

Automated teller machine operator

China Financial Services

FinTronics (706 HK, HK\$0.60)

Not Rated

Company background. Listed in 1998 on the mainboard of HKEx, FinTronics originally engaged in software development and integration services. It started moving into the automated teller machine (“ATM”) business in China with the acquisition of 30% in Loten Technology Co. Ltd. (“Loten”) in March 2005 and the remainder in December 2005. It completely disposed of its original business in February 2007 and successfully entered China’s financial services industry with the procurement, deployment and operation of ATMs. It also provides maintenance and technical support services for ATMs and develops value-added services in collaboration with commercial banks in China.

Business model. FinTronics’ major customers are commercial banks in China, i.e. state-owned, joint-stock, city and rural. According to KPMG, China had about 336 commercial banks in 2005. FinTronics sources ATMs from manufacturers, including regional and domestic brands such as “Nautilus” by Hyosung, “LEAD” and “GRG Banking”. With 10-year operating rights, the company customizes the ATMs and installs them at rented sites. FinTronics is responsible for their daily operations, such as transaction processing and 24-hour monitoring. It also provides hardware maintenance and cleaning services. The investment cost is totally borne by FinTronics and averages RMB90,000 per ATM. In return, the company collects money from inter-bank transactions processed by the ATM, which represent c.75% of total transactions. According to the inter-bank transaction revenue sharing arrangement, a fixed withdrawal fee of RMB3.6 is imposed on each transaction. FinTronics is entitled to 65-90% of the RMB3.0 collected, according to different sharing ratios negotiated with commercial banks. The remaining RMB0.6 goes to the China UnionPay. (refer to table 1)

Table 1: Revenue model

	2006A	2007F	2008F	2009F
No. of daily transactions per ATM	70	70	70	70
Fee charged per transaction (RMB)	3	3	3	3
% sharing by FinTronics	78	78	78	78
No. of ATMs	400	2,000	4,000	7,000
Avg. no. of ATM		1,200	3,000	5,500
Total revenue (RMBm)	24	71	178	327

Source: Company data, SBI E2-Capital

Table 2: Capex plan and cost structure

	2007F	2008F	2009F
Capex per ATM (RMB)	90,000	90,000	90,000
Total capex (RMBm)	180	360	630
Cost Structure			
Rental cost per ATM per month (RMB)	700	700	700
Annual maintenance cost per ATM (RMB)	4,000	4,000	4,000
Staff cost/sales (%)	16	16	16
Depreciation (10 years)	18	54	135

Source: Company data, SBI E2-Capital

2,000 ATMs by end-2007. Currently, FinTronics operates c.400 ATMs in China and plans to add another 1,500 ATMs in 2007F, with an ultimate goal of 7,000 ATMs in total by 2009F (refer to Table 1). The average number of transactions per ATM ranges from 25 to 130 a day, with a ramp-up period of three months for new ATMs. The

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company expects to break even in 2007F, with 2,000 ATMs in total.

Contracts with commercial banks. FinTronics has signed contracts with Shenzhen Commercial Bank to install c.2,000-3,000 ATMs in Beijing and Guangzhou. It is also discussing with the bank to offer services in other cities such as Shanghai, Wenzhou, Ningbo and Dalian. It has already signed contracts with the Bank of Communications (Shenyang Branch), China Merchant Bank (Xiamen Branch), CITIC (Shenyang Branch), Pudong Bank (Dalian Branch), HengFeng Bank (Jinan and Qingdao Branches), Xiamen Post Office Bureau and Nantong Commercial Bank.

Industry outlook. According to the People's Bank of China (PBOC), China has only 52 ATMs per million people, compared with the global average of 204 and 1,324 in developed countries such as the US. Currently, the ratio of off-premise vs on-premise ATM deployment is 20/80 in China, compared with 70/30 in the US. The company expects the ratio to reach the US levels in the future as China began to develop. Moreover, commercial banks, which used to operate their own ATMs, has begun to outsource the services in 2004 due to high costs of expansion.

Our take. With huge capital investment involved, we expect initial startup losses. Margin is expected to be under pressure in the future, since no special skills are required to operate ATMs and there are other local competitors such as GRG, King Teller, Digital China and Shenzhen Donar. The largest, King Teller, has 700-800 ATMs. We believe the key to FinTronics' success at present is its 1) relationship with commercial banks; 2) ability to locate best sites for ATMs with heavy traffic flow and 3) strong financial background to gain a dominant market share within a short period of time. Further away, the company will have to beef up its ability to 1) maintain margins and 2) diversify its revenue base – expand into value-added services - on top of cash withdrawals.

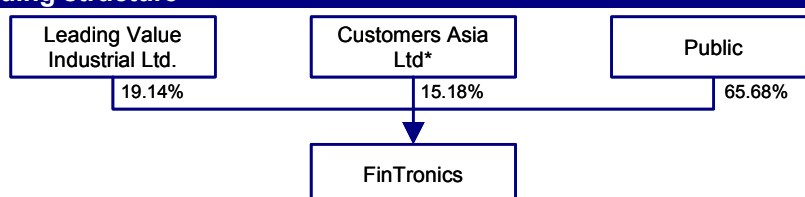
Valuation. Global ATM operators, Cash Systems (CKNN US, US\$5.1, NR) and Euronet Worldwide (EEFT US, US\$27.15, NR) trade at 42.8x and 49.1x prospective P/E in FY12/08F. However, other operators are loss making. FinTronics' total cash in hand amounted to c.HK\$120m. Its previous business is disposed at a loss. As a result, earnings is not expected until FY12/08F.

Table 3: Peer comparison

Stock	Ticker	Currency	Share Price	Market cap (US\$m)	P/E (x) 1-yr Fwd	P/E (x) 2-yr Fwd	Operating Margin (%)	ROA (%)	ROE (%)
Cash Systems Inc.	CKNN	USD	5.1	11.7	n.a.	42.8	(9.1)	(9.8)	(21.0)
Euronet Worldwide Inc.	EEFT	USD	27.15	131.1	56.0	49.1	8.3	4.6	18.7
Global Axcess	GAXC	USD	0.31	0.9	n.a.	n.a.	n.a.	n.a.	n.a.
TRM Corp.	TRMM	USD	2.94	6.5	n.a.	n.a.	1.4	(2.6)	(7.5)
Customers Ltd.	CUS	AUD	0.235	90.7	n.a.	n.a.	10.1	(1.5)	(4.1)
Average					56.0	46.0			

Source: Bloomberg

Chart 1: Shareholding structure



Source: SBI E2-Capital

*Customers Asia Ltd. are jointly owned by Customers Ltd.(CUS AU), one of the largest merchant ATM networks in Australia and First Capital Partners, a fund management company who specializes in investing in card servicing companies worldwide.

Corporate governance. In Nov 2006, the Group has issued 210m new shares at HK\$0.261/shs, represent c.18.14% of existing issued share capital. It has further issued a convertible loan of HK\$60m at a conversion price of HK\$0.26/shs to Customers Asia Ltd, represent 20.7% of existing issued share capital. If the convertible loan is fully converted, Customer Asia Ltd. will become the largest shareholders.

Major risks. 1) Change in the ATM charging method and profit sharing ratio; 2) Higher rental costs on leased ATM sites and 3) Increased competition from large banks, which lower its bargaining power in obtaining good sites.