

## Shinhint Acoustic: Value play with iPod exposure

**Recommendation: Not Rated**

**Hong Kong Industrials**

<b>Price</b>	<b>HK\$0.93</b>	<b>Yield (12/06A)</b>	25.3%
<b>12 mth range</b>	HK\$0.45-1.44	<b>ROE (12/06A)</b>	27.3%
<b>Market cap.</b>	US\$39.0m	<b>Net gearing (12/06A)</b>	30.2%
<b>No. shares o/s</b>	330.5m	<b>Net debt/sh. (12/06A)</b>	HK\$0.131
<b>Daily t/o, 3 mth</b>	<US\$0.4m	<b>BV/sh. (12/06A)</b>	HK\$0.79
<b>Free float %</b>	40.9%	<b>Consensus EPS</b>	
<b>Major shareholder</b>	Mr. Jacky Cheung (Founder) -46.2%	<b>- 12/07F</b>	Na
<b>Ticker</b>	2728.HK/ 2728 HK	<b>- 12/08F</b>	Na

### Key points:

- World leader in ODM/OEM production of consumer acoustic accessories such as iPod docking stations and bluetooth headsets.
- Major supplier to Logitech and Altec Lansing, accounting for over 60.0% of their respective consumer audio product lines.
- New customers and products coming on line in FY12/08, including 7 models of consumer audio headsets with Sennheiser and other products under Best Buy's "Rocketfish" brand.
- Shinhint's products are strategically placed in macro growth sectors, driven by: 1) increasing aftermarket demand for iPod accessories; 2) growing proliferation of music phones and 3) increasing demand for bluetooth headsets driven by hands-free laws globally.
- A value play. Despite being exposed to several high growth sectors, valuation is undemanding. Assuming Shinhint's net profit can grow 15.0% in FY12/07F, it is currently trading at only 5.4x FY12/07F P/E.

**Company profile.** Listed in 2005, Shinhint is one of the prominent OEM/ODM manufacturing services providers of electro acoustic peripherals for leading consumer electronic brands. The company produces a broad range of electro acoustic peripherals. Shinhint has two factories; both are located in Dongguan, with a staff of c.4, 300. The company offers products under the following categories:

- ❑ Speaker systems for PCs, compressed audio players, multimedia devices, automobiles and home theatres;
- ❑ Headsets for PCs, gaming consoles, communications and other multimedia devices.

**Business segments.** The company organized its business into five revenue streams: sales of 1) communication products; 2) multi-media products; 3) entertainment products; 4) audio products and 5) others. The company is an ODM/OEM manufacturer. Its clients typically specifies the overall aesthetics outlook and user interface of the product while Shinhint designs the remaining acoustics, circuitry and mechanics, and then proceeds to manufacture and assemble the product.

**Table 1: Turnover breakdown by business segments**

HK\$m	2006	%	2005	%
Communication products	169.4	14.4	162.2	16.0
Multimedia products	515.6	43.9	440.8	43.4
Entertainment products	357.9	30.5	289.2	28.5
Audio products	40.9	3.5	46.5	4.6
Others	90.4	7.7	77.5	7.6
Total	1,174.2	100.0	1,016.2	100.0

Source: Company data

**Table 2: Revenue breakdown by geographical market**

HK\$m	2006	%	2005	%
China	68.5	5.8	100.3	9.9
Others Asian Regions	78.4	6.7	64.6	6.4
North America	490.8	41.8	434.5	42.8
Europe	536.6	45.7	416.8	41.0
Total	1,174.2	100.0	1,016.2	100.0

Source: Company data

**Shinhint is key ODM/OEM to industry leaders.** Shinhint has established strategic collaborations with some of the leading brands in the consumer audio electronics industry. Its key customers include Logitech Group, Altec Lansing Group (now under US-listed Plantronics). Other customers include Sennheiser Communications and Directed. Logitech and Altec Lansing are by far the company's largest customers, together accounting for about 70.0% of total revenues. Through these relationships, Shinhint has developed into a world leader in the ODM/OEM of audio products. The company has been worked together with Altec Lansing for over seven years and Logitech for some ten years, and now accounts for in excess of 60.0% of their respective lines of audio products. The fact that Shinhint is able to secure such large allocations for two of the largest players in the consumer audio products segment, who are essentially competitors, is a testament to the ODM and technology expertise, quality, reputation and execution ability that Shinhint has built up over the years.

**R&D to drive cross product applications.** To further leverage its leadership position, Shinhint aims to strengthen its design capability and product development while facilitating greater cross-device applications. The company set up an R&D center in Shenzhen in Apr 2005, focusing on the development of wireless audio products. Shinhint has been exclusively partnering with New Transducer Limited (NXT), a leader in flat-panel loudspeaker technology to produce flat-panel acoustic products mainly targets at LCD and Plasma TV industry and automotive sectors since mid 2006.

**Table 3: Top ten brand for multimedia speakers**

1	Logitech	6	Klipsch
2	Bose	7	JBL
3	Cyber Acoustics	8	Harman Kardon
4	Altec Lansing	9	Sony
5	Creative Labs	10	Jasco

Source: NPD Group (for the period from Nov 2006 – Apr 2007)

**Broadening customer base and products range.** While the long collaborative relationships with industry leaders such as Logitech and Altec Lansing forms a good fundamental customer base, Shinhint is actively aware of its needs to broaden its customer base to: 1) improve bargaining power with potential customers; 2) broaden into other niche acoustic products segments; 3) further develop technology expertise through technology transfer from new customers and 4) diversify revenue risk. The company has been proactive in this matter to set up both new customers and enriching its product offerings.

- Shinhint has successfully secured a landmark contract from Sennheiser to provide a range of consumer level audio headsets and headphones (7 models in total). These new products will be launched in 2008 and we expect revenue contribution in the same year.
- After establishing the partnership with NXT, Shinhint has already secured a first tier, US-based LCD TV manufacturer to provide acoustic solutions for 4 models of high-end LCD TVs. Factory is Chang An, Dongguan which dedicated to the production of these products is already in full operation and the first batch of shipment is expected to be end of this year.
- Shinhint is already producing a number of communications based acoustic products such as bluetooth headsets,

VoIP headsets and is set to supply PC and audio based bluetooth headsets to Best Buy under the retailer's "Rocketfish" brand. The company started to work with Best Buy in 2006.

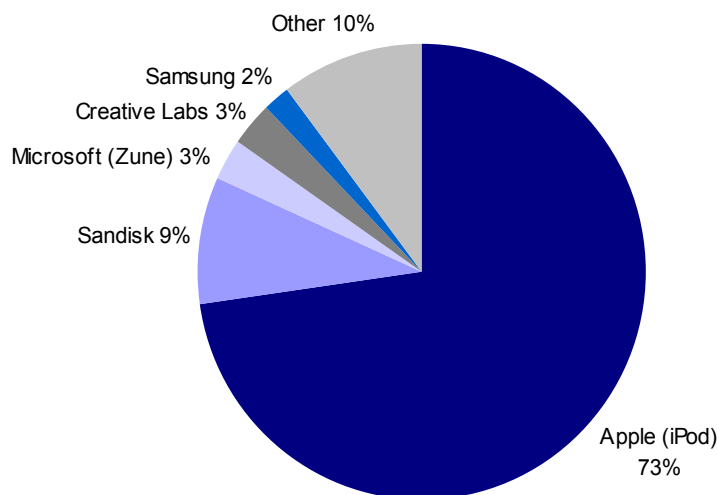
- Other products to be launched by Shinhint include car audio solutions such as 3-in-1 speaker/headset/iPod systems,

**Strong seasonality due to product nature.** Shinhint's financials are subjected to strong seasonality effects. This is because much of its products are purchased for gifts as well as for peripheral purchases for upgrades of gaming and home theatre systems, which generally occur in holiday seasons. Therefore, much of its sales revenues are booked in the second half of each financial year. Generally, 1H accounts for 35.0-40.0% of the total revenue and 2H accounts for 60.0% to 65.0%.

**Clear macro drivers.** Shinhint audio acoustic products are well entrenched in a growth market, backed by macro drivers including the following:

- *Proxy to demand for aftermarket iPod accessories.* According to a survey conducted by NPD, retail music player sales reached US\$225.0m in Jan 2007, and Apple's iPod accounted for 72.7% of the total sales. With such a high install base, there is a tremendous aftermarket demand for iPod accessories such as docking audio solutions. Global shipments of iPod accessories such as high-end docking stations are on the upswing, riding high on the steady growth of the iPod users. Worldwide audio entertainment solutions are expected to grow at around 15.0-20.0% annually between 2006-2011 according to various researches by CES and IDC.
- *Growing proliferation of music phones.* According to Strategic Analytics, by 2008, over 50.0% of mobile handsets sold will be music phones. This is expected to drive demand for high-quality audio headsets as well as bluetooth headsets for mobile phones in the aftermarket. In fact, the unit growth of music mobile phones is expected to be significantly higher than portable music players (such as iPod), given the potential from the emerging markets such as China and India.
- *Regulatory environment driving use of bluetooth headsets.* Though hands-free driving laws are already well established in developed countries such as the US and Europe, they have often been poorly enforced in the past. However, there are signs that local governments aim to significantly strengthen enforcement of these laws in the interest of road safety. According to Strategy Analytics, global bluetooth headset sales grew skyrocketing 153.0% in 2005 and believe will grow an impressive 70.0% annually in 2006.

**Chart 1: Music players by brand**



Source: NPD Group (for Jan 2007)

**M&A.** Currently, the company is considering possible M&A with other companies to achieve either: 1) vertical integration of technologies/expertise and 2) further expand its customer base, geographical or break into new niche audio segments. As the size of the acquisition is expected to be small; acquisition risk should be low.

**Growth driver and valuations.** We see Shinhint as a direct play to the increasing popularity multimedia players. For FY12/07F, the company's key growth drivers will continue to be organic growth from Logitech and Altec Lansing with their iPod related audio entertainment products. However, new growth drivers should emerge in FY12/08, with contribution from Sennheiser headsets and other new products. We expect that the company's FY12/07F top line growth could reach 20% YoY, though bottom line growth may be slightly less due to a slight margin compression caused by intensifying competition related to its core Logitech/Altec Lansing products. Thus,

FY12/07F net profit grows is more likely to be in the region of 15-18%. Based on a 15% net profit growth, the company is trading at a FY12/07F forward P/E of 5.4x on a fully diluted basis. The counter is undemanding comparing to Fujikon Industrial (927 HK, HK\$3.93, NR), which is trading at 7.3x forward P/E consensus.

**Corporate governance and fund raising history.** The company was listed on Hong Kong Stock Exchange in 2005. The company appointed Deloitte as its auditor. The major shareholder, Jacky Cheung holds 46.2%, Martin Currie owns 12.9% in total (Martin Currie Investment 6.6% + China Development Capital 6.3%). Public shareholders account for 40.9%. In Mar 2007, Martin Currie's China Development Capital Fund acquired a 6.3% stake in the company through a top-up placement of 27.1m shares at HK\$0.75 per share.

**Table 4: Margin**

(%)	2004	2005	2006
Gross margin	17.1	13.8	12.9
Net margin	7.6	4.5	4.3

Source: SBI E2-Capital

**Table 5: P&L**

Year to Dec (HK\$m)	2004	2005	2006
<b>Revenue</b>	<b>529.9</b>	<b>1,016.2</b>	<b>1,174.2</b>
Cost of sales	(439.5)	(875.9)	(1,022.3)
<b>Gross profit</b>	<b>90.5</b>	<b>140.3</b>	<b>151.9</b>
Other income	3.5	2.0	2.7
Selling and distribution costs	(12.6)	(18.4)	(22.4)
Administrative expenses	(33.8)	(65.5)	(68.0)
Share of result of an associate	(0.0)	(2.9)	0.0
Loss on disposal of an associate	-	-	(3.9)
Amortization of goodwill	(0.1)	-	-
Release of negative goodwill	1.2	-	-
Revaluation of investment properties	1.5	-	-
Other expenses	(0.2)	-	-
Finance costs	(1.4)	(2.0)	(2.5)
<b>Before tax profit</b>	<b>48.4</b>	<b>53.5</b>	<b>57.7</b>
Tax	(7.5)	(8.0)	(7.4)
<b>Profit of the year</b>	<b>40.9</b>	<b>45.4</b>	<b>50.3</b>
Minority interests	(0.6)	-	-
<b>Net profit</b>	<b>40.3</b>	<b>45.4</b>	<b>50.3</b>
Dividends	25.0	7.5	13.0
EPS - Basic (HK\$)	0.180	0.170	0.170
EPS - Diluted (HK\$)	na	0.170	0.170

Source: Company data