

19 May 2014

Valuetronics Holding Ltd.

Too much Value to ignore. PE ex cash of 4.0x.



SG | MANUFACTURING | ELECTRONICS

Rating: **Trading Buy**

Initiate with Trading Buy

Target Price (SGD)	0.430
Forecast Dividend (SGD)	0.018
Closing Price (SGD)	0.335
Potential Upside	28.4%

Company Background

- Valuetronics provides OEM and ODM services via 2 business segments of Consumer Electronics Products ("CE"), and Industrial and Commercial Electronics Products ("ICE"). They have more than 20 years of operations with revenues crossing HK\$2 Billion since 2012.
- Established in 1992, Valuetronics has maintained relevance by growing from an integrated EMS provider, towards a premier design and manufacturing partner for the world's leading brands in the consumer, industrial and commercial electronics sectors. This relevance manifests itself in ~27% and 18% revenue CAGR in both CE and ICE ending FY13.
- They have grown their product offering from OEM (GSM Wireless Telephone, Cold Chain Temperature Monitor, Thermal Label Printer) and ODM (Baby Monitor, Alcohol Tester, Digitally Controlled Home Appliances) in 2007, to include LED energy saving luminaries and shavers (CE) and transaction printers, GPS, medical equipment and access card readers for (ICE) in 2013.
- CE segment makes up ~70% all revenues and has a segment profit margin of ~10%. ICE segment is at present ~30% all revenues and growing, with a higher margin of ~17%.
- At present, LED lamps make up ~40% of all revenues, with PCBAs for shavers and electric toothbrushes ~20% of all revenue.

Opportunities

- CE segment provides an earnings base, albeit with cycle volatility**, as the whole lamp market will pick up with 1) global recovery (single digit growth); as well as 2) the burgeoning LED lamps revolution product cycle itself. The LED lamp cycle continues to take up market share within the slowly growing lighting market with accelerated sales growth as they continue to render incandescent lamps obsolete – implying a conservative double digit sales growth rate as prices decrease attracting mainstream take up. It is estimated the global monetary value of the LED retrofit market was EUR 190m in 2011 and will grow to EUR 905m by 2016.
- Their efforts to grow their higher margin ICE segment has been encouraging**, as evidenced by 2 key ICE customers closing their production in US and China respectively, and transferring all their production to Valuetronic's facility.

Investment Merits

1. Trading at attractive values with net cash accounting for 53% of market cap, a conservatively estimated idle cash of 26% of market cap.

- PE of 5.5x, PE ex idle cash of 4.0x.
- Earnings growth is likely to be single digit.

2. Shows ability to maintain revenue and bottom line growth in their continuing operations ex loss making licensing business segment

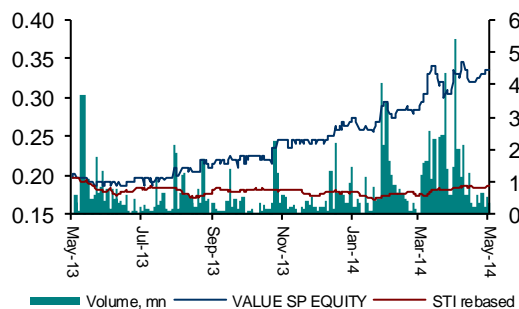
- If we ignore the loss-making licensing business that they have fully written off and discontinued, their CE and ICE have increased at 27% and 18% revenue CAGR respectively. Continuing 3-yr net profit CAGR is 26% from FY10 to FY13.
- They have managed to mitigate the increasing costs of wages in their China operations with cost cutting and automation projects

Company Description

Valuetronics Holding Limited provides integrated electronics manufacturing services through its Consumer Electronics (CE), and Industrial & Commercial Electronics segments that include design, engineering, manufacturing, and supply chain support services for electronic and electro-mechanical products. The company serves multinational and mid-sized companies in the consumer industrial, telecommunications, and medical equipment industries in the US, Europe and Asia Pacific.

Company Data

Raw Beta (Past 2yrs weekly data)	0.42
Market Cap. (SSD mn / HKD mn)	122 / 755
Ent. Value (SGD mn / HKD mn)	56 / 353
3M Average Daily T/O (mn)	1.0
Closing Px in 52 week range	0.19 - 0.35



Major Shareholders

	(%)
1. Chong Hing Tse	18.6
2. Kok Kit Chow	17.4
3. Pyn Rahastoyhti o	5.9

Valuation Method

PE

Analyst

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3. LED lighting for general lighting burgeoning at a value sweet spot - mid expansion phase amidst falling prices.

LED light manufacturing for a prominent multinational accounts for 40% of their revenues. The LED general lighting market is estimated to be EUR 64B by 2020 (EUR 9B in 2011) – with ~ 45% sales CAGR but a -15% price CAGR to 2016 for LED retrofit lamps. As price drops, LED lights will be penetrating into mainstream causing increasing sales and by 2020 will render the older incandescence bulbs obsolete. 2013 to 2016 is considered the sweet spot in terms of value of the LED lighting market for manufacturers.

Perceived Risks

- **Their revenues are sensitive to fluctuation in macro-economic conditions.** Any significant turn down in the general economy will likely negatively impact top and bottom lines. They also face uncertainty in demand.
- **Client Concentration risk: a major client makes up ~60% of revenues.** Although this client is one of the top MNCs for consumer manufacturing, this may limit their pricing power and increases the volatility of their earnings.
- **Product Concentration risk:** at present, LED lamp assembly make up ~40% of revenue.
- **Margins may be impacted due to the potential changing labour conditions and wage increases in China** unless they can execute their plans to increase efficiency through process improvement.
- **The eventual fall in LED lamp market** demand may occur faster than expected or price erosion occurs faster than expected, if Valuetronics cannot offset this with new product offerings, the top line will be negatively impacted.
- **There is uncertainty in their year to year demand forecast due to lack of order book, although this is common to the EMS industry.**

Investment Action

We believe it is more than fair that Valuetronics should at least trade at the peer average PE of 7.8x given that Valuetronics has, operated on good net margins of >5% vs the typical 3%, have never turned in a loss making year even from before IPO, and has done so without leverage (having a net cash ratio to market cap of ~50%).

Assuming FY14 net earnings of \$139M HKD, this implies a FY14PE of 5.5x at present. Valuing Valuetronics at 7.8x implies a value of SGD \$0.48. Adding SGD \$0.09 per share of idle cash gives us \$0.57. This is conservative considering we are only taking half the net cash into our value consideration, and the global GDP recovery and favorable LED lighting cycle should provide a tailwind buffer.

Finally, to conservatively account for any unaccounted unsystematic risks, we apply a 25% discount and we arrive at our **final fair value of \$0.43 SGD**. Or, a total 28% upside (inclusive of any dividend) from today's price of SGD \$0.335.

Please note FYE is March.

Key Financial Summary (FY14)

FYE Dec	FY11	FY12	FY13	FY14F
Revenue (HKD '000)	1,970,421	2,378,625	2,242,888	2,329,657
NPAT, cont. (HKD '000)	141,100	160,281	118,435	137,630
EPS. (HK cents)	34.20	36.50	21.90	38.29
P/E (X),adj.	6.0	5.3	8.7	5.5
P/B (X)	1.31	0.99	0.77	1.16
DPS (HK cents)	14.0	17.0	8.0	11.5
Div. Yield (%)	8.0%	10.8%	6.3%	5.5%

Source: Bloomberg, PSR est.

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

Key Financial Summary (9M14)

FYE Dec	FY11	FY12	FY13	9M14
Revenue (HKD '000)	1,970,000	2,379,000	2,243,000	1,820,000
NPAT, cont. (HKD '000)	141,100	160,281	118,435	126,482
EPS. (HK cents)	34.20	36.50	21.90	29.90
P/E (X), T12M	6.0	5.3	8.7	5.6
P/B (X)	1.31	0.99	0.77	1.12
DPS (HK cents)	14.00	17.00	8.00	8.03
Div. Yield (%)	8.0%	10.8%	6.3%	3.8%
Cash (HK'000)	221,579	396,245	288,732	402,395

Source: Bloomberg, PSR est.

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

Business Overview

Established in 1992 and headquartered in Hong Kong, Valuetronics has grown through the years to become more than an integrated EMS provider with principal business segments ranging from Consumer Electronics Products (“CE”) to Industrial and Commercial Electronics Products (“ICE”). Today, they pride themselves as a premier design, manufacturing partner for the world’s leading brands in the consumer, industrial and commercial electronics sectors, which span across a wide geographical region that covers America, Europe and Asia Pacific.

1992	2002	2003	2005	2007
Headquartered in Hong Kong with manufacturing facilities in Danshui Town, PRC	Use of ROHS equipment and accredited with TL9000	Adopted work cell management & updated to ISO9001:2000	Became Philips preferred supplier	Listed on SGX-Mainboard & Commenced construction for Daya Bay Facility
				
2008	2009	2010	2011	2012
Completed Phase 1 construction of Daya Bay Facility	Opened Daya Bay Facility Acquired medical business	Signed first Licensing agreement	Signed second Licensing agreement	Celebrated 20 th anniversary with revenue crossing HK\$2 Billion
				

Key Milestones

Source: Company presentation

Their primary manufacturing plant in Daya Bay facility sports a total site area of more than 110,000 m² in which location B3 is still available for further expansion.



Bird's-eye View – Daya Bay Facility

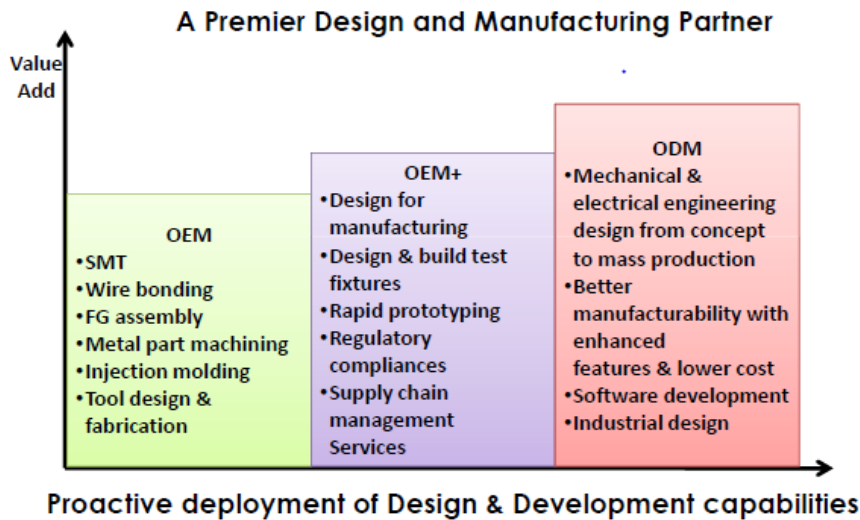
Source: Company presentation

Business Model

Within their CE and ICE segments, Valuetronics utilizes a mixture of OEM (Original Equipment Manufacturing) to ODM (Original Design Manufacturing) to support their clients. Going forward, Valuetronics is concentrating their resources in more value added services, especially within the ICE, where segment margins can be almost double of CE. (2013: 10% (CE) vs: 17% (ICE))



Our Business Model



6

Business Model

Source: Company presentation

Relevance and evolution of service over the years. Established in 1992, Valuetronics has kept themselves relevant by growing from an integrated EMS provider, towards a premier design and manufacturing partner for the world's leading brands in the consumer, industrial and commercial electronics sectors. This relevance manifests itself in 27 % and 18% CAGR growth in both CE and ICE. Within this timeframe, they have grown their product offering from OEM (GSM Wireless Telephone, Cold Chain Temperature Monitor, Thermal Label Printer) and ODM (Baby Monitor, Alcohol Testor, Digitally Controlled Home Appliances) in 2007, to include LED energy saving luminaries and shavers (CE) in 2013.

Design and Development / ODM

Valuetronics differentiates themselves from the competition through engineering design capabilities that cover the expertise required to develop or co-develop turnkey products whether they are simple consumer products or complex industrial or wireless products.

Sporting a team of engineers of various expertise, since 1998, Valuetronics has been involved in the developmental process of a wide variety of products across many segments such as: Residential Caller ID telephone products, Residential Cordless telephones, GSM Fixed Wireless phones, Wireless analog and digital audio baby monitors, Digitally controlled home appliance, thermostats systems, alcohol breath analyzer, thermal label printers, industrial grade air purifiers and gas level monitors.

Valuetronics design and developmental capabilities include:

- Mechanical Design
- Plastic Tool Design
- Electronics, RF and Software Designs
- Regulatory Compliance Engineering & Testing
- Product Test Development

Manufacturing

Valuetronics manufacturing capabilities enables ability to accommodate customers' requirements for volume, mix and complexity. They excel in a variety of volume requirements from low-volume complex custom products to high-volume standards products.

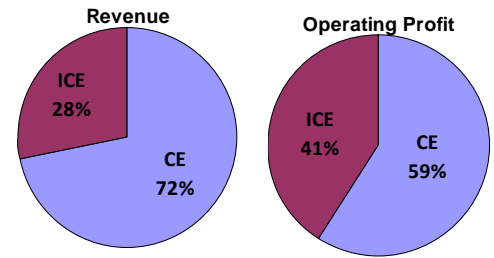
Manufacturing capabilities include:

- Plastic Tool Fabrication and Injection Molding
- Metal Stamping and Machining
- Printed Circuit Board Assemblies, including complex multi layer boards
- Sub-Assemblies and Full Product Assemblies (Box Build) across a wide variety of segments
- Reliability Engineering and Testing
- Quality Systems
- Materials Procurement
- On-site Program Management



Production of Thermal Label Printers

Source: Company



Source: Company, PSR

Reclassification of OEM, ODM and discontinuing of Licensing

Previously, the Group classified its business into three segments – Original Equipment Manufacturing (OEM), Original Design Manufacturing (ODM), and Licensing products (Licensing). Due to the high involvement in the designing and manufacturing engineering process of their OEM customers, the differentiation between their services provided to their OEM and ODM customers is blurring and may not reflect the actual performance of each business segment. With effect from 1 April 2012, their business segments have been reclassified according to the nature and characteristics of the market where the product is sold, namely CE and ICE.

The loss making licensing segment has been discontinued, and has been completely written off since 4Q13 or end Mar 2013. No doubt, the continued losses accounted for since Jun 2011 all the way to end Mar 2013 had put a negative sentiment on share price. There is no surprise that net profits had also recovered significantly following Mar 2013. Hence, all earnings are now solely on the continued earnings of CE and ICE.

Operating Segment: Consumer Electronics

Concentrated (40% sales) on LED lighting in portfolio

Today's present product mix includes energy saving LED lamps, shavers, baby monitors and bug zappers. Where the LED lamps and PCBAs (Printed Circuit Board Assembly for shavers, trimmers and electronic toothbrushes) make up majority of CE revenue and ~60% of all revenue (LED ~40%). At the moment, management is diverting efforts into growing the higher margin ICE segment; therefore, earnings for CE will be dependant on LED general lighting sales.

Both LED lamps and PCBAs for shavers and electronic toothbrushes are manufactured for a top 5 MNC global consumer electronics manufacturer. LED vendors right now are riding a sweet spot as LED lights are increasing their market penetration in the lightings market and are considered the "next generation" of lighting. The LED general lighting market is estimated to be EUR 64B by 2020 (EUR 9B in 2011) – with ~ 45% sales CAGR but a -15% *price* CAGR to 2016 for LED retrofit lamps. The LED retrofit market value, which is a subset of general lighting and includes various LED replacement bulbs, is estimated to be EUR 690m in 2020 (EUR 190m in 2011) – with ~40% sales CAGR but -12% average unit price CAGR.

LED lamp profitability is driven up:

1. Increasing size of the LED lighting market due to mid-cycle of adoption of technology to totally replace the incandescence lamps by 2020.
2. Cyclical nature of new lighting installation with the business cycle.

LED retrofit market		2012-2016				
forecast		2011	2012	2016	2020	CAGR
Number of light Sources	m pcs	29	73	290	254	41.2%
ASP per light source	EUR/unit	6.58	5.11	3.12	2.70	-11.6%
Monetary Value of market	m EUR	190.82	373.03	904.8	685.8	24.8%

LED retrofit market forecast

Source: McKinsey's 2012 Global Lighting Market Model, PSR

Electronic shavers lean more towards being a staple although you could make the argument the more expensive ones are discretionary in nature. Their profitability is likely correlated to consumer spending and GDP which is estimated to grow by an average of 3.4% CAGR till 2016 in real terms. Refer to the next section for LED industry outlook.

Valuetronics are focusing their efforts to develop the higher margin ICE segment; hence, until they develop newer products for CE, **CE's profitability will mainly be affected by the secular growth rates associated with its current position in the underlying product cycle for LED's invasion of the lighting industry; and, macro-economic conditions for LEDs and shavers.**

LED lighting market analysis

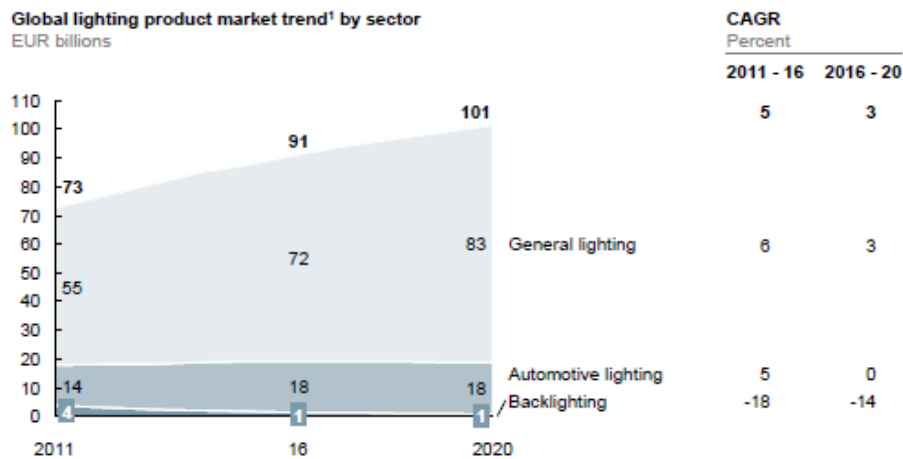
LED lighting for general lighting burgeoning at a value sweet spot – early stages of expansion phase into mainstream market.

Light emitting diodes (LEDs) will become the default option for most lighting applications. They are longer lasting, more efficient and more flexible than the traditional incandescent and fluorescent lights they are trying to replace. A typical LED lamp will use 90% less energy than an incandescent and 50% less than a fluorescent. The value of the market for high brightness LEDs used in general lighting will likely peak in 2017 before dropping away as the cost of technology falls sharply. IMS Research opines that the “best years” for LED vendors selling into the general lighting market would be 2013-2017.

According to a report by McKinsey (2012), LED general lighting is potentially a EUR 60B industry with an expected 45% sales CAGR to 2016 and a 15% CAGR to 2020. This will occur as the average price per LED lighting becomes cheaper due to supply and scale. ASP (average selling price) for LED per light source retrofit in general lighting was EUR 5.11 in 2012.

The global general lighting market (all types of lights) is going to increase at a 5% CAGR from 2011 (EUR 55B) till 2016, with a slower growth rate to 3% to 2020 to ~EUR 83B. We think this is reasonable considering our world GDP estimation of 3.4% annual real growth rate.

The global lighting market is growing steadily, and is expected to exceed a market size of EUR 100 billion in 2020



Global lighting product market trend by sector

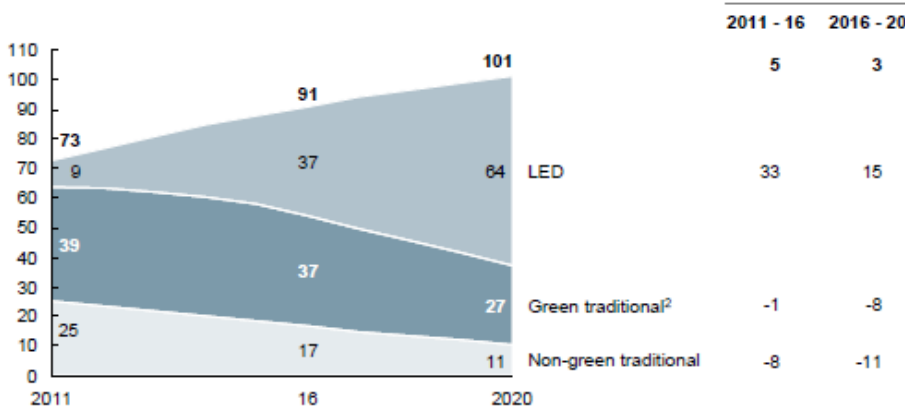
Source: McKinsey’s 2012 Global Lighting Market Model

¹ Note: Total general lighting market (new fixture installation market incl. full value chain, Incl. lighting system control components and light source replacement market,) automotive lighting (new fixture installations and light source replacement), and backlighting (light source only: CCFL and LED package)

At the same time, LED lights are increasing their market share within the expanding lighting market. The compounded effect on market value of LED lighting based on growth within growth is estimated to be a revenue CAGR of 33% till 2016, followed by a slow down to 15% to 2020. The LED lighting market size overall is anticipated to be around EUR 37 billion in 2016 and EUR 64 billion in 2020. Or, almost 45% in 2016 and almost 70% in 2020.

Currently, traditional energy-efficient technologies are the mainstream, but LED is forecast to take the lead position in around 5 years

Global lighting product market trends¹ for energy-efficient products
EUR billions



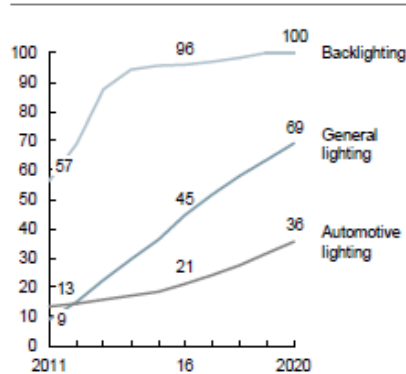
Global lighting product market trends for energy-efficient products

Source: McKinsey's 2012 Global Lighting Market Model

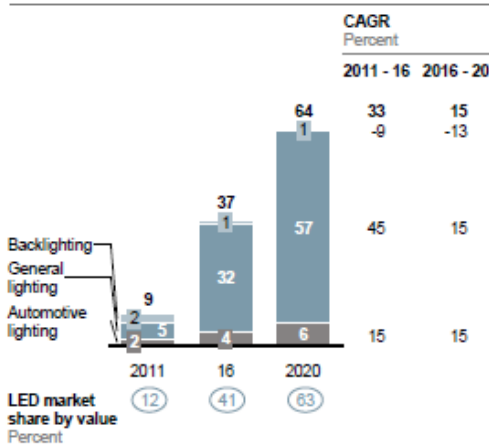
Within this expanding LED lighting segment, general lighting is also expanding the fastest. Valuetronic's LED lamps fall as a subsection of the general lighting segment.

LED lighting market is expected to increase very rapidly in the coming 10 years

LED value-based market share by sector¹
Percent



LED lighting market by sector¹
EUR billions



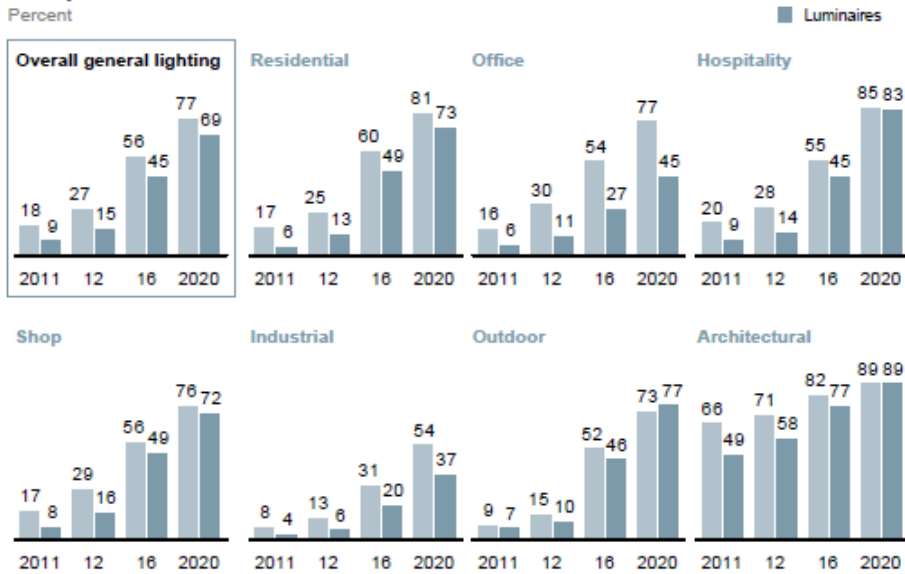
¹ Total general lighting market (new fixture installations incl. full value chain, incl. lighting system control components and light source replacements), automotive lighting (new fixture installations and light source replacement), and backlighting (light source only: CCFL and LED package)
NOTE: Numbers may not add up due to rounding

LED lighting market

Source: McKinsey's 2012 Global Lighting Market Model

McKinsey's 2012 Global Lighting Market Model calculates the light sources share in general lighting at 56% in 2016 and almost 77% in 2020 as LED lighting penetrates the mainstream. General lighting will grow at 45% CAGR till 2016, and then hit an inflexion point (slower rates) to 15% till 2020. According to the US Department of Energy (April 2012), in some countries, the price of LED lamps is expected to become competitive with CFLs (compact fluorescent lamps) as soon as 2015, which will immediately speed up the transition from CFLs to LEDs. Moreover, accentuated regulation roadmaps to phase out inefficient light bulbs (particularly in China and Europe) increase this acceleration.

LED penetration forecast – value basis



LED penetration forecast – value basis

Source: McKinsey's 2012 Global Lighting Market Model

Finally, within the LED general lighting segment, the estimation of the LED retrofit lamp market is below.

LED retrofit market forecast					2012-2016	
		2011	2012	2016	2020	CAGR
Number of light Sources	m pcs	29	73	290	254	41.2%
ASP per light source	EUR/unit	6.58	5.11	3.12	2.70	-11.6%
Monetary Value of market	m EUR	190.82	373.03	904.8	685.8	24.8%

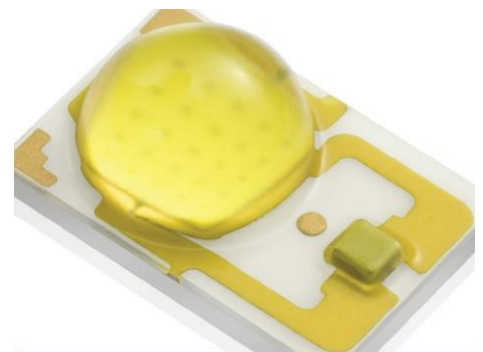
LED retrofit market forecast

Source: McKinsey's 2012 Global Lighting Market Model, PSR

Bottom line, these next few years (likely till 2016), barring unexpected turn in the business cycle or macro risks, is a sweet spot for the LED market in terms of monetary value.

Additional note: Falling Costs of LED packages (raw material) offsets margin compression

While LED retrofit lamp prices are dropping at an estimated double digit rate (~12%), LED packages, one of the largest cost component of LED lamps and luminaires, are the building block of most LED products, is also falling concordantly by 13-14% a year. This helps to offset the margin compression based on the LED lamp product cycle.



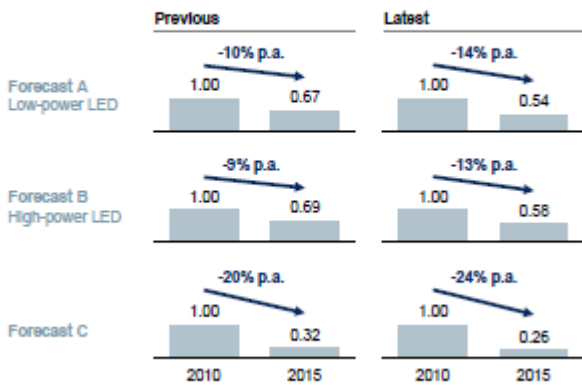
An LED package, the building block of most LED products.
Image credit: Philips Lumileds

Example of an LED package

Source: Phillips Lumileds

Forecasts for the reduction in LED package price have accelerated since McKinsey's 2011 lighting report

LED package price forecast comparison based on third-party research¹
2010, indexed



¹ General lighting sector. Calculated by both value-based and unit-based market size

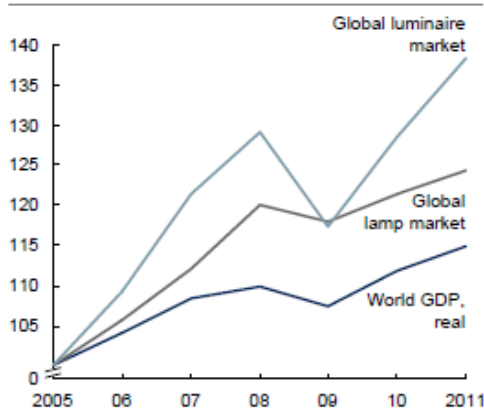
LED package price forecast

Source: McKinsey analysis, Strategies Unlimited (Sept 2011), Strategies Unlimited (June 2010), IMS (April 2012), IMS (June 2011)

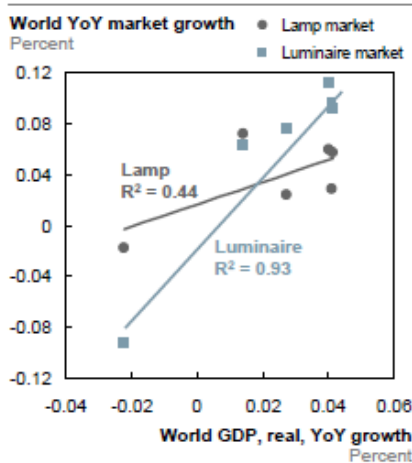
LED lighting sales are sensitive to macroeconomic conditions and business cycle.

According to the McKinsey (2011) report, the market for luminaire and lighting systems is predominantly driven by new installations. New installations are linked to construction activity, and there is a clear correlation with GDP. Real GDP growth is estimated to be +3.4% annually from 2014-2016.

World real GDP vs. global lamp and luminaire markets
2005, indexed; based on GDP real basis (2005, USD billions) and market data (2010, USD billions)



World real GDP vs. world global lamp and luminaire markets: YoY growth rates



World GDP vs world global lamp and luminaire market

Source: McKinsey 2012

Replacement market eroded by the success of LED

The replacement market is a relatively small percentage of the total market – currently worth EUR 8B out of EUR 57B. This is estimated to fall to EUR 7B in 2020. This makes it important for Valuetronics to ride this wave of LED market penetration while developing other product offerings to clients.

Conclusions for CE

Valuetronics' CE products will have nice tailwinds due to LED's lighting's current position in its product life cycle, as well as mildly improving GDP and consumer spending in the broader world economy. However, this sweet spot for LED lightings will hit an inflexion point by 2016-2017. Valuetronics must be able to develop new products for the CE / ICE segment until then or suffer from decreasing profitability. At present, both world GDP and LED lighting product cycle are favourable for the CE segment. If both estimations go without a hitch, top line can grow as much as 20%. **However, to be conservative, to account for an unexpected turn in the business cycle and concentration risk, we will ascribe a simple longer term growth rate of *only* 1% to account for the possibility of a mean reversion to normalized earnings since we are already 5 years into the global recovery.**

Operating Segment: Industrial and Commercial Electronics

Diversified portfolio

Today's present product mix includes:

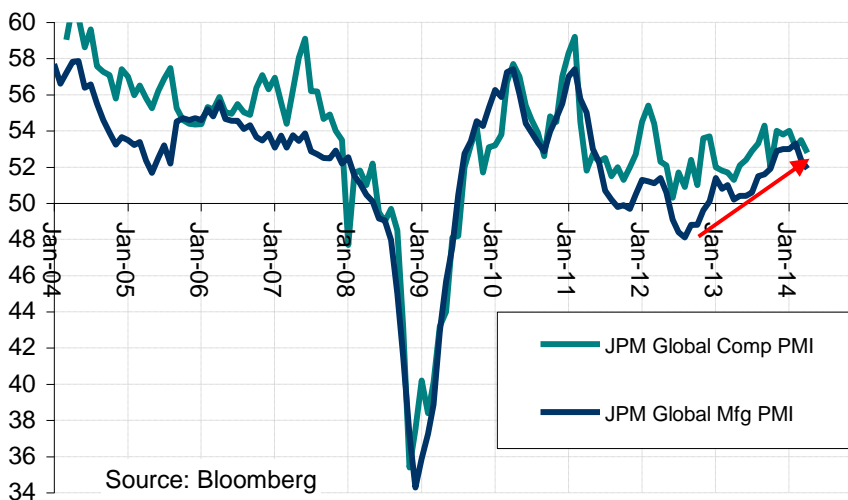
- Slot, POS & Teller Station Machines
- Thermal Label Printer for ICE use
- Access Card Readers
- In-vitro Diagnostic Medical Equipment for Testing Human Tissue Samples
- High Precision GPS for Industrial use
- Cold Chain Temperature Monitor for ICE use

Looking for growth in a higher margin segment

During the year, their well-balanced mix of ICE customers continued to flourish as revenues increased for 4 quarters in a row (~20% top-line 12-trailing month growth).

Valuetronic's modus operandi is to hunt for small-to-mid-sized companies with revenues typically under 500M USD who are leaders in their segment and have grown to a stage whereby they are thinking about outsourcing their manufacturing and typically have small design and development teams. Using their team of engineers, they provide not only OEM services to start with, but also offer other value-added services including design for manufacturability, design and building test fixtures, rapid prototyping, regulatory compliances and supply chain management (OEM+ services), and possibly ODM services later on.

The potential to their competitive advantage is hinted In 2013 as 2 clients found it cost effective to outsource their entire production to Valuetronics. Their GPS precisions product ICE customer shut down its production facilities in North America and moved its production facilities to Valuetronics' facilities in China. Additionally, they managed to tap into a new customer involved in production of intelligent temperature control modules as they closed their own production facilities in PRC and also transferred the operations to Valuetronics.



Global PMIs

Source: Bloomberg, JP Morgan, PSR

The recovery in global PMIs with the single digit growth in real GDP provides tailwinds for growth within existing ICE products.

Though the recent year had a 20% topline growth, we will conservatively assume a 5% growth going forward to account for macro risks and the lack of order book.

Plans going forward

- To enhance marketing efforts to broaden their customer base, especially in the ICE segment.
- They will concentrate of improving their fundamentals, including their design and development capabilities, production efficiencies and inventory management
- They will continue to pursue operating margin stabilization against rising cost pressure in China via improved product mix and process automation has started 18 month ago.

Short term risks

1. Sensitivity to the business cycle. Will impact both CE and ICE, particularly LED lighting sales because of positive correlation between lighting sales and GDP. We estimate that we are on mid-bull, late expansion phase of the cycle now. A quicker than expected contraction of the economy will have a direct impact on profitability, especially the CE segment.

2. Single client concentration risk. This may lead to pricing pressure and greater volatility on earnings for CE.

3. Small Cap risk. Tendency for earnings to be to be more volatile, and sensitive to macro or company specific shocks as compared to bigger companies.

Long term risks

Valuetronics long term survival and profitability proposition hinge on their ability to:

1. Continue to adapt to a changing marketplace. They have continually grown revenues by a CAGR of 25% and have net profit for continuing operations CAGR of 26%. They have done so by net increasing their client base as well as shifting their manufacturing towards newer products as evidenced by the changing of their product mix over the years. They must continue to do so if they want to grow earnings.

2. Gradually offset the eventual LED lighting sales and profitability decline with point 1. The LED retrofit market size is estimated to reach it's peak in 2016, before declining by ~30% through to 2020. An extension to point 1, Valuetronics must be able to grow other product offers before the eventual decline of LED retrofit market value.

3. Continue Lean manufacturing for greater productivity and efficiency to combat wage inflation or changes of labour regulations in China. Although they have had moderate success, through working on over 40-in-house process automation projects starting in 2012 so as to improve productively and efficiency, while reducing our workforce requirements. It is uncertain how much more low hanging fruits are available to them in the efficiency arena.

To account for these risks, we will place a 25% discount to fair price under the Company Valuations section below.

Company Valuations

Estimating FY14 earnings to be HKD \$139M (9M14 earnings are already HKD 108M or 78% of FY14) implies a FY14 PE of 5.5x.

We estimate that 50% of their cash is idle and not necessary for operations, this values of the company at a more attractive PE ex cash of 4.0x.

Peer comparisons

We compare Valuetronics to its comparable peers in Table 1 below. We separate out Venture Corp because of the major differences in the much larger size as well as longer history, giving Venture a much better valuation. In comparing the more similar EMS or contract manufacturing firms listed in Singapore of comparable market cap, we see that Valuetronics has performed admirably. They 1) managed to operate with net margins of >5% which is higher than the typical 3% average for contract manufacturers, 2) managed to do so with a healthy net cash position (no net debt). Also of interest that even before IPO till now, Valuetronics has never turned in a loss making year.

	Px	MrkCap	P/B	PE	3 yr average Gross Margins	3 Yr average Net Margins	Net Debt Ex Cash / Equity
	(\$)	(M)	(x)	(x)	(%)	(%)	(%)
AMTEK ENGINEERING LTD	0.595	324 M	1.55	9.70	16.3	5.3	24%
AZTECH GROUP LTD	0.129	066 M	0.81	8.06	8.9	-2.6	5%
EXCELPOINT TECHNOLOGY LTD	0.093	048 M	0.80	6.19	7.3	0.9	66%
KARIN TECHNOLOGY HOLDINGS	0.305	065 M	0.85	9.89	7.6	1.9	7%
SERIAL SYSTEM LTD	0.138	124 M	0.93	8.97	9.4	1.4	53%
SUNNINGDALE TECH LTD	0.156	119 M	0.48	6.09	13.4	0.7	3%
VALUETRONICS HOLDINGS LTD	0.330	122 M	1.09	5.55	14.0	5.1	-38%
SPINDEX INDUSTRIES LTD	0.500	058 M	0.92	5.81	18.9	6.8	-34%
Average			0.91	7.82	11.7%	2.1%	17.8%
VENTURE CORP LTD	7.250	1,992 M	1.07	14.89	-	6.0	-13%

Table 1: Values obtained on May 14, 2014

Source: Bloomberg, PSR

As such, it is more than fair that Valuetronics should at least trade at the peer average PE of 7.8x.

Assuming FY14 net earnings of \$139M HKD, this implies a FY14PE of 5.5x at current price. Valuating Valuetronics at 7.8x implies a fair value of SGD \$0.48. We conservatively estimate that 50% of the cash (SGD \$0.09 per share) on the balance sheet is idle and not necessary for continuing operations. This likely understates value as total net cash is double of that. If the company distributes the cash back to investors, or invests the money in an earnings accretive manner, this enhances the value to the investor. Added together, this gives us a total value of SGD \$0.57 per share.

Finally, to conservatively account for the small cap, macro and concentration risks, we apply a 25% discount and we arrive at our conservative **final fair value of \$0.43 SGD**. Or, a 28% upside (inclusive of any dividend) from today's price of SGD \$0.335.

Perceived Risks and Responses

Q) Concentration Risk: What if that one big client pulls out?

- That client is a global top 5 manufacturer of lighting
- Valuetronics was 1 of 8 global preferred manufacturer shortlisted
- They have had a relationship since 2005
- Valuetronics handles ~90% of those specific types of LED lamps
- Realistically, even if that top 5 LED producer MNC wanted to pull out for whatever reason, it would likely be done incrementally, not immediately.

Q) Typical EMS are low margin, combined with China's cost pressures is a bad combination?

- Valuetronics has admirably been operating above a 5% net margin for years.
- Average contract manufacturing net margins are closer to 3%.
- Additionally, even before IPO, they have not had a loss making year.
- They are proactive in stabilizing margins via LEAN manufacturing and other process improvements.
- This is why Valuetronics, in the near future, is focused on developing higher margin ventures like OEM+ services that utilize valued added services, particularly in the ICE segment.

Q) There is no orderbook.

- This is the case for most contract manufacturers. However, the following points help to mitigate this lack of clarity.
- Manufacturing LED and personal care products for a top global manufacturer allows revenue correlations to the global economy.
- The estimated 3.4% annual GDP growth provides tailwinds for both CE and ICE segments.
- The LED growth at this part of the technological adoption to the mass market provide also provides tailwinds for the CE segment.

FYE Dec	FY11	FY12	FY13
Income Statement (HKD '000) (Continuing operation)			
Revenue	1,970,421	2,378,625	2,242,888
EBITDA	188,522	218,142	173,655
Depreciation & Amortisation	33,210	41,265	43,768
EBIT	155,312	176,877	129,887
Net Finance (Expense)/Inc	(1,688)	(1,606)	(1,414)
Profit Before Tax	157,000	178,483	131,301
Taxation	(15,900)	(18,202)	(12,866)
Profit After Tax	141,100	160,281	118,435
Non-controlling Interest	0	0	0
Net Income, continuing	141,100	160,281	118,435
Net Income, discontinuing	121,200	130,326	78,683

FYE Dec	FY11	FY12	FY13
Per share data (HK cents) (Continuing operations)			
EPS, basic	34.2	36.5	21.9
EPS, adj.	34.0	36.1	21.8
DPS	14.0	17.0	8.0
BVPS	133.9	158.5	164.5

FYE Dec	FY11	FY12	FY13
Cashflow Statements (HKD '000) (Continuing Operations)			
CFO			
PBT	157,000	178,483	131,301
Adjustments	35,845	43,834	48,875
WC changes	(126,254)	42,108	(88,213)
Cash generated from ops	66,591	264,425	91,963
Others (Income tax, interest)	(8,825)	(18,004)	(19,095)
Cashflow from ops	57,766	246,421	72,868
CFI			
CAPEX, net	(71,861)	(44,218)	(17,926)
Others	15,879	406	(2,967)
Cashflow from investments	(55,982)	(43,812)	(20,893)
CFF			
Share issuance	1,506	2,505	268
Loans, net of repayments	38,015	(18,015)	(20,000)
Dividends	(24,654)	(49,998)	(61,022)
Others	0	0	0
Cashflow from financing	14,867	(65,508)	(80,754)
Net change in cash	16,651	137,101	(28,779)
Effects of exchange rates	63	1,294	548
CCE, end	136,185	263,730	221,579

Source: Company Data, PSR est

Note: Historical Multiples use Historical Price, Forward Multiple use Current Price

FYE Dec	FY11	FY12	FY13
Balance Sheet (HKD '000)			
PPE	211,538	222,689	196,454
Intangibles	10	10	0
Investments	0	0	0
Others	21,111	21,509	22,740
Total non-current assets	232,659	244,208	219,194
Inventories	213,033	204,090	178,358
Accounts Receivables	430,785	508,120	481,509
Investments	0	0	2,476
Cash	136,185	263,730	221,579
Others	18,725	13,238	9,327
Total current assets	798,728	989,178	893,249
Total Assets	1,031,387	1,233,386	1,112,443
Short term loans	38,015	9,000	0
Accounts Payables	498,753	625,937	506,337
Others	14,906	15,130	10,491
Total current liabilities	551,674	650,067	516,828
Long term loans	0	11,000	0
Others (Deferred tax)	3,503	3,944	3,388
Total non-current liabilities	3,503	14,944	3,388
Non-controlling interest	0	0	0
Shareholder Equity	476,210	568,375	592,227

FYE Dec	FY11	FY12	FY13
Valuation Ratios			
P/E (X) (Total)	6.0	5.3	8.7
P/B (X)	1.31	0.99	0.77
EV/EBITDA (X)	2.9	1.6	1.4
Dividend Yield (%)	8.0%	10.8%	6.3%
Growth & Margins (%)			
Growth			
Revenue	73.4%	20.7%	-5.7%
EBITDA	110.4%	15.7%	-20.4%
EBIT	137.3%	13.9%	-26.6%
Net Income, adj.	106.2%	7.5%	-39.6%
Margins			
EBITDA margin	9.6%	9.2%	7.7%
EBIT margin	7.9%	7.4%	5.8%
Net Profit Margin	7.2%	6.7%	5.3%
Key Ratios			
ROE (%)	33.3%	30.7%	20.4%
ROA (%)	15.7%	14.2%	10.1%
Net Debt/(Cash)	(98,170)	(243,730)	(221,579)
Net Gearing (X)	Net Cash	Net Cash	Net Cash
Net Cash/Market Cap	16%	43%	49%

Fig 1: CE and ICE Revenue

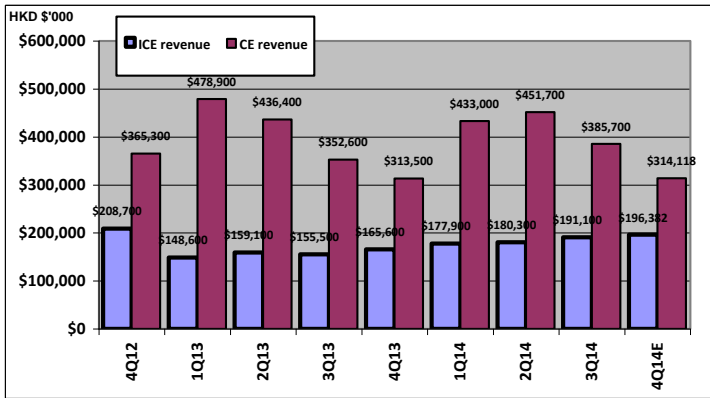


Fig 2: Net Profit and Net Profit Margins

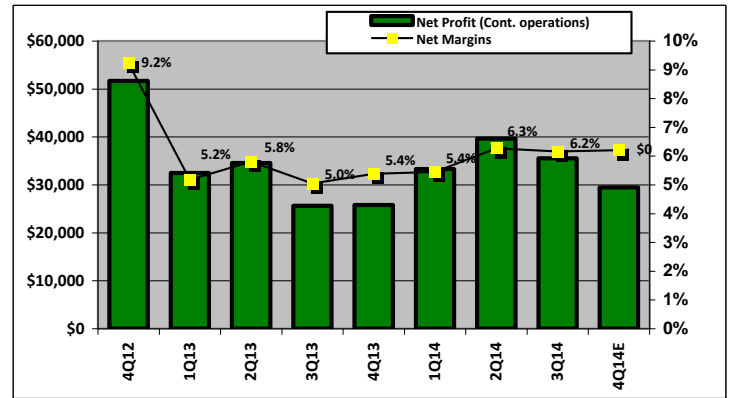


Fig 3: ICE and CE revenue

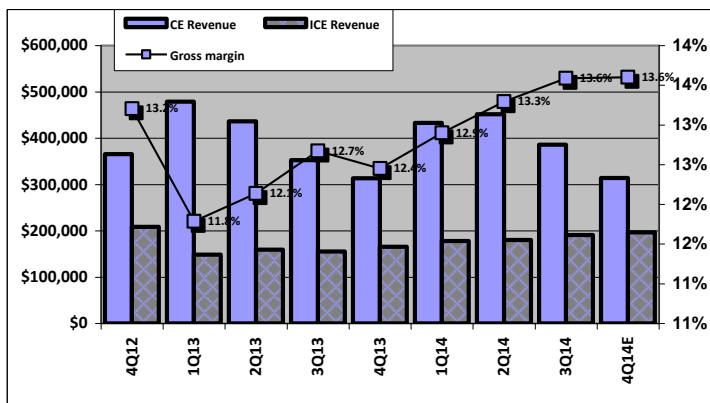


Fig 4: Annual Figures: CE & ICE Revenues

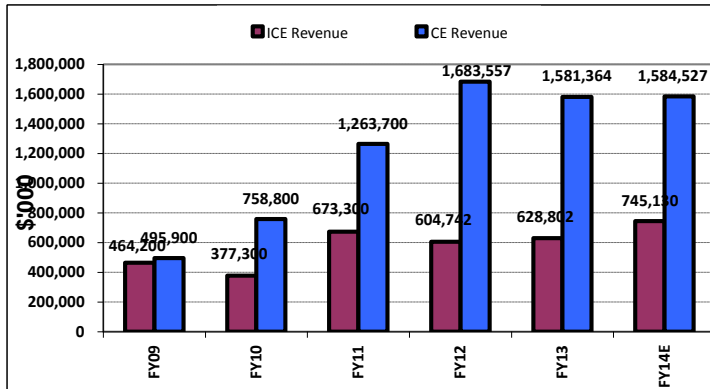


Fig 5: Annual Figures: Net Profit & Net Margins (Continuing Operations)

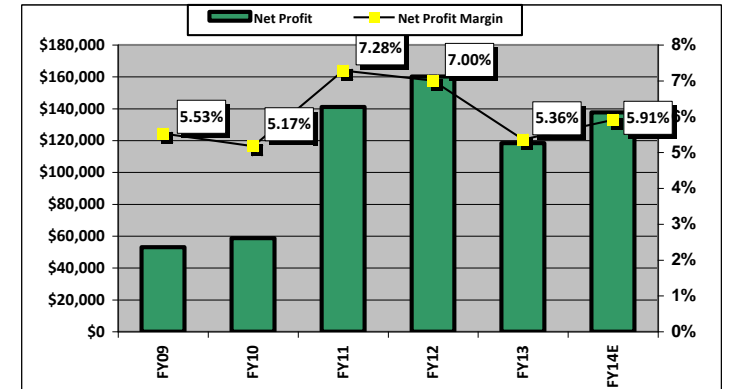
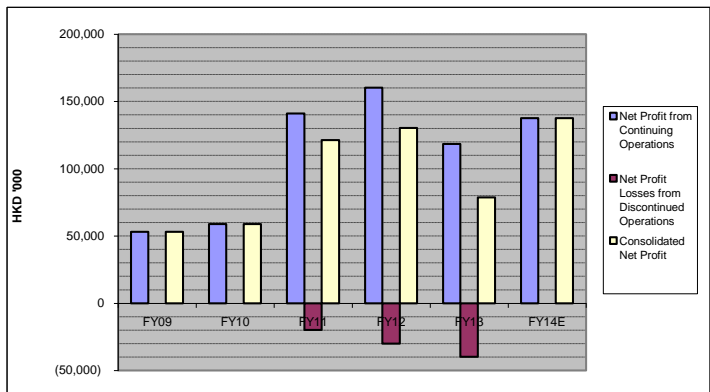


Fig 6: Net Profit (Continuing and Discontinued Operations)



Source: Company, PSR



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