

Company Report

China Merchants Securities (HK) Co., Ltd.
Hong Kong Equity Research

TK Group (2283 HK)

FY14 results above; Better GPM trend in 2H14

- FY14 NP beats our/consensus estimates by 1%/5%; Lower-than-expected revenue offset by better cost control and lower eff. tax rate
- Expect solid FY15E outlook backed by wearables (Apple/ Fitbit /GoPro) and medical (Philips/Coloplast/Mindray) segments
- Valuation remains undemanding at 8.6x FY15E P/E; Maintain BUY with DCF-derived TP HK\$2.21 (10x FY15E P/E)

FY14 NP beats; 2H14 GPM recovery on track

TK Group just reported a solid set of FY14 results with revenue/net profit of (+12%/+27% YoY). Net profit beats our/consensus estimates by 1%/5% thanks to better cost control and effective tax rate, while revenue is slightly below by -7/-9% due to delayed automobile shipments (-18% yoy, 17% of sales mix) and slower growth of video game segment (-89% yoy, 1% of sales mix). GPM was flat yoy at 27.3% in FY14, in-line with estimates, given 2H14 GPM's recovery to 28.4% (vs 25.6% in 1H14). FY14 NPM improved 140bps yoy to 11.5%, due to effective tax rate decline to 19% (vs 28% in FY13) helped by 15% preferential tax rate announced in Jan 15.

Expect stronger momentum from wearables/medical and improving profitability on higher automation

We believe the core businesses (handset/wearables, household, medical, communications) will continue its strong momentum in FY15-16E (vs +52%/78%/111%/ 27% yoy in FY14), driven by new clients/projects wins in FY14 (Jabra, GoPro, Philips), favourable industry trends in wearables (Fibit, Apple Watch) and revenue/cost synergies through recent M&A (S&B in Germany). We also expect TK's margins to improve from 27.3% in FY14 to 28.0%/28.2% in FY15E/FY16E, given higher level of automation and better economies of scale.

Valuation/ Key risks

Trading at 8.6x FY15E P/E, we believe the current valuation is still undemanding (vs peers' 10x P/E). Company will host analyst meeting at 10:30am on 24 March. We maintain our BUY rating, and are now reviewing our TP and estimates.

Financials

17D mn	2012	2013	2014	2015E	2016E
Revenue	1,096	1,198	1,339	1,739	1,998
Growth (%)	40.2%	9.3%	11.8%	20.6%	14.9%
Net profit	135	121	154	177	207
Growth (%)	60.0%	-10.2%	26.8%	16.4%	16.7%
EPS-adj (HKD)	0.17	0.15	0.19	0.22	0.25
DPS (HKD)	-	-	0.07	0.06	0.08
P/E (x)	7.0	8.7	10.1	8.6	7.6
P/B (x)	-	2.8	3.0	2.3	1.8
ROE (%)	48.9%	32.8%	29.2%	25.7%	24.1%

Source: Company data, CMS (HK) estimates

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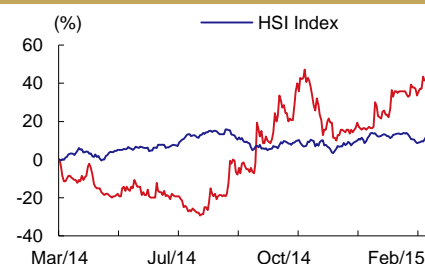
WHAT'S NEW

N/A

BUY

Previous	BUY
Price	HK\$1.89
12-month Target Price (Potential up/downside)	HK\$2.21 (+17%)
Previous	HK\$2.21

Price Performance



Source: Bigdata

%	1m	6m	12m
2283 HK	4.7	58.4	49.4
HSI	(1.8)	0.3	15.1

Industrial Goods

Hang Seng Index	24495
HSCEI	12156

Key Data

52-week range (HK\$)	0.96-2.09
Market cap (HK\$ mn)	1,576
Avg. daily volume (mn)	2.45
BVPS (HK\$)	0.64

Shareholdings Structure

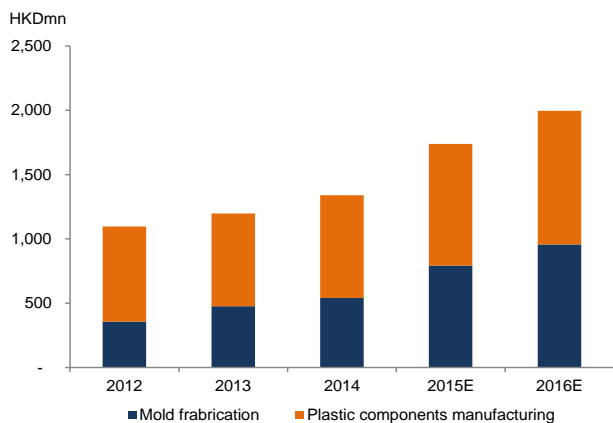
Li Pui Leung	61.8%
Value Partners	7.1%
Michael Yung King Cheun	6.5%
Yiu Lee Leung	6.3%
No. of shares outstanding (mn)	827
Free float	25.8%

Related Research

1. TK Group (2283 HK) - Key takeaways from Shenzhen company visit - 9 Jan 2015

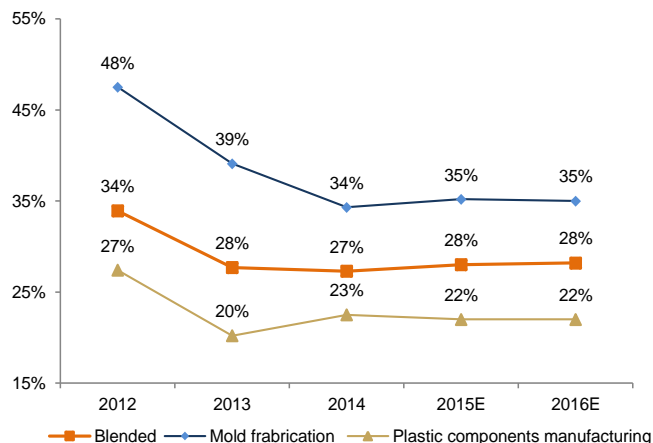
Focus charts

Figure 1: Rev was up by 12%YoY in FY14



Source: Company data, CMS (HK) estimates

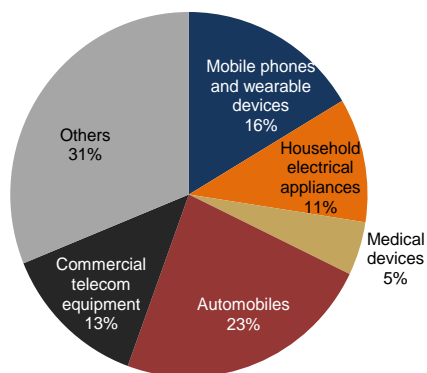
Figure 2: Expect GPM recovery in FY15-16E



Source: Company data, CMS (HK) estimates

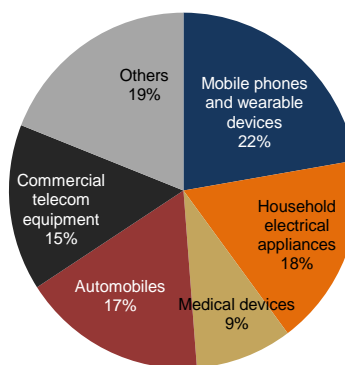
Figure 3: FY14 revenue mix shifting to fast-growing handset/wearables and medical devices segments

FY13 Revenue Mix



Source: Company data, CMS (HK) estimates

FY14 Revenue Mix



Source: Company data, CMS (HK) estimates

Table 1: FY14 results summary

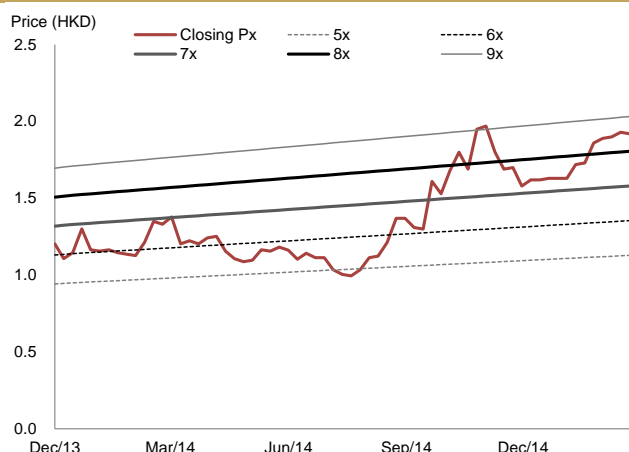
HKDmn	FY13	FY14	YoY	CMS		Consensus	
				FY14E	Diff (%)	FY14E	Diff (%)
Revenue	1,198	1,339	12%	1,442	-7%	1,470	-9%
Gross profit	332	365	10%	390	-6%	402	-9%
Operating profit	176	187	6%	195	-4%	207	-9%
Net profit	121	154	27%	152	1%	147	5%
EPS (HKD)	0.15	0.19	27%	0.18	4%	0.18	2%
Gross margin	27.7%	27.3%		27.1%		27.3%	
Operating margin	14.7%	14.0%		13.5%		14.0%	
Net Margin	10.1%	11.5%		10.4%		10.0%	

Source: Bloomberg, CMS (HK) estimates

Valuation

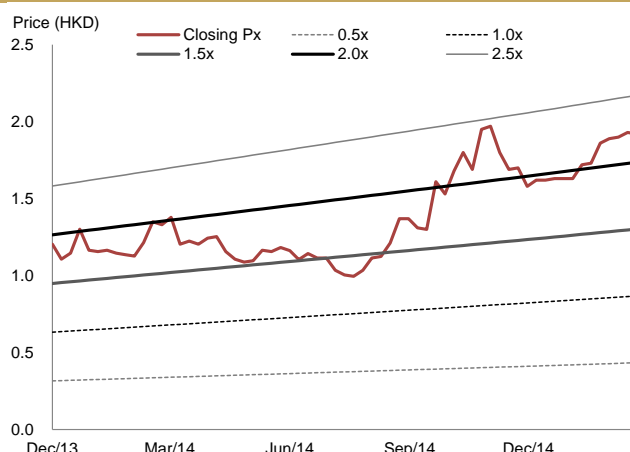
We expect FY15E-16E EPS to be HK\$0.22 and HK\$0.25 respectively. Averaging the results of DCF and P/E valuation methodologies, we set 1-yr target price at HK\$2.21, equivalent to 10.0x 2015E P/E. We maintain our BUY rating given TK's promising outlook and its attractive valuation of 8.6x FY15E P/E.

Figure 4: 1-yr forward P/E band



Source: Ipsos, CMS(HK)

Figure 5: 1-yr forward P/E band



Source: Ipsos, CMS(HK)

Peer Comparison

Table 2: Sector valuation comparison

Company	Ticker	Rating	Mkt Cap (USD mn)	Current Price (local)	Target Price (HKD)	Upside (%)	P/E (x)		P/B (x)		ROE (%)	
							FY15E	FY16E	FY15E	FY16E	FY15E	FY16E
TK Group	2283 HK	BUY	202	1.89	2.21	17%	8.6	7.6	2.3	1.8	26%	24%
Components												
FIH Mobile Ltd	2038 HK	NR	4,030	4.01	N/A	N/A	17.8	16.2	1.0	0.9	5%	6%
Jabil Circuit Inc	JBL US	NR	4,570	23.65	N/A	N/A	11.7	10.0	1.9	1.7	13%	16%
Federal Signal	FSS US	NR	1,005	16.02	N/A	N/A	15.8	13.8	2.3	N/A	16%	16%
Molds												
CW Group	1322 HK	NR	177	2.23	N/A	N/A	N/A	N/A	11.7	8.6	27%	31%
HI-P Intl	HIP SP	NR	329	0.56	N/A	N/A	19.8	20.6	0.7	0.7	4%	4%
Molds + Components												
EVA Prevision	838 HK	NR	509	2.25	N/A	N/A	11.8	8.9	1.4	1.3	14%	17%

Source: CMS (HK), Bloomberg

Table 3: Valuation matrix

Valuation method	Weight	Target price(HK\$)
DCF valuation	50%	1.91
P/E valuation	50%	2.51
1-yr target price	100%	2.21
Current price		1.89
Upside potential		17%

Source: CMS (HK) estimates

DCF Valuation

We valued TK at HK\$1.91, using DCF valuation methodology with the following key assumptions:

Table 4: DCF Free Cash Flow Forecast

HKD Million	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E
FCF	59	171	212	157	127	110	114	117	120	123
FCF discounted total	858									
Future value	819									
Corporate value	1,677									
Cash and other capital	119									
-Net debt	214									
Equity value (HK\$)	1.91									

Source: CMS (HK) estimates

Table 5: DCF Sensitivity Analysis (HK\$ fair value per share)

		WACC				
		7.8%	8.3%	8.78%	9.3%	9.8%
Growth (%)	1.0%	1.77	1.77	1.77	1.77	1.77
	1.5%	1.84	1.84	1.84	1.84	1.84
	2.0%	1.91	1.91	1.91	1.91	1.91
	2.5%	2.00	2.00	2.00	2.00	2.00
	3.0%	2.11	2.11	2.11	2.11	2.11

Source: CMS (HK) estimates

P/E Valuation

Based on the principle of conservatism the estimated industry average P/E ratio 11.4x 2015E P/E was chosen, therefore, we value TK at HK\$2.51.

We selected eight listed companies from the industry around the globe for comparison, with the markets covering Hong Kong, the PRC, the United States, and Singapore. We divided the companies into the following three groups based on their business, 1) business involving both mold manufacturing and component production; 2) business involving mold manufacturing only; or 3) business involving component production only.

Financial Summary

Balance Sheet

HKD million	2012	2013	2014	2015E	2016E
Current Assets	655	746	801	1,112	1,366
Cash & equivalents	94	333	267	538	707
Trading investments	25	0	0	0	0
Trade receivables	201	229	295	296	340
Other receivables	137	0	0	0	0
Inventories	150	184	239	278	319
Other current assets	49	0	0	0	0
Non-current assets	296	210	337	310	307
Investment property	1	0	0	0	0
Property, Plant & Eq.	258	200	324	298	294
Intangible assets	29	4	9	7	7
Other non-current assets	9	6	4	6	6
Total assets	951	956	1,137	1,423	1,673
Current liabilities	605	528	560	665	748
Trade payables	405	380	444	513	588
Tax payables	38	31	31	52	60
Short-term loan	162	117	85	100	100
Long term Liabilities	70	58	51	70	70
Loans	52	53	47	60	60
Others	18	5	4	10	10
Total Liabilities	675	586	611	735	818
Issued capital	0	80	83	83	83
Capital reserves	200	59	244	343	511
Reserves	77	231	284	262	262
Minority interests	0	0	0	0	0
Net Profit attribute to share holders	276	370	527	688	855
Total equity and liabilities	951	956	1,137	1,423	1,673

Cashflow Statement

HKD million	2012	2013	2014	2015E	2016E
Operating cashflow	222	183	84	244	275
Pre-tax profit	186	169	190	177	207
Deprec & Amort.	47	52	54	67	67
Working capital change	5	(3)	(57)	(4)	(2)
Others	(16)	(35)	(103)	4	4
CF from FA	(147)	(92)	(107)	(69)	(59)
Capital expenditure	(148)	(100)	(107)	(74)	(65)
Sales of assets	12	1	0	1	1
Investment change	(17)	(7)	0	0	0
Other	5	0	0	4	5
CF from FA	(60)	146	(43)	(16)	(47)
Borrowings	(13)	83	(38)	30	0
Share capital	0	237	0	0	0
Dividends	(55)	(311)	0	(38)	(39)
Other financing	(102)	136	(5)	(8)	(9)
Others	110	1	0	0	0
Net cash flow	14	238	(66)	159	169

Source: Company data, CMS (HK) estimates

Profit & Loss Statement

HKD million	2012	2013	2014	2015E	2016E
Revenues	1,096	1,198	1,339	1,739	1,998
Cost of sales	724	866	974	1,252	1,434
Gross profit	372	332	365	487	564
Other income	24	30	4	18	19
SG&A	198	186	197	264	304
Other expense	0	0	0	0	0
Op Profit	197	176	173	240	279
Fin expense	11	7	(5)	8	9
Interest	0	0	4	4	5
Non-op inc	0	0	0	0	0
Non-op exp	0	0	0	0	0
PBT	186	169	190	236	275
Taxes	51	48	(37)	59	69
Minority interests	0	0	0	0	0
Net Profit to shareholders	135	121	154	177	207
EPS (HKD)-adjusted	0.17	0.15	0.19	0.22	0.25

Financial Ratios

	2012	2013	2014	2015E	2016E
YoY growth rate					
Revenue	40%	9%	12%	30%	15%
Op profit	52%	-11%	-2%	39%	16%
Net profit	60%	-10%	27%	15%	17%
Profitability					
Gross margin	33.9%	27.7%	27.3%	28.0%	28.2%
NP margin	12.1%	9.9%	11.5%	10.2%	10.2%
ROE	48.9%	32.8%	29.2%	25.7%	24.1%
ROIC	29.2%	23.3%	20.6	19.3	21.0%
Liquidity					
Debt to Asset	70.9%	61.3%	52.8%	51.7%	48.9%
Liquid ratio	1.1	1.4	1.4	1.7	1.8
Quick ratio	0.8	1.1	1.10	1.3	1.4
Operating efficiency					
Asset turnover	1.2	1.3	1.18	1.2	1.2
Inventory turnover	5.9	5.2	5.60	4.9	4.8
AR turnover	3.5	4.3	4.54	6.5	6.3
AP turnover	2.1	2.2	2.19	2.7	2.6
Per share ratios (HKD)					
EPS	-	0.22	0.19	0.22	0.25
CFPS	-	0.23	0.00	0.30	0.33
BVPS	-	0.46	0.64	0.83	1.03
DPS	-	-	0.07	0.06	0.08
Valuation ratios					
P/E	6.95	8.65	10.14	8.59	7.56
P/B	3.44	2.83	2.96	2.28	1.83
EV/EBITDA	0.00	5.36	6.87	5.08	4.51

Investment Ratings

Rating	Definition
BUY	Expected to outperform the market index by >10% over the next 12 months
NEUTRAL	Expected to outperform or underperform the market index by 10% or less over the next 12 months
SELL	Expected to underperform the market index by >10% over the next 12 months

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