

A bumpy road ahead

Hong Kong Industrials

Ju Teng (3336 HK, HK\$1.34)

HOLD (unchanged)

Target price: HK\$1.47 (+9.7%)

Poor interim results in line with expectations. Ju Teng reported a net profit of HK\$70.3m (down 10% YoY) on a revenue growth of 34% YoY to HK\$1.47b for 1H FY12/06. The poor results were generally in line with our expectations. Gross margin came down to 14.2% in 1H FY12/06 (cf. 18.1% in 1H FY12/05). We mentioned in our last update that the company did ask for higher selling prices for its shipments this year, but the rise is mostly offset by raw material cost hikes and RMB appreciation. With a tight cost control, the company managed to maintain its operating margin at around 9% in 1H FY12/06. Meanwhile, interest expenses surged to HK\$43.4m (cf. HK\$22.3m in 1H FY12/05) due to increase in bank borrowings and interest rates. The company paid a 19.6% effective tax rate in 1H FY12/06, which was higher than our assumption of 13% during the period.

Table 1: Interim results comparisons

(HK\$m)	1H FY12/06A	1H FY12/06F	Difference (%)	1H FY12/05	YoY (%)
Revenue	1,471	1,501	(2.0)	1,097	34.1
Gross profit	209	218	(4.1)	198	5.4
Operating profit	130	126	3.4	113	14.9
Pre-tax profit	87.5	86	1.8	91	(4.0)
Net profit	70.3	74	(4.9)	78	(9.9)
Gross margin (%)	14.2%	14.5%		18.1%	
Operating margin (%)	8.9%	8.4%		10.3%	
Net margin (%)	4.8%	4.9%		7.1%	

Source: Company and SBI E2-Capital

Remained highly geared. We estimate that the net gearing ratio increased slightly to 58% in 1H FY2/06 (cf. 48% at the end of 2005). Inventory turnover went up slightly to 115 days in 1H FY12/06, as we believe the company has been ramping up shipments in preparation for peak seasonal in 3Q FY12/06. Capex amounted to HK\$200m in 1H06. The company will keep its capex for less than HK\$300m for the full year.

Acquisitions strengthened its market positioning. Ju Teng has done three acquisitions in 1H FY12/06. Following these acquisition, the company should be able to work closely with Wistron and has better access to mouldings and coating supply.

- In January 2006, the company acquired a 70% interest in Mindforce Holdings Limited for HK\$38.2m. Wistron (Taiwan) holds the remaining 30% interest in Mindforce. Following the acquisition, Ju Teng has

Table 2: Financial summary

Year to Dec	Net profit HK\$m	EPS HK\$	EPS Δ %	P/E x	P/B x	EV/EBITDA x	Yield %	ROE %	ROCE %	N. Gearing %
04A	241.4	0.241	46.5	5.6	1.4	7.9	-	47.7	24.8	113.9
05A	192.1	0.192	(20.4)	7.0	1.1	6.8	-	19.8	14.3	51.8
06F	195.9	0.196	2.0	6.8	0.8	5.5	-	13.7	12.5	35.4
07F	245.4	0.245	25.3	5.5	0.7	4.4	2.7	13.5	12.1	24.1
08F	287.4	0.287	17.1	4.7	0.6	3.9	3.2	13.3	11.8	26.1

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become a major notebook casings supplier to Wistron. Wistron accounted for less than 5% of Ju Teng's total casing shipments in 2005 and will account for 15% in 2006.

- In February, Ju Teng also acquired a 36.5% interest in Smart Success Enterprise for HK\$17.1m. Ju Teng is now able to secure a stable supply of mouldings. Smart success is principally engaged in the manufacture and sale of moulds and has been one of the Ju Teng's moulding suppliers.
- In March, Ju Teng acquired Pak Teng Technology for HK\$18m, which is principally engaged in the provision of coating services and has been a subcontractor for coating services of Ju Teng.

A better 2H FY12/06. We understand that the company's shipments should improve significantly in 2H FY12/06 with all of its clients reporting better shipments since June. Shipments to Apple should also improve, thanks to the increased shipments of Macbook in white and the ramp up of new generation iMac G5. We currently estimate that revenue to grow 36% HoH to close to HK\$2,000m with a net profit of HK\$131m (up 87% HoH). However, we remain concerned with Ju Teng's new product progress, especially its current imprint finish designs for HP and Compeq. We believe colorful casings (some with engraved patterns) can only be a story next year at the earliest. The progress of adopting carbon fiber casings has also been going quite slowly. Notebook OEMs seem to lose interests in carbon fiber casings, as they are busily cutting prices to sustain their market shares.

Peer has become more aggressive in expansion. Recently, one of Ju Teng's competitors (Huan Hsin) acquired a company called AJC Manufacture Tech (AMT) in Suzhou. AMT's plant is fully equipped with machinery and equipment for the manufacture of magnesium alloy enclosure for consumer electronics including computer. The acquisition will enable Huan Hsin to extend its footing to the higher margin magnesium casing arena.

Meanwhile, Asustek Computer (2357 TT) and Huan Hsin (HUAN SP) also plan to form JVs in Shanghai to make notebook casings. Asustek accounted for 3% of Ju Teng revenue in 2005 and is expected to rise to around 10% in 2006. While the contribution is relatively small, Ju Teng has originally expected that more orders will come from Asustek going forward. Not long ago, Huan Hsin also announced the restructuring of its 51%-owned subsidiary Zhan Yun electronics, a JV with Quanta (Taiwan), with a possible listing in the future. One may expect Quanta would place more orders to Zhan Yun to boost its profitability in the future. In 2005, Quanta contributed about 45% of Ju Teng's revenue. All of these incidents suggest that Ju Teng could be losing market share to Huan Hsin in the longer term.

Limited upside in near term. The stock currently trades at 6.8x FY12/06F P/E and 5.5x FY12/07F. While the downside is limited at the current share price, we believe the upside will be capped by the delay of new product launch this year and expected more fierce competition in the longer term. Also, Huan Hsin seems to have better prospects in 2007 and 2008, leading us to believe that Ju Teng should trade at a lower earnings multiple than that of Huan Hsin. As a result, we have fine-tuned our earnings by 6% to HK\$246m in 2007 to reflect more difficult situation going forward and slightly higher effective rate. We maintain our HOLD rating for the counter and lower our target price to HK\$1.47 (or 6x FY12/06 P/E).

Table 3: Peer group comparisons

	Currency	Price	Market Cap (US\$m)	P/E (x)		ROE (%)		Net gearing (%) 1H06
				2006	2007	2006	2007	
Ju Teng International (3336 HK)	HKD	1.34	176.9	6.8	5.5	12.1	12.1	58
Huan Hsin (HUAN SP)	SGD	0.56	143.5	7.5	6.4	9.7	10.2	26
Catcher Technology (2474 TT)	NT\$	309	3,935.5	20.7	15.5	43.3	36.2	Cash
Foxconn Tech (2354 TT)	NT\$	320	6,441.9	33.9	22.5	34.3	33.2	Cash
Average				17.2	12.5	24.9	22.9	

Source: IBES and SBI E2-Capital