

## Alltronics (833.HK)

Date: 12 January 2017

### Company Data

|   |       |            |
|---|-------|------------|
| Company                                       |       | Alltronics |
| Stock code                                    |       | 833.HK     |
| # of shares                                   | m     | 525.6      |
| Closing price                                 | HK\$  | 2.72       |
| Mkt. cap.                                     | HK\$m | 1,429.7    |
| Fully diluted FY15A EPS                       | HK\$  | 0.0788     |
| Fully diluted BVPS as of the end of June 2016 | HK\$  | 0.7049     |

Source: The company

### Shareholding structure

|   | Number<br>of shares<br>(m) | % of Issued<br>Capital |
|---|----------------------------|------------------------|
| Lam's family                            | 249.0                      | 47.4                   |
| Liu Jing                                | 69.2                       | 13.2                   |
| China Huarong Asset Management Co., Ltd | 76.0                       | 14.4                   |
| Public                                  | 131.4                      | 25.0                   |
| <b>Total</b>                            | <b>525.6</b>               | <b>100.0</b>           |

Source: The company

Note: Chairman Mr. Lam Yin Kee and his family collectively own 47.4% interest in Alltronics. Executive Director Ms Liu Jing acquired 69.2m shares of the group at HK\$1.88 each via a new share placement in November 2015. China Huarong Asset Management acquired 76.0m shares of the group at HK\$1.49 each via two new shares subscriptions in 2016.

- FY16E earnings growth is expected to be exceptionally strong.
- A proxy to the strong U.S economy and strengthening in USD exchange rate.
- Posted to benefit from the depreciation in RMB exchange rate.
- Well diversified electronic products portfolio
- New products in the pipeline to seize new opportunities.
- Acquisition of Beijing property are EPS and equity accretive

**Positive outlook.** Thanks to strong order flow from its U.S. customers, margin expansion and strengthening in USD exchange rate since 3Q 2016, we expect Alltronics (833 HK) to post stellar results for FY16E. We are very positive to the earnings outlook and prospect of Alltronics for FY17F onward, given its new products in the pipeline and lucrative rental yield generated from its retail property in Beijing. The group is expected to launch a number of new products in FY17F on top of its well-diversified product portfolio. Further, the acquisition of Beijing property at discount to its estimated NAV is net earnings and equity accretive.

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**Stunning growth for FY16E is expected.** Between FY11A and FY15A, the group's net earnings and equity increased at a four-year CAGR of 5.5% and 13.9%, respectively. For 1H FY16A, its revenue and net profit increased 8.0% YoY and 28.3% YoY, respectively, to HK\$471.0m and HK\$29.2m, for 1H FY16A ended June 30<sup>th</sup> 2016. Given to the surge in revenue attributable to the increase in orders from the customers in the U.S. and orders from new customers, margin expansion on enhanced economy of scale and the strengthening in USD exchange rate since 3Q 2016, we expect the group to post stunning growth in net profit for FY16E.

### Track record

| (FY ended Dec 31, HK\$m) | FY11A | FY12A | FY13A | FY14A | FY15A |
|--------------------------|-------|-------|-------|-------|-------|
| Revenue                  | 801.7 | 788.7 | 775.9 | 957.5 | 886.3 |
| Pre-tax profit           | 45.4  | 48.8  | 54.6  | 61.7  | 59.6  |
| Net profit               | 33.4  | 38.3  | 45.6  | 45.2  | 41.4  |
| Equity                   | 215.1 | 227.3 | 244.6 | 245.1 | 361.4 |

Source: The company

**Diversified product portfolio.** Emerging from a leading adaptor manufacturer in Southern China, Alltronics has been evolving into a comprehensive electronic products OEM/ODM manufacturer with well-diversified electronic products portfolio offering broad product categories. The U.S. is the major market for the group, providing more than 50.0% of its revenue. Thus, the group is well posted to benefit from strong U.S. economy and strengthening in USD exchange rate. Major products of the group include:

- *Irrigation system.* Alltronics has been on the vendor list of a leading U.S. based irrigation solutions provider whom is providing full range of water-efficient, easy-to-use irrigation solutions for residential, commercial, and golf course applications. Revenue generated from the customer has been accounting for substantial chunk of the group's revenue for times. In the past, the customer had four suppliers in China region. The customer has then eliminated three suppliers from its vendor list and retains Alltronics as its exclusive supplier in China region. Such move has led to increase in orders from such customer to the group substantially. The group has been deploying four production lines for the production of more than 500 types of irrigation system products to cater the demand of such customer.
- *Walkie-talkie.* Alltronics has been expanding into the previously untapped U.S. wireless communication equipment market by supplying walkie-talkies to a leading U.S. based electronic products and wireless communication devices provider since 2Q 2016. Such customer has affiliates in Italy, Bulgaria, Germany, Poland, Russia, Spain, and the United Kingdom, as well as representation in Latin America. The customer has been developing and providing wearable action cameras, GMRS two-way radios, citizen band (CB) radios, marine radios, bluetooth intercom systems, and all hazards/weather alert radios for global market. The customer has manufactured quality two-way radios for over 50 years. It is also a leading manufacturer of land mobile radios and supplying professional grade analog and digital (P25 Technology) portables, mobiles and base stations/repeaters for government entities such as forestry and public safety, as well as other commercial users. Currently, Alltronics deploys five production lines for the production of walkie talkie products for that customer.
- *Security token.* Demand for security token for internet banking is expect to expand rapidly as online banking has become a necessity. Alltronics is supplying security token to a leading security identity solution provider based in the U.S. The group is the exclusive vendor in Hong Kong for such customer. The Security token is a credit card sized personal security device that

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allows user to generate the One-Time Password (OTP) that is needed to login to online banking and carry out transactions that require OTP.

- *Audio systems.* Alltronics is also providing audio systems products for a renowned computer-based audio production and DJing audio system provider based in Europe. Two production lines have been assigned for the production of audio systems.
- *Solenoids.* To tap into the mass solenoids market in the U.S, Alltronics has been teaming with experts in the U.S. to develop solenoids. Under the partnership, the U.S. solenoid expert, a former solenoid producer based in the U.S. would be responsible for the design, market and sales of solenoid products produced by the group in the U.S., while Alltronics and its engineer who is based in the U.S. would produce solenoid products in the group's production facilities in China. A solenoid is a coil of insulated or enameled wire wound on a rod-shaped form made of solid iron, solid steel, or powdered iron. It can be applied as electromagnets, such as inductors in electronic circuits, and as miniature wireless receiving antennas. Electromechanical solenoids are commonly installed into electronic paintball markers, pinball machines, dot matrix printers and fuel injectors, switches of washing machines, switches of gas stoves, switches of refrigerators and switches of vending machines.
- *Inductor.* The group is a leading inductor producer globally, supplying 5.0% of global inductor consumption of 1.2b units per annum. Inductor is a crucial component in mobile phone chargers. Twenty production lines have been earmarked for production of inductors.

**New products in the pipeline.** The group has been working with a scholar to develop air purifier adopting optical technology, which can perform sterilization and deodorization. Ozone emission of the air purifier under development is less than 0.1 ppm, substantially lower than that of most of the domestic made products, and the air purifier is designed not to produce anion, making it very suitable to be installed into public indoor space such as hospitals and schools. The group plans to market the product via direct sales at launching stage and introduce it to mass market via major e-commerce platforms thereafter.

The group and partner formed a 49:51 JV in Yichin, Jiangxi Province, China with registered capital of RMB30.0m in November 2014 to pursue opportunities in China printer market and printing industry. Instead of the conventional OEM/ODM/OBM mode, management of the JV is merging/ implementing concept of share-economy into features of its printers and marketing channel of those.

**Lucrative VSA: Acquisition of retail property in Beijing.** Alltronics expects to complete the acquisition of 100.0% interest in Beijing Wan Heng Da at cash consideration of US\$1.0 in January 2017. Beijing Wan Heng Da owns the entire interest in Pretty Shopping Centre, a commercial/retail complex which is situated in Beijing. As of the end of June 2016, the asset to be acquired was in net debt position of about RMB1.5b. Net asset value of the asset to be acquired was RMB207.5m as of the end of June 2016. Following the acquisition, Alltronics would assume the debts and liabilities of the target group which owns the property.

- *Location and features of the property.* Comprising two-storey and one-level of basement with GFA of 40,083.94 sq.m, Pretty Shopping Centre is a shopping mall attached to the residential buildings. Built in 1999, Pretty Shopping Centre locates at No. 68 Anli Road, Chaoyang District, Beijing, adjacent to National Stadium which also known as Bird's Nest. Tenants of Pretty Shopping Centre include supermarket, banks, cinema, restaurants and retail shops. Since Pretty Shopping Centre is situated within a cluster of residential projects and a number of Grade B office towers, pedestrian flow is expected to be busy
- *Shareholder value accretive.* In the nutshell, the consideration (in the form of debt assuming) for the acquisition is at 30.0% discount to the value of RMB2, 137m estimated by LCH (Asia-Pacific)

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Surveyors Ltd. The deal is a bargain in our view. The acquisition has been approved by shareholders already. In our view, the acquisition is shareholder value accretive. Even though the acquisition would boost up the group total liability by 5.6x on pro forma basis, based on the group's debt position as of the end of June 2016, it would expand the group's total asset and net asset by almost four-folds and 163.5%, respectively.

- *Acquiring cash cow without cash outlay.* The acquisition would diversify the group' source of revenue and asset portfolio. It does not involve any immediate substantial cash outflow of the group nor dilutive equity financing such as issuance of new shares. Immediately after the acquisition, the property would generate stable cash rental income to the group.
- *Ample room for rental hike.* Based on the GFA of 40,083.94 sq.m. and a 100.0% occupancy rate as of the end of June 2016, average monthly rental/sq.m. of the property was approximately RMB152.5/sq.m. Yield potentials of the property are yet to be fully developed, in our view. Except the supermarket operator, most of the tenants of the property are either unbranded retailers or retailers operated under domestic low-end brands. Further, since management of the property has been less optimal, fixtures and interiors of the mall are outdated and in a state of disrepair. Following the acquisition, management of the group could hike rental and boost up yield of the property by revamping the property and improving the management of the property to attract high-end, luxury and premium brands retailer's tenants.

**China Huarong as strategic substantial shareholder.** China Huarong has subscribed for an aggregate of 76.0m new shares of Alltronics recently and has become one of its substantial shareholder. Relying on the strong financial position and business connections of China Huarong in the PRC, it will help the group to explore more business opportunities in the PRC and also enhance the group's borrowing power and fund raising ability in Hong Kong at comparatively more favourable terms for future needs.

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