Techtronic Industries

Reiterate OW rating - Strong growth with margin improvement

Overweight

0669.HK, 669 HK

Price: HK$26.55

Price Target: HK$36.00

China
SMID-Caps

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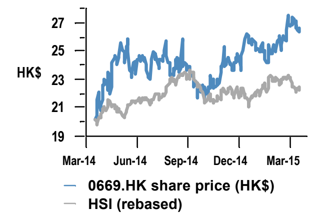
Price Performance



	YTD	1m	3m	12m
Abs	6.2%	2.7%	4.1%	32.1%
Rel	4.0%	5.6%	-1.5%	20.3%

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. Overall the results for 2014 are in line and we see better margins in 2015 resulting from strong demand, lower commodity costs and RMB depreciation. The recovery in demand for floor care is a key area of uncertainty but is still a small blip relative to the strong improvement in the tools business. Maintain OW rating and PT of HK$36.

- **Strong growth with margin improvement**. In 2014, TTI managed to achieve strong sales growth in a tough environment without relying on lowering prices. Both GPM and EBIT margins improved although the benefits of lower raw materials and RMB depreciation did not manifest in 2014 and should be more impactful in 2015, in our view.
- **Earnings estimates revision**. We cut sales by 0.6% as we lower our assumption for floor care sales growth in 2015 from 11% to 8% but raise power tool sales growth assumption for 2015 from 10% to 12% for 2015 following the trends indicated in 2014 sales. We increase our GPM estimates slightly to factor in recent drops in raw material prices and the RMB depreciation – both of which have a positive influence on GPM. Our NP forecasts are revised slightly as a result; our FY15 and FY16 EPS estimates are 6% higher than consensus.
- **Valuation, price and risks.** TTI trades at 16.7x 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.

Techtronic Industries (Reuters: 0669.HK, Bloomberg: 669 HK)

$ in mn, year-end Dec	FY12A	FY13A	FY14A	FY15E	FY16E
Revenue ($ mn)	3,852	4,300	4,753	5,187	5,803
Net Profit ($ mn)	202	250	300	381	456
EPS ($)	0.11	0.13	0.16	0.20	0.24
DPS ($)	0.02	0.04	0.04	0.05	0.06
Revenue growth (%)	5.1%	11.6%	10.5%	9.1%	11.9%
EPS growth (%)	25.0%	17.3%	20.2%	26.8%	19.7%
ROCE	9.7%	10.9%	11.9%	13.4%	14.2%
ROE	14.5%	15.2%	16.2%	18.0%	18.8%
P/E (x)	30.0	25.5	21.2	16.7	14.0
P/BV (x)	3.9	3.7	3.2	2.8	2.5
EV/EBITDA (x)	13.8	13.3	11.5	9.2	7.6
Dividend Yield	0.6%	1.0%	1.2%	1.5%	1.8%

Source: Company data, Bloomberg, J.P. Morgan estimates.

Company Data	
Shares O/S (mn)	1,770
Market Cap ($ mn)	6,058
Market Cap ($ mn)	6,058
Price (HK$)	26.55
Date Of Price	18 Mar 15
Free Float(%)	-
3M - Avg daily vol (mn)	3.03
3M - Avg daily val (HK$ mn)	77.76
3M - Avg daily val ($ mn)	10.0
HSI	2,4120.08
Exchange Rate	7.76
Price Target End Date	31-Dec-15
Price Target (HK$)	36.00

See page 13 for analyst certification and important disclosures, including non-US analyst disclosures.

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Key catalysts for the stock price:	Upside risks to our view:	Downside risks to our view:
• New figures to support improving European sales demand • More growth statistics for new products such as and tools and accessories • Better economic and housing figures from the key US market	• Improvement in European demand which has been poor from 2010 to 2013 • New designs for the floor care unit improves sales and margins • Falling cost of material and value of Renminbi helps margins	• Rising cost of production in China and a slower than expected recovery in US demand. • Implementation risk on new product introductions and whether or not they are accepted by customers. • Downturn in US housing market crimping demand

Key financial metrics	FY13A	FY14A	FY15E	FY16E
Revenues (LC)	4,300	4,753	5,187	5,803
Revenue growth (%)	11.6%	10.5%	9.1%	11.9%
EBITDA (LC)	470	539	655	753
EBITDA margin (%)	10.9%	11.3%	12.6%	13.0%
Tax rate (%)	11%	8%	10%	9%
Net profit (LC)	250	300	381	456
EPS (LC)	0.134	0.161	0.204	0.245
EPS growth (%)	17.3%	20.2%	26.8%	19.7%
DPS (LC)	0.04	0.04	0.05	0.06
BVPS (LC)	0.93	1.06	1.21	1.39
Operating cash flow (LC mn)	355	308	584	639
Free cash flow (LC mn)	198	111	383	410
Interest cover (x)	19	21	24	33
Net margin (%)	5.8%	6.3%	7.3%	7.9%
Sales/assets (X)	1.13	1.14	1.13	1.13
Debt/equity (%)	47.5%	44.5%	41.2%	35.8%
Net debt/equity (%)	13.3%	9.3%	-0.4%	-10.4%
ROE (%)	15%	16%	18%	19%
Key model assumptions	**FY13E**	**FY14E**	**FY15E**	**FY16E**
Power tools (sales gth)	9.8%	13.0%	9.9%	12.1%
Floor care (sales gth)	17.0%	3.9%	6.9%	11.1%
Power tools EBIT margin	8.3%	8.2%	9.5%	9.7%

Source: Company and J.P. Morgan estimates.

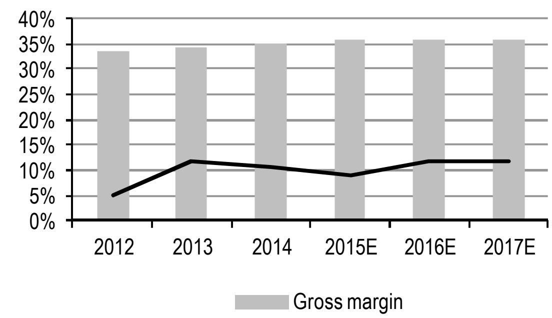
Sensitivity analysis	EBITDA		EPS	
Sensitivity to	FY15E	FY16E	FY15E	FY16E
1% chg in sales volume growth	0.7%	0.7%	1.2%	1.1%
1% chg in copper	1.1%	1.0%	1.8%	1.7%
1% chg in steel	1.1%	1.1%	2.0%	1.8%
1% chg in GPM	7.1%	7.0%	12%	12%

Source: J.P. Morgan estimates.

Valuation and price target basis

Our Dec-15 price target is based on a 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. Accordingly, we assume a WACC of 9.0%.

Sales growth and margin trends



Source: Bloomberg, Company and J.P. Morgan estimates.

JPMe vs. consensus, change in estimates		
EPS (LC)	FY15E	FY16E
JPMe old	0.20	0.24
JPMe new	0.204	0.245
% chg	*0%*	*1%*
Consensus	0.191	0.227

Source: Bloomberg, J.P. Morgan estimates.

Peer valuation comparison

Company Name	Code	Price (TP) Local ccy	MCAP US$mn	Vol US$mn	1W Chg	3M Chg	14 PE (x)	15e PE (x)	14 EV/ EBITDA (x)	ROE (%)	P/B (x)	Yld (%)
Industrial peers												
XINYI GLASS HOLD (OW)*	868 HK	4.71 (6.1)	2,366	8.2	3.5	20.6	13.5	**8.3**	6.4	11.1	1.4	3.2
KINGBOARD CHEM (OW)*	148 HK	12.34 (19)	1,642	2.5	(1.6)	(4.6)	5.0	**7.0**	4.8	7.3	0.4	4.0
SHENZHOU (OW)*	2313 HK	31.10 (38)	5,726	6.1	2.4	25.7	18.5	**15.0**	12.4	17.9	2.8	3.1
LM PAPER (OW)*	2314 HK	3.74 (6)	2,258	1.9	(1.1)	(13.4)	9.2	**7.8**	8.8	12.6	1.1	3.8
TECHTRONIC INDS (OW)*	**669 HK**	**26.55 (36)**	**6,221**	**10.8**	**(2.8)**	**3.1**	**21.2**	**16.7**	**11.5**	**16.2**	**3.2**	**1.2**
ND PAPER (OW)*	2689 HK	4.89(8.2)	2,960	7.4	0.2	(27.0)	6.6	**6.7**	7.9	7.5	0.9	2.0
HAITIAN (OW)*	1882 HK	16.10 (22)	3,387	2.6	2.9	8.1	16.5	**13.9**	13.2	19.2	3.4	1.2
VTECH (UW)*	303 HK	113.5 (80)	3,671	4.3	1.9	4.1	17.3	**17.1**	14.3	35.4	5.5	5.5
WASION GROUP (OW)*	3393 HK	7.81(10.5)	952	1.0	0.6	4.3	12.0	**9.6**	7.6	16.0	1.8	3.2
Average							12.4	**10.6**	8.9	15.5	2.0	3.3

Source: Company data, Bloomberg, J.P. Morgan estimates (*). Share prices are as of close of Mar 18, 2014

Highlights from analysts briefing

- **Strong growth in all regions**. USA sales continued to grow at 9% in 2014, faster than the overall market. European sales grew 11 % despite concerns over the macro environment and some drags from falling currencies. According to the company, TTI is gaining market share in all the major markets that they are operating in.
- **Big jump in GPM due to innovation**. TTI lifted GPM by 1.0%, which is better than management's plans and also in a tough environment. TTI also increased spending in SG&A costs in order to focus on expanding new regions (for example, Australia ranking for TTI has gone from number 6 in 2009 to number one in 2014, according to the company).
- **High end Milwaukee driving growth**. TTI achieved 22% growth rate in the professional tool brand Milwaukee (20 Percent CAGR in the past 3 years). TTI will continue to focus on high end growth where margins are better and more sustainable. TTI mentioned that they have the widest selection of cordless products in the Milwaukee line.
- **Ryobi ranks as number one "do it yourself" brand**. According to the company, Ryobi is now the number one brand in the world and achieved this by focusing on cordless products with new technology and at a low price.
- **Focus on margins for floor care**. Management stated that they had a strategy to increase margins for floor care instead of rapidly growing sales. TTI plans to lift sales only after the margins reach an acceptable level. TTI plans to use cordless products that are just being launched in 2015.
- **Capex increased by 48% to improve productivity**. TTI is undertaking measures to improve labor productivity as wages rise. Such measures should help enhance margins in the future. Headcount growth of 7% is 3% lower than sales growth. There were some new warehouses built in 2014 that are not recurrent in nature. Management plans to maintain a Capex level over the next 3 years at a similar level to 2014 (unlikely to have higher Capex even with higher sales, in our view).
- **Brand new products in 2015**. TTI is launching the following products this year. Light weight cordless circular saws and hole saws under the Milwaukee brand will be introduced. New brushless tools for Milwaukee will be targeted at the mass market (not under premium fuel brand). New hand tools will be added (10 types in 2010 and now 390 types for 2015). It will also add tape measure categories from 2 to 10, new line of tin snips, tool storage box and backpacks (not available in 2014), Position Hart brand of mid end hand tools, new balancing measuring tools under Empire brand acquired in 2014, more air strike brand Nailers (launched 2013 but still being ramped up), more concrete power drills that were just recently launched and Hoover cordless wood floor scrubbers (world's first in this category). 40 volt lawn mowers were launched in 2014 but still adding new products such as a new snow blower. Pressure washer is a new product for 2015. Another new product includes Ryobi "Phone works" line of measuring tools that uses the iphone to measure distance, metal, moisture, etc.

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Home Depot great 4QFY15 results would be positive for TTI

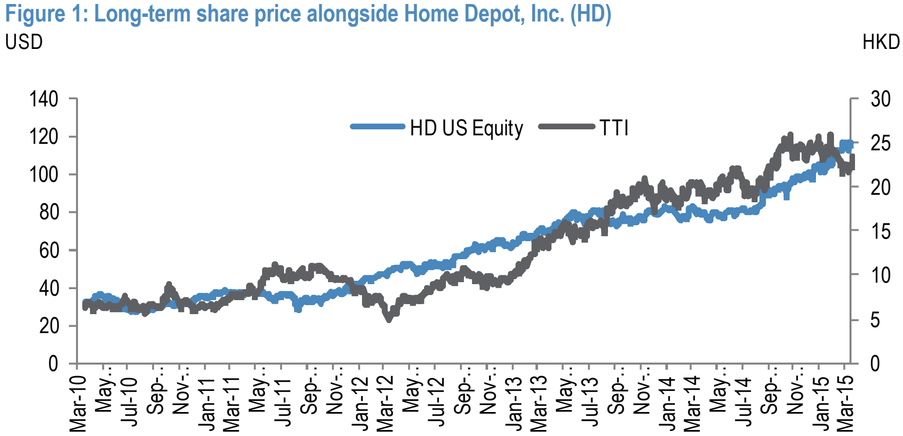
Home Depot (HD) reported great 4Q FY15 result last night. We believe HD's strong 4Q FY15 would be positive for TTI as HD is the largest customer for TTI. HD reported adjusted operating EPS of $1.00 vs. $0.88E and consensus of $0.89, growing 37% YOY, representing a 13% beat vs. the Street. This excludes a net $0.05 benefit from the HDS stock sale. Sales increased 8.3%, with total comps at 7.9% vs. 5.3%E and consensus of 5.5%E. US comps came in at 8.9%, strongly ahead of our 5.8% forecast. Gross margin leveraged 10 bps YOY to 35.1%, 10 bps ahead of our estimate. Total expenses were $4.12B vs. $4.49E, or 21.5% of sales, levering ~140 bps YOY vs. 90E. In total, operating margin expanded 150 bps vs. 100E with operating income up 25% and EPS up 37% YOY (*For detailed information, please refer to latest note, "The Home Depot: 13% EPS Beat, U.S Comps Blow Past Estimates; 2015 Guide As Expected with No Debt and Conservative Flow Through – ALERT" from Christopher Horvers and the teams*).

Lower oil is positive for stimulating demand for Home Depot but may be even better for TTI on demand and cost perspectives. Demand would be stimulated similar to what is happening at HD but we note that oil based petrochemicals, copper and metals that make up approx. 30-40% of total COGS for TTI has been falling for the past 6 months. In a time of high demand, we expect TTI to be able to benefit for a short period (6-12 months) where margins can expand. This period of positive cost impact would be most likely seen in 1HFY15 and 2HFY15 figures.

2015 would be a particularly good year for floor care products as well. Most of the new products for floor care were launched between April 2013 and June 2014 (we estimate over 80% of all of Hoover's new products came out during this period). Most products tend to have high marketing costs during the first year of introduction, which increases selling costs and depresses margins. We note that 2015 is the prime harvesting period for floor care (new products ramped up and less marketing costs required), which should give an extra boost to sales and margins.

The following two charts show that there is a strong long-term relationship between HD and TTI share price (both up roughly the same for past 5 years).

Figure 1: Long-term share price alongside Home Depot, Inc. (HD)



Source: Bloomberg.

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These are some of the reasons we can think of for the poor performance of TTI over the past few months that we believe are more sentiment-related than fundamental:

- Chinese market for SMID Caps has been quite weak (the weakness is mostly due to domestic macro uncertainties and that should not be a factor for TTI).
- Demonstrations in HK have dampened sentiment (we see this local factor as not fundamental for TTI as it has insignificant sales in HK).
- TTI reported 1H14 results that were lower than consensus due to higher than expected marketing expenses (we see this as preparation for strong 2H14 sales and some promotional programs for new floor-care products were front loaded in the first half).

Key summary for FY14 annual results

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

- **2014 results in line on sales**. TTI reported 11% growth in sales with EBIT up 20%. 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.
- **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 slowdown 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 expected 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 products than its peers , in our view.

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Net profit estimates revised up 0.2% for FY15E and 1.5% for FY16E

Table 2: Estimate revisions

	New		Old		Change	
Year to Dec (USDm)	**FY15E**	**FY16E**	**FY15E**	**FY16E**	**FY15E**	**FY16E**
Turnover	5,187	5,803	5,218	5,759	-0.6%	0.7%
Gross profit	1,857	2,083	1,845	2,044	0.6%	1.9%
EBIT	450	524	444	512	1.3%	2.4%
Net profit	381	456	380	449	0.2%	1.5%
EPS (HKD)	0.204	0.245	0.204	0.241	0.2%	1.5%
Assumptions						
Gross margin	35.8%	35.9%	35.4%	35.5%	0.4%	0.4%

Source: J.P. Morgan estimates

We cut sales by 0.6% as we lower our assumption for floor care sales growth in 2015 from 11% to 8% but raise power tool sales growth assumption for 2015 from 10% to 12% for 2015 following trends indicated in 2014 sales. Our GPM is lifted slightly to factor in recent drops in raw material prices and the depreciation of the Renminbi, both of which have a positive influence on GPM. Our NP forecasts are revised slightly as a result; and our FY15 and FY16 EPS estimates are 6% higher than consensus.

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Valuation and share price analysis

DCF valuation

Our Dec-15 price target is based on a 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. Accordingly, we assume a WACC of 9.0%. 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.

Table 3: TTI—Base-case DCF analysis

US$ MM, year-end Dec	2013A	2014E	2015E	2016E	2017E	2018E	2019E	Terminal
Cash flow estimates								
Sales	4,300	4,753	5,187	5,803	6,491	7,261	8,122	9,086
EBIT	301	350	450	524	581	641	698	763
NOPAT	271	313	414	472	528	581	633	692
Capex, net	(163)	(224)	(223)	(247)	(263)	(281)	(300)	(290)
Depreciation	169	188	206	229	253	278	304	328
Change in working capital	(93)	(202)	(45)	(73)	(109)	(122)	(137)	(154)
Free operating CF (FoCF)	**184**	**76**	**351**	**383**	**410**	**459**	**504**	**582**
DCF Parameters			**Assumptions**					
Liabilities as a % of EV	20%		Terminal growth			3.0%		
WACC	9.0%		Risk-free rate			4.2%		
			Market risk			6.0%		
Enterprise NPV (10E-16E)	**8,008**		Beta			1.0		
+ Net cash (debt), current	517		Cost of debt			4%		
- Minorities (Market value)	(23)							
+/- CB conv proceeds	0		Implied exit P/E multiple (x)			15x		
= Equity value	**8,502**							
/ Number of shares (m)	1,822							
= Equity value per share (HK$)	36.0							

Source: Company data, J.P. Morgan estimates.

Table 4: TTI—Sensitivity analysis based on WACC and perpetual terminal growth rate

		Terminal growth rate						
		1.5%	**2.0%**	**2.5%**	**3.0%**	**3.5%**	**4.0%**	**4.5%**
WACC	**7.5%**	38.5	41.3	44.5	48.5	53.5	59.9	68.5
	8.0%	35.6	37.9	40.5	43.7	47.6	52.5	58.8
	8.5%	33.1	35	37.2	39.8	42.9	46.8	51.5
	9.0%	30.9	32.5	34.4	36.5	39.1	42.2	45.9
	9.5%	29	30.4	32	33.8	35.9	38.4	41.4
	10.0%	27.3	28.5	29.9	31.4	33.2	35.3	37.7
	10.5%	25.9	26.9	28.1	29.4	30.9	32.6	34.7

Source: J.P. Morgan estimates.

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Financial analysis

Table 5: TTI—P&L statement

Year to Dec (US$ MM)	2010	2011	2012	2013	2014	2015E	2016E
Total Revenues	**3,398**	**3,667**	**3,852**	**4,300**	**4,753**	**5,187**	**5,803**
YoY change (%)	10.0%	7.9%	5.1%	11.6%	10.5%	9.1%	11.9%
Cost of Goods Sold	(2,304)	(2,473)	(2,563)	(2,827)	(3,080)	(3,331)	(3,719)
YoY change (%)	8.5%	7.3%	3.6%	10.3%	8.9%	8.1%	11.7%
Gross Profit	1,094	1,194	1,289	1,472	1,673	1,857	2,083
YoY change (%)	13.3%	9.1%	8.0%	14.2%	13.6%	11.0%	12.2%
Gross Margin	32.2%	32.6%	33.5%	34.2%	35.2%	35.8%	35.9%
SGA	(911)	(985)	(1,033)	(1,175)	(1,326)	(1,411)	(1,564)
YoY change (%)	6.6%	8.0%	5.0%	13.7%	12.8%	6.4%	10.8%
Other Income/(Expenses)	17	9	5	4	3	4	4
Operating profit	200	219	261	301	350	450	524
EBITDA	**312**	**338**	**389**	**423**	**487**	**598**	**690**
EBITDA margin	9.2%	9.2%	10.1%	9.8%	10.2%	11.5%	11.9%
Depreciation & Amortization	(113)	(119)	(128)	(122)	(136)	(148)	(166)
YoY change (%)	63.7%	5.8%	7.6%	-5.2%	12.1%	8.9%	11.7%
EBIT	**200**	**219**	**261**	**301**	**350**	**450**	**524**
EBIT margin	5.9%	6.0%	6.8%	7.0%	7.4%	8.7%	9.0%
Net Interest Expense	(72)	(58)	(37)	(25)	(25)	(28)	(23)
Exceptional item	(27)	0	0	0	0	0	0
Associates	(1)	(0)	(0)	(0)	0	0	0
Gains/losses	0	0	0	0	0	0	0
Net Income Before Taxes	99	160	224	276	325	422	501
YoY change (%)	-17.7%	61.5%	39.5%	23.5%	17.8%	29.7%	18.8%
Tax	1	(9)	(22)	(29)	(26)	(42)	(46)
Effective Tax rate	-0.6%	5.8%	9.9%	10.5%	7.9%	9.9%	9.2%
Minority Interests	(7)	(1)	1	3	1	1	1
Net Income	**93**	**150**	**202**	**250**	**300**	**381**	**456**
YoY change (%)	28.7%	61.3%	34.9%	23.5%	20.2%	26.8%	19.7%
Net margin	2.7%	4.1%	5.3%	5.8%	6.3%	7.3%	7.9%

Source: Company data, J.P. Morgan estimates.

Table 6: Interim estimates

Year to Dec (US$ MM)	1H13	2H13	1H14	2H14	1H15E	2H15E
Total Revenues	2,042	2,257	2,249	2,504	2,696	2,491
Gross Profit	694	778	787	886	959	897
EBIT	142	159	161	189	227	223
Net Income Before Taxes	127	148	148	177	213	209
Net Income	117	133	136	164	192	189
Diluted EPS (HK$)	0.063	0.071	0.073	0.088	0.103	0.101
Ratios						
Revenue split	47.5%	52.5%	47.3%	52.7%	52.0%	48.0%
GPM	34.0%	34.5%	35.0%	35.4%	35.6%	36.0%
EBIT margin	6.9%	7.1%	7.2%	7.6%	8.4%	8.9%
NPM	5.7%	5.9%	6.0%	6.6%	7.1%	7.6%
YoY						
Revenue	10.1%	13.0%	10.1%	10.9%	19.9%	-0.5%
GP	11.6%	16.6%	13.4%	13.9%	21.9%	1.3%
EBIT	11.7%	19.0%	13.5%	18.9%	41.0%	17.6%
NP	21.7%	25.2%	16.0%	24.0%	41.4%	14.8%

Source: Company data, J.P. Morgan estimates.

Table 7: TTI—Balance sheet

Year to Dec (US$ MM)	2010	2011	2012	2013	2014	2015E	2016E
Cash and Cash Equivalents	515	460	698	597	690	937	1,200
Inventories	647	704	689	884	1,056	1,153	1,290
Accounts receivable	621	673	689	784	820	895	1,001
Other Current Assets	130	138	62	227	169	236	267
Total Current Assets	1,914	1,976	2,138	2,492	2,736	3,220	3,758
Intangible Assets	887	902	930	992	1,050	1,000	950
Property and Equipment, Net	339	360	384	384	425	481	541
Other Assets	125	131	129	144	140	143	146
Non-Current assets	1,352	1,394	1,443	1,520	1,616	1,624	1,637
Total Assets	**3,266**	**3,370**	**3,581**	**4,013**	**4,351**	**4,845**	**5,395**
Accounts Payable	483	619	710	1,040	1,136	1,264	1,442
Other Accrued Expenses	143	106	379	233	202	200	211
Taxes Payable	8	11	19	50	58	74	78
ST and current LT debts	796	867	455	454	552	509	509
Total Current Liabilities	1,423	1,603	1,563	1,777	1,947	2,046	2,240
Long-term Debt	596	397	349	375	322	420	420
Other Noncurrent Liability	120	116	113	115	115	124	138
Noncurrent liabilities	716	513	462	490	437	544	558
Total Liabilities	2,139	2,115	2,025	2,267	2,385	2,591	2,798
Share capital	21	21	23	23	644	644	644
Reserves and Surplus	1,094	1,225	1,525	1,717	1,323	1,611	1,955
Total Shareholders' Equity	1,115	1,246	1,549	1,741	1,967	2,255	2,599
Minority Interest	15	9	8	5	(1)	(1)	(1)
Total Shareholders' Equity	1,130	1,254	1,557	1,745	1,967	2,254	2,597
Total Liabilities and Equity	**3,269**	**3,370**	**3,581**	**4,013**	**4,351**	**4,845**	**5,395**

Source: Company data, J.P. Morgan estimates.

Table 7: TTI—Cash flow statement

Year to Dec (US$ MM)	2010	2011	2012	2013	2014	2015E	2016E
EBIT	200	219	261	301	350	450	524
Depreciation and Amortization	155	169	183	169	188	206	229
Working Capital Changes	(86)	(74)	96	(93)	(202)	(45)	(73)
Tax Paid	(112)	1	(9)	(22)	(29)	(26)	(42)
Cash Flow From Operations	157	313	531	355	308	584	639
Capital expenditures	(148)	(161)	(158)	(163)	(224)	(223)	(247)
Investments and others	(7)	(6)	13	(15)	4	(3)	(3)
Net Interest	(72)	(58)	(37)	(25)	(25)	(28)	(23)
Cash Flow from Investing	(228)	(197)	(182)	(204)	(245)	(254)	(273)
Free Cash Flow	**(71)**	**116**	**275**	**151**	**63**	**330**	**366**
Dividends	(16)	(21)	(33)	(52)	(70)	(84)	(103)
Common issue	0	0	134	0	0	0	0
Debt	617	(133)	(215)	(198)	100	9	13
Other Financing	(439)	4	3	(2)	0	(9)	(13)
Cash Flow from financing	163	(171)	(111)	(252)	30	(84)	(103)
Change in cash	86	(56)	238	(101)	93	247	263
Cash beginning	428	515	460	698	597	690	937
Foreign exchange changes	2	0	0	0	0	0	0
Cash at end	**515**	**460**	**698**	**597**	**690**	**937**	**1,200**

Source: Company data, J.P. Morgan estimates.

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Investment Thesis, Valuation and Risks

Techtronic Industries *(Overweight; Price Target: HK$36.00)*

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 US during a slump in demand, and is well positioned to benefit in a recovery, in our view. 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 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.

Techtronic Industries: Summary of Financials

Income Statement					
$ in millions, year end Dec	**FY13**	**FY14**	**FY15E**	**FY16E**	**FY17E**
Revenues	4,300	4,753	5,187	5,803	6,491
% change Y/Y	11.6%	10.5%	9.1%	11.9%	11.9%
Gross Profit	1,472	1,673	1,857	2,083	2,319
% change Y/Y	14.2%	13.6%	11.0%	12.2%	11.3%
EBITDA	470	539	655	753	834
% change Y/Y	5.8%	14.6%	21.6%	14.9%	10.9%
EBIT	301	350	450	524	581
% change Y/Y	15.4%	16.3%	28.3%	16.5%	11.0%
EBIT Margin	7.0%	7.4%	8.7%	9.0%	9.0%
Net Interest	(25)	(25)	(28)	(23)	(18)
Earnings before tax	276	325	422	501	564
% change Y/Y	23.5%	17.8%	29.7%	18.8%	12.5%
Tax	(29)	(26)	(42)	(46)	(52)
as % of EBT	10.5%	7.9%	9.9%	9.2%	9.3%
Net income (reported)	250	300	381	456	513
% change Y/Y	23.5%	20.2%	26.8%	19.7%	12.5%
Shares outstanding	1,864	1,864	1,864	1,864	1,864
EPS (reported)	0.13	0.16	0.20	0.24	0.28
% change Y/Y	17.3%	20.2%	26.8%	19.7%	12.5%

Cash flow statement					
$ in millions, year end Dec	**FY13**	**FY14**	**FY15E**	**FY16E**	**FY17E**
EBIT	301	350	450	524	581
Depr. & amortization	169	188	206	229	253
Change in working capital	(93)	(202)	(45)	(73)	(109)
Taxes	(22)	(29)	(26)	(42)	(46)
Cash flow from operations	355	308	584	639	679
Capex	(179)	(220)	(226)	(250)	(266)
Net Interest	(25)	(25)	(28)	(23)	(18)
Other	-	-	-	-	-
Free cash flow	198	111	383	410	429
Equity raised/(repaid)	0	0	0	0	0
Debt raised/(repaid)	(198)	100	9	13	15
Other	(2)	0	(9)	(13)	(15)
Dividends paid	(52)	(70)	(84)	(103)	(119)
Beginning cash	698	597	690	937	1,200
Ending cash	597	690	937	1,200	1,477
DPS	0.04	0.04	0.05	0.06	0.07

Balance sheet					
$ in millions, year end Dec	**FY13**	**FY14**	**FY15E**	**FY16E**	**FY17E**
Cash and cash equivalents	597	690	937	1,200	1,477
Accounts receivable	784	820	895	1,001	1,120
Inventories	884	1,056	1,153	1,290	1,443
Others	227	169	236	267	301
Current assets	2,492	2,736	3,220	3,758	4,340
LT investments	144	140	143	146	149
Net fixed assets	384	425	481	541	597
Total Assets	4,013	4,351	4,845	5,395	5,985
Liabilities					
Short-term loans	454	552	509	509	509
Payables	1,040	1,136	1,264	1,442	1,613
Others	283	260	274	289	306
Total current liabilities	1,777	1,947	2,046	2,240	2,428
Long-term debt	375	322	420	420	420
Other liabilities	115	115	124	138	153
Total Liabilities	2,267	2,385	2,591	2,798	3,002
Shareholders' equity	1,741	1,967	2,255	2,599	2,986
BVPS	0.93	1.06	1.21	1.39	1.60

Ratio Analysis					
$ in millions, year end Dec	**FY13**	**FY14**	**FY15E**	**FY16E**	**FY17E**
Gross margin	34.2%	35.2%	35.8%	35.9%	35.7%
EBITDA margin	10.9%	11.3%	12.6%	13.0%	12.9%
Operating margin	7.0%	7.4%	8.7%	9.0%	9.0%
Net margin	5.8%	6.3%	7.3%	7.9%	7.9%
Sales per share growth	6.0%	10.5%	9.1%	11.9%	11.9%
Sales growth	11.6%	10.5%	9.1%	11.9%	11.9%
Net profit growth	23.5%	20.2%	26.8%	19.7%	12.5%
EPS growth	17.3%	20.2%	26.8%	19.7%	12.5%
Interest coverage (x)	19.0	21.5	23.5	32.8	47.3
Net debt to equity	13.3%	9.3%	(0.4%)	(10.4%)	(18.4%)
Working Capital to Sales	16.6%	16.6%	22.6%	26.2%	29.4%
Sales/assets	1.1	1.1	1.1	1.1	1.1
Assets/equity	2.3	2.3	2.2	2.1	2.0
ROE	15.2%	16.2%	18.0%	18.8%	18.4%
ROCE	10.9%	11.9%	13.4%	14.2%	14.2%

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

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JPM Q-Profile

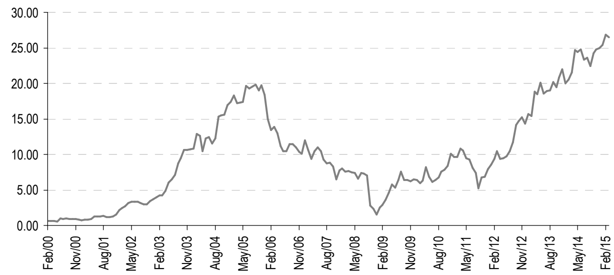
Techtronic Industries Co., Ltd. (HONG KONG / Consumer Discretionary)

As Of: 13-Mar-2015

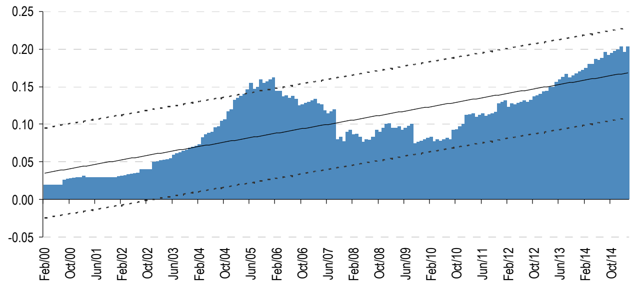
Global Equity Quantitative Analysis

Quant_Strategy@jpmorgan.com

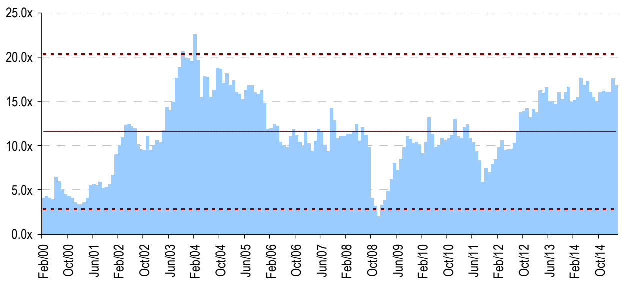
Local Share Price Current: 26.55



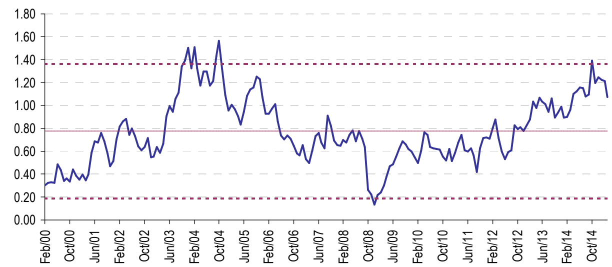
12 Mth Forward EPS Current: 0.20



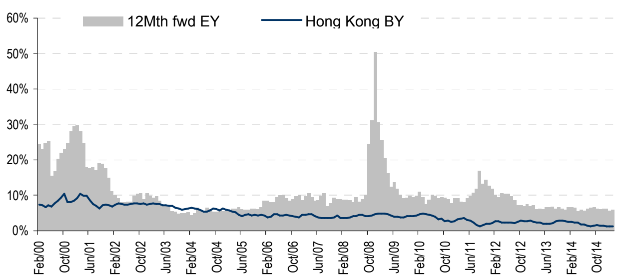
PE (1Yr Forward) Current: 16.8x



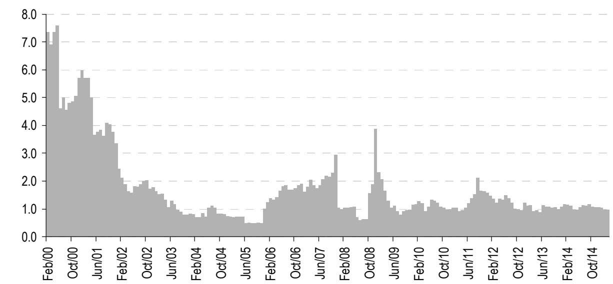
P/E Relative to Hong Kong Index Current: 1.07



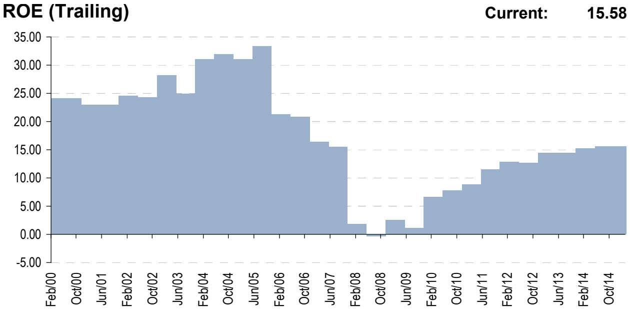
Earnings Yield (& Local Bond Yield) Current: 6%



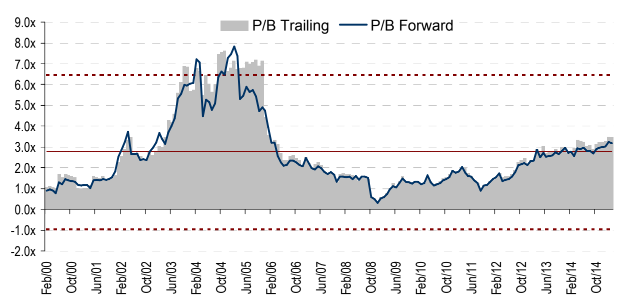
Dividend Yield (Trailing) Current: 0.98



ROE (Trailing) Current: 15.58



Price/Book (Value) Current: 3.4x



Summary

Techtronic Industries Co., Ltd. — As Of: 13-Mar-15
HONG KONG — **TICKER** **669 HK** — **Local Price:** 26.55
Consumer Discretionary — **EPS:** 0.20

	Latest	Min	Max	Median	Average	2 S.D.+	2 S.D. -	% to Min	% to Max	% to Med	% to Avg
12mth Forward PE	**16.84x**	1.99	22.60	11.20	11.62	20.37	2.87	-88%	34%	-33%	-31%
P/BV (Trailing)	**3.44**	0.34	7.61	2.24	2.77	6.47	-0.94	-90%	121%	-35%	-20%
Dividend Yield (Trailing)	**0.98x**	0.48	7.59	1.19	1.74	4.58	-1.10	-51%	676%	22%	78%
ROE (Trailing)	**15.58**	-0.40	33.26	15.58	17.26	36.21	-1.69	-103%	114%	0%	11%

Source: Bloomberg, Reuters Global Fundamentals, IBES CONSENSUS, JPMorgan Quantitative & Derivative Strategy

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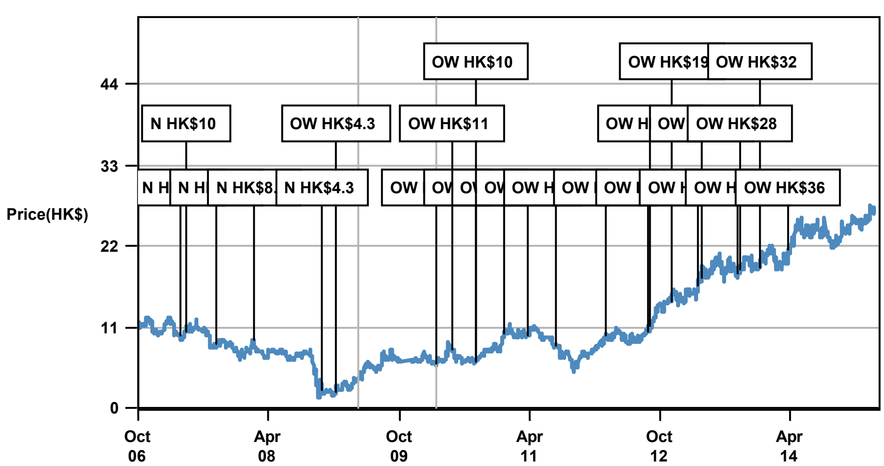
Techtronic Industries (0669.HK, 669 HK) Price Chart



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
Initiated coverage Mar 22, 2007.

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

The chart(s) show J.P. Morgan's continuing coverage of the stocks; the current analysts may or may not have covered it over the entire period.
J.P. Morgan ratings or designations: OW = Overweight, N= Neutral, UW = Underweight, NR = Not Rated

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Coverage Universe: Chik, Leon: China Auto Rental Incorporated (0699.HK), China Lesso (2128.HK), China State Construction (3311.HK), China Travel International Investments HK Ltd (0308.HK), Dah Chong Hong (1828.HK), Fufeng Group (0546.HK), Haitian International Holdings (1882.HK), Johnson Electric Holdings (0179.HK), Kingboard Chemical (0148.HK), Kingboard Laminates (1888.HK), Lee & Man Paper Manufacturing (2314.HK), New Oriental Education (EDU), Nine Dragons Paper Holdings Ltd (2689.HK), Nord Anglia Education (NORD), PAX Global Technology Ltd (0327.HK), Shenzhou International (2313.HK), Skyworth Digital Holdings (0751.HK), TAL Education Group (XRS), TCL Multimedia (1070.HK), Techtronic Industries (0669.HK), Texhong Textile (2678.HK), VTech Holdings (0303.HK), Wasion Group Holdings Ltd (3393.HK), Xinyi Glass (0868.HK), Xinyi Solar (0968.HK), eHi Car Services Ltd (EHIC)

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IB clients*	56%	49%	33%
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IB clients*	75%	67%	52%

*Percentage of investment banking clients in each rating category.
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