

Hi-P International Ltd

Turning the Tide

SINGAPORE | INDUSTRIAL | INITIATION

Highlights

- Strong turnaround performance in sight as Hi-P stands to benefit from Xiaomi Mi4 sales and positive outlook on global smartphone industry.
- Currently trading at discount to peers' average of EV/EBITDA of 8.6x and P/B of 1.2x.
- **Initiate Buy with target price of \$0.88**, implying over 20% potential upside.

Company Background

Hi-P International is a vertically-integrated turnkey contract manufacturer, serving some of the biggest names in the mobile phones, household & personal care appliances, computing and peripherals, medical devices and industrial devices. Customer base include well-known brand names such as Apple, Motorola, Blackberry, Xiaomi, P&G, Colgate and Braun. The company has over a dozen manufacturing plants primarily in the People's Republic of China, Poland, Singapore and Thailand and is expected to commence production at its new Nantong plant from end of 4Q14.

Components and assembly for major smartphone brands

Hi-P has helped Apple to manufacture components and provides assembly for its iPhones and iPads. It is also one of the two suppliers for Xiaomi Mi4's metal frame. The company also designs and manufacture the YotaPhone 2, a 5-inch dual-screen Android smartphone with sales launched in Russia, UK and the UAE and is expected to hit China and South-East Asian markets in the 1st quarter of 2015.

Catering to the "Metal" trend in smartphones

More smartphones are adopting metal frames and shifting away from plastic encasing. Hi-P has invested in metal technology, equipment and training to cater for rising demand for metal components in smartphones and capture the opportunities.

Opportunities abound from IoT and consumer wearables

Emerging Internet of Things (IoT) trend may also offer potential growth opportunities for Hi-P's wireless SBU, as the industry geared toward smart home initiatives. IDC forecasts the IoT market to grow at 7.9% CAGR from 2013 to 2020. Demand for consumer wearables may also add on to potential opportunities for the company.

Investment Merits

- Strong sales of Xiaomi phones would lead to significant boost to revenue.
- New Nantong plant will improve cost structure and expand production capacity.
- New dual-screen YotaPhone 2 offers potential sales boom.

Risk Factors

- High FX volatility among USD, RMB and SGD may result in significant impact, given its high net transactional currency exposure.
- Business operates in highly competitive and volatile industries.
- Sales heavily reliant on key major customers.

Investment Actions

We opined the stock is undervalued as it trades at 1.0x fwd P/B, below its peers. We recommend a BUY with a target price of S\$0.88, based on a peer's multiple of 1.2x forward P/B, implying over 20% upside potential from current share.

23 January 2015

BUY (INITIATE)

LAST DONE PRICE	SGD 0.720
FORECAST DIV	SGD 0.006
TARGET PRICE	SGD 0.880
TOTAL RETURN	23.1%

COMPANY DATA

O/S SHARES (MN):	87
MARKET CAP (USD mn / SGD mn):	440 / 588
52 - WK HI/LO (SGD):	0.79 / 0.52
3M Average Daily T/O (mn):	0.69

MAJOR SHAREHOLDERS (%)

HSIAO TUNG YAO	60.3%
MOLEX INCORPORATE	21.8%
FIDELITY MANAGEMENT	2.5%

PRICE PERFORMANCE (%)

	1M TH	3M TH	1YR
COMPANY	4.3	14.3	213
STIRETURN	1.2	5.6	10.9

PRICE VS. STI



Source: Bloomberg, P SR

KEY FINANCIALS

SGD M N	FY 12	FY 13	FY 14 e	FY 15e
Revenue	1,167	1,262	1,010	1,259
EBITDA	82	95	81	110
NPAT (adj.)	18	6	8	25
EPS (adj.)	2.12	0.78	1.01	3.01
PER, x (adj.)	32.74	68.66	71.60	23.89
P/BV, x	0.99	0.73	0.99	0.95
DPS (SGD)	1.20	0.60	0.60	2.00
Div Yield, %	1.7%	1.1%	0.8%	2.8%
ROE, %	3.1%	1.1%	1.4%	4.1%

Source: Company Data, P SR est.

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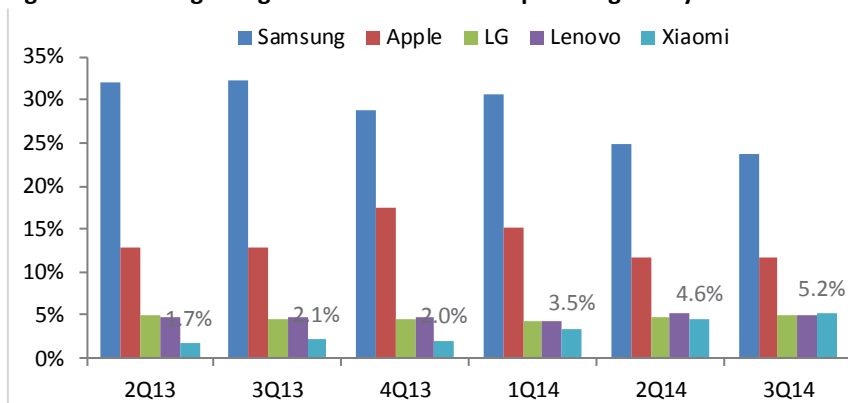
Investment Thesis

Hi-P has seen a continuous price drop due to declining profits over FY11-FY13 period but earnings is expected to turnaround in 2H14, benefiting from the strong smartphone sales outlook and the popularity of Xiaomi Mi4 phone, which Hi-P supplies the components and the phone encasing. The stock has seen a rebound in share price of over 10% over the last six months and we think there is still further upside and it is currently trading below its peers in terms of P/B and EV/EBITD. Hi-P's growth prospects is looking promising with the expected commencement of production at its new Nantong plant and favourable industry wide changes, which we believed to provide a significant boost to its earnings.

Riding on Xiaomi's growth wave

Xiaomi adopted a metal frame for its Mi4 phone, unlike its predecessor models which were built with plastic frames. **Hi-P International is one of the 2 suppliers (the other being Foxconn) engaged to make stainless steel casing for Xiaomi phones.** The success of Mi4 has led to Xiaomi becoming the world's 3rd top selling phone maker after Samsung and Apple.

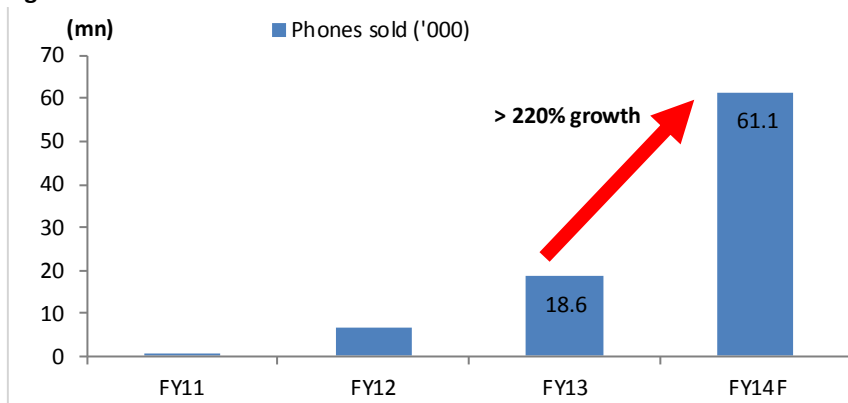
Figure 1: Xiaomi gaining market share in smartphones globally



Source: IDC, Bloomberg

Sales growth in Mi4 phones would further boost Hi-P's revenue as Xiaomi looks to penetrate more markets in Southeast Asia and other emerging markets such as Brazil, Mexico, and other South American countries for global expansion where it sees high demand for low-cost smartphones. It has planned to launch its Mi4 phone in India, the world's 3rd largest market for mobile phones, on 28 January this year. With an expected price tag of about Rs20,000 (cheaper than Samsung Galaxy S4's Rs27,699 and S5's 32,999)¹, Hi-P may see more orders from Xiaomi.

¹ Prices obtained from Flipkart.com, a leading online store selling mobile phone in India.

Figure 2: Xiaomi Phone Sales


Source: IDC, Bloomberg, Web sources

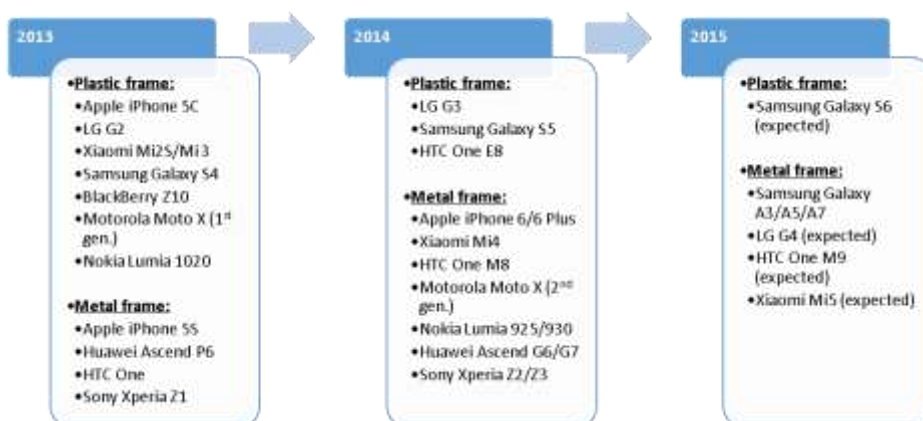
Room for further upside in Xiaomi production yield

Hi-P's production yield for Xiaomi's Mi4 was about 30-40% as of 3Q14 and is targeted to reach 60% by end of FY14. We believe this would **contribute to improving margins as Hi-P improves on the production process.**

Riding on industry-wide design change in smartphones

More non-Apple smartphones were gradually shifting away from plastic to metal frames and components as they sought to **differentiate their premium models against stiffer competition** from cheaper handsets. Samsung and Xiaomi were some of the latest brands to adopt the metal unibody design for their flagship products as metal facilitate thinner smartphone design and offer sturdier support for bigger screens. The **Mi4 phones from Xiaomi serve to showcase the quality of Hi-P's work**, which may **potentially lead to more business opportunities for Hi-P** as the company look to ride on the industry-wide trend through gradual shift to more metal processing for its wireless segment products.

Samsung recently unveiled new Galaxy A series model, its first unibody metal phone design, in contrast to its Galaxy S series.

Figure 3: Plastic vs Metal – Comparison of some popular smartphones


Potential boom from YotaPhone 2

The 2nd generation smartphone from Yota Devices, a Russian company, is a unique concept phone which has dual screens. The main selling point of the phone is its secondary 4.7-inch E-ink display. The YotaPhone promises longer overall battery life (approx. 50 hours) than other smartphones when user utilises its less power-consuming e-ink screen more than its primary OLED display for daily tasks like reading and viewing notifications.

Hi-P provides the design and assembly of the YotaPhone 2. The smartphone is selling in Russia and the UK and is expected to expand into other markets in China and Asia-Pacific this year. **Hi-P would benefit from strong sales of the YotaPhone** through an increase in orders if the phones sell exceedingly well in those markets.

Figure 4: Front and back of the YotaPhone 2



Source: Yotaphone.com

Favourable smartphone outlook benefits Hi-P International

Hi-P also manufactures smartphone components and provides assembly for other smartphones and handsets, which include the Apple iPhones and iPads. The industry outlook is positive as **IDC forecasted a 12.7% CAGR in smartphone shipments worldwide** to reach 1.8 billion units in 2018, over the 2013-2018 period, with **emerging markets expected to account for over 50% of annual smartphone shipments**.

Higher production capacity, cost optimisation with new Nantong plant

The Group revealed during the 3Q14 earnings release that it will commence phase 1A production at its new Nantong plant from end of 4Q14 gradually, which we **estimate it may increase the Group's production space by at least 17%**. The 65,000 sqm plant would help Hi-P to **optimise its cost structure and manufacturing processes through more integrated processes under one campus**.

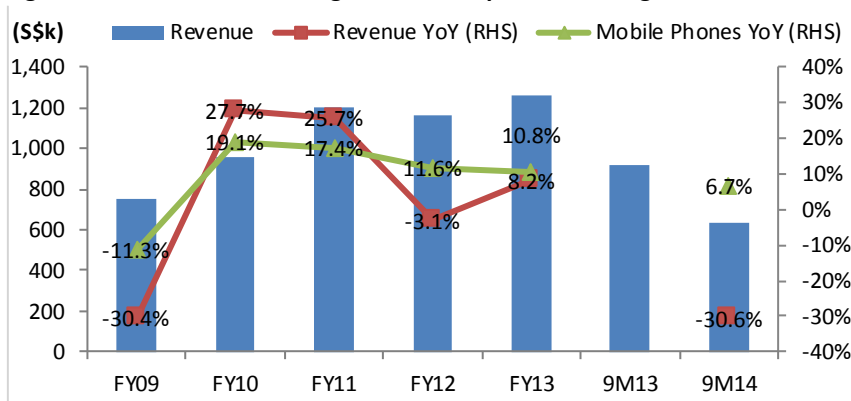
Entire phase 1 development is expected to add an additional 35,000 sqm of built-up area, bringing a total of 100,000 sqm in Nantong Plant.

Financials and Forecast

Revenue drivers and geographical breakdown

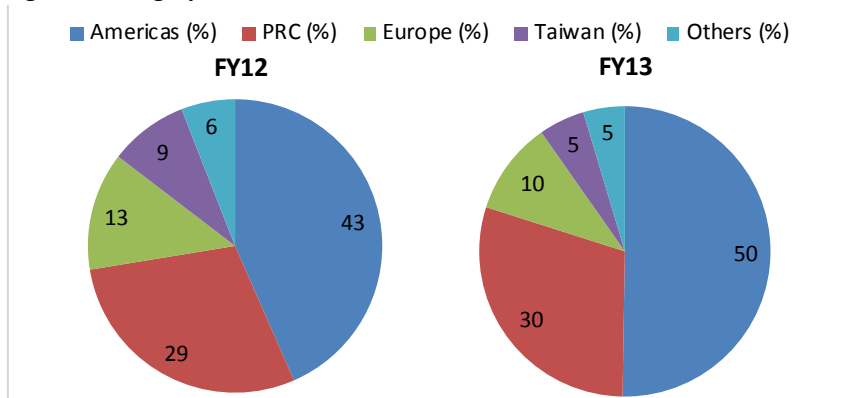
US and China accounted for most of Hi-P's FY13 revenue and the group's wireless strategic business unit (SBU) derives its revenue mainly from the mobile phone industry. Hi-P's wireless SBU accounts for roughly 60% (PSR est.) of its total revenue, while the remaining 40% is accounted for from its consumer electronics SBU. Revenue was down in 9M14 as a result of lower orders from 2 key customers, which were Motorola and Blackberry.

Figure 5: Hi-P's revenue with global mobile phones value growth



Source: Company, IDC, Bloomberg

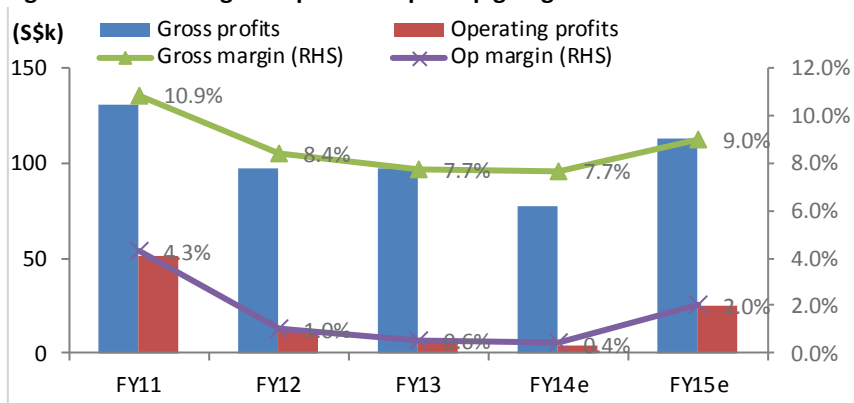
Figure 6: Geographical Breakdown in Revenue



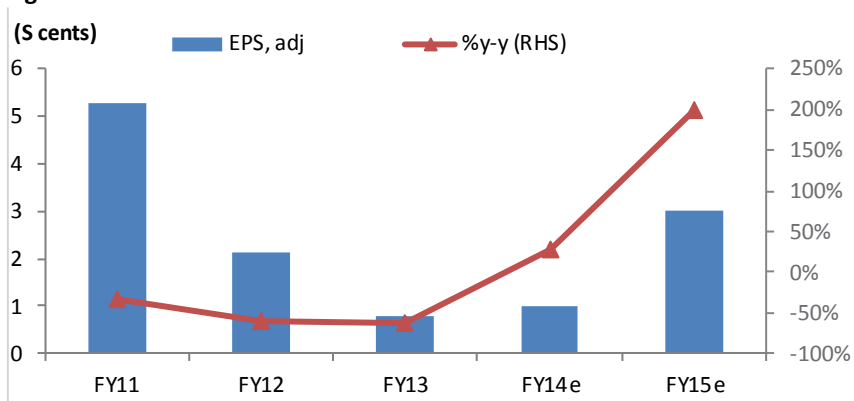
Source: Company

Expect improving margins ahead

Decline in margins in recent financial years was attributed to a change in product mix and increases in component assembly projects, which generally yield lower margins. On positive note, Hi-P also saw gross margins improved to 9.4% in 3Q14m due to positive shift in product mix. We believe improving production yield may have also contributed to better margins. **We think the worst may be over for Hi-P and we expect overall improving margins going forward.**

Figure 7: Profit margins expected to pick up going forward


Source: Company, Phillip Securities Research (Singapore) estimates

Figure 8: EPS forecasts


Source: Company, Phillip Securities Research (Singapore) estimates

Trading at discount to peer's average in terms of P/B and EV/EBITDA

With expected strong turnaround performance in sight, we opined there is still further potential upside to Hi-P's share price as the stock is trading at forward P/B of ~1.0x and forward EV/EBITDA of ~6.6x, below its peers' average of 1.2x and 8.6x respectively.

Figure 9: Peer Comparison

BB Ticker	Company	FYE	Mkt Cap (\$m)	Gross mar (%)		P/E			P/B			EV/EBITDA		
				FY13/14	FY13/14	FY13/14	FY14/15F	FY15/16F	FY13/14	FY14/15F	FY15/16F	FY13/14	FY14/15F	FY15/16F
VMS SP Equity	VENTURE CORP LTD	Dec	2,184	-	5.6	16.1	15.4	13.9	1.2	1.2	1.2	10.7	10.6	9.5
AMTK SP Equity	AMTEK ENGINEER	Jun	322	14.8	4.7	15.3	6.3	5.5	1.6	1.2	1.1	6.2	6.7	6.0
	Average			14.8	5.1	15.7	10.9	9.7	1.4	1.2	1.1	8.4	8.6	7.8
HIP SP Equity	HI-P INTL LTD	Dec	584	7.7	1.8	75.0	71.6	14.3	0.8	1.0	0.8	4.1	6.6	5.1
<i>Smaller peers:</i>														
MFS SP Equity	MFS TECHNOLOGY	Sep	80	16.1	5.1	20.0	N.A.	N.A.	0.8	N.A.	N.A.	3.7	N.A.	N.A.
FUYU SP Equity	FU YU CORP LTD	Dec	79	7.2	-3.0	8.8	N.A.	N.A.	0.4	N.A.	N.A.	1.7	N.A.	N.A.
ACM SP Equity	ACMA LTD	Dec	59	-	1.1	330.0	N.A.	N.A.	1.4	N.A.	N.A.	33.0	N.A.	N.A.
WAE SP Equity	WILLAS-ARRAY ELE	Mar	57	10.3	1.5	12.7	N.A.	N.A.	0.7	N.A.	N.A.	11.9	N.A.	N.A.
CHOS SP Equity	CHOSEN HOLDINGS	Jun	40	7.3	4.1	11.9	N.A.	N.A.	0.6	N.A.	N.A.	2.8	N.A.	N.A.
JLJ SP Equity	JUBILIEE INDUSTR	Dec	17	-0.2	-15.0	-	N.A.	N.A.	1.0	N.A.	N.A.	843.2	N.A.	N.A.

Source: Bloomberg, Phillip Securities Research (Singapore) estimates

Financials

Income Statement

Y/E Dec SGD mn	FY11	FY12	FY13	FY14e	FY15e
Revenue	1,204	1,167	1,262	1,010	1,259
Cost of sales	(1,073)	(1,069)	(1,165)	(932)	(1,146)
Gross profit	131	98	98	78	113
EBITDA	111	82	95	81	110
Depreciation & Amortisation	(59)	(70)	(88)	(77)	(85)
EBIT	52	12	7	4	25
Net Finance (Expense)/Inc	3	3	1	0	1
Share of assoc's, JVs profit	0	0	(0)	0	0
Others	4	7	3	6	5
PBT	59	23	11	10	31
Tax	(14)	(5)	(5)	(2)	(7)
PAT	45	18	6	8	25
Minority interest	0	(0)	(0)	0	(0)
Net Income, reported	45	18	6	8	25
Net Income, adj.	45	18	6	8	25

Per share data (SG cents)

Y/E Dec (SG cents)	FY11	FY12	FY13	FY14e	FY15e
EPS, reported	5.28	2.12	0.78	1.01	3.01
EPS, adj.	5.28	2.12	0.78	1.01	3.01
DPS	2.40	1.20	0.60	0.60	2.00
BVPS	72.21	70.10	73.09	73.10	75.51

Cash Flows

Y/E Dec SGD mn	FY11	FY12	FY13	FY14e	FY15e
CFO					
PBT	59	23	11	10	31
Adjustments	66	80	116	80	84
WC changes	(1)	(113)	(38)	68	(30)
Cash generated from ops	124	(11)	90	159	85
Taxes paid, others	(23)	(2)	(8)	(12)	(7)
Cashflow from ops	102	(13)	82	147	78
CFI					
CAPEX, net	(66)	(151)	(66)	(115)	(99)
Others	9	8	(2)	(1)	3
Cashflow from investing	(56)	(143)	(68)	(116)	(97)
CFF					
Share issuance	0	0	0	0	0
Loans, net of repayments	116	31	(44)	5	0
Dividends	(30)	(20)	(10)	(5)	(5)
Others	(12)	60	(4)	3	(2)
Cashflow from financing	74	71	(58)	3	(7)
Net change in cash	119	(85)	(44)	33	(25)
Effects of exchange rates	5	(12)	9	0	0
CCE, end	264	167	132	165	140

Source: Company, Phillip Securities Research (Singapore) Estimates

*Forward multiples and yields are based on current market price; historical multiples and yields are based on historical market price.

Balance Sheet

Y/E Dec SGD mn	FY11	FY12	FY13	FY14e	FY15e
ASSETS					
PPE	284	364	346	387	404
Intangibles	0	0	6	4	1
Associates & JVs	2	2	2	2	2
Others	14	14	34	38	38
Total non-current assets	301	380	388	431	445
Inventories	125	146	163	153	166
Accounts Receivables	293	328	323	263	328
Cash & equivalents	264	166	132	165	140
Others	93	31	21	15	14
Total current assets	775	671	639	596	648
Total Assets	1,076	1,051	1,026	1,027	1,094
LIABILITIES					
Short term loans	117	142	102	107	107
Accounts Payables	311	278	239	241	288
Others	47	48	83	77	77
Total current liabilities	475	468	424	426	473
Long term loans	3	2	2	1	1
Others	477	469	426	427	474
Total non-current liabilities	479	471	427	428	476
EQUITY					
Non-controlling interest	1	1	1	1	1
Common Equity	596	579	598	597	617

Valuation Ratios

Y/E Dec	FY11	FY12	FY13	FY14e	FY15e
P/E (X), adj.	17.3	32.7	68.7	71.6	23.9
P/B (X)	1.3	1.0	0.7	1.0	1.0
EV/EBITDA (X)	5.9	6.8	4.3	6.6	5.1
Dividend Yield (%)	2.6%	1.7%	1.1%	0.8%	2.8%

Growth & Margins (%)

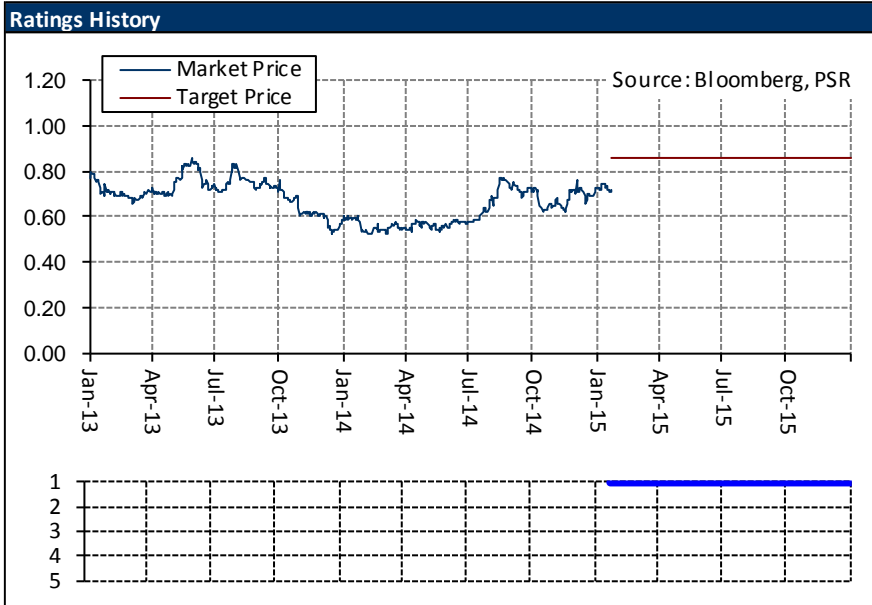
Growth					
Revenue	25.7%	-3.1%	8.2%	-20.0%	24.7%
EBITDA	-26.6%	-26.4%	16.0%	-14.8%	36.2%
EBIT	-51.1%	-76.7%	-40.7%	-43.4%	523.5%
Net Income, adj.	-33.1%	-60.1%	-64.4%	28.5%	199.5%

Margins

EBITDA margin	9.2%	7.0%	7.5%	8.0%	8.7%
EBIT margin	4.3%	1.0%	0.6%	0.4%	2.0%
Net Profit Margin	3.7%	1.5%	0.5%	0.8%	2.0%

Key Ratios

ROE (%)	7.7%	3.1%	1.1%	1.4%	4.1%
ROA (%)	4.7%	1.7%	0.6%	0.8%	2.3%
Interest Coverage (X)	n.m.	n.m.	n.m.	n.m.	n.m.
Net Gearing (X)	Net cash	Net cash	Net cash	Net cash	Net cash



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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