

1H13 results review

Rating	Neutral	Downgrade
Target Price	HKD 2.30	From 2.42
Current price	HKD 2.68	Upside -14%

2H13E magnesium ultrabook casing on track

Ka Shui has reported in-line 1H13 results with 37.6%/69.4% yoy revenue/ net profit growth, mainly driven by magnesium ultrabook casing for Lenovo. In 2H13E, Ka Shui will be the major case suppliers of Lenovo's new flagship product, Helix and New Yoga. And Ka Shui will start to ship to HP and Toshiba. We expect Ka Shui's revenue from magnesium segment will maintain the momentum and deliver 88.6% growth in FY13E.

But plastic protective cases slowing down

It is expected Apple will unveil iPhone 5S, iPhone 5C and iPad 5 at the conference on 10 Sep. Following in iPad Mini's footsteps, iPhone 5C will be a higher-volume product than iPhone 5S. However, iPhone 5C's targeted low-and-mid-end customers will probably not be targeted high-end customers of Otter, to which Ka Shui supplies plastic smartphones and tablets protective cases mainly for Apple's products. We thus expect a moderate growth of 9.0% in plastic segment in FY13E.

Downgrade to NEUTRAL with TP of HK\$2.30

We revise down our FY13/14/15E earnings by 1.8%/5.1%/6.2%, mainly because of the slowdown of plastic injection moulding business growth. The company is trading at 14.2x FY13E PER, which is 16.7% higher than the average 12.2x of peers. Despite its best exposure to Lenovo's market share gain and customer base expansion, we believe valuation premium with the first tier manufacturers will be narrowed. We downgrade the company to NEUTRAL with TP of HK\$2.30 based on 12.2x FY13E PER.

Potential aluminum smartphone casing upside however

Management said Ka Shui is making smartphone casing sample products, which is via aluminum alloy die casting and sent to several handset OEMs. If the company does receive orders, we will see a substantial upside to aluminum alloy die casting business and valuation of Ka Shui, the first manufacturer to provide aluminum casing in die casting method.

HKD mn	FY11A	FY12A	FY13E	FY14E	FY15E
Revenue	1,192	1,569	2,040	2,543	3,033
Net Profit	63	126	167	205	238
Consensus NP			161	223	268
EPS (HKD)	0.07	0.14	0.19	0.23	0.27
P/E (x)	37.8	18.9	14.2	11.6	10.0
Dividend yield (%)	1.9	3.7	4.9	6.0	7.0

Sources: Bloomberg, CIRL estimates

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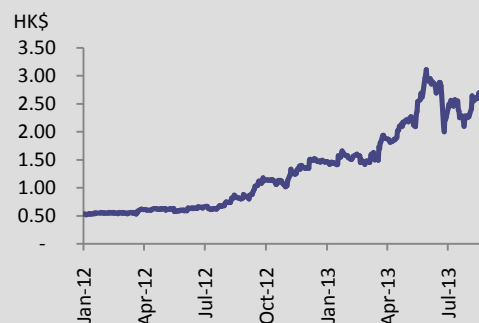
Trading data

52-Week Range (HK\$)	0.80/3.15
3 Mth Avg Daily Vol (m)	2.42
No of Shares (m)	893.45
Market Cap (HK\$m)	2,394.46
Major Shareholders (%)	Lee Yuen Fat (68%) Directors (6%)
Auditors	RSM Nelson Wheeler
Result Due	1H13: Aug

Company description

Established in 1980, Ka Shui is a leading manufacturer engaging in magnesium (for notebook cases), zinc (for household products and consumables), and aluminium (for household products and auto parts) alloy die casting components, and plastic (for smart device protective cases) injection moulding components. The company is currently the 4th magnesium alloy notebook case manufacturer in the Greater China, following Foxconn Technology (2354.TT), Juteng (3336.HK) and Catcher (2474.TT).

Price chart



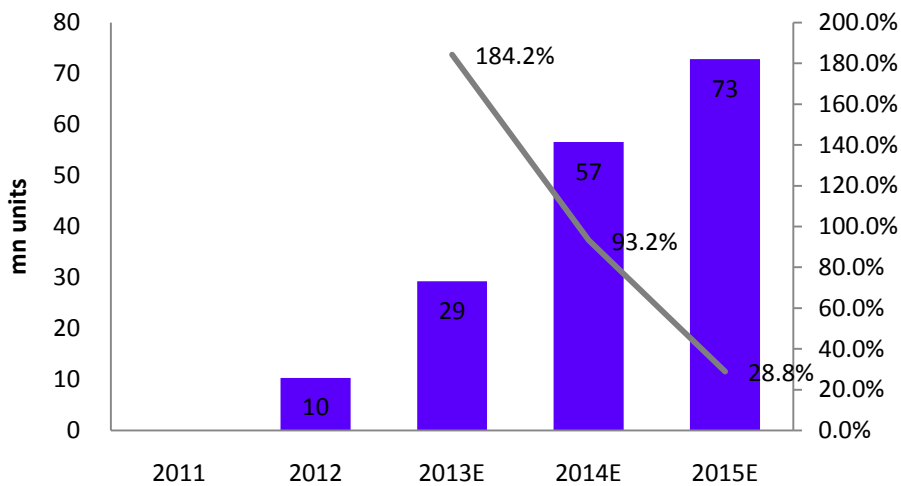
2H13E magnesium ultrabook casing on track

Ka Shui has reported 1H13 results with 37.6% yoy revenue growth (43.2% of our prior full year estimation) and 69.4% yoy net profit growth (41.4% of our prior full year estimation), which is in-line with 40:60 of the normal seasonal sales split. The growth is mainly driven by magnesium ultrabook casing for Lenovo (992.HK).

Ultrabooks continuing to outgrow the market

According to DisplaySearch, touch notebook (mostly ultrabooks) penetration will reach ~15.0% for 2013, but will quickly approach 30.0-40.0% in 2014-2015 in Taiwan Touch Conference. We expect ultrabook shipment will grow at 184.2%, representing 15.0% of total notebooks in 2013 versus 5.1% in 2012, amid sluggish PC sector.

Exhibit 1: Global ultrabook shipment



Source: IDC, CIRL

Exhibit 2: Lenovo's ThinkPad Helix



Source: Lenovo, CIRL

Getting orders from Lenovo's new flagship product

As for Ka Shui's orders on hand, Ka Shui will be the major case suppliers of Lenovo's second-generation multimode product, including Helix and New Yoga in 2H13E. And Ka Shui will start to ship to HP (HPQ.US) and Toshiba (6502.JT), which will be >100k and ~20k per month respectively. Therefore, we expect Ka Shui's revenue from magnesium alloy die casting will maintain the momentum and deliver 88.6% growth in FY13E.

But plastic protective cases slowing down

It is expected Apple will unveil iPhone 5S, iPhone 5C (colorful low-cost iPhone) and iPad 5 at the conference on 10 Sep. Following in iPad Mini's footsteps, iPhone 5C will be a higher-volume product than iPhone 5S.

Exhibit 3: iPhone production mix forecast

mn unit	1Q13	2Q13	3Q13E	4Q13E
iPhone 4	9	7	5	
Phone 4S	2	2	3	2
iPhone 5	24	18	9	1
iPhone 5S			5	22
iPhone 5C			13	32
Total	36	26	35	57

Source: CIRL

Exhibit 4: iPad production mix forecast

mn unit	1Q13	2Q13	3Q13E	4Q13E
iPad 2	2	2	1	
iPad 4	7	6	3	0
iPad 5			4	12
9.7" iPad	8	7	8	12
iPad mini	12	8	6	8
iPad mini 2			0	0
7.85" iPad mini	12	8	6	8
Total	20	15	14	20

Source: CIRL

However, iPhone 5C's targeted low-and-mid-end customers will probably not be targeted high-end customers of Otter, to which Ka Shui supplies plastic smartphones and tablets protective cases mainly for Apple's products (i.e its iPhone 5 cases cost

USD24.95-99.95 and iPad mini cases cost USD69.95). Therefore, we expect a moderate growth of 9.0% in plastic injection moulding business in FY13E, after explosive CAGR of 118.3% in FY09-FY12.

Exhibit 5: Otter's protective cases



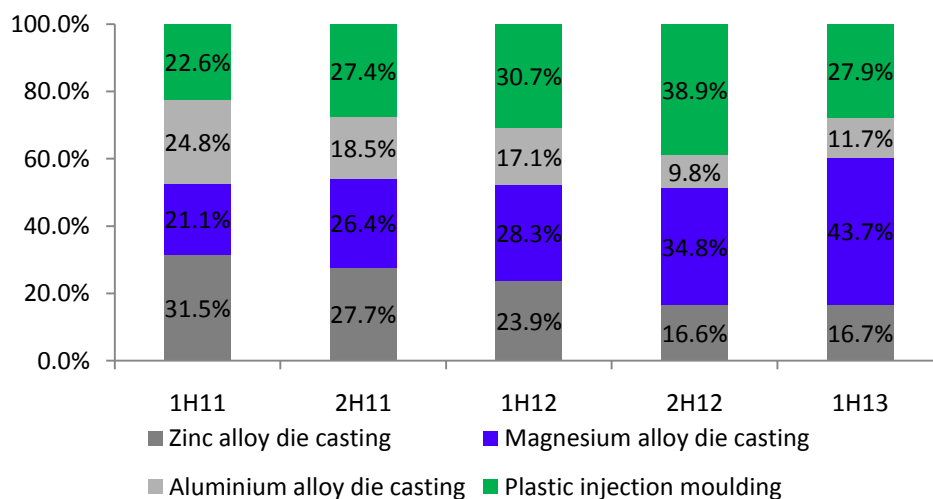
Source: Company data, CIRL

Product mix shift positive to margins

GPM and NPM have risen to 23.7%/7.9% in 1H13 from 21.6%/6.4% in 1H12, thanks to the high-margin magnesium alloy die casting business,

- 1) the proportion of magnesium segment has increased to 43.7% in 1H13 from 28.3% in 1H12;
- 2) the GPM of magnesium segment has increased to 25.9% in 1H13 from 23.6% in 1H12, thanks to economies of scale.

Exhibit 6: Ka Shui's product mix



Source: Company data, CIRL

Exhibit 7: Ka Shui's margin trend

	1H12	2H12	1H13	hoh	yoy
Zinc alloy die casting	18.0%	12.0%	18.1%	6.1%	0.1%
Magnesium alloy die casting	23.6%	27.1%	25.9%	-1.2%	2.3%
Aluminium alloy die casting	20.8%	16.1%	21.9%	5.8%	1.1%
Plastic injection moulding	24.2%	26.8%	25.1%	-1.7%	0.9%
Total	21.6%	23.2%	23.7%	0.5%	2.1%

Source: Company data, CIRL

We expect the GPM in FY13E will be stable or even on the uptrend, on the back of its new products in 2H13E.

Downgrade to NEUTRAL with TP of HK\$2.30

We revise down our FY13/14/15E earnings by 1.8%/5.1%/6.2% to HKD170.4mn/HKD215.7mn/HKD253.4mn, mainly because the slowdown of plastic injection moulding business growth.

Exhibit 8: Revising earnings forecast

HKD mn	FY13E (new)	FY13E (old)	Diff	FY14E (new)	FY14E (old)	Diff	FY15E (new)	FY15E (old)	Diff
Revenue	2,040	2,064	-1.2%	2,543	2,585	-1.6%	3,033	3,054	-0.7%
Operating profit	218	222	-1.9%	269	283	-5.0%	313	333	-5.9%
Net profit	167	170	-1.8%	205	216	-5.1%	238	253	-6.2%
EPS (HKD)	0.19	0.19	-1.8%	0.23	0.24	-5.1%	0.27	0.28	-6.2%

Source: Company data, CIRL

The company is trading at 14.2x FY13E PER, which is 16.7% higher than the average 12.2x of the peers. Despite its best exposure to Lenovo's market share gain and customer base expansion, we believe the valuation premium with the first tier manufacturers will be narrowed. We downgrade the company to NEUTRAL with TP of HK\$2.30 based on 12.2x FY13E PER.

Exhibit 9: Peer comparison

	Ticker	Market cap (HKD mn)	PE (x)			PB (x)			Dividend yield (%)			
			FY12A	FY13E	FY14E	FY12A	FY13E	FY14E	FY12A	FY13E	FY14E	
China metal casing manufacturers												
Dongguan Eonte-A	300328 CH	1	2,231.21	40.1	27.6	19.3	3.0	-	-	0.6	0.0	0.0
Tongda Group Hld	698 HK	1	2,210.78	7.1	6.1	5.2	1.0	0.9	0.8	4.4	4.8	6.2
Average				23.6	16.8	12.2	2.0	0.9	0.8	2.5	2.4	3.1
Global metal casing manufacturers												
Foxconn Technolo	2354 TT	1	25,351.30	11.4	12.1	11.3	1.5	1.3	1.2	1.3	1.3	1.4
Catcher Tech	2474 TT	1	27,871.02	9.8	8.2	9.4	1.7	1.5	1.4	4.2	4.5	4.4
Ju Teng Intl Hdg	3336 HK	1	4,991.70	8.2	6.9	5.4	0.9	0.8	0.7	2.8	3.0	3.6
Average				9.8	9.0	8.7	1.4	1.2	1.1	2.8	2.9	3.2
Ka Shui Intl Hld	822 HK	1	2,394.46	18.9	14.2	11.6	3.4	2.5	1.8	3.7	4.9	6.0

Source: Bloomberg, CIRL

Potential aluminum smartphone casing upside

however

Despite slowing-down plastic protective case business, we see a huge upside potential for aluminum smartphone casing. High-end phones at ASP of >USD400 are facing stiff competition, with moderate CAGR of 13.7% in 2012-2015. It is because of high penetration rate in developed markets and slow innovation curve delaying replacement sales. Using metal casing is one way for smartphone vendors to differentiate their more expensive products.

Exhibit 10: High-end smartphones has started to saturate

Price (USD)	2010	2011	2012	2013E	2014E	2015E	2012-2015 CAGR
<= \$100	7	5	7	21	57	146	175%
\$100 - \$200	74	82	129	221	378	460	53%
\$200 - \$300	74	112	179	213	240	256	13%
\$300 - \$400	49	84	104	122	133	126	7%
\$400 - \$500	43	71	102	138	160	187	22%
\$500+	53	119	195	259	250	249	8%
Total	300	473	716	974	1,218	1,424	26%

Source: CIRL

Exhibit 11: New HTC One's casing



Source: HTC, CIRL

Therefore, we expect to see markedly rising metal adoption for smartphone. Among non-Apple smartphone brands, HTC (2498.TT) is one of the most active one changing from plastic casing to metal casing in 2013, like New HTC One and the upcoming flagship models. Although Samsung (5930.KS) is using plastic for the Galaxy S4, it is

rumored to be using metal for Galaxy S5 and Galaxy Note 4. And even PRC smartphone brands have considered HTC-like designs in 2014.

Management said Ka Shui is making smartphone casing sample products, which is via aluminum alloy die casting and sent to several handset OEMs. The cost of aluminum casing in die casting method, which incurs shorter manufacturing time, is at least 20.0% lower than that of aluminum casing in CNC method. The handset OEMs show their interests, on the back of the more competitive pricing and shorter lead time.

If the company does receive orders, we will see a substantial upside to aluminum alloy die casting business and valuation of Ka Shui, the first manufacturer to provide aluminum casing in die casting method.

Exhibit 12: Financial statement

Income statement						Cash flow					
Year to Dec (HKD mn)	FY11A	FY12A	FY13E	FY14E	FY15E	Year to Dec (HKD mn)	FY11A	FY12A	FY13E	FY14E	FY15E
Revenue	1,192	1,569	2,040	2,543	3,033	Pre-tax profit	82	157	209	255	295
Gross profit (reported)	231	354	489	607	717	Taxes paid	(4)	(11)	(28)	(41)	(50)
EBITDA	145	227	294	361	427	Depreciation	56	63	76	93	114
Depreciation	(58)	(63)	(76)	(93)	(114)	Associates	0	0	0	0	0
EBIT	87	164	218	269	313	CFO bef. WC change	135	210	257	307	359
Net interest income (exp.)	(5)	(7)	(10)	(14)	(18)	Change in working cap	(114)	(108)	(129)	(138)	(133)
Associates	0	0	0	0	0	Cashflow from operation	20	102	128	169	225
Exceptionals/others	0	0	0	0	1	CAPEX	(165)	(172)	(224)	(279)	(333)
Profit before tax	82	157	209	255	296	Free cash flow	(145)	(71)	(96)	(110)	(108)
Tax expenses	(19)	(31)	(41)	(50)	(58)	Dividends	44	88	117	143	166
Minority interest	0	0	0	0	0	Balance sheet adj.	0	0	0	0	0
Net profit	63	126	167	205	238	Share issued	14	(123)	0	0	0
Balance sheet						Others	0	0	29	26	23
Year to Dec (HKD mn)	FY11A	FY12A	FY13E	FY14E	FY15E	Net cash flow	(87)	(105)	50	59	82
Cash & equiv	179	135	259	421	604	Net cash (debt) start	(4)	(90)	(196)	(146)	(86)
Trade receivables	272	486	654	845	1,044	Net cash (debt) at year-end	(90)	(196)	(146)	(86)	(5)
Other receivables	0	0	0	0	0	Ratios					
Inventories	197	254	337	430	527	Year to Dec	FY11A	FY12A	FY13E	FY14E	FY15E
Other current assets	27	59	59	59	59	Growth rate (%)					
Fixed assets	554	663	811	997	1,216	Revenue	30.5	31.7	30.0	24.7	19.3
Intangible assets	0	0	0	0	0	EBITDA	10.3	57.0	29.3	23.0	18.3
Investment, associates etc	0	0	0	0	0	EBIT	14.5	88.6	33.0	23.2	16.6
Total assets	1,230	1,597	2,120	2,753	3,450	Net profit	11.9	100.4	33.0	22.3	16.0
Account payables	154	320	442	589	751	EPS	11.2	99.8	33.0	22.3	16.0
Other payables	0	0	0	0	0	Margins (%)					
Short-term debt	264	330	403	506	607	Gross margin (reported)	19.4	22.5	24.0	23.9	23.6
Other current liabs	63	110	123	132	140	EBITDA	12.1	14.5	14.4	14.2	14.1
Long-term debts	5	1	1	1	1	EBIT	7.3	10.5	10.7	10.6	10.3
Deferred tax and others	19	20	20	20	20	Net margin	5.3	8.0	8.2	8.1	7.8
Other long-term liabs	0	0	0	0	0	Other ratios					
Total liabilities	505	781	990	1,249	1,520	ROE (%)	8.7	15.4	14.8	13.6	12.3
Share capital	89	89	89	89	89	ROA (%)	5.1	7.9	7.9	7.4	6.9
Reserves	636	727	1,040	1,415	1,842	Net gearing (%)	12.5	24.0	12.9	5.7	0.2
Shareholders' equity	724	816	1,129	1,504	1,931	Interest coverage (x)	18.7	24.2	22.8	19.9	17.1
Minorities	0	0	0	0	0	Receivables days	83.4	113.1	117.1	121.3	125.6
Total equity	724	816	1,129	1,504	1,931	Payables days	58.4	96.1	104.1	111.0	118.3
Net cash (debt)	(90)	(196)	(146)	(86)	(5)	Inventory days	74.9	76.2	79.2	81.1	83.0
						Effective tax rate (%)	23.7	19.9	19.7	19.7	19.7

Source: Company data, CIRC

Rating Policy

	Rating	Definition
Stock Rating	Buy	Outperform HSI by 15%
	Neutral	Between -15% ~ 15% of the HSI
	Sell	Underperform HSI by -15%
Sector Rating	Accumulate	Outperform HSI by 10%
	Neutral	Between -10% ~ 10% of the HSI
	Reduce	Underperform HSI by -10%

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Analyst Certification

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