Corporate Snippet

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Progress slower than expected — Hong Kong Industrial

Ju Teng (3336 HK, HK$1.70) — HOLD (Downgraded from BUY)

Target price: HK$ 1.85(+9%)

Margin improvement unlikely to happen in 2006. We visited Ju Teng recently. The progress of margin improvement is likely to be slower than expected. 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. Given the pricing pressure across the notebook industry, the cost hikes (partially caused by oil price surge) seem to be more difficult to pass on to end clients than we originally thought. As a result, we believe gross margin will drop further to 14.5% in 1H FY12/06 (cf. 15.5% in 2H FY6/05 and 18.1% in 1H FY12/05). Management believes gross margin will improve slightly in 2H FY12/06 on the back of increase shipments of higher margin products (e.g. Apples' Macbook and iMAC and Compaq V3000). However, we estimate that the full-year gross margin will still lag behind our original expectation and will only reach 15.4% in 2006 (cf. 16.5% in 2005). Note that we originally expected that there would be a 1% gross margin improvement in 2006 with better selling price this year.

1H FY12/06 results likely to disappoint market. We currently estimate that 1H FY12/06 net profit to be around HK$74.4m (down 4.6% YoY and 34.7% HoH) with a revenue of HK$1.5b (up 36.8% YoY but down 5% HoH). As we mention above, gross margin is likely to drop 100 basis points to 14.5% for the period. Raw materials contributed 65% of its COGS, while plastic, paint and metals accounted for 50%. A 1% RMB appreciation is expected to reduce earnings by 0.5%.

Table 1: P&L

	1H06F	1H05	*YoY %*	2H05	*HoH %*
Revenue	1,501	1,097	*36.8*	1,575	*(5)*
Gross Profit	218	198	*9.7*	244	*(11)*
Operating profit	126	113	*10.7*	156	*(19)*
Pre-tax profit	86	91	*(6.1)*	118	*(27)*
Net profit	74	78	*(4.6)*	114	*(35)*
Gross margin (%)	*14.5*	*18.1*		*15.5*	
Operating margin (%)	*8.4*	*10.3*		*9.9*	
Net margin (%)	*5.0*	*7.1*		*7.2*	

Source: Company data and SBI E2-Capital

New product progress disappointing. Previously, we were positive on Ju Teng, as we believe the company will successfully launch some colorful casings (some with engraved patterns) this year, which are expected to attract

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	7.0	1.8	7.9	-	47.7	24.8	113.9
05A	192.1	0.192	(20.4)	8.8	1.4	6.8	-	19.8	14.3	51.8
06F	205.7	0.206	7.1	8.3	1.1	5.5	-	14.4	12.7	35.0
07F	263.7	0.264	28.2	6.4	0.8	4.2	2.3	14.5	12.7	23.2
08F	287.4	0.287	9.0	5.9	0.7	3.9	2.5	13.3	11.8	26.1

consumers' attention. Meanwhile, we think that some OEMs will promote notebooks with multiple casings (e.g. changing colorful casings just like handsets). We also envisioned that more and more notebook OEMs will try to use rather expensive (but lighter-weighted) materials such as carbon fiber for their high-end models. However, the progress of these new products is all behind our expectations.

New products still look too boring. Management said Compaq's Presario V3000 and HP's dv 2000 are the new products from Ju Teng. The company adopts an imprint finish design for these new products. The imprint process incorporates an advanced molding technique using Nissha Film Products. The imprint-finish offers a subtle weave pattern integrated into a polished metallic and piano black high-gloss finish. Although the company claimed these models have been well received by the market, we think these changes are too conservative to attract customers' attention. Besides, the progress of adopting carbon fiber casings has been going quite slowly, according to the management. Acer has been quite excited with this new material for its high-end notebooks in 2Q06, but the interest in carbon fiber seems to cool down lately.

Pic 1: Compaq's Presario V3000

Source: www.pconline.com.cn

Pic 2: HP's dv 2000

Source: www.pconline.com.cn

Notebook OEMs cutting prices. We believe the slow progress of new product launch stems from the current poor market condition. Dell (US) has guided poor 2Q06 results and the market expects more price-cutting in 2H06. We believe other notebook OEMs are busily cutting prices to sustain their market shares. Ju Teng expects contribution from Compal and Quanta (e.g. outsourcing partners for HP & Dell) to fall this year, while contribution from Asustek, Wistron and Inventec (e.g. outsourcing partners with Apple and Toshiba) are expected to increase.

Apple in black does not work too well. The company currently ships Macbook (mainly in black) and iMac G5 casings for Apple (through Asustek). However, shipments of black color Macbook do not appear to be strong, given that customers still prefer Macbook in white. We expect things to turn better towards the end of the year due to (1) a potential increase in shipments of Macbook in white (due to competitors' failure to meet production quality), and (2) ramping up shipments of new generation iMac G5. Shipments to Apple contributed around 5% of revenue in 2005 and we expect the contribution to rise to 10% in 2006.

Is shipment rebound sustainable? All Taiwanese notebook OEMs reported better shipments in June following a poor 2Q FY12/06. Recent CPU price cut by Intel (US) and AMD (US) should aid better PC shipments in 3Q FY12/06 due to seasonal demand. Most of the Taiwanese notebook OEMs are expected to see sequential shipment growth of 20% (from a rather low base) in 3Q06 on the back of seasonality. However, we believe the shipments improvement is mainly attributed to restocking for the selling seasons (e.g. back to school) and whether this improvement can be sustainable is still too early to say. We will only see the real demand in Sept.

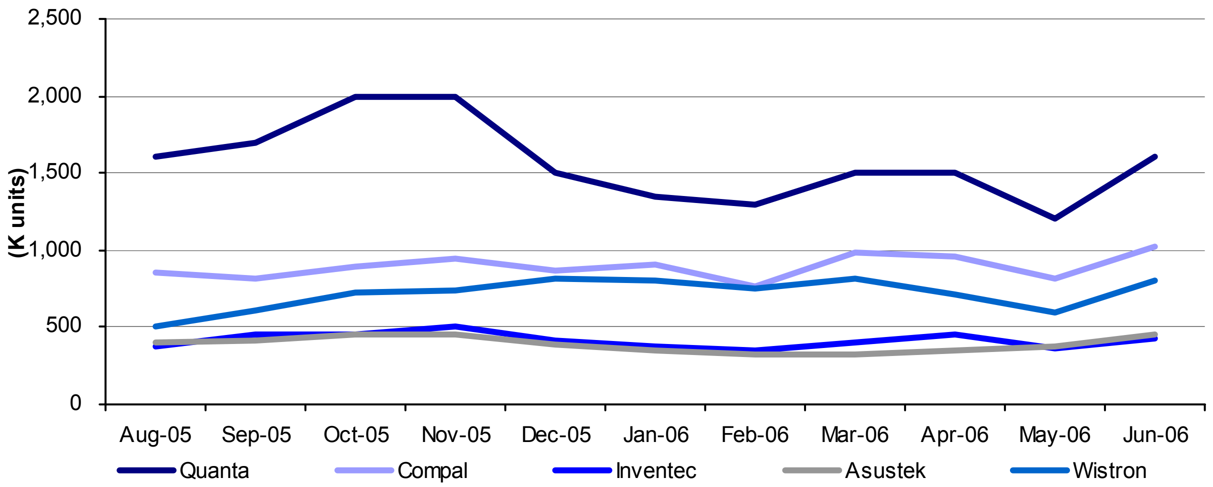
Pic 3: Macbook

Source: www.google.com

Pic 4: iMac G5

Source: www.google.com

Chart 5: Shipments of Taiweanese notebook OEMs



Source: Company data and SBI E2-Capital

Valuation not demanding, but the story is not as compelling as previously thought. To reflect weaker margin assumptions and the slow progress of new product launch, we have cut our earnings by 9% to around HK$206m for FY12/06 and by 11.5% to around HK$265m for FY12/07. The stock currently trades at 8.5x 06F P/E and 6.6x 07F P/E. While valuation is not demanding and shipments are expected to improve in the near term (as a result of seasonality), we think that any meaningful shipments of colorful and engraved casings are unlikely to materialize until 2007 at the earliest. As a result, we have downgraded our rating from BUY to HOLD and have revised down our target price to HK$1.85 (previously HK$3), 7x 07F P/E.

Table 3: Peer group comparisons

	Currency	Price	P/E (x)		ROE (%)		Net gearing (%)
			2006	2007	2006	2007	2005
Ju Teng International (3336 HK)	HK$	1.70	8.3	6.4	14.4	14.5	51.8
Huan Hsin (HUAN SP)	SG$	0.58	8.9	8.2	7.8	8.4	18.2
Catcher Technology (2474 TT)	NT$	335	18.6	14.6	43.3	36.2	Cash
Foxconn Tech (2354 TT)	NT$	231.5	26.3	21.4	34.3	33.2	Cash
Average			**15.5**	**12.6**	**24.5**	**22.6**	

Source: SBI E2-Capital