend in Aug.
- Although 2H outlook is expected to improve but management continues to guide for a flat turnover growth for the full year FY3/07. As such, we maintain our HOLD recommendation and forecasts but have revised down the target price from HK\$2.96 to HK\$2.59 based on 7x FY3/07 P/E.

Table 1: Financial summary

Year to	Net profit	EPS	EPS	P/E	P/B	EV/EBITDA	Yield	ROE	ROCE	N. Gearing
Mar	HK\$m	HK\$	Δ %	x	x	x	%	%	%	%
05A	146.6	0.362	57.4	6.7	2.20	5.7	8.6	35.5	20.0	57.0
06A	186.4	0.455	25.6	5.3	1.90	4.1	10.3	38.2	21.4	22.8
07F	151.6	0.368	(19.2)	6.6	1.65	5.1	7.0	26.7	18.5	23.9
08F	183.2	0.444	20.9	5.5	1.40	4.2	7.8	27.7	21.4	11.9
09F	213.6	0.518	16.5	4.7	1.18	3.4	8.2	27.4	21.8	0.6

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Table 2: Quarterly results

Year to Mar (HK\$m)	1Q FY05	2Q FY05	3Q FY05	4Q FY05	1Q FY06	2Q FY06	3Q FY06	4Q FY06	1Q FY07
Turnover	559.5	594.0	703.4	706.4	819.3	945.7	1,028.2	799.5	753.2
Cost of sales	(493.0)	(520.4)	(615.3)	(616.5)	(738.3)	(853.9)	(928.0)	(691.2)	(679.5)
Gross profit	66.4	73.6	88.1	89.9	81.0	91.8	100.3	108.3	73.7
Other revenue	2.1	3.6	1.9	4.7	2.4	2.9	3.7	5.6	8.7
Distribution & selling expenses	(6.8)	(7.3)	(8.7)	(7.8)	(6.0)	(7.3)	(9.0)	(8.9)	(7.3)
General & admin expenses	(27.8)	(31.0)	(32.3)	(30.0)	(30.8)	(34.0)	(37.1)	(34.4)	(33.5)
Profit from operations	33.9	39.3	48.6	53.9	46.6	53.4	57.9	60.6	41.6
Finance costs	(1.2)	(2.2)	(2.2)	(3.1)	(5.5)	(5.6)	(6.7)	(6.8)	(5.0)
Associates	(0.8)	(0.9)	(1.4)	(7.2)	-	-	-	-	-
Profit before tax	31.9	36.2	45.1	46.5	41.1	47.8	69.1	46.2	36.5
Tax	(3.0)	(3.3)	(4.1)	(2.8)	(3.6)	(4.2)	(4.5)	(5.5)	(3.2)
Net profit	29.0	32.9	40.9	43.8	37.5	43.6	46.8	58.5	33.3
<i>Gross margin (%)</i>	11.9	12.4	12.5	12.7	9.9	9.7	9.8	13.5	9.8
<i>Operating margin (%)</i>	6.1	6.6	6.9	8.6	5.7	5.6	5.6	7.6	5.5
<i>Pre-tax margin (%)</i>	5.7	6.1	6.4	6.5	5.0	5.1	6.7	5.8	4.9
<i>Net margin (%)</i>	5.2	5.5	5.8	8.3	4.6	4.6	4.6	7.3	4.4

Source: SBI E2-Capital and company data

Table 3: Earnings model

Year to Mar (HK\$m)	2004A	2005A	2006A	2007F	2008F	2009F
Turnover						
Metal & plastic products	963.0	1,172.8	1,431.4	1,445.7	1,546.9	1,670.7
Electronic manufacturing services	730.0	1,390.4	2,161.3	2,161.3	2,420.7	2,735.4
	1,693.0	2,563.2	3,592.7	3,607.1	3,967.6	4,406.1
Operating profit						
Metal & plastic products	80.6	121.3	161.9	128.7	151.6	170.4
Electronic manufacturing services	19.4	45.2	52.1	43.2	53.3	65.6
	99.9	166.4	214.0	171.9	204.9	236.1
Other revenue	6.6	12.3	14.6	12.3	10.6	13.0
Other income	5.0	8.3	4.5	4.5	4.5	4.5
Interest income	1.6	4.0	10.1	7.8	6.1	8.5
Interest expenses	(6.1)	(8.7)	(24.5)	(18.2)	(14.8)	(15.1)
Associates	(1.8)	(10.2)	0.0	-	-	-
Pre-tax profit	98.6	159.8	204.1	166.0	200.7	233.9
Tax	(8.2)	(13.2)	(17.8)	(14.4)	(17.5)	(20.3)
Net profit	90.4	146.6	186.4	151.6	183.2	213.6
% chg	(25.3)	62.1	27.2	(18.7)	20.9	16.5
Dividends	(80.2)	(85.9)	(102.8)	(70.1)	(78.3)	(82.5)

Source: SBI E2-Capital