

HL Technology

Yet to wait for market recovery

to summarize...

- Q4 orders not as strong as previously expected
- Further slight margin squeeze in 2H 2011 on weak market demand
- Downward revision of numbers for 2011
- HL Tech remains fundamentally strong and positions for recovery in 2012
- Expect to receive more additional orders from new tenders and new clients
- Remove reference target price due to removal of this rating class

HL expresses cautiousness at year-end. HL Tech expressed cautious tone on comparatively low Q-T-D orders and shorter procurement lead time in its newsletter in early Dec. The management indicates that normally orders targeting Thanksgiving and Christmas would be confirmed before. In addition to overall weak market demand, increased selling expenses and R&D expenses for specific high-end products and new products have also has negative impact. As a result, top-line as well as net margin would be possibly affected in Q4 and thus 2011.

Change in forecast for 2H 2011. Table 1 shows historical figures for 1H this year. While for 2H, due to weak sentiment in US and Europe, we believe orders are weak especially in Q4 for the whole industry. As such, we recommend cautious in 2011. We originally forecast revenue of RMB2,078m with 9% net margin in 2011. Upon our preliminary review, revenue may be revised down to around RMB1,700m with 7.5% net margin. We would fully review our assumptions and update investors any changes on reference target price of accordingly.

Table 1. Top line growth in 1H

Year to Dec (RMB m)	1H 10A	1H 11A	YoY change
Revenue	635.7	881.7	38.7%
ESCA	160.4	181.9	13.5%
ISCA	137.4	169.1	23.1%
PCA	112.8	136.4	20.9%
STWC excl. HDB	153.2	209.1	36.5%
Connectors	20.4	28.2	38.5%
Antenna	3.9	18.9	379.8%
Others	51.6	41.6	-19.3%
TJRT	0.0	69.0	n.a.
HDB*	0.0	27.4	n.a.

YoY growth excl. TJRT and HDB

23.5%

Source: SBI E2-Capital

Latest development and outlook for 2012. While 2011F may not be as strong as previously expected, fundamental of HL Tech remains solid. We expect HL Tech to further consolidate its newly acquired business and receive increasing orders from new clients in 2012. According to our channel checks, HL Tech is performing well in recent biddings and order placements. In 2H, Huawei tendered bids of communication cables for its base station constructions and HL Tech received satisfactory results. On the other hand, it is expected that Apple and Dell would place more orders since 2012. For instance, Apple is currently requesting up to US\$1m thunderbolt a month. On the other hand, Dell normally places a smaller order in its first year with a particular, which would go up substantially in the second year upon satisfaction. It is expected that orders from Dell could be one of the main contributors to potential top-line growth in 2012.

Please refer to important disclosures at the end of this report

Ticker	1087 HK
Rating	Not Rated
Price (HK\$)	1.12
Target Price (HK\$)	n.a.
12m Price Range (HK\$)	0.91 - 2.95
Market cap. (US\$m)	103.4
Daily t/o (US\$m)	0.1
Free float (%)	35.4

Financial summary

Year to Dec	08A	09A	10A
Turnover (RMBm)	898	872	1,414
Net Profit (RMBm)	54	88	153
EPS (RMB)	0.112	0.169	0.275
P/E (x)	8.7	5.8	3.5
P/B (x)	2.38	1.66	0.58
EV/EBITDA (x)	7.5	5.5	3.3
Yield (%)	0.0	0.0	0.0
ROE (%)	27.8	32.8	24.9
ROCE (%)	17.2	17.7	15.2
N. Gear. (%)	83.6	72.9	8.4

Source: SBI E2-Capital

	11F	12F	13F
Consensus EPS (RMB)	0.255	0.290	0.360
Previous earnings (RMBm)	-	-	-
Previous EPS (RMB)	-	-	-

Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	(6.6)	(15.8)	(34.4)
Actual price changes (%)	(4.3)	(11.8)	(47.4)



Source: Bloomberg

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Position view unchanged for high-growth perspective. Entry barrier to low-end cables such as power cords is low. On the contrary, transmission cables and connectors partly determine signal transmission speed. As such, known-how and experience are essential to high quality signal cables. For instance, with strong R&D capability, HL Tech is the only provider of Thunderbolt I/O for Apple. HL Tech has a transmission cables portfolio that made up 70%+ total sales. We remain positive and expect organic top-line growth for 2012. With further new product development and potentially new client acquisition in the future, we expect HL Tech to grow quickly before reaching a critical business size. According to Bloomberg consensus, HL Tech is currently trading at 3.6x and 2.9x P/E, which is rather optimistic, in our view.

Table 2. Key financials

Year to Dec (Rmb m)	08A	09A	10A
Revenue	898.0	872.4	1,414.0
Gross profit	174.8	198.0	325.6
Operating profit	81.7	110.5	192.3
Net profit	54.4	88.3	152.7
EBITDA	102.2	139.7	230.2
Fixed assets	268.4	308.6	448.9
Inventories	115.3	115.6	178.5
Receivables	338.8	423.5	725.5
Payables	335.3	302.0	384.6
Cash	58.4	115.2	585.1
Short-term debt	243.3	353.4	663.1
Long-term debt			
Shareholders' fund	221.1	316.6	909.9
Total equity	221.1	327.0	923.5
Net cash from operating activities	1.7	0.5	(114.5)
Net cash used in investing activities	(117.5)	(70.5)	(549.9)
Net cash from financing activities	119.4	120.4	751.1
Net change in cash and cash equivalents	3.6	50.3	86.7

Source: SBI E2-Capital

Table 3. P&L

Year to Dec (Rmb m)	09A	10A	1H 10A	1H 11A
Revenue	872.4	1,414.0	635.7	881.7
Cost of sales	(674.4)	(1,088.3)	(491.7)	(693.8)
Gross profit	198.0	325.6	144.0	187.9
Other gains and losses	8.3	(2.6)	(2.0)	17.4
Distribution and selling expenses	(20.5)	(27.2)	(12.9)	(22.1)
Administrative and general expenses	(48.0)	(72.5)	(29.0)	(48.9)
Research and development expenses	(27.3)	(30.9)	(12.7)	(25.2)
Profit from operations	110.5	192.3	87.4	109.1
Finance costs	(13.9)	(19.1)	(8.9)	(11.0)
Profit before taxation	96.6	173.3	78.5	98.1
Income tax expenses	(8.1)	(18.2)	(8.3)	(7.4)
Profit for the period	88.5	155.0	70.2	90.8
Attributable to:				
Owners of the Company	88.3	152.7	69.7	88.2
Non-controlling interests	0.2	2.4	0.5	2.6
EPS - Basic (Rmb)	0.169	0.275	0.133	0.122

Source: SBI E2-Capital

Table 4. Shareholding structure

Shareholders	Interest
Chi 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

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