

## HL Technology

### Multiple drivers to sustain the growth

to summarize...

- Reference target price at HK\$3.00.
- The company is a global leading “one-stop” supplier of cable assembly and connectors, which are mainly used in consumer electronics.
- Industry entry barriers are witnessed by the high market concentration. Top five vendors captured 71-94% global market share in 1H.
- HLT built its own competitive edge upon consistent research input and thorough cost control. The company outperformed the market in the past three years in turns of market share and gross margin.
- FY12/10F profit is guided at Rmb150m+, up from Rmb88m one year ago.
- Growth looks sustainable, underpinned by the strong momentum of consumer electronics industry, new customers coming-in and new products rollout. Net profit is estimated to increase 22% in FY12/11F to Rmb184m.
- Market demand for HLT’s existing products is anticipated to grow at double-digit. New customers, mainly Japanese brands, may contribute 5-10% of total revenue in FY12/11F. Three more new products will be put into operation this year.
- The counter is trading at 9.0x FY12/11F (market consensus: 7.7x) in our base-case scenario, which is at the lower end of peer group.

**A consumer electronics-related player.** Headquartered in Weihai, Shandong province, HL Technology (HLT) is a “one-stop” provider of cable assembly and connectors, which are mainly used in consumer electronics such as laptop PCs (~30% of sales), desktop PCs (~25% of sales), digital cameras (~20% of sales), mobile handsets, TVs and etc. Principal products include external signal cable assembly (ESCA), internal signal cable assembly (ISCA), power cord assembly (PCA) and signal transmission wire & cable (STWC), which accounted for 25%, 22%, 18% and 24% of the company’s total revenue, respectively, in 1H FY12/10A.

**Industry barriers witnessed by high market concentration.** We believe the industry barriers stand upon technology, scale and client relationship, which are relatively high suggested by concentrated market occupation. For ESCA, ISCA, PCA and STWC, the top five vendors controlled 70-95% global market in 1H 10. HLT’s share was 21.8%, 19.0%, 5.6% and 7.3%, respectively, ranking No. 2, No. 3, No. 5 and No. 3.

**Table 1. Top five players for the four principal products in 1H 10**

	ESCA	Market share	Notebook ISCA	Market share
No. 1	Foxconn	29.4%	Foxconn	25.4%
No. 2	HLT	21.8%	Wanshih	19.5%
No. 3	Luxshare	16.3%	HLT	19.0%
No. 4	Horton	12.2%	ACON	17.2%
No. 5	Glory Mark	6.5%	Marunix	13.0%
<b>Top 5 aggregate</b>		<b>86.2%</b>		<b>94.1%</b>
	PCA	Market share	STWC	Market share
No. 1	I-Sheng	29.3%	Sumitomo	28.5%
No. 2	Longwell	21.4%	LTK	21.7%
No. 3	Line Tek	18.8%	HLT	7.3%
No. 4	Well Shin	19.1%	Copartner	6.9%
No. 5	HLT	5.6%	Space Shuttle	6.6%
<b>Top 5 aggregate</b>		<b>94.2%</b>		<b>71.0%</b>

Source: Frost & Sullivan

Ticker	1087 HK
Rating	Not Rated
Price (HK\$)	2.63
Target Price (HK\$)	n.a.
12m Price Range (HK\$)	1.94-2.80
Market cap. (US\$m)	242.8
Daily t/o (US\$m)	2.9
Free float (%)	30.3

#### Financial summary

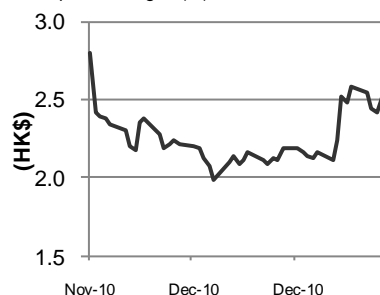
Year to Dec	07A	08A	09A
Turnover (RMBm)	653	898	872
Net Profit (RMBm)	63	54	88
EPS (RMB)	0.132	0.112	0.169
P/E (x)	17.3	20.4	13.5
P/B (x)	7.26	5.58	3.90
EV/EBITDA (x)	17.2	15.1	11.1
Yield (%)	0.0	0.0	0.0
ROE (%)	36.8	27.8	32.8
ROCE (%)	23.4	17.2	17.7
N. Gear. (%)	56.9	83.6	72.9

Source: SBI E2-Capital

	10F	11F	12F
Consensus EPS (RMB)	0.215	0.285	0.415
Previous earnings (RMBm)	-	-	-
Previous EPS (RMB)	-	-	-

#### Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	+18.5	n.a.	n.a.
Actual price changes (%)	+22.9	n.a.	n.a.



Source: Bloomberg

Norman Zhang, CFA

(852) 2533 3723

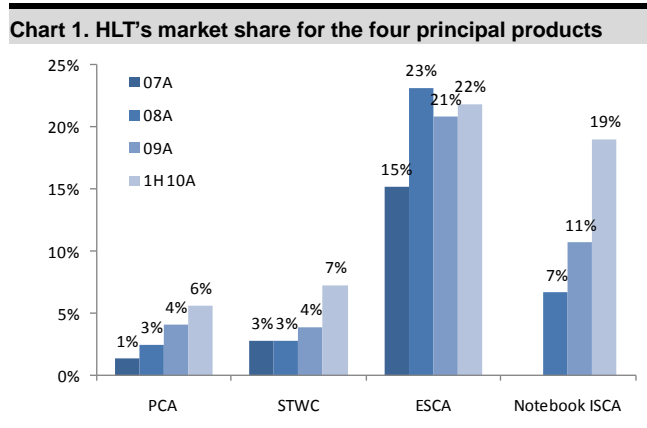
[normanzhang@sbie2capital.com](mailto:normanzhang@sbie2capital.com)

**Competitive edge built upon R&D and cost control.** The management believes its major strength relies on R&D and cost control, which not only ensures a better-than-average gross margin but also ability to expand market occupation. According to our survey, HLT's gross margin was 5-7pcp higher than industry average. Meanwhile, market share expansion was recorded for all the four principal products from 2007 to 1H 10.

- R&D – HLT has one of the highest research budgets among the industry in terms of either absolute amount or proportion to revenue. Such investment enables the company to: 1) trace technology and market movement; 2) develop more profitable new products.
- Cost control – A vertically-integrated operation model has been established. Compared with its peers, HLT has extra advantage on: 1) localization as a pure Chinese company (majority of the competitors are Taiwanese); 2) geographic allocation of its manufacturing facilities nationwide (Weihai, Suzhou, Dezhou and Wuhan), covering major consumer electronic production centres in China.

Company	Ticker	07A	08A	09A
HLT	1087 HK	20.7%	19.5%	22.7%
Line Tek	2462 TT	13.3%	15.1%	19.8%
Space Shuttle	2440 TT	10.3%	-3.1%	16.9%
ACON	5491 TT	21.2%	18.6%	21.0%
I-Sheng	6115 TT	11.7%	12.0%	21.0%
Glory Mark	8159 HK	10.8%	9.3%	16.0%
Wanshih	6134 TT	17.5%	14.3%	18.3%
Horton	3092 TT	17.7%	10.2%	13.2%
Longwell	6290 TT	8.5%	11.9%	24.0%
Foxconn	2038 HK	9.2%	6.9%	5.9%
Copartner	3550 TT	15.7%	14.8%	20.9%
Luxshare	002475 CH	19.2%	19.0%	21.6%
<b>Average</b>		<b>14.1%</b>	<b>11.7%</b>	<b>18.1%</b>

Source: Bloomberg



Source: Frost & Sullivan

Year to Dec	Company	R&D expenditure (US\$m)				R&D expenditure / turnover (%)			
		07A	08A	09A	3-Y total	07A	08A	09A	3-Y average
HLT	1087 HK	3.0	3.8	4.0	10.8	3.5	2.9	3.1	3.2
Line Tek	2462 TT	0.5	0.7	0.6	1.8	0.6	0.6	0.6	0.6
Space Shuttle	2440 TT	0.1	0.1	0.1	0.3	0.1	0.1	0.2	0.1
ACON	5491 TT	9.7	11.3	12.3	33.2	5.1	4.3	5.2	4.9
I-Sheng	6115 TT	0.4	0.6	1.0	2.0	0.2	0.2	0.5	0.3
Wanshih	6134 TT	1.2	1.3	5.8	8.3	0.9	0.7	2.9	1.5
Horton	3092 TT	0.2	0.2	0.4	0.8	0.4	0.3	0.6	0.4
Longwell	6290 TT	1.1	1.2	0.9	3.1	0.5	0.6	0.5	0.6
Foxconn	2038 HK	100.9	230.9	195.3	527.0	0.9	2.5	2.7	2.1
Copartner	3550 TT	1.5	1.7	1.4	4.6	0.8	1.0	1.2	1.0

Source: Bloomberg

**Multiple drivers in sight.** We reckon the entire consumer electronics industry will likely to remain prosperous (double-digit growth) backed by economy recovery and technology innovation, which serves as solid ground for HLT to grow its business. Amid this backdrop, specific drivers may include:

- New customers – the company used to supply Korean and Taiwanese clients. It has been qualified by several Japanese brands such as Canon and shipment will start this year. The management estimates new customers will contribute 5-10% of its total revenue in FY12/11F. Meanwhile, cross selling opportunity exists within existing customer base.
- New products – operation of wireless antenna and low smoke free halogen (LSFH) insulating material started already. Other three new products (automotive wiring harness, specialty power cable and solar connector) will launch this year. Sales of these products are anticipated to account for ~10% of FY12/11F revenue, which will further increase to ~30% the next year. Although impact on the bottom line is minimal at the beginning stage, the new products carry higher gross margin (~30%, versus blended 22.6% in 1H FY12/10A) and may make meaningful contribution in FY12/12F.

Product	Status
Antenna	Operation launched in 2010
LSFH	Shipment to Samsung started already in 2010
Automotive wiring harness	Business will be obtained through M&A. Volume manufacturing will start in 1H 11
Special power cable	Volume manufacturing will start by 2H 11
Solar connector	Volume manufacturing will start by 2H 11

Source: compiled by SBI E2-Capital

**Table 5. Industry outlook by product**

Product	07-09A CAGR	09A-13E CAGR	Key applications
ESCA	-8.7%	16.9%	display, LCD and LED TV, notebook, digital camera, mobile handset, printer
ISCA	21.7%	17.0%	notebook
PCA	2.5%	18.2%	PC, display, notebook, LCD and LED TV
STWC	-9.2%	33.5%	Signal cable assembly
Connector	-12.1%	21.9%	automotive, computer & computer peripherals, communication, industrial equipment and aviation/military
Antenna	1.5%	6.8%	notebook, router, GPRS and mobile handsets
Automotive wiring harness	-6.9%	7.1%	automobile
Specialty power cable	18.5%	19.2%	solar, ship board, wind power, railway
Solar connector	2.6%	25.1%	solar

Source: Frost & Sullivan

**Profitability immunized from copper price fluctuation.** Copper accounted for ~45% of HLT's COGS in 1H FY12/10A. Despite the fluctuation of copper price, its impact on gross margin seems insignificant thanks to the company's pricing policy. Around half of HLT's orders use floating price, calculated based on the actual copper cost incurred during production. For the other half, copper cost is locked in via forward contracts at inception. Comparably, competition environment and a certain product's life stage are two major factors in our eyes, to influence gross margin. Accordingly to the management, a new product normally enjoys higher gross margin (~30%), which stabilizes at ~20% when matures.

**Growth to retain.** The company was listed in HK exchange in Nov 10. A Rmb150+ net profit was guided for FY12/10F (1H: Rmb70m), up 71% YoY. The management re-affirmed the guidance in a recent tele-conference. For the next year, we are optimistic and looking for 54% jump on top line to Rmb2,104m, backed by: 1) double-digit growth of the consumer electronics market; 2) acquisition of new clients (5-10% of revenue); 3) launch of new products (10% of revenue); 4) hiking copper price (Rmb69,300/mt in Dec 10, 17% higher than the year average of Rmb59,167), which will certainly push up ASP. Assuming absolute gross margin (i.e. per unit gross profit) will remain unchanged (**base-case scenario**), we calculate the company's bottom line with reach Rmb184m in FY12/11F. The number will be Rmb219m and Rmb161m, respectively, in our **bull-case scenario** (assuming intact percentage gross margin) and **bear-case scenario** (assuming declining absolute gross margin).

**A reference target price at HK\$3.00.** The counter is trading at 10.9 multiples of our estimated earnings for FY12/10F or 9.0 times FY12/11F, which looks undemanding compared with 44.3% CAGR from FY12/09A through FY12/11F. The peers group's P/E range is 7.7-73.9x two year forward. By applying the average ratio (excl. Foxconn and Luxshare) of 10.2X, we derive a reference price target at HK\$3.00. We reckon even a premium valuation might be justifiable given HLT's better-than-average growth pattern during the track record period (i.e. market share expansion) as well as the high growth potential.

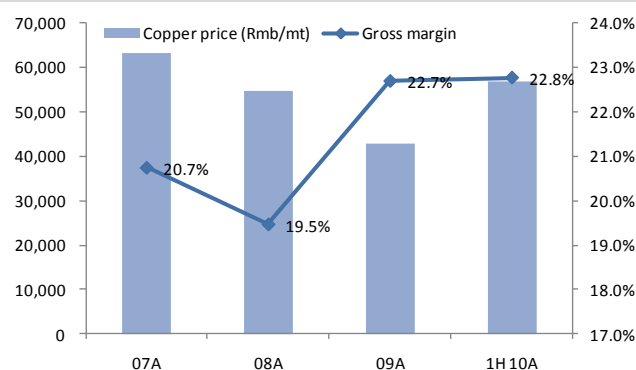
**Risks.** We think market risk is the major uncertainty the company needs to face at the moment.

**Table 6. Valuation matrix**

Company	Ticker	Fiscal year end	Market cap (US\$m)	Historical PER (x)	1-year PER (x)	2-year PER (x)	P/BV (x)	ROE (%)
HLT	1087 HK	12/2009	242.8	13.2	10.4	7.8	n.a.	32.8
Line Tek	2462 TT	12/2009	90.8	6.8	8.5	7.7	1.8	29.4
LTK	LTK MK	03/2010	591.0	18.7	16.0	14.0	4.4	20.3
Space Shuttle	2440 TT	12/2009	42.3	14.1	n.a.	n.a.	0.8	7.2
ACON	5491 TT	12/2009	102.7	10.8	n.a.	n.a.	0.9	7.6
I-Sheng	6115 TT	12/2009	264.7	7.6	10.2	10.7	1.9	25.9
Glory Mark	8159 HK	12/2009	15.3	6.7	n.a.	n.a.	n.a.	14.9
Wanshih	6134 TT	12/2009	95.0	5.9	3.8	n.a.	1.5	27.4
Horton	3092 TT	12/2009	56.1	18.1	n.a.	n.a.	1.5	8.6
Longwell	6290 TT	12/2009	190.0	9.6	9.8	8.3	1.9	21.3
Foxconn	2038 HK	12/2009	5,307.3	n.a.	n.a.	73.9	1.5	1.1
Copartner	3550 TT	12/2009	89.4	9.3	n.a.	n.a.	1.0	11.6
Luxshare	002475 CH	12/2009	1,280.0	84.1	68.9	42.2	19.5	27.6
Average				17.4	19.5	26.2	3.3	16.9
Average excl. Foxconn and Luxshare				10.7	9.7	10.2	1.7	17.4

Source: Bloomberg

**Chart 2. HLT's gross margin versus copper price**



Source: Company data, Bloomberg

Table 7. Preliminary forecasts

Year to Dec	07A	08A	09A	1H 10A	2H 10F	10F	11F		
							Base-case	Bull-case	Bear-case
<b>Copper price (Rmb/mt)</b>	63,120.0	54,591.7	42,798.3	56,800.0	61,534.2	59,167.1	69,300.0	69,300.0	69,300.0
<b>Output (units m)</b>									
ESCA	58.2	74.6	75.2	49.4	49.4	83.0	104.1	104.1	104.1
ISCA	22.7	8.6	20.4	32.6	32.6	52.3	67.1	67.1	67.1
PCA	12.2	24.2	47.8	39.7	39.7	54.5	70.7	70.7	70.7
STWC	0.4	0.6	0.7	0.7	0.7	1.0	1.3	1.3	1.3
Connector	42.2	124.6	146.5	89.8	89.8	133.2	168.8	168.8	168.8
<b>Effective ASP (turnover/output volume) (Rmb/unit)</b>									
ESCA	5.41	5.73	4.29	3.86	4.14	4.00	4.41	4.53	4.31
ISCA	3.18	9.81	6.22	5.26	5.61	5.43	5.96	6.15	5.84
PCA	4.88	4.76	3.56	4.14	4.46	4.30	4.77	4.87	4.73
STWC	322.49	300.08	249.74	313.32	336.59	324.96	359.72	367.87	354.97
Connector	0.03	0.19	0.25	0.31	0.33	0.32	0.35	0.36	0.34
<b>Gross margin</b>									
ESCA	23.2%	20.2%	23.0%	22.8%	21.3%	22.0%	20.0%	22.0%	18.2%
ISCA	17.8%	25.3%	25.5%	27.7%	26.0%	26.8%	24.4%	26.8%	22.9%
PCA	18.2%	15.5%	18.7%	17.6%	16.4%	17.0%	15.3%	17.0%	14.5%
STWC	19.8%	20.0%	26.8%	19.7%	18.3%	19.0%	17.1%	19.0%	16.0%
Connector	8.1%	15.1%	27.3%	30.6%	28.8%	29.7%	27.2%	29.7%	25.1%
New products							10.0%	10.0%	10.0%
<b>Effective gross profit per unit (gross profit/output volume) (Rmb/unit)</b>									
ESCA	1.25	1.16	0.99	0.88	0.88	0.88	0.88	1.00	0.78
ISCA	0.57	2.48	1.59	1.46	1.46	1.46	1.46	1.65	1.34
PCA	0.89	0.74	0.66	0.73	0.73	0.73	0.73	0.83	0.68
STWC	64.01	60.09	66.84	61.69	61.69	61.69	61.69	69.83	56.93
Connector	0.00	0.03	0.07	0.09	0.09	0.09	0.09	0.11	0.08
<b>Revenue (Rmbm)</b>									
ESCA	314.9	427.2	322.5	160.4	171.8	332.2	459.4	471.5	449.3
ISCA	72.3	83.9	126.6	137.4	146.5	283.9	399.6	412.5	391.6
PCA	59.7	115.3	170.2	112.8	121.4	234.2	337.4	344.2	334.1
STWC	142.2	173.4	172.1	153.2	164.6	317.8	464.4	474.9	458.2
Connector	1.4	23.1	36.1	20.4	21.7	42.1	58.3	60.3	56.7
New products							200.0	200.0	200.0
Others	62.0	75.0	44.9	51.6	103.1	154.7	185.6	185.6	185.6
<b>Gross profit (Rmbm)</b>	135.3	174.8	198.0	144.0	157.0	301.0	403.5	447.9	374.3
<b>Operating profit (Rmbm)</b>	77.3	81.7	110.5	87.4	100.1	187.5	220.4	260.9	193.7
<b>Net profit (Rmbm)</b>	62.7	54.4	88.3	69.7	81.0	150.7	183.7	218.9	160.6

Source: Company data, SBI E2-Capital

**Table 8. Key financials**

Year to Dec (Rmbm)	07A	08A	09A
Revenue	652.6	898.0	872.4
Gross profit	135.3	174.8	198.0
Operating profit	77.3	81.7	110.5
Net profit	62.7	54.4	88.3
EBITDA	89.8	102.2	139.7
Fixed assets	193.8	268.4	308.6
Inventories	139.1	115.3	115.6
Receivables	241.3	338.8	423.5
Payables	320.6	335.3	302.0
Cash	39.1	58.4	115.2
Short-term debt	140.2	243.3	353.4
Long-term debt			
Shareholders' fund	170.1	221.1	316.6
Total equity	177.6	221.1	327.0
Net cash from operating activities	10.8	1.7	0.5
Net cash used in investing activities	(92.0)	(117.5)	(70.5)
Net cash from financing activities	90.9	119.4	120.4
Net change in cash and cash equivalents	9.7	3.6	50.3

Source: Company data

**Table 9. P&L**

Year to Dec (Rmbm)	07A	08A	09A	1H 10A
Revenue	652.6	898.0	872.4	635.7
Cost of sales	(517.3)	(723.2)	(674.4)	(491.7)
Gross profit	135.3	174.8	198.0	144.0
Other gains and losses	10.8	(2.5)	8.3	(2.0)
Distribution and selling expenses	(14.8)	(18.9)	(20.5)	(12.9)
Administrative and general expenses	(30.9)	(45.4)	(48.0)	(29.0)
Research and development expenses	(23.2)	(26.3)	(27.3)	(12.7)
Profit from operations	77.3	81.7	110.5	87.4
Finance costs	(9.1)	(15.6)	(13.9)	(8.9)
Share of loss of an associate	(0.2)	0.0	0.0	-
Profit before taxation	68.0	66.1	96.6	78.5
Income tax expenses	(2.4)	(11.5)	(8.1)	(8.3)
Profit for the period	65.5	54.5	88.5	70.2
Attributable to:				
Owners of the Company	62.7	54.4	88.3	69.7
Non-controlling interests	2.8	0.1	0.2	0.5
EPS - Basic (Rmb)	0.132	0.112	0.169	0.133

Source: Company data

**Table 10. Shareholding structure**

Shareholders	Interest
hi Shaolin	40.87%
Yongchang Joint Stock Company Limited	18.59%
Hongxin Joint Stock Company Limited	5.11%
Others	35.43%
Total	100.00%

Source: HKEx

---

SBI E2-Capital is a dedicated small/mid cap investment banking/ stockbrokerage house. Find our research on: [sbie2capital.com](http://sbie2capital.com), [thomsononeanalytics.com](http://thomsononeanalytics.com), [factset.com](http://factset.com) and [multex.com](http://multex.com)

**SBI E2-Capital stock ratings:**

**STRONG BUY** : absolute upside of >50% over the next three months

**BUY** : absolute upside of >10% over the next six months

**HOLD** : absolute return of -10% to +10% over the next six months

**SELL** : absolute downside of >10% over the next six months

Investors should assume that SBI E2-Capital is seeking or will seek investment banking or other related businesses with the companies in this report.

**Analyst certification:** The views expressed in this report accurately reflect the analyst's personal views of the subject securities and that the analyst has not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

**Disclaimer:** This research report is not an offer to sell or the solicitation of an offer to buy or subscribe for any securities. The securities referred to in this report may not be eligible for sale in some jurisdictions. The information contained in this report has been compiled by the Research Department of SBI E2-Capital Securities Limited ('SBI E2-Capital') from sources that it believes to be reliable but no representation, warranty or guarantee is made or given by SBI E2-Capital or any other person as to its accuracy or completeness. All opinions and estimates expressed in this report are (unless otherwise indicated) entirely those of SBI E2-Capital as of the date of this report only and are subject to change without notice. Neither SBI E2-Capital nor any other person, accepts any liability whatsoever for any loss howsoever arising from any use of this report or its contents or otherwise arising in connection therewith. Each recipient of this report shall be solely responsible for making its own independent investigation of the business, financial condition and prospects of the companies referred to in this report. SBI E2-Capital and their respective officers, directors and employees, including persons involved in the preparation or issuance of this report, may from time to time (1) have positions in, and buy or sell, the securities of companies referred to in this report (or related investments); (2) have a consulting, investment banking or broking relationship with any company referred to in this report; and (3) to the extent permitted under applicable law, have acted upon or used the information contained or referred to in this report including effecting transactions for their own account in an investment (or related investment) in respect of any company referred to in this report, prior to or immediately following its publication. This report may not have been distributed to all recipients at the same time. This report is issued only for the information of and may only be distributed to professional investors and dealers in securities and must not be copied, published, reproduced or redistributed (in whole or in part) by any recipient for any purpose. This report is distributed in Hong Kong by SBI E2-Capital. Any recipient of this report who requires further information regarding any securities referred to in this report should contact the relevant office of SBI E2-Capital located in such recipient's home jurisdiction.

Copyright © SBI E2-Capital Securities Limited 2008. All rights reserved.

---