

Picking up speed

China Industrials

Launch Tech (8196 HK, HK\$1.29)

BUY (unchanged)

Target price: HK\$3.09 (+139.5%)

In line. In FY12/07A, Launch's net profit rose 49.2% to RMB61.3m and turnover 35.6% to RMB412.5m, slight below our estimates of RMB451.7m, mainly due to lower-than-expected sales of automobile maintenance equipment. Its gross profit increased 40.4% to RMB228.7m and gross margin widened 1.8pcp to 55.4%. The company declared a final DPS of RMB0.054, representing a payout ratio of 49.2%.

Table 1: Annual results

12 months to Dec	Turnover (RMBm)	Gross profit (RMBm)	Gross margin (%)	Pre-tax profit (RMBm)	Tax rate (%)	Net profit (RMBm)	EPS (RMB)	DPS (RMB)
FY06	304.1	162.9	53.6	39.1	5.2*	41.1	0.074	0.035
FY07	412.5	228.7	55.4	61.4	0.2	61.3	0.109	0.054
YoY (%)	35.6	40.4				49.2		54.3

Source: Company data

X431 Electronic Eye – earnings driver. Launch has moved gradually from the automotive pre-market to aftermarket. In 2007, global sales of the company's "signature" product, X431 Electronic Eye, rose 41.0% to 22,000 units, of which 12,000 units were sold in overseas. Last year, Launch was able to secure new orders from Weichai Power, by supplying 1,000 units of X431 diagnostic devices. During the year, the company launched X431 Top, which was well received by 4S stores and garages, and contributed to the company's profit growth. A new series of X431 is expected to be launched this June. We expect X431 diagnostic devices to remain as its core revenue generator in the future, mainly because: 1) enormous growth potential in China driven by roaring automobile market; 2) increasing number of after-sales service workshops such as 3S and 4S in China (expected to grow at the rate of 13.8% annually to 2009); 3) increasing new customers; 4) expanding its market coverage to Europe and Japan and 5) new products.

Capturing the emerging DIY market. In 2007, the company developed CRecorder and started distributing it free of charge in the US, Hong Kong and Shenzhen, on a trial basis. We are confident that this product will be well received in the US as CReader, which offers similar features, sold 90,000 units there in 2007 compared with 30,000 in 2006. In view of the increasing popularity of DIY in the US, we expect CRecorder to become a main growth driver for Launch from FY12/08.

Strategic cooperation with Weichai Power. In Oct 2007, Launch signed a strategic cooperation agreement with Weichai Power to carry out research and development of diesel-engine systems. The first diesel-engine model is expected to be launched in this September.

Main board migration on track. Launch plans to withdraw from the GEM board and list on the Main Board of

Table 2: Financial summary

Year to Dec	Net profit RMBm	EPS RMB	EPS Δ %	P/E x	P/B x	EV/EBITDA x	Yield %	ROE %	ROCE %	N. Gearing %
06A	41.1	0.074	4.2	17.4	1.7	9.6	2.7	10.9	10.9	59.0
07A	61.3	0.102	37.4	12.7	1.5	6.9	3.9	13.0	13.0	34.7
08F	82.2	0.136	34.0	9.5	0.8	4.9	5.2	10.7	10.7	Cash
09F	105.6	0.175	28.6	7.4	0.6	3.8	6.7	9.2	9.2	Cash
10F	132.0	0.219	25.0	5.9	0.5	3.1	8.4	9.4	9.4	2.3

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the HKEx by this July. We believe that, if successful, the move will boost its image, recognition and share liquidity, benefiting its future growth and development.

Forecast changes. We have reduced our turnover forecast to HK\$548.3m for FY12/08F and HK\$700.2m for FY12/09F due to slower-than-expected sales of automobile maintenance equipment. We expect Launch to grow organically though increasing orders and new products. Its X431 Electronic Eye remains a core revenue driver with sales expected to top 25,000 units in FY12/08F from 22,000 in FY12/07A. The company's effective tax rate is 7.5% and we estimate its net profit will rise 34.1% to HK\$82.2m in FY12/08F. The automobile diagnostic business will remain the main contributor. Our current estimates do not include Launch's cooperation with Weichai Power.

Bullish outlook remains intact, maintain BUY. We remain bullish on the company's long term prospects as it is operating in attractive business segments, with growth fuelled by 1) booming automobile and automobile aftermarket; 2) emerging DIY market; 3) increasing number of 4S stores in China and 4) second hand market in China. We maintain our BUY call with a target price of HK\$3.09. The valuation looks appealing, with the counter trading at fully diluted FY12/08F P/E of 9.5x and FY12/09F P/E of 7.4x, compared to peers' average FY12/08F P/E of 12.7x.

Table 3: Peer comparison

Company name	Ticker	Market Cap (US\$m)	P/E (x)			ROA (%)	ROE (%)
			Historical	Current	1-yr forward		
Bosch Corporation	6041 JP	1,767.5	9.6	9.3	9.2	7.5	11.6
Autobacs	9832 JP	971.9	10.7	23.2	18.1	3.9	5.6
Snap-On Inc	SNA US	2,775.5	15.6	13.0	11.5	6.7	15.4
3M Co.	MMM US	55,162.3	13.9	14.3	13.0	17.8	37.7
Stanley Works	SWK US	3,745.4	12.0	11.0	10.1	7.7	20.5
SPX Corporation	SPW US	5,545.8	19.9	16.9	14.2	5.0	14.3
Average			13.6	14.6	12.7		

Source: SBI E2-Capital

Table 4: P&L

Year end Dec (RMBm)	06A	07A	08F	09F	10F
Turnover					
Automobile diagnostic devices and other equipments	231.2	302.5	388.8	492.8	612.1
Automobile lift	73.0	110.0	159.5	207.4	259.2
	304.2	412.5	548.3	700.2	871.3
Cost of sales	(141.3)	(183.8)	(275.8)	(353.7)	(440.4)
Gross profit	162.9	228.7	272.6	346.5	431.0
Other income	19.8	23.7	31.5	40.2	50.1
Selling expenses	(64.9)	(74.3)	(82.2)	(105.0)	(130.7)
Administrative expenses	(37.7)	(44.6)	(43.9)	(56.0)	(69.7)
R&D expenses	(12.9)	(16.0)	(20.1)	(24.1)	(29.0)
Loss on disposal of assets	(7.8)	-	-	-	-
Write off of payment for other investment	(5.4)	-	-	-	-
Other operating expenses	(2.1)	(30.1)	(30.1)	(40.0)	(51.1)
Finance costs	(11.1)	(23.2)	(7.3)	(29.0)	(36.3)
Share of result of an associate	-	(2.7)	-	-	-
Before tax profit	39.1	61.4	88.8	114.2	142.8
Tax	2.0	(0.1)	(6.7)	(8.6)	(10.7)
Profit of the year	41.1	61.3	82.2	105.6	132.0
Minority interest	-	-	-	-	-
Net profit	41.1	61.3	82.2	105.6	132.0

Source: SBI E2-Capital