

JPM-pp1

Asia Pacific Equity Research

17 March 2015

Ju Teng International Holdings Limited (3336 HK)

Overweight

Price: HK\$4.87

17 Mar 2015

Price Target: HK\$6.40

PT End Date: 30 Jun 2015

Guidance ahead of expectations; Reiterate OW

Ju Teng's 2H14 result beat JPMe by 7% with lower-than-expected tax rate, while core business came in line with our estimates. For 2015, management expects to see 5-10% Y/Y revenue growth and 1-2 pts GM improvement, which implies some upside to our current estimates (4% Y/Y top line growth & 1 pt GM uptick), mainly driven by strong demand for tablet and 2-in-1 models. We remain positive on the name with its recovering top line momentum, enhanced product mix and better pricing power due to its strong position in Sichuan. Remain OW with Jun-15 PT of HK \$ 6.4 (8x 2015-16 PER). A key moving part would be Ju Teng's potential warrant issuance, which would imply 12.5% EPS dilution for the next 18 months.

- **Guidance for 2015 implies some upside to our current numbers:** Ju Teng expects its revenue to see 5-10% Y/Y growth in 2015 with GM likely to improve by 1-2 pts, which implies some upside to our estimates (4% Y/Y growth and 1 pt GM improvement). Specifically, management expects to see strong demand from 2-in-1 models and larger size tablets (esp for Asus and MSFT respectively, in our view), which should uplift its pricing (ASP could be up to \$60 compared to ~ \$ 20 for regular plastic casing Notebooks) and margin profile given the high end metal casing adoption. Besides, Ju Teng believes its NB growth could outpace the market (which management forecasts to see ~7% Y/Y decline in 2015) due to its dominant capacity in Sichuan ([here](#)), which should contribute to rising market share for Ju Teng's commercial NB (to 40% this year from 25-30% in 2014).

- **1H15 – demand to be back-end loaded; 2H15 – promising H/H momentum on the way:** For 1H15, Ju Teng expects 0-5% Y/Y revenue growth with demand emerging to be quite back-end loaded, as momentum for NB and tablet should pick up by 2Q with inventory restocking. For 2H15, we expect both product lines to witness stronger H/H growth with NB demand likely to be sustained by Win 10 launch and tablet traction should be uplifted by new model for MSFT. With favorable mix change (metal & composite / tablet contribution likely to rise to 40/30% respectively in 2015 from 30/15% a year ago), we believe the management target of 1-2 pts GM improvement to be achievable.

- **2H14 result a beat with lower tax rate:** Ju Teng's 2H14 core biz came in line with our estimates with stronger-than-expected GM (19.9%) from rising non-NB mix offset by higher OPEX due to relocation-related expenses. Net profit beat our estimate by 7% due mainly to lower tax rate (17.6% vs JPMe of 20%) with Ju Teng's operation focus shifting to Sichuan where tax rate is lower.

- **Bonus issue of warrants – a nimble financing strategy, which favors qualified shareholders:** Ju Teng plans to issue 1 warrant for every 8 outstanding shares held (12.5% share dilution) on the record date Mar 31st. Subscription price is HK \$ 4.6 (5.5% discount to current level) and the warrant will take effect from mid April 2015 and remain effective for 18 months. Two major implications of the warrant issuance are: (1) Management viewed HK \$ 4.6 as a trough for its share price, which supports our OW view; (2) qualified shareholders, who bought the stock no later than Mar 31st will benefit the most from ordinary share gain and leveraging call option value, once share price trends up.

- **Remain OW:** We reiterate OW on Ju Teng with Jun-15 PT of HK \$ 6.4 (8x 2015-16E PER). We expect the recovering top line momentum, enhancing mix as well as better pricing power due to its strong position in Sichuan to be the main earnings drivers for the name. We suggest investors to accumulate the stock at current levels to capture the upcoming heating momentum from 2Q on.

Table 1: Ju Teng 2H14 result comparison table

HK\$ mn, except per share data	2H14A	JPMe	Variance	2H13A	Y/Y
Sales	5,173	5,117	1.1%	4,958	4.3%
Gross profit	1,031	958	7.6%	1,080	-4.5%
Operating profit	606	600	1.0%	700	-13.4%
PBT	578	599	-3.4%	669	-13.6%
Net income	454	424	7.1%	502	-9.5%

EPS (HK\$ cents)	0.39	0.36	6.8%	0.43	-9.8%
Gross margin	19.9%	18.7%	121 bps	21.8%	-185 bps
Operating margin	11.7%	11.7%	-1 bps	14.1%	-240 bps

Source: Company reports and J.P. Morgan estimates.

Ju Teng 2H14 Earnings call

2014 review

- Still highly related to NB market, which was quite stable in 2014 with support of Win XP expiry and commercial models.
- Focused more on tablet – able to work with one of the largest tech company (MSFT).
- Smartphone biz – 2H13 started – compared with 2013 – saw large growth in 2014.
- Also completed production for NB casing in Zhongqing – commenced production in Dec 2014.

2015 preview

- Expect rev to grow by 5-10% and GM to improve by 1-2 pts for 2015.
- 2015 – we expect NB to be stable and will focus more on tablet and 2-in-1.
- Smartphone will be a relatively smaller revenue contribution.
- Strong replacement demand for NB in 2H15 once Win 10 is available.
- NB – quite stable. Look for more mkt share gains.
- We have more capacity now for NB casing.

Product / material mix

- 2014 - NB/tablet/smartphone/others – accounted for 75/15/5/5% of revenue.
- 2014 - Plastic – 70% / metal & composite – 30% of revenue.
- 2015 (E) - /tablet/smartphone/others – accounted for 50-55/30/5/10% of revenue.
- 2015 (E) - Plastic – 60% / metal & composite – 40% of revenue.

Warrant

- Subscription price: HK \$ 4.6.
- Subscription period: 15 April 2015 to 14 Oct 2016.
- Total warrant issued shares: 143, 954 K (12.5% dilution).
- Total proceeds: HK \$ 661.7 M.

Q&A session

NB & Tablet growth?

- NB – expect the entire NB market to drop by 7% Y/Y.
- Tablet – will see more upsides esp for the larger size tablet (12-13’).

How to leverage our dominant share in Sichuan?

- 60% of the total plastic casing capacity (industry wide) is in Sichuan.
- 2H – our commercial NB mkt share could rise to 40% from 27% in 2014.

Smartphone progress?

- We have seen limited progress for new customer development for smartphone, due to rising pricing competition with more

vendors joining the fray.

- We have laid more focus on tablet-like 2-in-1 models (ASP could be \$ 60+).
- Smartphone life cycle is shorter, and our CNC machining UTR is quite full now so prefer to focus on tablet and 2-in-1.

5-10% revenue growth? More for ASP or volume growth?

- ASP growth should be more significant.
- NB volume growth should be stable or down by less than 5%.
- Tablet & 2-in-1 models should see bigger volume growth.

GM difference?

- Metal casing – 25-30%. Plastic casing – 10-15%.

UTR?

- Plastic / Mg-AL metal casing is ~70%.
- CNC machining – will be 100% next month.

Smartphone casing?

- 1Q15 volume is quite the same as 1Q14.

2015 Capex?

- US \$ 60m for CNC machining and US \$ 20m for new product development.
- We have 4k CNC machines, and 1K out of which is dedicated for one major customer (MSFT).
- Will buy 600 CNC machines this year.

1H momentum?

- 1Q – NB demand is bad.
- 1H – 0-5% Y/Y revenue growth.
- Plastic casing demand is not good, but metal casing is stronger.
- Margin – 150 bps margin expansion achievable.

Investment Thesis

We remain OW on Ju Teng as we expect the company to enjoy a better margin profile with enhancing product mix due to increasing metal, handset as well as composite casing contributions.

Valuation

Our Jun-15 PT of HK\$6.4 is based on 8 x 2015E/16E earnings. 8x is the average P/E multiple Ju Teng has seen during margin upcycles and we think Ju Teng should be able to trade at this multiple, given the 2H14 and 2015 margin uptick.

Risks to Rating and Price Target

Key downside risks are: (1) serious price competition; (2) NB demand further deteriorates; (3) unfavourable RMB trend (appreciation).

Technology - Hardware
AC

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06-Nov-06	OW	1.32	2.00
13-Feb-07	OW	1.70	2.50
18-Apr-07	OW	1.73	2.70
15-Jul-07	OW	3.47	4.50
04-Sep-07	OW	3.26	5.70
15-Aug-08	OW	4.30	6.00
08-Dec-08	OW	1.48	3.00
18-Aug-09	OW	5.38	7.50
29-Nov-09	OW	5.62	10.00
19-Aug-10	N	5.18	6.00
26-Aug-10	N	4.79	5.30
07-Sep-11	N	1.70	1.40
22-Mar-12	N	2.27	2.50
10-May-12	OW	1.58	2.60
09-Aug-12	OW	2.35	4.80
22-Aug-12	OW	3.39	5.00
19-Mar-13	OW	4.78	6.00
22-Aug-13	OW	4.64	6.30
19-Mar-14	OW	6.11	7.20
21-Aug-14	OW	5.27	6.90
25-Feb-15	OW	4.58	6.40

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