Cowell e Holdings (1415.HK)

Low valuation has basically reflected multiple risks

Hong Kong | TMT| Company report

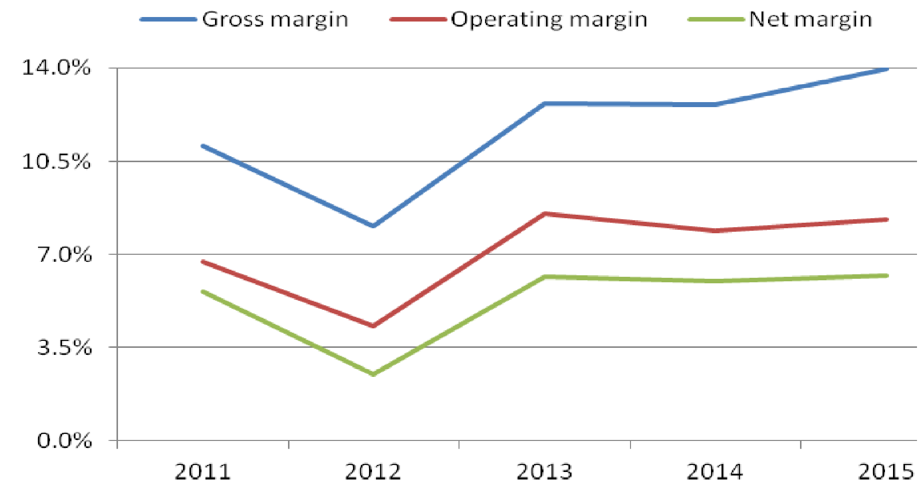
9 MAY 2016

Steady Growth in 2015

The annual revenue of Cowell e (hereinafter referred to as the "Company") in 2015 was USD980 million with a YoY increase of 10.6%, and net profit was USD60.7 million with a YoY increase of 14.1%. The sales growth of flip-chip camera modules had driven the total module shipments by an increase of 2% to 197.4 million pieces, and the sales price had also increased due to structure upgrade. However, delivery of the Company`s chip-on-board (COB) modules to LG had declined.

In respect of profitability, the Company`s gross profit margin had increased by 1.3 percentage points to 14%, which was mainly the result of the Company`s effective management of supplies (with supplies reduced) and productivity improvement. Additionally, the asset-liability ratio had dropped by 25 percentage points to 36.9% through listing and financing, while financial expenses had also decreased by USD1.5 million, making further contribution to performance growth.

Recovered earning capabilities



Source: Company report, Phillip Securities (HK) Research

Orders of Apple Continue to Be the Main Driving Force in Growth

With advanced flip-chip packaging technology, strong R&D capability, and its high-quality lens modules, the Company has been the only manufacturer supplying Apple with front lens modules for each generation of iPhone/iPad since 2009 (with 50%/20% share of orders). Decrease in the order share of iPhone front lenses is the short-term uncertainty facing the Company, but the Company still has better capacity advantage over potential new suppliers (Foxconn or ASE). In 2016, the Company will have the largest flip-chip front lens module production capacity (with an increase of 35% to 20kk/m already in 2015), so we think the market has worried too much about potential competitors.

Buy (Initially)

CMP: HKD 2.78
(Closing price as at 5 May 2016)
TARGET: HKD 3.70 (+33%)

COMPANY DATA

O/S SHARES (MN) :	832
MARKET CAP (HKDMN) :	2,312
52 - WK HI/LO (HKD):	8. 85/2. 10

SHARE HOLDING PATTERN , %

Kwak Joung Hwan :	45

PRICE PERFORMANCE , %

	1M	3M	1Y
Cowell e	-8.25	27.88	-55.26
HSI	-9.98	21.46	-29.22

PRICE VS. HSI

Source: Phillip Securities (HK) Research

KEY FINANCIALS

US$ mn	FY14	FY15	FY16E	FY17E
Net Sales	886	980	1096	1167
Net Profit	53	61	66	73
EPS, US$	-	0.08	0.08	0.09
PER, x	-	4.8	4.5	4.1
BVPS, US$	0.26	0.34	0.42	0.51
P/BV, x	1.4	1.0	0.8	0.7
ROE, %	32.0	25.4	20.8	18.8
Debt/Equity (%)	162.9	58.4	66.7	66.7

Source: Company reports, Phillip Securities Est.

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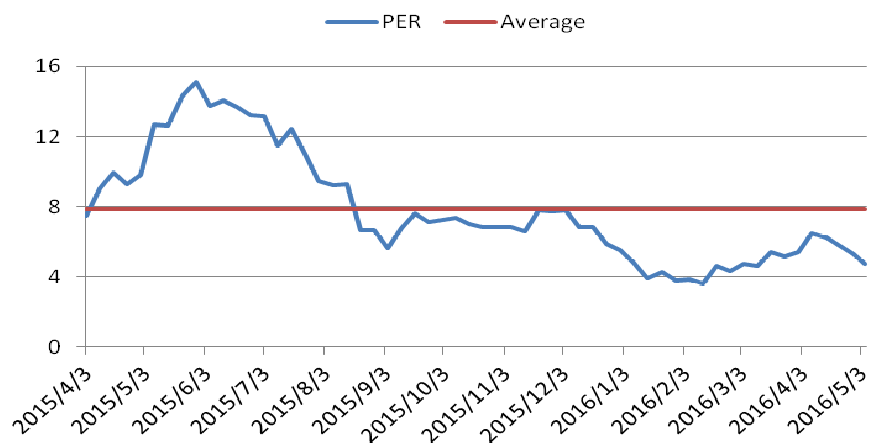
It is worth noting that Apple currently contributes 82% of the Company`s revenues, which is expected to maintain a steady growth in 2016. Apart from the increase of sales price due to lens upgrade, the output of flip-chip camera modules is expected to grow further. Delivery of CM of Apple`s iPhone SE began in April 2016. It is reported that the market demand for the model has exceeded expectation, and Apple has already increased its orders in the second quarter from 3.5 to 4 million units to over 5 million units, and the order in the third quarter will keep up to the same level. In addition, Apple plans to launch new generations of iPhone and iPad in the second half of the year or present substantial innovations. As it is normally the case that shipments will be greatly increased following the introduction of Apple new products, Cowell e is also expected to benefit therefrom.

The new-generation iPhone 7 will probably be installed with dual rear cameras. Since Sharp`s financial problem may affect the stability of its supply, Apple may probably introduce new suppliers of rear camera module. The Company, with experience of advanced packaging technology and stable supply since 2009, has the hope to become one of the suppliers of rear cameras to Apple in 2016. The average sales price of rear camera is USD14, which is at least twice the average price of front camera of USD6. Furthermore, the complex production process of rear camera creates higher profit margin than front camera, which can positively impact on the Company`s profitability.

Diversification of Risks and Underestimation of Value

In addition to expanding and maintaining good working relationship with Apple, the Company`s management intends to take the lead in expanding the Company`s product portfolio using its expertise in semiconductor industry, such as to develop advanced infrared cut-off filters, and at the same time, develop diversified customer base to reduce risks of excessive dependence on one single company. Besides, with the Company`s steady growth and good capital structure, we believe that the Company has basically reflected the multiple risks in its valuation which is fairly low. We grant the company the target price of hk$3.7, equivalent to 6X EPS in 2016, with the “Buy” rating initially. (Closing price as at 5 May 2016)

Historical P/E valuation



Source: Bloomberg, Phillip Securities (HK) Research

Peer Comparison

Ticker	Name	P/E	ROE（%)	Dvd 12M Yld（%)
1415 HK Equity	**COWELL E HOLDINGS INC**	**4.8**	**25.4**	**-**
1639 HK Equity	AKM INDUSTRIAL CO LTD	15.6	7.8	-
2038 HK Equity	FIH MOBILE LTD	13.9	6.0	6.0
2018 HK Equity	AAC TECHNOLOGIES HOLDING:	17.4	30.4	1.8
2382 HK Equity	SUNNY OPTICAL TECH	27.2	21.6	0.8
1478 HK Equity	Q TECHNOLOGY GROUP CO LT	13.9	28.1	3.0
005930 KS Equit	SAMSUNG ELECTRONICS CO L	10.0	10.0	1.6
066570 KS Equit	LG ELECTRONICS INC	95.6	0.8	0.7
Average		16.3	14.9	2.3

Source: Bloomberg, Phillip Securities (HK) Research

Risks

Market competition has increased.
Shipment of iPhone and iPad is lower than expected.

Financials

FYE	2013	2014	2015	2016F	2017F
Valuation Ratios					
Price Earnings	-	-	4.8x	4.5x	4.1x
Price to Book	-	1.4x	1.0x	0.8x	0.7x
Per share data(US$)					
EPS Adjusted	-	-	0.08	0.08	0.09
Book Value Per Share	-	0.26	0.34	0.42	0.51
Growth& Margin					
Revenue growth	-	8.9%	10.6%	11.8%	6.5%
Gross Profit growth	-	8.6%	22.1%	8.1%	7.3%
Net Profit growth	-	26.8%	14.0%	9.4%	10.1%
Profitability Ratios					
Gross Margin	12.7%	12.6%	14.0%	13.5%	13.6%
Net Profit Margin	6.2%	6.0%	6.2%	6.1%	6.3%
Key Ratios					
Return on Assets	12.9%	11.8%	12.7%	12.8%	11.3%
Return on Equity	44.4%	32.0%	25.4%	20.8%	18.8%
Effective Tax Rate	21.3%	21.2%	21.2%	21.2%	21.2%
Liability ratio	65.1%	62.0%	36.9%	40.0%	40.0%
Income Statement(US$: mn)					
Revenue	***814***	***886***	***980***	***1,096***	***1,167***
- Cost of Goods Sold	*711*	*774*	*843*	*948*	*1,008*
Gross Income	***103***	***112***	***137***	***148***	***159***
- Selling, General & Admin Exper	*34*	*44*	*57*	*66*	*70*
Operating Income	***69***	***70***	***82***	***84***	***91***
- Interest Expense	*5*	*3*	*2*	*1*	*1*
Pretax Income	*64*	*68*	*77*	*84*	*93*
- Income Tax Expense	*14*	*14*	*16*	*18*	*20*
Net Profit	***50***	***53***	***61***	***66***	***73***

Source: Company, Phillip Securities (HK) Research Estimates

(Financial figures as at 5 May 2016)

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

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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