

Neo-Neon



Not Rated

Light leads the way

Key points:

- Leading manufacturer of decorative LED bulbs.
- 30.0% industry organic growth rate each year.
- Illuminative LED could be a future driver.
- In-house production of LED chip to kick off in 2009.
- Undemanding valuation compared to peers.

Summary. Neo-Neon is a decorative lighting manufacturer, headquartered in Guangdong. Products include LED-based bulb and incandescent tungsten light bulb, contributing 62.3% and 34.7%, respectively, of total HK\$1,572.1m turnover in FY12/07A.

Table 1: Sales breakdown

(HK\$m)	06A	07A	YoY growth (%)
Sales	1,258.8	1,572.1	24.9
LED-based	729.2	979.7	34.4
Decorative lighting	497.0	683.8	37.6
General lighting		33.5	n.a.
Entertainment lighting	232.2	262.4	13.0
Incandescent-based	482.8	545.9	13.1
Others	46.8	46.5	(0.6)

Source: Company data

Industry overview. Global lighting fixtures market is estimated at US\$71.5bn in 2005 and expected to grow at 4.7% each year till 2010. A major industry trend is consumers are looking for more energy-saving and environment-friendly technologies to replace traditional incandescent products. LED is one of these technologies and has been adopted in some areas. Market size of entire high brightness (HB) LED is expected to grow from US\$3.9bn in 2005 to US\$8.3bn in 2010, representing a CAGR of 16.2%.

Decorative LED. We think Neo-Neon's competitiveness mainly relies on its: 1) industry expertise (more than 20 years experience in decorative lighting products, 10 years research and 5 years mass production expenses for LED products); 2) scale (one of the largest LED bulb manufacturers in the world). According to the company, demand for its decorative LED products rises steadily at around 30.0% per annum. Existing capacity (over 300m LED light bulbs per month) has been fully utilized and the company intends to expand it by 30.0% this year.

China Industrials

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Stock data

Price	HK\$3.30
12 mth range	HK\$3.05-18.50
Market cap.	US\$322.8m
No. shares o/s	761.2m
Daily t/o, 3 mth	US\$1.4m
Free float %	39.3%
Major shareholder	Fan Ben- 52%
Ticker	1868.HK/1868 HK

Financial summary

Year to Dec	07A
Yield (%)	0.0
ROE (%)	15.2
Net gearing (%)	Cash
Net debt/sh. (HK\$)	Cash
BV/sh. (HK\$)	3.12
Consensus EPS (HK\$)	
- 12/08F	0.526
- 12/09F	0.675

Price Chart



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Illuminative LED. The company launched its own LED-based general lighting products in 2007. We think it will take time for LED-based lamp to penetrate the market cause it is still 5 – 8 times more expensive than a compact fluorescent lamp (the most widely used energy saving lighting product at present) . In addition, LED has to compete with other energy-saving technologies, which brings in extra uncertainties. Overall we do not expect this new business to make significant contribution for the company in the next two to three years.

Upstream extension. LED chip plant will start trial in 4Q 2008 and mass production is expected to commence in mid-2009. The initial capacity will be around 200m units per month. This in-house production will bring down the company's LED chip cost by 25.0%, which will apparently impact gross margin as LED chip accounts for 16.0 – 17.0% of total COGS. The company also plans to self-produce more components in the future to further enhance margin.

Growth Outlook. We do not expect any major growth of the company's incandescent light bulb business given its maturity and potential substitution by LED products. Overall, we think the company will be able to maintain middle – high teens top growth. Gross margin will be sustained by sales mix change (more from higher-margin LED products) and upstream extension in production (starting from FY12/09F).

Corporate governance. The company listed in Hong Kong exchange in Dec 2006 via a global offering of 200.m shares (160.0m new shares) at HK\$6.90 each. Substantial shareholders include Mr. Fan Ben (52.0%), Chairman of the company, and Fidelity (9.0%).

Valuation. Another major listing LED bulb manufacturer is Everlight (2393 TT). Nevertheless Everlight concentrates on LED bulbs used in electronic products. Another peer group of Neo-Neon should be those traditional lighting companies, which now is trading at an average forward P/E of 14.1x in A-share market.

Table 2: Peer comparison

Company name	Ticker	Fiscal Year end	Mkt Cap (US\$m)	His P/E (x)	Curr-Yr Fwd P/E (x)	Nxt-Yr Fwd P/E (x)	ROE (%)
Neo-Neon	1868 HK	12/2007	322.8	7.5	6.3	4.9	15.2
LED manufacturer							
Everlight	2393 TT	12/2007	3,986.3	12.1	11.6	10.0	23.8
Lighting companies							
Foshan Electrical & Lighting	000541 CH	12/2007	713.6	12.5	12.8	11.1	15.7
Yankon Group	600261 CH	12/2007	296.2	18.4	15.4	12.9	13.0
Average				15.5	14.1	12.0	14.4

Source: Bloomberg

Table 3: P&L

Y/F 31 Dec (HK\$m)	05A	06A	07A
Turnover	971.3	1,258.8	1,572.1
Cost of goods sold	(632.2)	(758.7)	(966.9)
Gross profit	339.1	500.1	605.2
Other income	25.5	58.8	78.3
Distribution and selling expenses	(49.4)	(70.8)	(76.3)
Administrative expenses	(147.4)	(219.6)	(279.6)
Finance costs	(5.9)	(8.9)	(1.5)
Write-off of deposits made on acquisition of investment properties	(11.2)		
Increase in fair value of investment properties			21.1
Share of profits of associates	(1.5)	2.0	0.3
Share of results of a jointly controlled entity	3.1	4.1	(0.9)
Profit before taxation	152.3	265.7	346.5
Taxation	(8.9)	(5.0)	(14.8)
Profit before minority interest	143.5	260.7	331.7
Minority interest	(0.6)	(0.7)	2.3
Net profit	142.9	260.0	334.0
EPS - basic (HK\$)	0.238	0.439	0.439
EPS - diluted (HK\$)	0.238	0.437	0.437
Dividend	65.3	120.0	20.6

Source: Company data