

On the way to turnaround

Hong Kong Industrials

Playmates (635 HK, HK\$1.15)

BUY (unchanged)

Target price: HK\$1.50 (+28.2%)

- ❑ **Weak box office takings.** Almost a month after its debut, the computer-animated Teenage Mutant Ninja Turtles (TMNT) movie grossed US\$53.1m (domestic only) (table 1), compared with market estimates of US\$100m.

Table 1: TMNT movies results

Rank	Movie	Studio	Gross / Theaters		Opening / Theaters		Date
1	Teenage Mutant Ninja Turtles	New Line	US\$135,265,915	2,377	US\$25,398,367	2,006	3/30/90
2	Teenage Mutant Ninja Turtles II	New Line	US\$78,656,813	2,868	US\$20,030,473	2,868	3/22/91
3	TMNT	Warner Bros.	US\$53,078,353	3,120	US\$24,255,205	3,110	3/23/07
4	Teenage Mutant Ninja Turtles III	New Line	US\$42,273,609	2,087	US\$12,419,597	2,087	3/19/93

Source: <http://www.boxofficemojo.com/>

- ❑ **Turnaround in FY12/07F.** Despite the weak box office takings, we are confident of a turnaround for Playmates' toy segment in FY12/07F, given that 1) 2006 was exceptionally poor for toys sellers in the US and 2) other toy manufacturers, such as Hasbro (HAS US), Mattel (MAT US), RC2 Corp (RCRC US) and Jakks Pacific (JAKK US) (table 2) recorded strong sales and earnings in 1Q07. While its quarterly operational data was not provided, we believe competitors' good results indicate that things are looking up for Playmates. From a microeconomic perspective, TMNT sales should pick up in FY12/07F as 2006 was a planned transition year in anticipation of CGI animated movies. Its gross margin is expected to return to 50% given a 2-3% increase in the ASP and retailers' acceptance of the price adjustment.

Table 2: 1Q07 performance by other US toys sellers

Stock	Ticker	1Q07 Sales YoY %	1Q07 Net profit YoY %
Hasbro	HAS US	33.6	Returned to profits
Mattel	MAT US	18.5	Returned to profits
RC2 Corp	RCRC US	8.8	5.7
Jakks Pacific	JAKK US	15.8	(36.8)

Source: SBI E2-Capital

- ❑ **Toy segment spin-off proposed.** The company has submitted a proposal to the HK Stock Exchange to spin off its toy business on the main board, according to its announcement on 27th April. We believe the proposal is positive as it 1) will allow clear delineation between its property and toy business; 2) will generate a

Table 3: 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 %
05A	196.1	0.110	(34.2)	10.5	1.2	14.2	4.3	13.7	11.7	Cash
06A	260.4	0.139	26.6	8.3	1.0	47.2	6.1	13.9	1.5	Cash
07F	*180.2	0.096	*(30.8)	11.9	1.1	10.3	3.4	8.8	7.4	Cash
08F	212.5	0.114	17.9	10.1	1.0	8.1	4.0	8.8	7.4	Cash
09F	243.8	0.130	14.7	8.8	0.9	8.1	4.0	8.8	7.4	Cash

*distorted by revaluation gains in FY12/6A

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one-off disposal gain and 3) implies a potential turnaround in the toy segment this year. We estimate the segment is worth c.HK\$1,686m, based on an EBIT margin of 10% and a comparable P/E of 13x (compared with 16.3x industry average) in FY12/07F. (table 4)

- **Reiterate BUY.** We are certain of a turnaround this year and reiterate our BUY recommendation. The counter is trading at 11.9x P/E FY12/07F. We have fine-tuned our earnings forecast with our target at HK\$1.50, representing an 11.8% discount to our NAV per share of HK\$1.70.

Table 4: Sum-of-the-parts evaluation

	Gross asset value (HK\$m)	Basis of valuation
Toys	1,686.4	Assume 10% EBIT margin for the toy segment; 13x FY12/07F
Investment property	1,118.0	Market value
<i>Net cash (debt)</i>	<i>393.0</i>	
Net asset value	3,197.4	
no. of shares	1,872.4	
NAV/ shs (HK\$)	1.7	

Source: SBI E2-Capital

Table 5: Comparable valuations

Stock	Ticker	Mkt Cap (US\$m)	Curr Last Price	P/E (x) 1-yr forward	P/E (x) 2-yr forward	Operating Margin (%)	ROA (%)	ROE (%)
Hasbro	HAS US	5,282.6	USD 32.3	18.6	18.5	11.9	7.2	14.1
Mattel	MAT US	11,365.3	USD 28.7	17.9	16.5	12.9	12.7	26.2
RC2 Corp	RCRC US	910.1	USD 41.7	15.9	14.2	16.7	5.5	8.0
Jakks Pacific	JAKK US	691.8	USD 24.4	10.3	10.1	12.1	8.9	12.8
Marvel	MVL US	2,545.4	USD 29.4	20.6	21.6	32.0	9.8	19.1
Leapfrog	LF US	705.3	USD 10.9	-	-	(24.8)	(27.5)	(36.3)
Vtech	303 HK	1,833.2	HKD 60.0	11.9	11.2	11.6	23.0	50.6
IDT	167 HK	141.2	HKD 0.4	-	22.0	(8.9)	(12.2)	(26.3)
<i>Average</i>				15.9	16.3	7.9	3.4	8.5

Source: SBI E2-Capital & Bloomberg estimates