

## Ten Pao Group 天寶集團 (1979 HK)

### Continuous raw material price hike hurting margin

The orders of Ten Pao is still growing stably and the company is continuously adding new clients like Vivo and Amazon, and is gaining shares from industrial clients like Makita. This has supported a stable 6.9% YoY topline growth in 1H18, while the only weakness is on the cost side, with significant hike in raw material price hurting Ten Pao's margin, and resulted in HK\$12mn 1H18 net loss. Ten Pao has added new suppliers to mitigate the impact and the margin pressure should ease HoH in 2H18. We revised down our earnings forecast on lower GP margin and thus lowers our DCF-based target price to HK\$0.75, by keeping WACC and terminal growth rate unchanged, which translates into 19.3x/7.9x 2018E/2019E PER, 12% upside. Downgrade to Accumulate.

**1H18 topline growth in line.** 1H18 revenue grew 6.9% YoY to HK\$1,470mn, roughly in line with expectation, supported by stable growth of telecommunication segment (+3.8% YoY) and strong growth of industrial segment (+38.4% YoY). OPPO remains its largest client, contributing ~HK\$340mn (23% of total revenue) in 1H18.

**New clients added – Vivo and Amazon.** Ten Pao will start shipment of smartphone chargers to Vivo at end-September, and is already manufacturing power supply for Amazon Echo. We estimate ~HK\$60mn revenue contribution from these two new clients this year, and it represents a good start for building business relationship with renowned brands. Ten Pao is also considering whether or not to supply for Xiaomi given their low ASP and margin.

**Strong growth of industrial sector, shares gain from Makita.** Ten Pao secured an orders from Makita in 1H18 and it makes Makita Ten Pao's fourth largest client in 1H18 (contributing HK\$78mn). Bosch (contributing HK\$250mn) and Black and Decker (contributing HK\$91mn) remains Ten Pao's second and third largest client in 1H18.

**Price hike of its key raw material like MLCC.** The recent price hike of key raw materials like passive components starting end-2017 is the most severe in decade, and Ten Pao's margin is significantly dragged by the raw material price hike (MLCC, MOSFET) and its 1H18 GP margin dropped 8.8ppts to 10.7%. Ten Pao has added new suppliers to mitigate the impact and has seen effect, and the margin should improve HoH in 2H18.

**Downgrade to Accumulate.** Due to the higher-than-expected raw material price this year, the share price has dropped 60% YTD. The shares are now trading at 17.2x/7.1x 2018E/2019E PER. We adjusted lower our earnings forecast at we lowers our 2018E/2019E GP margin forecast down by 5.0ppts/4.5ppts, and based on the revised earnings we lower our DCF-based target price to HK\$0.75, by keeping WACC and terminal growth rate unchanged. Our new target implies 19.3x/7.9x 2018E/2019E PER, 12% upside. Downgrade to Accumulate.

### Investment Summary

FY-end Dec	2016	2017	2018E	2019E	2020E
Turnover (HK\$m)	2,583	3,007	3,625	4,186	4,618
Chg (%)	15	16	21	15	10
Net Profit (HK\$m)	194	158	39	95	108
Chg (%)	52	(19)	(75)	144	14
EPS (HK\$)	0.19	0.16	0.04	0.09	0.11
Chg (%)	16	(19)	(75)	144	14
P/E (x)	7.3	11.1	17.2	7.1	6.2
P/B (x)	3.1	3.0	0.8	0.7	0.6
P/OCF (x)	4.1	3.4	3.3	3.3	3.1
EV/EBITDA (x)	4.5	6.2	5.4	3.6	3.2
DPS (HK\$)	0.06	0.05	-	-	-
Yield (%)	3.9	3.4	-	-	-

Source: Company data, Orient Securities (Hong Kong)

### Accumulate

Share Price	Target Price
HK\$0.67	HK\$0.75

China / Technology / Electronic Component

17 September 2018

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### Latest Key Data

Total shares outstanding (mn)	1,000
Market capitalization (HK\$m)	670
Enterprise value (HK\$m)	841
12M daily turnover (HK\$m)	3.3
12M volatility (%)	54.9
PEG FY17-19E (X)	-
RoE avg FY17-19E (%)	12.6
P/B FY18E (x)	0.8
Net debt/equity FY18E (%)	1

### Performance (%)

	1M	YTD	12M
Absolute	(14)	(62)	(77)
Relative to HSI	(12)	(53)	(75)

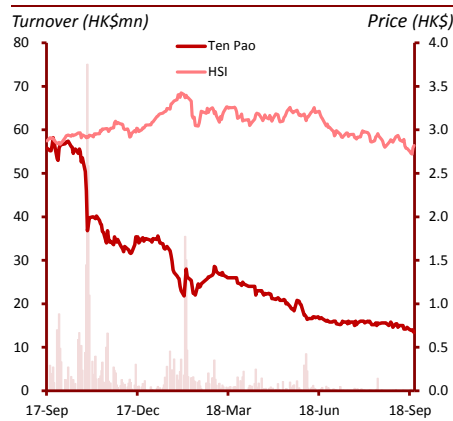
### Major Shareholders (%)

Hung Kwong Yee	65
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### Auditor

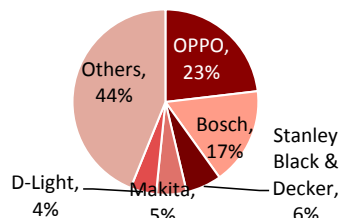
PricewaterhouseCoopers

### Price Chart



Source: Bloomberg, Orient Securities (Hong Kong)

**Figure 1: 1H18 Revenue breakdown of Ten Pao – OPPO remains the largest client**



Source: Company data, Orient Securities (Hong Kong)

**The significant decline of GP margin has resulted in HK\$12mn net loss in 1H18.**

**Downstream selling price of capacitors and resistors in China has surged 15-25 times so far this year.**

## Margin pressure from price hike of passive components

### 1H18 topline in line, pressure on margin

Ten Pao's 1H18 revenue grew 6.9% YoY to HK\$1,470.3mn, mainly driven by strong growth in smart chargers and controllers for industrial use (+38.4% YoY). Telecommunication remains as the largest business segment of Tenpao, representing 37.5% of total revenue, and it grew stably by 3.7% YoY in 1H18.

However, gross profit margin dropped significantly on all business segments in 1H18 (see table below), and on average GP margin was down 8.8 ppts to 10.7% from 19.5% in 1H17. This is mainly due to industry-wide price hike of key raw materials like passive components including MLCC (Multi-layer Ceramic Capacitor).

**Figure 2: Ten Pao's revenue and GP margin breakdown**

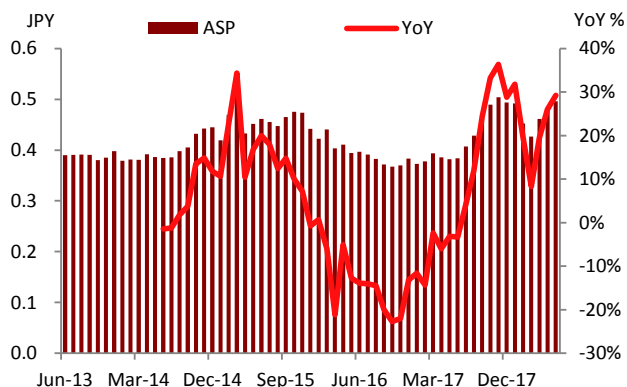
HK\$mn	1H18	1H17	YoY Chg.	Weighting
<b>Revenue</b>				
Telecommunication	550.9	530.6	3.7%	37.5%
Media and entertainment	162.9	264.0	-38.3%	11.1%
Electronic cigarette	15.8	14.0	13.0%	1.1%
Electrical home appliances	82.8	84.2	-1.7%	5.6%
Smart chargers and controllers	487.9	352.5	38.4%	33.2%
Lighting	88.7	90.1	-1.5%	6.0%
Others	81.4	40.5	101.1%	5.5%
<b>Total</b>	<b>1,470.3</b>	<b>1,375.8</b>	<b>6.9%</b>	<b>100.0%</b>
<b>Gross profit</b>				
Telecommunication	6.0%	12.0%	-6.0 ppts	
Media and entertainment	15.8%	25.2%	-9.4 ppts	
Electronic cigarette	28.0%	30.2%	-2.2 ppts	
Electrical home appliances	18.1%	25.5%	-7.4 ppts	
Smart chargers and controllers	12.2%	22.2%	-10.0 ppts	
Lighting	14.0%	25.5%	-11.5 ppts	
Others	9.0%	28.8%	-19.8 ppts	
<b>Total</b>	<b>10.7%</b>	<b>19.5%</b>	<b>-8.8 ppts</b>	

Source: Company, Orient Securities (Hong Kong)

### Supply of MLCC to remain tight, but raw material pressure start to ease in 2H18E

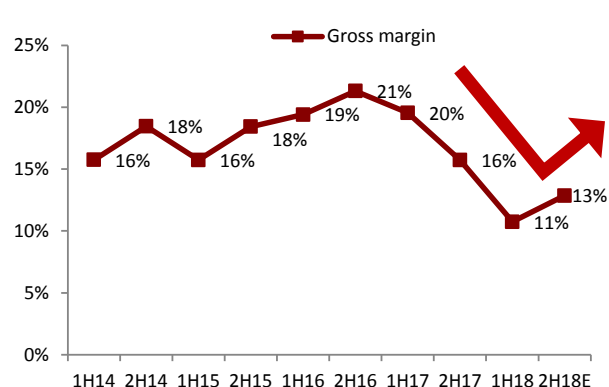
The demand for MLCC is pushed by more and more number of MLCC needed for smartphones with more and more upgraded functions and EV (over 10,000 MLCC needed for one unit of EV as compared to around 3,000 MLCC for traditional cars). While on the other hand, supply of MLCC will not increase a lot given fixed production capacity, and it has caused the price hike. We think supply of certain raw material will remain tight in 2H18, but Ten Pao has added new suppliers to mitigate the impact and has already seen positive effect, and the margin will start to recover in 2H18.

**Figure 3: Price movement of ceramic capacitors in Japan**



Source: METI, Orient Securities (Hong Kong)  
See last page for disclaimer.

**Figure 4: Ten Pao's GP margin to recover in 2H18E**



Source: Company data, Orient Securities (Hong Kong)

## Model revision; revise down target price

### Maintain 2018E topline growth forecast, revise down GP margin

We keep our 2018E revenue forecast unchanged at HK\$3,625mn and revise up our 2019E revenue forecast slightly up by 1.3% to reflect higher contribution from new client like Vivo and Amazon. We revised down 2018E/2019E GP margin significantly by 5ppts/4.5ppts to reflect the high-than-expected raw material price hike. This implies 2018E/2019E GP margin of 12.0%/13.0%, and the net effect is 79.9%/60.5% downward revision to 2018E/2019E net profit.

**Figure 5: Revision to Ten Pao model**

HK\$mn	2018E				2019E			
	Revision	Previous	Chg. (%)	YoY (%)	Revision	Previous	Chg. (%)	YoY (%)
Revenue	3,625	3,625	(0.0)	20.6	4,186	4,133	1.3	15.5
Gross profit	435	616	(29.4)	-17.2	544	723	(24.8)	25.1
EBIT	65	254	(74.3)	-68.5	126	310	(59.5)	92.4
Pretax profit	62	247	(75.1)	-69.3	122	308	(60.5)	97.2
Net profit	39	193	(79.9)	-75.3	95	240	(60.5)	144.2
Gross margin (%)	12.0	17.0	-5.0 ppt	-5.5 ppt	13.0	17.5	-4.5 ppt	1.0 ppt
Operating margin (%)	1.8	7.0	-5.2 ppt	-5.1 ppt	3.0	7.5	-4.5 ppt	1.2 ppt
Net margin (%)	1.1	5.3	-4.3 ppt	-4.2 ppt	2.3	5.8	-3.5 ppt	1.2 ppt

Source: Company data, Orient Securities (Hong Kong)

**Figure 6: Assumptions of Ten Pao's DCF model**

WACC	12.5%
Terminal growth rate	2%
PV of Terminal value (HK\$mn)	383.0
<b>Total PV of FCF (HK\$mn)</b>	<b>758.3</b>
Net Cash/Debt (HK\$mn)	(5.7)
<b>Target price (HK\$)</b>	<b>0.75</b>
Upside potential	12%

Source: Company data, Orient Securities (Hong Kong)

### Revise down target price to HK\$0.75, downgrade to Accumulate

As we adjusted lower our earnings forecast, we revised our DCF-based target price to HK\$0.75, by keeping WACC and terminal growth rate unchanged. Current share price implies 17.2x/7.1x 2018E/2019E PER. Our new target implies 19.3x/7.9x 2018E/2019E PER, 12% upside. Downgrade to Accumulate on uncertainties of raw material price.

**Figure 7: Ten Pao's DCF forecast**

HK\$mn	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E
Pre-tax income	62	122	139	172	195	207	221	230	240	272
Tax paid	(25)	(29)	(34)	(42)	(47)	(50)	(53)	(56)	(58)	(66)
Depreciation & Amortization	90	110	123	131	141	147	158	169	181	194
Change in Working Capital	61	(3)	(15)	(21)	(13)	(13)	(15)	(14)	(13)	(19)
Capex	(182)	(172)	(166)	(178)	(190)	(200)	(214)	(229)	(245)	(264)
<b>Free Cash flow</b>	<b>7</b>	<b>27</b>	<b>46</b>	<b>63</b>	<b>85</b>	<b>92</b>	<b>97</b>	<b>100</b>	<b>104</b>	<b>117</b>

Source: Company data, Orient Securities (Hong Kong)

**Figure 8: Valuation Comparison**

Company	Bloomberg Code	Rating	Price (Local)	Target (HK\$)	Mkt Cap (HK\$bn)	PER (x)	PEG (x)	EV/EBITDA (x)	P/B (x)	Yield (%)	ROE (%)	Net Gearing (%)
						17A	18E	19E		18E	17A	17A
<b>Ten Pao's key clients</b>												
Black & Decker	SWK US	Not Rated	147.36	-	177	22.8	17.6	15.7	4.5	11.8	2.6	38.5
TTI	669 HK	Not Rated	49.8	-	91	25.4	20.5	17.2	0.9	13.9	3.8	1.0
Makita	6586 JP	Not Rated	5010	-	98	23.6	21.5	19.6	1.3	12.1	2.3	Net cash
<b>Average</b>						<b>23.7</b>	<b>19.3</b>	<b>17.1</b>	<b>2.7</b>	<b>12.4</b>	<b>2.8</b>	
<b>Power supply unit manufacturer</b>												
Ten Pao	1979 HK	Accumulate	0.67	0.75	1	11.1	17.2	7.1	-	5.4	0.8	1
Delta	2308 TT	Not Rated	116.50	-	77	20.3	19.0	16.0	-	10.0	2.4	Net cash
Liteon	2301 TT	Not Rated	37.35	-	22	35.9	12.0	10.4	0.4	4.3	1.1	Net cash
Chicony Power	6412 TT	Not Rated	43.00	-	4	14.7	11.8	9.9	0.5	7.3	2.1	Net cash
AcBel	6282 TT	Not Rated	20.40	-	3	37.1	-	-	-	-	-	Net cash
Moso Power	002660 CH	Not Rated	6.05	-	2	191.6	-	-	-	-	-	Net cash
<b>Average</b>						<b>23.7</b>	<b>16.7</b>	<b>14.1</b>	<b>0.4</b>	<b>8.5</b>	<b>2.0</b>	

Source: Bloomberg, Orient Securities (Hong Kong)



## Financial statements & forecasts

### Income Statement (consolidated)

FY-end Dec (HK\$m)	2016	2017	2018E	2019E	2020E
<b>Revenue</b>	<b>2,583</b>	<b>3,007</b>	<b>3,625</b>	<b>4,186</b>	<b>4,618</b>
For consumer products	1,966	2,224	2,608	2,914	3,092
For industrial use	617	783	1,018	1,272	1,527
<b>Cost of sales</b>	<b>(2,055)</b>	<b>(2,481)</b>	<b>(3,190)</b>	<b>(3,642)</b>	<b>(4,018)</b>
<b>Gross profit</b>	<b>529</b>	<b>526</b>	<b>435</b>	<b>544</b>	<b>600</b>
Other income	12	10	18	21	23
Other gains/ (losses)	15	(12)	(4)	-	-
Selling and distribution expenses	(115)	(121)	(149)	(172)	(185)
Administrative expenses	(174)	(196)	(236)	(268)	(296)
<b>Operating Profit</b>	<b>268</b>	<b>207</b>	<b>65</b>	<b>126</b>	<b>143</b>
Finance cost	(5)	(6)	(4)	(4)	(4)
<b>Profit before tax</b>	<b>262</b>	<b>201</b>	<b>62</b>	<b>122</b>	<b>139</b>
Income tax expenses	(68)	(43)	(23)	(27)	(31)
<b>Net profit</b>	<b>194</b>	<b>158</b>	<b>39</b>	<b>95</b>	<b>108</b>
<b>EBITDA</b>	<b>323</b>	<b>270</b>	<b>156</b>	<b>235</b>	<b>266</b>
<b>EBIT</b>	<b>268</b>	<b>207</b>	<b>65</b>	<b>126</b>	<b>143</b>
<b>EPS (HK\$)</b>	<b>0.19</b>	<b>0.16</b>	<b>0.04</b>	<b>0.09</b>	<b>0.11</b>
<b>DPS (HK\$)</b>	<b>0.055</b>	<b>0.047</b>	-	-	-

### Cash Flow (consolidated)

FY-end Dec (HK\$m)	2016	2017	2018E	2019E	2020E
Pre-tax profit	262	201	62	122	139
Taxes paid	(50)	(64)	(25)	(29)	(34)
Depreciation	54	62	88	108	121
Amortization	1	1	2	2	2
Change in working capital	(109)	(14)	61	(3)	(15)
Others	5	13	15	4	7
<b>Operating cash flow</b>	<b>163</b>	<b>196</b>	<b>204</b>	<b>203</b>	<b>219</b>
CAPEX	(78)	(169)	(182)	(172)	(166)
Disposals	4	3	3	3	3
Grants from government	2	-	-	-	-
Others	-	-	-	-	-
<b>Investing cash flow</b>	<b>(73)</b>	<b>(167)</b>	<b>(179)</b>	<b>(170)</b>	<b>(163)</b>
Change in debt	(26)	8	19	21	182
Dividends paid	(40)	(60)	(24)	-	(16)
Repayments to/from related comp	-	-	-	-	-
Others	(3)	(8)	-	-	-
<b>Financing cash flow</b>	<b>(70)</b>	<b>(59)</b>	<b>(5)</b>	<b>21</b>	<b>166</b>
<b>Free cash flow</b>	<b>81</b>	<b>17</b>	<b>7</b>	<b>27</b>	<b>46</b>
<b>Net cash flow</b>	<b>21</b>	<b>(30)</b>	<b>20</b>	<b>54</b>	<b>222</b>

### Semi-Annual Breakdown

FY-end Dec (HK\$m)	2H16	1H17	2H17	1H18	2H18E
<b>Revenue</b>	<b>1,441</b>	<b>1,376</b>	<b>1,631</b>	<b>1,470</b>	<b>2,155</b>
Gross profit	307	269	257	158	277
Operating profit	155	121	85	(14)	80
Pre-tax profit	114	118	82	(18)	79
Tax	(7)	(26)	(18)	6	(29)
<b>Net profit</b>	<b>118</b>	<b>93</b>	<b>65</b>	<b>(12)</b>	<b>50</b>
Gross margin (%)	21.3	19.5	15.7	10.7	12.9
Operating margin (%)	10.8	8.8	5.2	-1.0	3.7
Effective tax rate (%)	5.8	21.8	21.3	34.6	36.5
Net margin (%)	8.2	6.7	4.0	-0.8	2.3
EPS (HK\$)	0.114	0.090	0.068	(0.012)	0.050
DPS (HK\$)	0.035	0.025	0.022	-	-

Source: Company data, Orient Securities (Hong Kong)

### Balance Sheet (consolidated)

FY-end Dec (HK\$m)	2016	2017	2018E	2019E	2020E
<b>Current assets</b>	<b>1,216</b>	<b>1,429</b>	<b>1,542</b>	<b>1,763</b>	<b>2,133</b>
Inventories	305	400	428	459	505
Trade, bills and other receivables	681	819	884	1,021	1,123
Available for sale financial assets	-	-	-	-	-
Bank balances and cash	205	181	201	255	477
Other current assets	24	29	29	29	29
<b>Non-current assets</b>	<b>318</b>	<b>451</b>	<b>536</b>	<b>597</b>	<b>640</b>
Fixed Assets	276	401	489	549	588
Intangible assets	5	6	6	5	5
Land use rights	5	11	10	10	10
Investment properties	5	6	6	6	6
Other non-current assets	26	27	25	28	31
<b>Total assets</b>	<b>1,534</b>	<b>1,880</b>	<b>2,078</b>	<b>2,361</b>	<b>2,773</b>
<b>Current liabilities</b>	<b>990</b>	<b>1,156</b>	<b>1,311</b>	<b>1,487</b>	<b>1,727</b>
Trade, bills and other payables	809	1,008	1,162	1,327	1,460
Short-term borrowings	96	74	52	57	102
Current portion of non-current	43	46	69	76	136
Other current liabilities	41	28	28	28	28
<b>Non-current liabilities</b>	<b>90</b>	<b>131</b>	<b>149</b>	<b>157</b>	<b>232</b>
Deferred tax liability	41	54	54	54	54
Non-current bank borrowings	39	68	86	95	170
Other non-current liabilities	10	10	9	9	8
<b>Total liabilities</b>	<b>1,080</b>	<b>1,287</b>	<b>1,460</b>	<b>1,644</b>	<b>1,959</b>
Share Capital	10	10	10	10	10
Share premium and reserves	444	582	609	707	802
<b>Total equity</b>	<b>454</b>	<b>592</b>	<b>619</b>	<b>717</b>	<b>812</b>
<b>Total liabilities &amp; equity</b>	<b>1,534</b>	<b>1,880</b>	<b>2,079</b>	<b>2,362</b>	<b>2,771</b>
Net cash/(debt)	26	(7)	(6)	28	68
Working capital	226	273	231	276	407
Total capital employed	544	724	767	873	1,046
Net gearing (%)	NC	1	1	NC	NC
<b>BVPS (HK\$)</b>	<b>0.594</b>	<b>0.775</b>	<b>0.810</b>	<b>0.939</b>	<b>1.063</b>

### Key Ratios

FY-end Dec	2016	2017	2018E	2019E	2020E
<b>Growth (%)</b>					
Revenue	15	16	21	15	10
Gross profit	35	(1)	(17)	25	10
EBITDA	59	(16)	(42)	51	13
EBIT	71	(23)	(68)	92	14
Net profit	52	(19)	(75)	144	14
EPS	16	(19)	(75)	144	14
<b>Margins (%)</b>					
Gross	20	17	12	13	13
EBITDA	13	9	4	6	6
EBIT	10	7	2	3	3
Net	8	5	1	2	2
<b>Others (%)</b>					
Effective tax rate	26	22	37	22	22
Dividend payout ratio	28	30	-	-	-
RoCE	36	22	5	11	10
Average RoE	50	30	6	14	14
Average RoA	23	16	8	11	10
Interest cover (x)	49	35	18	32	33

### Key Assumptions

FY-end Dec	2016	2017	2018E	2019E	2020E
OPPO's global shipment (mn)	99	112	118	126	135
Ten Pao's % in OPPO	20	30	32	33	35

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Accumulate – Describes stocks that we expect to provide a total return of >0% within a 12-month period.

Hold – Describes stocks that we expect to provide a total return of between -20% and +20% within a 12-month period.

Sell – Describes stocks that we expect to provide a total return of <0% within a 12-month period.

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