

TK Group (2283 HK)

Steady Growth Mode with Diversified Customer Network

Hong Kong | Mold | Company report

10 January 2017

We had a conference call with Executive Director, Chief Financial Officer & Assistant to Chairman Franky Cheung to conduct research on TK Group.

Company Overview

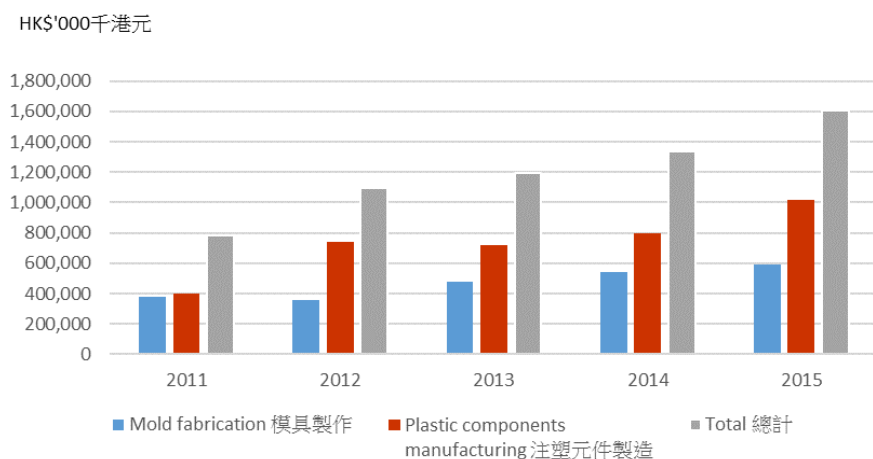
TK Group was established in Hong Kong in 1983. Business expanded to an industrial park of over 100,000 sq.meters (incl. Guangming Shenzhen, Buji Shenzhen, Suzhou and Germany) with a family of over 3,000 staff from a 70 sq. meters factory with 7 staff at the beginning. It was successfully listed on the main board of Hong Kong Stock Exchange on 20 Dec 2013.

The board of directors recently announced that according to the market research report of Ipsos Hong Kong Limited, TK Group exported approximately RMB470 million of plastic injection molds in 2015, representing 4.5% of PRC total export value of plastic injection molds in the amount of approximately US\$1.69 billion, making it the largest PRC manufacturer of plastic injection molds with level above MT3 (in terms of export value) in 2015. The board of directors also announced that the Company received the “2016 Hong Kong Awards for Industries: Upgrading and Transformation Award” from the Hong Kong Young Industrialists Council recently.

The development of TK Group benefits from China’s policy support, including “Made in China 2025” and “Industry 4.0”. The Company began to use the smart flexible production lines with Industry 4.0 concept in early 2015. It began to use automation technique to produce different products in the same line, which enhanced the production efficiency and therefore effectively controlled labor costs.

Five Year Revenue

Five Year Revenue—by business segments
按業務分部之五年收入



Source: Company reports, Phillip Securities (HK) Research

Buy

CMP HKD2.18

(Closing price at 6 Jan 2017)

TARGET HKD2.80 (+28.44%)

COMPANY DATA

O/S SHARES (MN) :	826.6
MARKET CAP (HKDMN) :	1,802
52 - WK HI/LO (HKD):	2.27/1.62

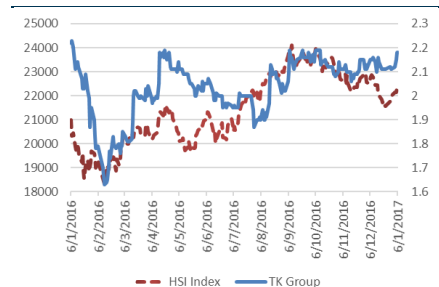
SHARE HOLDING PATTERN, %

Eastern Mix	50.99
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PRICE PERFORMANCE, %

	1M	3M	1Y
TK Group	+1.40	-0.46	-1.80
HSI	-0.76	-6.05	+7.26

PRICE VS. HSI



Source: Bloomberg, Phillip Securities (HK) Research

KEY FINANCIALS

HKD mn	FY14	FY15	FY16E	FY17E
Sales	1339	1606	1654	1853
Net Profit	154	187	205	238
EPS, HKD	0.186	0.226	0.248	0.286
PER, x	7.1	9.7	8.8	7.6
BVPS, HKD	0.733	0.837	0.877	1.06
P/BV, x	1.8	2.6	2.5	2.1
ROE, %	34.3	33.1	31.5	31.8

Source: Company reports, Phillip Securities Est.

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There are two main business segments—Mold fabrication business and plastic components manufacturing business. In 1H2016, the turnover of the mold fabrication business division amounted to approximately HK\$290.2 million, representing an increase of approximately 18.8% YoY and accounting for 40.2% of total revenue (from external customers). And the gross profit margin is 26.2%. And the turnover of the plastic components manufacturing business division amounted to approximately HK\$431.1 million, representing a decrease of 11.9% YoY, and accounting for approximately 59.8% of the Group's total revenue. Thanks to the Group's efforts in automation and product mix adjustment, the segment's gross profit margin increased from 23.4% to 26.6% YoY.

Revenue grew gradually from 2011 to 2015 at a CAGR of 19.7%.

Segment Revenue

	2011	2012	2013	2014	2015
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
	千港元	千港元	千港元	千港元	千港元
	2011	2012	2013	2014	2015
Mold fabrication 模具製作	378,286	356,245	476,024	540,259	588,800
Plastic components manufacturing 注塑元件製造	403,464	739,740	721,828	798,661	1,017,405
Total 總計	781,750	1,095,985	1,197,852	1,338,920	1,606,205

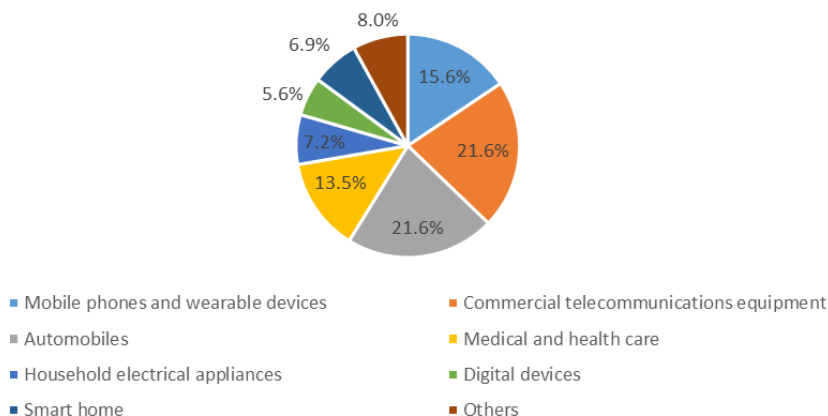
Source: Company reports, Phillip Securities (HK) Research

The clients of TK Group are from different sectors and are diversified enough to spread the risk of one specific industry suffering the economic slowdown. In 1H2016, the global and China market faced economic slowdown, demands for high-end electronics declined. Revenue from mobile phones and wearable devices division decreased by over 30% YoY. However, thanks to the rapid growth of automobiles molds and smart home markets, the total revenue only declined slightly. Automobile segment grew by 32.1% YoY, driven by the new automobile mold business in Germany. And smart home segment grew by 220.6% YoY, driven by new orders from a leading smart home brand customers and its rapid growth. Total revenue in 1H2016 was HK\$721.3 million, representing a decrease of 1.7% YoY.

The Group recorded a profit attributable to owners of the Company for 1H2016 of HK\$78.9 million (1H2015: HK\$71.2 million), representing a YoY increase of 10.8%. The net profit margin for the period was 10.9% (1H2015: 9.7%).

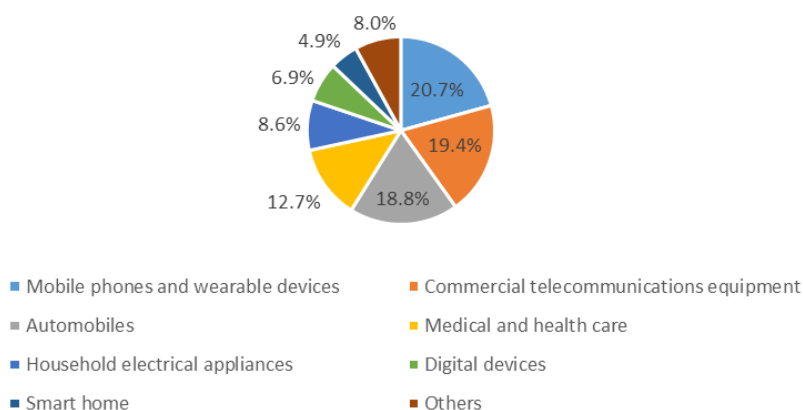
Here's the charts for 1H2016 and 2015 revenue breakdown by downstream industry:

1H2016 Revenue Breakdown by Downstream Industry



Source: Company reports, Phillip Securities (HK) Research

2015 Revenue Breakdown by Downstream Industry



Source: Company reports, Phillip Securities (HK) Research

The Group has sufficient orders on hand. As at 30 June 2016, the Group's orders on hand was HK\$712.7 million, representing an increase of 7.8% YoY. The following table shows the breakdown of orders on hands by downstream industry. On 30 Nov 2016, the Group's orders on hand increased to around HK\$750 million.

The breakdown of orders on hands by downstream industry


Industry	Amount(HK\$'000)	%
Mobile phones and wearable devices	85,682	12.0%
Commercial telecommunications equipment	82,692	11.6%
Automobile	330,742	46.4%
Medical and health care	39,807	5.6%
Household electric appliance	44,610	6.3%
Digital devices	18,866	2.6%
Smart home	38,601	5.4%
Others	71,701	10.1%
Total	712,701	

Source: Company, Phillip Securities (HK) Research

Company Products and Diversified Customer Network

The following table shows 1H2016 top six customers and their industries. The top six customers contributed 51.7% of TK's revenue in 1H2016. The cooperation with top six customers has a long history. Management mentioned that the cooperation with the largest customer Polycom has a history of 25 years. And the customer relationship is relatively strengthened.

Top six customers and their industries



	Company name	Industry	Product category
1	Polycom	Commercial telecommunications equipment	Mold and Plastic products
2	A leading health care product brand	Medical and health care	Mold and Plastic products
3	A first-tier manufacturer of world automobile components	Automobile	Mold
4	A leading smartphone brand	Mobile phones and wearable devices	Mold and Plastic products
5	A leading flash memory product brand	Digital devices	Mold and Plastic products
6	A leading smart home product brand	Smart home	Mold and Plastic products

Source: Company, Phillip Securities (HK) Research

Production Base and Capacity

TK Group has two production bases in China——Suzhou, Jiangsu Province and Shenzhen, Guangdong Province. The following table shows 1H2016 capacity and utilisation rate of the two production bases.

Capacity and utilisation rate of the two production bases

Location	Suzhou, Jiangsu Province	G.F.A	1H2016 capacity	Utilisation rate
Production base	TK Plastics Products	12,582 sq.m.	100,100 hours	68.4%
Location	Shenzhen, Guangdong Province	G.F.A	1H2016 capacity	Utilisation rate
Production base	TK Mold	33,112 sq.m.	523,120 hours	88.2%
	TK Precision Plastics	73,247 sq.m.	670,384 hours	63.7%

Source: Company, Phillip Securities (HK) Research

Future Segment Growth Expectation

TK Group might benefit from the development of mobile phones and wearable devices, automobiles molds, medical and health care, smart home and virtual reality(VR) segments in the future.

Mobile phones and wearable devices: The Group's mobile phones and wearable devices division experienced a decline of over 30% YoY in 1H2016. We expect a segment growth recovery in 2H2016 and the segment may perform better in 2017.

Automobiles molds: The Group developed its automobiles molds business in Germany through the newly acquired German Subsidiary. Now it's mass production stage. And the Group focuses on customer confidence building in Germany. Future performance of the segment may be driven by the business in Germany.

Medical and health care: We expect a faster segment revenue growth in 2017.

Smart home: Market research institution "Markets And Markets" issued a report anticipating the global smart home market may be worth US\$122 billion in 2022 at a CAGR of 14%. The smart home segment growth is also expected to accelerate in the future.

Virtual reality(VR): Another market research institution SuperData anticipates the market value for VR to reach \$28 billion by 2020. Oculus under Facebook has begun the cooperation with TK Group. The businesses include precision molds and plastic injection. The VR segment growth is expected to accelerate in 2018 accompanied with VR market's potential growth.

Prospects for Development

The Group keeps faith with its well-established philosophy of diversified customers and its development strategy of focusing on high-precision molds in these years. The precision mold design has core technology and is better than competitors' technology. It will drive the growth of plastic components manufacturing business. The dividend payout ratio is expected to rise to 50%. And the company positions itself as a high-tech company with high dividend payout ratio. As for gross profit margin, mold fabrication has long production cycle. Because of the lag effect, economy efficiency from capacity expansion will reflect in the financials later and the gross profit margin may rise in FY16. Part of FY17 CAPEX will be used for the development of automation. Automation may cause labor cost to drop and decline in number of employees.

TK Mold (Shenzhen) Limited and TK Precision Plastics (SZ) Limited, subsidiaries of the Group, were recognized as "New and High Technology Enterprise" and thus enjoy a preferential CIT rate of 15% from 1 January 2014 to 31 December 2016 and 1 January 2015 to 31 December 2017, respectively. Tax rate is reviewed every three years, and management expects they will continue enjoying a preferential tax rate.

TK group's financial situation is good, and they are considering buying into upstream and downstream companies and will have synergistic effect.

The Impact of RMB Depreciation on the Company

The mold fabrication business benefited more from RMB depreciation because steel as raw materials was paid using RMB. For the plastic components manufacturing business, raw materials were bought from outside China, so the segment benefited less. Because mold fabrication has long production cycle and sales is affected by the lag effect, the recent RMB depreciation may reflect in the financials of FY17. And most of the company cost is paid by RMB, while most of the revenue is USD and EURO. Such structure benefits from RMB depreciation. At the end of June 2016 company's cash is mainly HKD and USD, however, in 1H2015 it's mainly RMB. From 2H2015 company forecasted the RMB might depreciate and bring potential risk and therefore changed RMB deposit into foreign currency.

Shareholding Structure



Source: Company, Phillip Securities (HK) Research

Peers Comparison

Sector Valuation Comparison

Company	Ticker	Market Cap (HKD mn)	6/1/2017 Price (HKD)	P/E(x)		P/B(x)	
				FY16E	FY17E	FY16E	FY17E
TONGDA GROUP	698 HK Equity	12255	2.12	12.8	10.5	2.6	2.2
JU TENG INTERNATIONAL	3336 HK Equity	2791	2.46	5.3	4.4	0.4	0.4
BYD ELECTRONIC INTL	285 HK Equity	13767	6.11	10.2	8.9	1.2	1.1
EVA HOLDINGS	838 HK Equity	1601	0.86	39.1	11.9	0.6	0.6
HAITIAN INTERNATIONAL	1882 HK Equity	24642	15.44	14.8	13.6	2.7	2.4
TK GROUP HOLDINGS	2283 HK Equity	1802	2.18	8.8	7.6	2.5	2.1
Average				15.2	9.5	1.7	1.4

Source: Bloomberg, Phillip Securities Est.

Among them, EVA Holdings(838 HK) is the most similar company. The following table shows the respective Net Profit Margin, ROA and ROE of the two companies in 2015:

Net Profit Margin, ROA and ROE

	NPM	ROA	ROE
EVA Holdings 838	5.8%	4.0%	8.0%
TK Group 2283	11.6%	15.4%	33.1%

Source: Company Reports, Phillip Securities (HK) Research

We can see that TK Group has stronger profitability. EVA Holdings announced the net profit in 1H2016 was HK\$ 22.998 million with an 80.5% decrease YoY. However, TK Group announced the net profit in 1H2016 was HK\$78.9 million with a 10.8% increase YoY.

Valuation

Buy rating is given with TP of HK\$2.80. TK Group is the largest PRC manufacturer of plastic injection molds with level above MT3 (in terms of export value) in 2015. After the conference call with management, we forecast net profit growth of 9.8/16.1% in FY16/17, driven by 3.0/12.0% revenue growth. Our TP of HK\$2.80 represents 9.8 FY17E P/E, which is higher than the industry average. It also represents 0.55x PEG on an expected 17.8% EPS CAGR during FY16-18, which is lower than industry average. We believe TK Group deserves a higher multiple than 9.5 given its historical steady growth, diversified product structure which can spread the risk caused by slowdown in global economic growth, high dividend payout ratio and scarcity premium.

Risk

The liquidity risk in the trading process;
 The company doesn't maintain long-term purchase contracts with their customers, decrease or termination in the purchase orders by the customers may affect the company's financial results;
 Fluctuations in the price of raw materials.

Financials

FYE	FY13	FY14	FY15	FY16E	FY17E
Valuation Ratios					
P/E	5.4	7.1	9.7	8.8	7.6
P/B	1.3	1.8	2.6	2.5	2.1
Per Share Data(HKD)					
EPS,basic	0.219	0.186	0.226	0.248	0.286
Book Value Per Share	0.949	0.733	0.837	0.877	1.060
Dividend Per Share	0.018	0.070	0.100	0.123	0.150
Growth & Margins(%)					
Growth Rates					
Revenue	9.3%	11.8%	20.0%	3.0%	12.0%
EBIT	-7.4%	7.8%	12.8%	10.7%	18.8%
Net Profit	-10.2%	26.8%	21.5%	9.8%	16.1%
Margins					
Gross profit margin	27.7%	27.3%	26.1%	27.0%	28.0%
Operating profit margin	14.5%	14.0%	13.2%	14.1%	15.0%
Net profit margin	10.1%	11.5%	11.6%	12.4%	12.9%
Key Ratios					
ROE(%)	37.5	34.3	33.1	31.5	31.8
ROA(%)	12.7	14.7	15.4	14.9	16.0
Income Statement(HK\$'000)					
Revenue	1,197,852	1,338,920	1,606,205	1,654,391	1,852,918
Gross profit	331,714	365,416	418,874	446,686	518,817
EBITDA	225,983	239,246	275,665	292,129	351,525
EBIT	173,761	187,307	211,305	233,906	277,785
EBT	169,233	190,452	214,613	241,049	280,410
Net Income	121,348	153,923	187,088	205,374	238,348

Source: Company, Bloomberg, Phillip Securities (HK) Research Estimates
 (Financial figures as at 6 Jan 2017)

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 $\pm 5\%$ 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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