

ChungHong Holdings Ltd – A Stellar Performance

2 May 2008

Recommendation BUY

Bloomberg Code CHH SP

Share Price S\$ 0.25

Target Price S\$ 0.41

Upside Potential 64%

Report Type

Results Update

Company website

www.chunghong.com

Stock data

Sector : PCB

Share Cap : 220m shares

Market Cap: S\$ 55m

Major Shareholders:

ComWorld Inc. 72.21%

Fa-Lin 2.09%

Free float: 59.6m shares

Analyst

Lee Khai Chian

(65) 6319 4152

khaichian@westcombfinancial.com

www.estockresearch.com

MICA (P) 213/09/2007

1Q08 ChungHong (“CH”) Results Review

Year End: 31 Dec

RMB ('000)

	1Q08	1Q07	%
Revenue	202,990	154,629	31.3%
Cost of sales	-166,077	-135,214	22.8%
Gross profit	36,913	19,415	90.1%
Other income	713	500	42.6%
Selling and distribution expenses	-292	-182	60.4%
Administrative expenses	-14,044	-9,233	52.1%
Finance costs	-3,095	-1,352	128.9%
Other operating expenses	-1,601	-78	1952.6%
Profit before tax	18,594	9,070	105.0%
Income tax expenses	-4,727	-1,257	276.1%
Profit for the year	13,867	7,813	77.5%
Attributable to:			
Equity holders of the Company	13,867	7,758	78.7%
Minority Interests		55	-100.0%
Profit for the year	13,867	7,813	77.5%

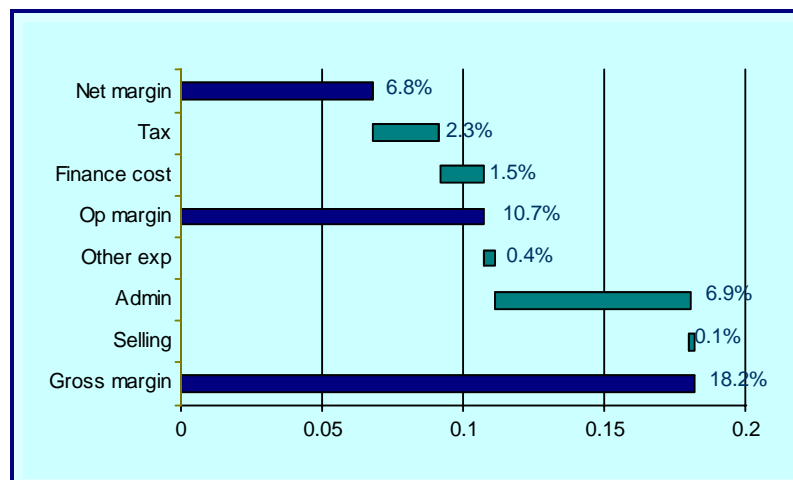
Gross profit margin up 5.6 ppt despite rising labour and depreciation cost: While the Poland investment and expansion in PCR plants led to approximately 48% increase in depreciation cost and higher labour cost resulting from higher headcount, the gross margin in 1Q08 made a dramatic improvement of 5.6 ppt to 18.2%. Depreciation cost as a percentage of total cost of goods sold (“COGS”) increased to 7.3% in 1Q08 compared to 6.1% in 1Q07. We, however, foresee the ramping up in capacity utilization, particularly during second half of 2008, would pull the depreciation/COGS ratio down to previous level. The increase in gross margin is due mainly to consignment orders for USB thumb drive which contributed 12.5% to the CH’s revenue in 1Q08.

Operating margin up 3.9 ppt: Although operating margin added 3.9 ppt from 6.7% in 1Q07 to 10.7% in 1Q08, the percentage increase lagged behind that of 5.6 ppt in gross margin. This is attributed to 52.1% increase in administration expenses stemming from higher salaries and benefits for staff, professional fees arising from listing at exchange, etc.

Net margin up 1.8 ppt: Net margin slightly increased 1.8 ppt to 6.8% in 1Q08 over the same period in previous year. The slight improvement in net margin was due to higher effective tax of 25.4% as most of CH’s manufacturing plants are no longer entitled to the previous tax incentive such as “two plus three” tax holiday. In 1Q07, the effective tax rate was 13.9%. On top of that, the finance cost which increased by RMB 1.7 million or 128.9% to RMB 3.1 million, also put a strain on net margin.

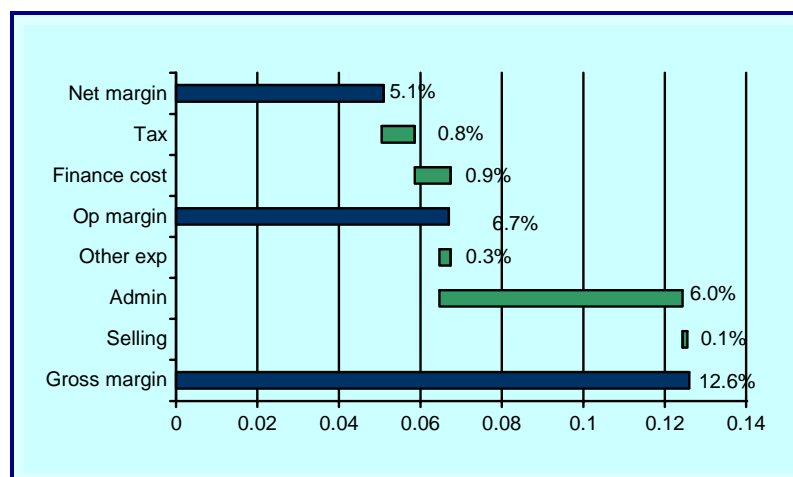
Outlook remains upbeat: CH posted 18.2% of gross margin, 10.7% of operating margin and 6.8% of net margin in 1Q08, outperforming our FY2008 forecast of 15.0%, 8.7% and 6.6% respectively. The revenue achieved in 1Q08 is approximately 19% of our full year forecast of RMB1,054 million. This comes as no surprise to us because first quarter has shorter working days and PCBA business is highly seasonal whereby its customers tend to build up their inventories during second of the year prior to shopping sprees.

Figure 1: 1Q08 Margin Analysis



Source: Westcomb Securities

Figure 2: 1Q07 Margin Analysis



Source: Westcomb Securities

	1Q08	1Q07	Difference
Gross margin	18.2%	12.6%	5.6%
Selling	-0.1%	-0.1%	0.0%
Admin	-6.9%	-6.0%	-0.9%
Other exp	-0.4%	0.3%	-0.7%
Finance	-1.5%	-0.9%	-0.7%
Tax	-2.3%	-0.8%	-1.5%
Net margin	6.8%	5.1%	1.8%
Spread (gross margin -net margin)	11.4%	7.5%	3.9%

Source: Westcomb Securities

As we can observe from charts and table above, the spread between gross margin and net margin for 1Q08 increased by 3.9 ppt to 11.4% over the same period last year. The major items (highlighted in yellow) that caused wider spread in 1Q08 are administrative expenses and income tax expenses. Nevertheless, we view the administrative expenses remains in check, given the initial start-up cost for Poland investment as well as expansion in PRC operation. On the other hand, we know of CH's application to the State is in progress so as to qualify as High/New Tech Enterprises ("HNTE"), which is eligible to enjoy reduced

income tax of 15% as opposed to the standard tax rate of 25%. If the application gets through successfully, we would see an increase in net margin from 6.6% to 7.5%.

$$(NM_n = \frac{0.85}{0.75} NM_{n-1}).$$

The revised net margin would lead to increase in earnings by approximately RMB 10 million, equivalent to earnings per share RMB 4.5 cts. Tentatively, we do not discount the potential gain in tax incentive until the application for HNTE is approved by the State.

Share purchase duly passed: The resolution to buy back shares by way of market purchase or off-market purchase was passed during the Extraordinary General Meeting on 30 April. We view the share buy-back is to add shareholders' values as depleted outstanding shares lead to higher returns per share. However, it may cause the stock to be less liquid.

Valuation:

The results is within our estimation, therefore, we keep our previous earnings forecast. Since our first initiation report, share price has increased by 19% to S\$0.25. Accordingly, forward PE has risen from 3.5x to 4.1x. We are still sanguine about the prospect of the company and its ability to deliver the forecast earnings growth of 39% in 2008, in which we believe no many other technology companies could achieve in the current economy battled by credit turmoil. On top of that, down side risk is limited due to low multiples the share currently trades at, specifically, 0.6x of price to book for 2008. We remain our previous valuation method: (i) PE multiples derived from valuation band ranging 4.5x to 7.5x and (ii) discounted free cash flow as a supporting metric to our former method (*more details please refer to initiation report dated on 22 April 2008*). Pegging to the 6.5x FY08 PER, we derive a target price of S\$0.41, a substantial upside potential of 64%.

Disclosure

Westcomb Securities Pte Ltd is a wholly-owned subsidiary of Westcomb Financial Group Limited ("WFG"). WFG and its related corporations (including Westcomb Securities Pte Ltd) (collectively the "Westcomb Group") are principally engaged in the provision of a wide range of capital market advisory and other related services.

Each member of the Westcomb Group together with their respective directors and employees may also act as a market maker, or have taken or take positions, or effect transactions in the securities covered or recommended in this Report and may also perform or seek to perform broking and other investment or securities-related services for the Company.

For purposes of Section 36 of the Financial Advisers Act (Chapter 110) ("FAA"), as at the date of this Report (being the date of publication of this Report):-

- (a) Westcomb Securities, its associated persons and its connected persons do not have an interest in the securities covered or recommended in this Report; and
- (b) The research analyst of Westcomb Securities who has prepared this Report and his associated persons and connected persons do not have an interest in the securities covered or recommended in this Report.

The terms "associated persons" and "connected persons" have the meanings ascribed thereto in and as defined in Sections 36(3), 2(1) and 3 of the FAA.

During the previous 12 months, Westcomb Capital Pte Ltd had acted as the issue manager for the IPO of the company.

Westcomb Securities Pte Ltd Rating System

Buy : >15% upside over the next 12 months
 Trading Buy : + 10% to + 15% range over the next 3 months
 Hold : +/- 15% range over the next 12 months
 Trading Sell : - 10% to - 15% range over the next 3 months
 Sell : >15% downside over the next 12 months

Disclaimer

This Report is based on information obtained from sources which Westcomb Securities Pte Ltd believes to be reliable and correct at the time of publication of this Report. Whilst Westcomb Securities Pte Ltd has taken all reasonable care to ensure that such information is correctly reproduced in the preparation of this Report, no guarantee is given as to the adequacy, accuracy, completeness, reliability or fairness of such information. Any opinion, estimate or recommendation in this Report is subject to change without notice.

This Report is not, and should not be construed as, an offer or a solicitation of an offer to buy or sell any securities covered or recommended in this Report. This Report may not be published, circulated, reproduced or distributed in whole or in part to any other person without the written consent of Westcomb Securities Pte Ltd. This Report is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any jurisdiction where such distribution or use would be contrary to applicable law or regulations. This Report and the recommendations (if any) therein:

- (i) is intended for general information and circulation only, and does not purport to contain all the information that a prospective recipient of this Report may require to make an investment decision on the securities covered or recommended in this Report;
- (ii) have not taken into account, the specific investment objectives, financial situation and particular needs of any specific recipient of this Report; and
- (iii) should not be taken in substitution of the exercise of judgment by any recipient of this Report, who should instead consult their own professional and financial advisers as to the legal, business, financial, tax and other aspects regarding the suitability of the securities covered or recommended in this Report for investment having regard to the specific investment objectives, financial situation or particular needs of such recipient, before making any investment decision in relation to such securities.

Consequently, Westcomb Securities Pte Ltd does not assume or accept any liability whatsoever for any direct or consequential loss occasioned to any recipient of this Report arising from any use of this Report or otherwise arising in connection with this Report.



Goh Mou Lih
Head of Research

Westcomb Securities Pte Ltd
 (Reg. No. 200300646M)
 A member of Singapore Exchange Securities Trading Limited
 5 Shenton Way #09-08
 UIC Building Singapore 068808
 Tel : 65- 6319 4988, Fax : 65-6220 4894