19 September 2014

Trigiant Group （1300.HK）

Strategic Cooperation May Lead to New Profit Point

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Phillip Securities (Hong Kong) Ltd

Rating : **Buy**

HONG KONG | TMT | SEMIANNUAL REPORT REVIEW

- Trigiant Group's interim statement in 2014 shows that it has achieved business revenue of RMB (the same below) 1.353 billion yuan, with a year-on-year growth of 6.9%. The net profit of the shareholders reaches 155 million yuan, with a year-on-year decrease of 5.9%. However, after deducting the loss of 47.1 million yuan caused by the change of the fair value of warrants, the net profit actually increases by 22.7% to 202 million yuan.
- Specifically, it is the price decline of copper that mainly affects the growth of business revenue, but the company's profitability remains relatively stable thanks to the cost-plus pricing model, and the overall gross margin drops only by 0.4% to 23% compared with that in last year. Moreover, because of the effective cost control, there is a downward trend in the major expenses, which causes the company's net profit margin to grow from 13% to 14.9% after deducting the loss caused by the change of the fair value of warrants.
- The construction of the 4G network will create an incentive for the company's continuous increase. At the same time, 20% of the radio-frequency coaxial cables of the existing base stations will be replaced per year due to normal deterioration. With the increase of the inland base stations, the replacement demand will keep rising steadily. In addition, the new base stations built by the Iron Tower Company will undertake more tasks, the height of the base stations may increase correspondingly, and a corresponding increase in the demand of RF coaxial cables is also expected.
- The company reaches a strategic cooperation agreement with an affiliated investment company of Haier, and establishes a fund management company to set up and manage its industrial fund and to be engaged in investment activities. It is expected to seek development opportunities mainly in fields like optical communications, internet of things and smart appliance. Currently, Haier is positively transforming itself into a platform company for small companies. If it is successful in the future, there will be an explosive growth in the demand of products such as emerging optoelectronic components and sensors, and Trigiant has advantages in the supply of these products. So, we expect that the strategic cooperation may lead to new profit point for the company.

Investment Action

Trigiant has achieved a compound growth of more than 20% since its foundation. The 4G opportunity will hopefully support the steady development of the company's traditional business, and its strategic cooperation with Haier is expected to result in a rapid growth of the company's emerging optoelectronics components.

The company is currently traded at the PER of around 5-6X, and the dividend yield is over 6%. We believe it is undervalued and grant it the target price of HK$3, corresponding to 7.1X EPS in 2014. We maintain it "Buy" rating.

Maintain at Buy

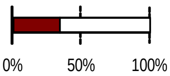
Target Price (HKD)	**3.00**
Forecast Dividend (RMB)	0.14
Closing Price (HKD)	2.18
Potential Upside	**44.0%**

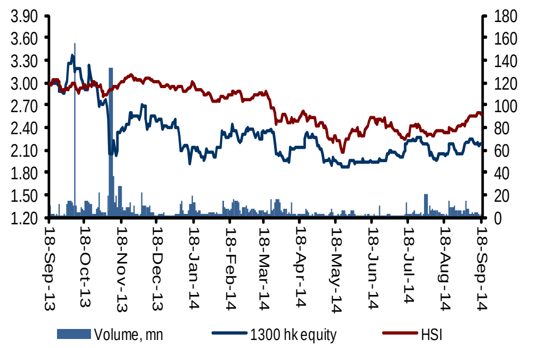
Company Description

Founded in 2007, Trigiant is a leading domestic vendor engaged in production of RF coaxial cable. It ranks the first place in sales volume of RF cable products with the market share of 25%. So far, the company's products have been extensively applied in telecom operators, service suppliers, and main equipment manufacturers' transmission systems. In addition to selling products to its main customers like domestic three major telecom operators and telecom equipment vendors (including ZTE and Huawei), the company also exports its products to overseas market.

Company Data

Market Cap. (HKD mn)	2,431
Enterprise Value (HKD mn)	2,666
52 week range (HKD)	1.42 - 3.65
Closing Price in 52 week range	





Major Shareholders

1.Qian Jindi	55.42%

Valuation Method

P/E

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Key Financial Summary

FYE	12/12	12/13	12/14F	12/15F
Turnover (RMB mn)	2,231	2,458	2,774	3,217
Net Profit, adj. (RMB mn)	252	314	376	474
EPS, adj. (RMB)	0.26	0.31	0.33	0.39
P/E (X)	6.6	5.7	5.2	4.5
BVPS (RMB)	1.00	1.35	1.54	1.73
P/B (X)	1.72	1.28	1.12	1.00
DPS (HKD)	0.10	0.14	0.14	0.15
Div. Yield	4.6%	6.4%	6.4%	6.9%

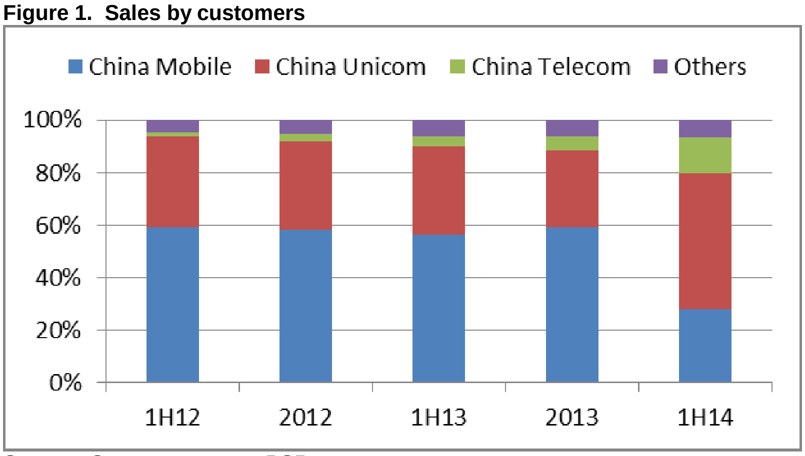
Source: Bloomberg, PSR est.
*All multiples & yields based on current market price

Declined Performance Affected by the Change of the Fair Value of Warrants

Trigiant Group's interim statement in 2014 showsit has achieved business revenue of RMB (the same below) 1.353 billion yuan, with a year-on-year growth of 6.9%. The net profit of the shareholders reaches 155 million yuan, with a year-on-year decrease of 5.9%. However, after deducting the loss of 47.1 million yuan caused by the change of the fair value of warrants, the net profit actually increases by 22.7% to 202 million yuan. Within the period, the company's EPS drop from 16.64 cents to its 13.9 cents, and it issues an interim dividend of 7 Hong Kong cents per share.

Specifically, the price decline of copper affects the growth of the business revenue. Though the sale of the main product radio-frequency coaxial cables rises by 18.1% to 74.5 thousand kilometers, its turnover increases only by 3.8% to 972 million yuan, which accounts for 71.8% of the whole turnover, because the price of the main raw material copper decreases by 10.2% on average and the company adopts the cost-plus pricing model. However, thanks to the orders from its major customers China Unicom and China Telecom, the revenue of the company's anti-flaming flexible cables grows by 12.2% to 300 million yuan. In fact, the two large operators contribute respectively to 51.8% and 13.4% of the company's overall revenue during this period.

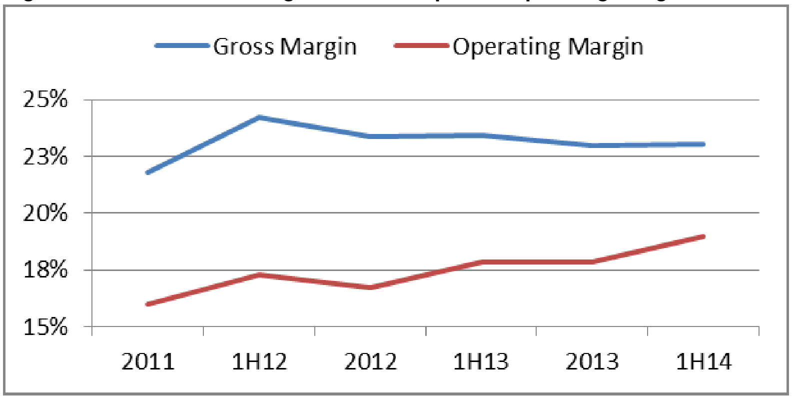
Figure 1. Sales by customers



Source: Company reports, PSR

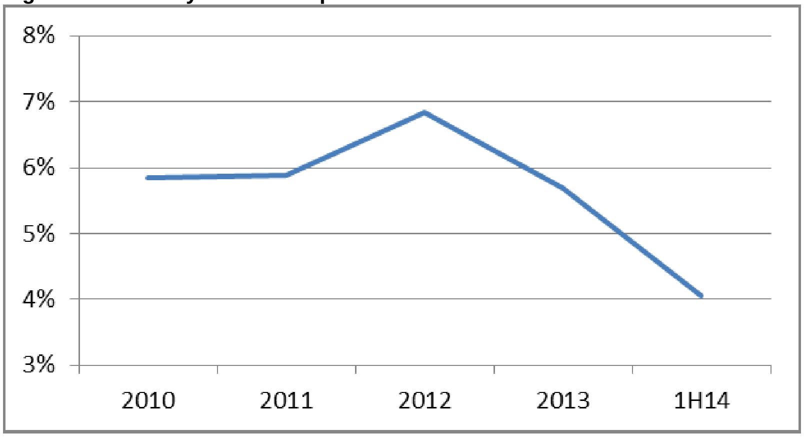
The company's profitability remains relatively stable thanks to its product pricing model, and its overall gross margin drops only by 0.4% to 23% compared with that in last year. Therein, the gross margin of radio-frequency coaxial cables falls by 1% to 23.8%, and that of flame-retardant flexible cable drops by 0.3% to 20.9%. It is worth mentioning that the cost of marketing and social engagement declines because of its effective cost control, and its sale and distribution cost and its administrative expenses decrease respectively by 30.3% and 14.6% to 23.9 million yuan and 22.3 million yuan. At the same time, after completing the research and development of several 4G projects, the research and development cost also drops by 9.7% to 11.1 million yuan. Therefore, after deducting the loss caused by the change of the fair value of warrants, the company's net profit margin actually increases from 13% to 14.9%.

Figure 2. Stable Gross margin but with improved operating margin



Source: Company reports, PSR

Figure 3. Gradually declined expense ratio



Source: Company reports, PSR

The Company May Continuously Benefit from the Construction of 4G Network

The company has a market share of more than 25% in telecommunication cable industry, and is expected to be a major beneficiary of 4G construction. Currently, the inland mobile internet users account for 83.4%, which has exceeded traditional personal computer internet users. The strong demand accelerates operators' construction of 4G network. After receiving 4G license in December 2013, China Mobile has constructed 410 thousand 4G base stations by the first half of the year, and is estimated to reach its goal of 700 thousand at the end of the year, higher than original target of 500 thousand. Moreover, China Unicom and China Telecom got the 4G test run license of 16 cities at the end of June, and then expanded to 40 cities at the end of August. Consequently, they also have an incentive to accelerate their construction of 4G network. We believe that the construction of 4G network will create an incentive for the company's continuous growth.

It is also worth noting that 20% of the radio-frequency cables of the existing base stations will be replaced per year due to normal deterioration. With the increase of the inland base stations, the replacement demand will keep rising steadily.

Furthermore, as for the establishment of the Iron Tower Company, because the three large operators have their own business frequency, they still need to lay different radio-frequency cable systems though they share the same iron tower. Moreover, because a single base station undertakes more tasks, the height of the base station may increase correspondingly, and a corresponding increase in the demand of the company's radio-frequency cables is also expected.

Strategic Cooperation May Lead to New Profit Point

In April, the company issued warrants to introduce Qingdao Haier Investment Company to be its strategic investor. Recently, the company has reached a strategic cooperation agreement with an affiliated investment company of Haier on August 20, and established a fund management company to set up and manage its industrial fund and to be engaged in investment activities. It is expected to seek development opportunities mainly in fields like optical communications, Internet of things and smart appliance.

We think that Haier is positively transforming itself into a platform company for small companies. If it is successful in the future, there will be an explosive growth in the demand of products such as emerging optoelectronic components and sensors. "Trigiant Optical Telecommunication Co., Ltd.", "Trigiant Sensing Technology Co., Ltd." and more, in which Trigiant has bought shares before, have advantages in the supply of these products. In the first half of the year, the company's new electronic components have achieved a revenue growth of 31.5% and a profit margin of over 30%.

Catalyst

The release of the national license of FDD;
The rapid growth of the emerging electronic business.

Risks

The fierce competition in the industry causes the decline in gross margin;
The construction investment of base stations fails to meet expectations.

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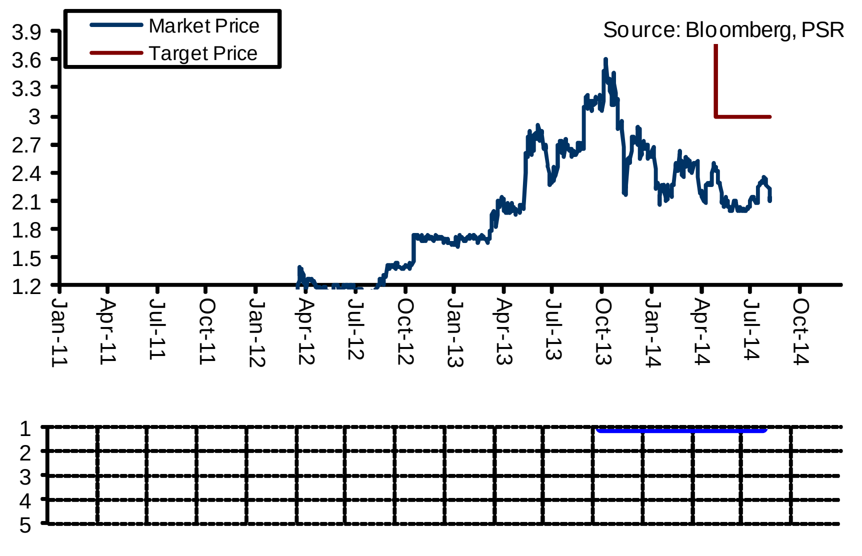
FYE	2011	2012	2013	2014F	2015F
Valuation Ratios					
Price Earnings	-	6.55	5.65	5.17	4.46
Price to Book	-	1.72	1.28	1.12	1.00
Dividend Yield	-	4.6%	6.4%	6.4%	6.9%
Per share data					
EPS Adjusted(RMB)	20.68	0.26	0.31	0.33	0.39
Book Value Per Share(RMB)	-	1.00	1.35	1.54	1.73
Dividends Per Share(HK$)	-	0.10	0.14	0.14	0.15
Growth& Margin					
Revenue growth	29.7%	22.4%	10.2%	12.8%	16.0%
Gross Profit growth	37.6%	31.3%	8.3%	11.9%	16.0%
Net Profit growth	-	22.0%	24.5%	19.8%	26.1%
Gross Margin	21.8%	23.4%	23.0%	22.8%	22.8%
Net Profit Margin	11.3%	11.3%	12.8%	13.6%	14.7%
Dividend Payout Ratio %	0.0%	31.7%	39.0%	33.0%	31.0%
Key Ratios					
Return on Assets	11.0%	11.2%	12.7%	13.2%	13.8%
Return on Equity	49.9%	31.2%	20.9%	23.0%	24.4%
Tax ratio	16.2%	16.7%	17.6%	17.8%	17.8%
Liability ratio	72.1%	56.7%	42.9%	48.5%	45.0%
Income Statement(RMB:mn)					
Revenue	**1,823**	**2,231**	**2,458**	**2,774**	**3,217**
- Cost of Goods Sold	1,425	1,709	1,893	2,141	2,484
Gross Income	**397**	**522**	**565**	**632**	**734**
- Selling, General & Admin Expenses	107	153	140	111	129
Operating Income	**292**	**374**	**439**	**531**	**617**
- Interest Expense	57	80	55	40	50
Pretax Income	**247**	**303**	**380**	**457**	**577**
- Income Tax Expense	40	51	67	81	102
Net Profit	**207**	**252**	**314**	**376**	**474**

Ratings History



PSR Rating System

Total Returns	Recommendation	Rating
> +20%	Buy	1
+5% to +20%	Accumulate	2
-5% to +5%	Neutral	3
-5% to -20%	Reduce	4
<-20%	Sell	5

Remarks

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20%upside from the current price
-5% to +5%	Neutral	3	Trade within ± 5% from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20%downside from the current price

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