

Launch Tech: Auto aftermarket play

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Recommendation: Not Rated

China Industrials

Price	HK\$1.80	Yield (12/06A)	2.6%
12 mth range	HK\$1.23-2.75	ROE (12/06A)	5.9%
Market cap.	US\$110.9m	Net gearing (12/06A)	58.9%
No. shares o/s	228.0m	Net debt/sh. (12/06A)	RMB0.98
Daily t/o, 3 mth	US\$0.1m	BV/sh. (12/06A)	RMB0.75
Free float %	46.5%	Consensus EPS	
Major shareholder	Liu Xin and Liu Jun – 24.9%	- 12/07F	RMB0.14
Ticker	8196.HK/ 8196 HK	- 12/08F	RMB0.16

Key points:

- Niche player in automotive aftermarket.
- Strong reputation of X431 Electronic Eye, its core product, among diagnostic brands.
- CRecorder to become new earnings driver.
- Bright prospects thanks to: 1) growing car industry; 2) increasing aftermarket service demand; and 3) growing DIY market.
- H-share issue planned.
- Trading at FY12/07F P/E of 12.8x and FY12/08F P/E of 11.3x, on a consensus basis.

Company background. Founded in 1992, Launch is a niche player in the automotive aftermarket, providing a range of automobile diagnostic devices and other garage equipment, such as automobile lifts. Headquartered in Shenzhen, Launch has two production facilities – in Shenzhen and Shanghai. It sells its products to automobile services centers and end users through sales offices in 65 cities in China. The company also exports its products to overseas by partnering with 600 partners around the world.

X431 Electronic Eye - core product. Its X431 Electronic Eye, a scan tool for vehicle diagnosis, is the core revenue generator for Launch. In 1H FY12/07A, the company sold 10,000 units (55.0% overseas), compared with 9,500 in 1H FY12/06A, contributing c. 46.0% of its total turnover. Sales are expected to remain strong in 2H07, thanks to new orders from the US, Japan and China. Currently, there is a new series of X431 in the pipeline, which will be launched by end-March 2008.

Table 1: Interim results

Six months to Jun	Turnover (RMBm)	Gross profit (RMBm)	Gross margin (%)	Pre-tax profit (RMBm)	Tax rate (%)	Net profit (RMBm)	EPS (RMB)	DPS (RMB)
1H FY06	159.1	82.1	51.6	30.0	6.0	28.2	0.05	-
1H FY07	202.8	97.0	47.8	33.1	-	33.3	0.06	-
YoY (%)	27.5	18.1		11.1		18.2	20.0	-

Source: Company data

Good diagnostic brand name. During a competition in 2004 in Holland, X431 beat a whole array of diagnostic tools to become the No. 1 scan tool, boosting the brand's profile. It is also a testament of its superior capability in redefining the landscape of the technology-centered industry. At present, Launch has c.80.0% of China's diagnostic market and c.5.0% of the global market.

New product - CRecorder. In 1H07, the company launched its first personal CRecorder to cater for the car DIY market. The small device records different parameters such as speed, direction and driving conditions. Though a

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USB and end-user software, users can connect the CRecorder to the company website, which will analyze the data and produce two types of reports, Class 1 (covering basic information for US\$0.90) and Class 2 (covering comprehensive evaluation for US\$5.0 – 10.0).

To be as popular as Creader. Launch has so far distributed 20,000 units of CRecorder free of charge to users in the US and 500 units in Hong Kong and Shenzhen. The trial will last until end-2007. We believe the product will be well received in the US, as the sales of Creader, a similar product, totaled 30,000 there in 2006.

Automobile lift business. In 1H FY12/07A, the sales of automobile lifts reached 7,500 units, from 6,000 in 1H FY12/06A, accounting for 24.0% of total turnover. Launch makes lifts at its Shanghai plant, the largest in Asia with a capacity of c. 21,000. The low-margin business can be boosted only by volume increases. The company has indicated that it may dispose of this non-core segment in the future.

Attractive market. As automobile maintenance is getting more complicated, diagnosis equipment is essential. We are positive on Launch's future prospects in the world's booming automobile market. The company said its old series of X431 Electronic Eye remains a bestseller and we expect the X431's ASP to remain stable. We expect Launch to grow organically in FY12/07 though increasing orders from new customers, with X431 Electronic Eye as the core earnings driver. New drivers will emerge in FY12/08 with contributions from CRecorder and a new series of X431 Electronic Eye.

Plan H-share issue. Launch plans to issue a maximum of 20.0% (c. 45.6m) of the company's existing number of H-shares. We expect the issue will dilute the EPS this and next year.

Corporate governance. Launch was listed on the GEM Board in 2002. The company changed its auditor once since the listing, replacing Deloitte with Grand Thornton in 2005. Its major shareholders, Lin Xin and Liu Jun, hold 24.9%, McCarthy Kent C. 21.8% and IFC 6.8%. Public shareholders account for 46.5%.

Valuation. Currently, the counter is trading at FY12/07F P/E of 12.8x and FY12/08F P/E of 11.3x, on a consensus basis.

Table 2: P&L

Year end Dec (RMBm)	04A	05A	06A
Turnover	277.6	342.6	304.2
Cost of sales	(144.7)	(190.2)	(141.3)
Gross profit	132.9	152.4	162.9
Other income	21.4	38.2	19.8
Selling expenses	(35.1)	(69.5)	(64.9)
Administrative expenses	(47.1)	(44.9)	(37.7)
R&D expenses	(8.0)	(8.5)	(12.9)
Loss on disposal of assets	-	(7.8)	-
Write off of payment for other investment	-	(5.4)	-
Other operating expenses	(17.2)	(2.1)	(19.1)
Finance costs	(8.4)	(11.1)	(8.1)
Share of result of an associate	-	-	(1.0)
Before tax profit	38.6	41.2	39.1
Tax	1.1	(4.1)	2.0
Profit of the year	39.7	37.1	41.1
Minority interest	(0.1)	(0.0)	-
Net profit	39.6	37.1	41.1
Dividend	18.2	19.5	19.5
EPS - basic (RMB)	0.076	0.071	0.074

Source: Company data