

Ju-Teng

3336 HK

Share price (17 Mar): **HKD4.87**

12-mth rating: **Hold (3)**

Target price: **HKD4.60**

2H14 profit margins missed market expectations; limited smartphone progress a concern to us

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■ What's new

Ju-Teng held its 2H14 results conference after the market close today (17 March). 2H14 net profit (HKD454m; EPS of HKD0.39) missed the Bloomberg consensus, but was ahead of our forecast on a lower-than-expected tax expense. For 2015, the management expects metal casing for tablets and 2-in-1 devices to be the key revenue driver and improve margins, but indicates very limited progress in both smartphone and composite material casing.

■ What's the impact

2H14 results recap – profit margins below market expectations

- **Profit margins weaker than expected.** Revenue reached HKD5.17bn (up 18% HoH and 4% YoY), generally in line with our forecast (HKD5.07bn) and the Bloomberg consensus (HKD5.13bn). However, both gross and operating margin in 2H14 (19.9% and 12.0%, respectively) fell YoY (from 21.8%

and 14.3% in 2H13) and also came in below the Bloomberg consensus estimates (ie 20.3% and 12.8%). The management attributed it to higher development cost for new products, increasing capacity build-up in Sichuan, and more notebook-related sales in 2H14.

- **Lower tax expense helped to lift the net profit.** While pre-tax profit in 2H14 (HKD578m) was in line with our forecast (HKD584m), the lower-than-expected tax expense (thanks to more inland China production, where the tax rate is lower than that in coastal areas) helped to lift the net profit, which beat our forecast by 8%, but still missed the consensus estimate by 5%.

- **Product mix.** In terms of product applications, notebook-related casing accounted for 75% of 2014 revenue (vs 76% in 2013, on our estimate), tablets about 15% (vs 16%), and smartphones about 5% (vs 3%).
- Cash dividend will be HKD0.15 for 2014, unchanged from 2013. The implied dividend yield is about 3%.

2015 outlook – metal casing the key focus

- **2015 guidance looks in line with consensus.** For 2015, Ju Teng guides for 5-10% YoY revenue growth and 1-2 ppt improvement on profit margins due to a better product mix. The guidance appears in line with the consensus and our forecast – we currently expect 9.5% YoY revenue growth and 1.1 ppt improvement on the operating margin in 2015.
- **Tablet-related revenue likely to rise in 2015.** In terms of applications, management expects the notebook-related sales

contribution to fall to 60-65% in 2015 (from 75% in 2014) while that of tablets may rise to 30% (from 15% in 2014), with little change in smartphone and other revenue contributions. Ju Teng is more positive on its tablet casing business given its order wins, which we believe are mainly for Microsoft's Surface tablets. Global notebook demand may continue to decline YoY in 2015, but Ju Teng aims to post YoY stable shipment via market share gains. As for smartphones, the management appears very cautious and indicates that new order wins are unlikely for the year.

- **Metal casing the key focus.** Ju Teng considers the metal casing for tablets and 2-in-1 devices the key growth driver for 2015. Currently the company expects its CNC capacities for its tablet client (which we believe is Microsoft) will soon be at full utilization in April, and it believes that the metal casing for 2-in-1 devices (eg. ASUS Transformer T300) and some commercial notebook models (eg. new project for Inventec since July 2015) will help boost its metal casing revenue. Ju Teng expects its non-plastic revenue contribution to increase from 30% in 2014 to 40% in 2015 (although this is actually below our current forecast of 45% for 2015E).

- **Limited progress in smartphone and composite material casing.** Despite the rising metal adoption trend in smartphone casing, Ju Teng admits that it's reluctant to increase its smartphone metal casing business given the intense market competition. As for composite material casing, the higher pricing remains an issue for market penetration. That said, the management indicates that some likely breakthrough in its magnesium alloy casing products, which are mainly for notebooks, may help it penetrate the smartphone area in the future. The management doesn't elaborate on the likely time frame for such a potential business opportunity though.
- **Profit margin should improve YoY on better product mix.** Ju Teng expects 1-2 ppt improvement in its 2015 profit margins, due to more sales contribution from its metal casing business, which has gross margin of 25-30%, better than the 10-15% for plastic casing.
- **CNC capacities:** Ju-Teng currently owns 4,300 CNC machines, of which 1,000 belong to a key client (which we believe is Microsoft). The company will add another 600 units in 2015.
- **Fund-raising plan.** Ju Teng is planning to raise funds by issuing warrants, which will be prioritized for its existing shareholders (one warrant for every 8 shares held). The initial subscription price is set at HKD4.6 per share (subject to change) and the warrant holders will have 18 months to decide whether to subscribe or not. Ju Teng expects a likely 12.5% dilution if there is full subscription. More details will be disclosed in due course.

■ What we recommend

- **We see improving near-term momentum but remain cautious longer term.** We consider the management comments in the results call to be generally in line with our view. As indicated in our recent note ("[Like modest recovery](#)" dated March 13), we expect 1H15 revenues to be driven by the rising metal casing shipment, which may also help improve profit margins. However, we remain cautious longer term given the very limited progress in the smartphone and composite casing area, and that the current growth driver for metal casing, which is mainly for Surface Pro, may not continue in the long run given this product's limited appeal beyond commercial users.
- **Hold (3) rating.** We have a Hold (3) rating and a TP of HKD4.6, based on 6x our 1-year-forward EPS (near the mid-point of 3-year-range of 4-9x). The key upside risk is major non-plastic order wins in the smartphone area, while weaker-than-expected metal casing orders represents the downside risk.

■ Ju-Teng 2H14 results

(HKDm)	Reported	HoH%	YoY%	Daiwa	Diff %	Consensus	Diff %
Revenues	5,173	18%	4%		5,072	2%	5,134
Gross profit	1,031	33%	-5%		991	4%	1,043
Gross margin (%)	19.9%				19.5%		20.3%
Operating profit	621	30%	10%		634	-2%	655
Operating margin (%)	12.0%				12.5%		12.8%
Pre-tax profit	578	34%	-14%		584	-1%	638
Net profit	454	46%	-10%		422	8%	478
EPS (HKD)	0.39	46%	-10%		0.36	8%	0.41

Source: Company, Daiwa forecasts, Bloomberg

In the interests of timeliness, this document has not been edited.

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