

JPM-pp1

Asia Pacific Equity Research

18 March 2015

Techtronic Industries (669 HK)

Overweight

Price: HK\$26.35

17 Mar 2015

Price Target: HK\$36.00

PT End Date: 31 Dec 2015

FY14 results first take

Techtronic Industries (TTI) is one of the largest producers of branded power tools and floor care products in China with sales mainly in the US and Europe. The company released FY14 results after market on Mar 18, 2015. 2014 results was in line on sales and net profit. The key negative is the flat sales of floor care products in 2H Y/Y and the best news is the strong growth of 15% in power tool sales in 2H Y/Y.

Key issues to watch for at the Thursday morning analyst briefing:

Impact of raw materials to benefit 2015 – there is a 4 month delay between the drop in the cost of petrochemicals, copper and other materials and the positive impact on COGS. We view 2015 as the best year in terms of lower Y/Y cost in production and this is happening at a time of robust demand, making it more likely to lead to margin expansion

Weakness in floor care a concern – there wasn't a good explanation for the sharp slow down in growth in floor care from 17% in 2013 Y/Y to 9% in 1H14 Y/Y to 0% in 2H14 Y/Y. We had been expecting a 10% growth in sales for 2HFY14 in floor care and this is an area of concern.

Strong demand in power tools driven by innovation. - Sales of power tools surged 15% in 2HFY14 Y/Y – the fastest growth for at least 8 years. This growth is amazing when compared to the 5.5% sales growth of Home Depot (HD US) over the same period (TTI's largest customer) and 2-3% growth of Stanley Black & Decker (SWK US) (TTI's largest competitor) over the same period suggesting that TTI is gaining market share in the US as TTI launches more innovative than its peers, in our view.

Valuation, price and risks. TTI trades at 14.3x 15E P/E. Our PT (Dec-15, DCF-derived: WACC 9.0% and terminal growth of 3%) of HK\$36.0 implies a forward P/E of 19x (FY16E). The key risks to our PT are rising costs of production in China and a slower-than-expected recovery in US demand.

Please refer to our latest note, "[Techtronic Industries: Strong demand and falling costs to lift margins](#)" dated Oct 14, 2014 for detail.

Table 1: FY14 results

FY14 results (US\$m)	FY13A	FY14A	Y/Y	FY14E	Var	Consensus
Turnover	4,300	4,753	11%	4,721	1%	4,732
Gross profit	1,472	1,673	14%	1,660	1%	1,659
GPM	34.2%	34.2%		35.2%		35.1%
EBIT	304	365	20%	368	-1%	354
EBITM	7.1%	7.1%		7.8%		7.5%
Net profit	250	300	20%	310	-3%	300

Source: Company, J.P. Morgan estimates

Investment Thesis

We believe TTI should benefit from the normalization of demand for power tools and floor care products in the U.S., which fell from 2006 to 2012 and has just started to rebound. TTI has been gaining market share in the U.S. during the slump in demand and, we believe, is well positioned to benefit in a recovery. TTI has 15% of its sales to euro-denominated markets and is now benefiting from a recovery in demand in Europe, as well as the rise in the euro in recent months.

Valuation

Our Dec-15 price target is based on our DCF valuation that assumes a market risk premium of 6.0% and a risk-free rate of 4.2% (yield on 10-year government notes in China). We have assumed a beta of 1.0. This is more conservative than the 0.7 Bloomberg beta. Accordingly, we assume a WACC of 8.9%. We estimate free cash flow until 2020 and assume a terminal growth rate of 3.0%. The terminal growth is based on the annual growth rate expected in 2020 (the final year of the estimate period) subject to a minimum of 1.5% and a maximum of 4.5%, depending on the nature of the industry and the level of maturity in China.

Risks to Rating and Price Target

The key risks to our PT are a rising cost of production in China and a slower-than-expected recovery in US demand. Another risk is the implementation of new product launches and whether or not they are accepted by customers.

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Date	Rating	Share Price (HK\$)	Price Target (HK\$)
22-Mar-07	N	9.66	9.50
19-Apr-07	N	10.40	10.00
22-Aug-07	N	8.65	9.50
29-Jan-08	N	9.16	8.70
09-Nov-08	N	2.50	4.30
09-Jan-09	OW	2.25	4.30
04-Mar-10	OW	5.88	8.50
11-May-10	OW	7.76	11.00
15-Aug-10	OW	6.13	10.00
20-Aug-10	OW	6.61	11.00
16-Dec-10	OW	10.18	15.00
28-Mar-11	OW	9.74	14.00
22-Jul-11	OW	8.40	12.00
15-Feb-12	OW	9.90	14.00
08-Aug-12	OW	10.24	15.00
20-Aug-12	OW	11.20	16.00
14-Nov-12	OW	14.40	19.00
05-Mar-13	OW	16.68	22.50
22-Mar-13	OW	17.70	23.00
22-Aug-13	OW	18.20	24.00
29-Aug-13	OW	18.72	28.00
20-Nov-13	OW	19.12	32.00
20-Mar-14	OW	21.60	36.00

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