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Wednesday, July 31, 2013
FBMKLCI: 1,795.08
Sector: Manufacturing

Jadi Imaging Holdings Berhad

A Victim of the Smartphone Revolution

TP: RM0.12*(-4.0%)*

Last traded: RM0.125

Sell, Cease coverage

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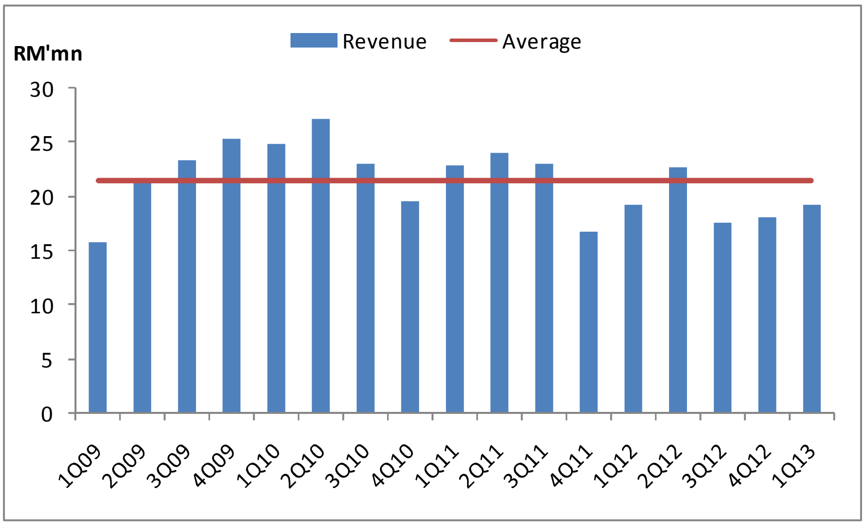
Threats vs opportunities

One of the key takeaways from our recent meeting relates to threats and opportunities to toner manufacturers against the backdrop of smartphone revolution. Certainly, management has observed changes in consumer printing behaviour as smartphone and cloud computing allow storage of images. Print on demand, which is defined as a printing technology and business process in which new copy of book or other documents are not printed until an order has been received, is gaining popularity and this has reduced the amount of printouts considerably.

The change in consumer behaviour can be evidenced by the decline in hardcopy peripherals market. According to International Data Corporation, shipment value for the worldwide large format printer market declined by 12.0% YoY in 1Q13. As far as Jadi is concerned, the drop in demand for printing hardware, resulted from the change in printing behaviour and the slowdown in Eurozone economies, has dented the group's profitability. The quarterly revenue has contracted to below RM20mn/quarter as shown in the chart below.

Chart 1: Contraction in quarterly revenue



Source: Jadi & TA Research

However, it is not all doom and gloom for Jadi in this digital printing revolution. At least, the company sees an opportunity from industrial printing or ceramic printing using ceramic toner. Ceramic printing is basically a system that enables user to decorate ceramics, glass and enameled metal using modified laser printers and copiers and specially formulated ceramic toners. According to management, the group would begin R&D on ceramic toners development given its hefty profit margin. However, we do not expect any contribution for the forecast period.

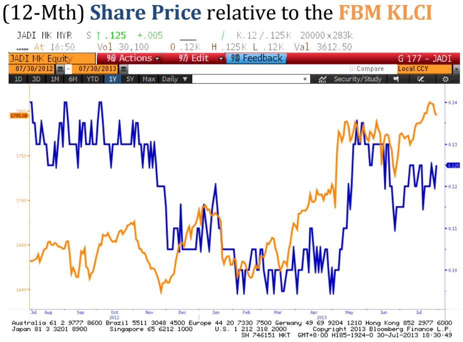
Share Information	
Bloomberg Code	JADI MK
Stock Code	7223
Listing	Main Market
Share Cap (mn)	706.2
Market Cap (RMmn)	88.3
Par Value	0.1
52-wk Hi/Lo (RM)	0.55-0.09
12-mth Avg Daily Vol ('000 shrs)	592
Estimated Free Float (%)	20.5
Beta	0.86
Major Shareholders (%)	
	LSI Holdings Sdn Bhd - 30.24
	Keen Capital Invt Ltd - 22.40
	Mega First Housing- 13.14
	Mega First Corp- 8.7
	Eu Lan Eng - 5.1

Forecast Revision	FY13	FY14
Forecast Revision (%)	(34.9)	(17.2)
Net profit (RMmn)	4.9	7.0
Consensus	-	-
TA's / Consensus (%)	nm	nm
Previous Rating		Sell (Maintained)

Financial Indicators	FY13	FY14
Net Debt/Equity (%)	15.5	4.1
CFPS (sen)	0.9	2.3
Price/CFPS (x)	14.3	0.0
ROE (%)	4.0	5.4
NTA/Share (RM)	0.2	0.2
Price/NTA (x)	0.7	0.7

Share Performance (%)		
Price Change	**JADI**	**FBM KLCI**
1 mth	8.7	1.2
3 mth	25.0	4.5
6 mth	19.0	10.3
12 mth	(10.7)	10.0

(12-Mth) **Share Price** relative to the **FBM KLCI**



Source: Bloomberg

Weathering the storm

To mitigate the impact of contraction in sales, Jadi started to produce toner resin beginning May-2013 with an initial output of 30-40mt. The impact to the bottom-line is minimal due to high operating leverage. However, once the company starts to ramp up capacity to 300mt by Jan-14, the cost saving could be enormous. According to management, Jadi would gradually convert the usage of resin from imported resin to its in-house standard resin. It is expected to convert the usage of standard resin to 22%/44%/89% of total resin requirement for 2013/2014/2015. This is expected to provide cost saving of about RM3-12mn over the next three years.

Conserving cash for rainy day

Other than lowering of the production cost, Jadi has adopted a conservative cash management approach by freeing up more cash. For instance, the company has reduced its average inventory to 3 months of requirement from 5 months previously. As a result, the group's inventory has dropped to RM26.5mn as at March 2013 from RM31.7mn a year ago. In addition, it reduced dividend to 0.2sen/share in FY12 as compared to the average 0.28sen/share over the past 5 years (no dividend was declared in FY11). In our earnings model, we reduce our dividend projections to 0.2sen/share for FY13 and maintain 0.3sen/share for FY14 and FY15.

We are positive on the prudent cash management approach, even though it could mean lower dividend to shareholders. This is important, we think, as the company's earnings prospect is relatively weak. Also, the pressure of cost escalation, typically from electricity tariff hike, would set to reduce the group's profit considerably. Note that the electricity cost constitutes up to 11% of total cost of production.

Impact

We reduce our FY13-14 earnings by 34.9% and 17.2% respectively to factor in decrease in demand for toner as well as increasing cost pressure arising from the impending electricity tariff hike.

Valuation

With the change in earnings, we reduce our target price to RM0.12/share (from RM0.145/share previously) based on unchanged 12x CY14 EPS. Given the potential downside risk of 4.0% and lack of positive catalysts in the future, we downgrade Jadi to **Sell** (from hold previously) **and cease coverage** on the stock.

Earnings Summary (RM'mn)

FYE Dec 31 (RMmn)	FY11	FY12	2013F	2014F	2015F
Revenue	86.7	77.7	80.5	93.8	104.8
EBITDA	13.3	10.0	17.1	20.1	20.9
EBITDA margin (%)	15.3	12.8	21.2	21.4	19.9
Pretax profit	3.5	(1.1)	5.4	7.7	9.5
Net profit	4.1	(0.1)	4.9	7.0	8.6
Core net profit	4.1	(0.1)	4.9	7.0	8.6
EPS (sen)	0.6	(0.0)	0.7	1.0	1.2
EPS growth (%)	(69.2)	>-100	>100	42.3	23.3
PER (x)	31.0	nm	25.9	18.2	14.7
GDPS (sen)	0.0	0.2	0.2	0.3	0.3
Div yield (%)	0.0	1.6	1.6	2.4	2.4
Core ROE (%)	3.3	(0.1)	4.0	5.4	6.4

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