Corporate Snippet

Tue, 12 Dec 2006

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Better outlook for 2007 | Hong Kong Industrials

Ju Teng (3336 HK, HK$1.24) | HOLD (unchanged)

Target price: HK$1.47 (+8.8%)

Gross profit margin likely to improve in FY12/07 at the earliest. Ju Teng's blended profit margin dropped 3.9 pcps to 14.2% in 1H FY12/06, on price competition, appreciation of RMB and increase in development costs for new castings models. Although raw materials prices have stabilized, the improvement in margin is likely to take place in 2007 at the earliest, since the group keeps four months stocks and the raw materials prices lag behind the feedstock prices. Appreciation in RMB will remain as the biggest swing factor going forward. Nonetheless, the group did manage to increase the ASP of its existing products by 5%-10%. Despite this, the ASP hike may not fully offset the negative impact from high raw materials prices and the appreciation in the currency in 2H FY12/06. R&D expenses peaked out in 1H FY12/06. Top line growth for the whole fiscal year is expected to be robust at above 30.0%.

Improving outlook for 2007. Stabilized raw materials prices should improve the group's gross profit margin. Further, the increase in sales of high-margin products should serves as another driver of the overall profitability. Gross margin of the newly launched IMD ("In-mold decoration") products and carbon fiber products are both estimated to be above 30%, compared with the gross margin of 18.0% commanded by the traditional plastic products. HP is the only customers that places orders for IMD casings so far. Acer is expected to place orders for such product soon in 2007. The group is eyeing to increase its blended margin and net margin to 15% and 6%-7%, respectively, from 14.2% and 4.8% reported in the 1H FY12/06A.

Growth momentum in top line remains strong. Some of the group's major customers like ASUSTek and Wistron have set up their production facilities in China. Both are expected to increase their orders to the group. The launching of the "Double shot" casing products could be another revenue driver in the future. Currently, only the group and Foxconn Tech have the capability to produce "Double shot" casing products in large scale. Last but not least, the introduction of Windows Vista in Jan 07, the new operating system from Microsoft, should trigger the replacement demand for notebook computers. A YoY 25.0% top line growth is expected in FY12/07F on a projected >10.0% growth in the global notebook computer sales.

Impacts from acquisitions are yet to be seen. The group acquired a 70% stake in Minforce for a consideration of HK$38.2m. Minforce is engaged in the manufacture and sale of notebook computer casings in China. Wistron, the leading notebook computer assembler owns a 30% stake in Minforce. Following the acquisition, Wistron has become one of the group's major customers. The group entered into a sales agreement with Wistron in March 2006. Nevertheless, material impact from the acquisition is not expected to emerge until FY12/08F. Further, more capex for Minforce is required in the near future. Following the acquisition of Smart Success, a mould manufacturer and a coating service provider, the group is now more vertically integrated.

Leading market position. Foxconn Tech and the group are the major players in the notebook computer casing

Table 1: 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	5.1	1.3	7.9	-	47.7	24.8	113.9
05A	192.1	0.192	(20.4)	6.5	1.0	6.8	-	19.8	14.3	51.8
06F	195.9	0.196	2.0	6.3	0.8	5.5	-	13.7	12.5	35.4
07F	245.4	0.245	25.3	5.1	0.6	4.4	3.0	13.5	12.1	24.1
08F	287.4	0.287	17.1	4.3	0.5	3.9	3.5	13.3	11.8	26.1

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industry, with each having market share above 20% (28% for Ju Teng). The group aims to focus on ASP and profit margins, while maintains its market share going forward.

Net gearing expected to come down. As at the end of 1H FY12/06A, the group's net gearing ratio stood at 65.2%. Capex for FY12/07F is budgeted to be not more than HK$250m. Going forward, the group will factor more trade receivables to banks and uses less trade facilities, which are charged at higher interest rates. This should improve the cash flow and reduce its financial expenses further.

Earning recovery will serve as catalyst. Trading at P/E of 5.3x and 4.5x for FY12/07F and FY12/08F, the counter's valuation is not demanding, compared with the sector average of 21.0x and 17.0x for FY12/07F and FY12/08F, respectively. However, its 1H FY12/07, the first set of results that would show a recovery, won't be announced at least until Aug 2007.

Table 2: Peer group comparisons

Company name	Ticker	Year End	Price (US$)	Market Cap (US$m)	P/E (x) FY07	P/E (x) FY08	3-yr EPS CAGR (%)
Ju Teng Intl.	3336 HK	Dec	0.17	173.7	5.1	4.3	14.4%
Huan Hsin Holds.	HUAN SP	Dec	0.37	146.2	6.1	5.1	22.4%
Catcher Technology	2474 TT	Dec	9.34	3,867.6	15.0	13.1	32.4%
Foxconn Technology	2354 TT	Dec	11.42	7,464.5	24.8	19.5	51.2%
Average					***21.0***	***17.0***	***44.1%***

Source: SBI E2-Capital, Bloomberg