

Hold

20 April 2005

2004 results: Not Exciting

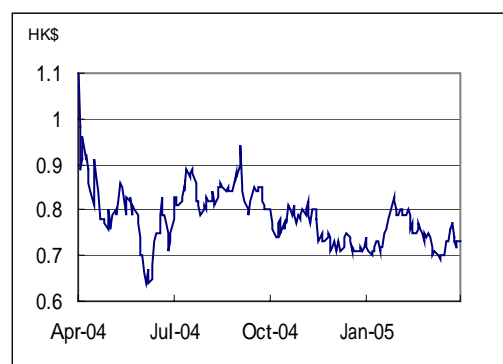
- **HK\$148mn boosted by accounting profits:** SCC's FY04 results were uplifted by HK\$67mn disposal gains from its subsidiaries and JC entity. Stripping off these exceptions and bad-debt provisions, its bottom line would have been HK\$84mn, which was 19% below our expectation of HK\$104mn.
- **Blame for margin squeeze in 2H04:** Despite that it doubled the production capacity in 2H04 and a 37% hoh increase in steel cord turnover, gross profit in 2H04 fell 6% hoh to HK\$46mn. The Company attributed the lower margin to rising material costs and intense market competition depressing steel cord prices. Gross margin of steel cord fell sharply to 30% in 2H04 from 44% in 1H04. For the copper/brass segment, without benefiting from the time lag between low costs of inventory and rising copper prices happened in 1H04, 2H04 gross profit fell 57% hoh to just HK\$5mn.
- **Delay of future capacity expansion plan:** The Company's expansion plan from 30,000 to 45,000 tons of steel cords is now planned in 2007, and its effect would not be seen until 2008. The near-term growth momentum driven by volume therefore disappears.
- **Earnings outlook:** In light of poorer-than-expected results, we have revised our forecasts downward to factor in the margin squeeze in the steel cord market and later-than-expected production capacity expansion. Subsequently, our earnings estimates for FY05 and FY06 have been cut by 40% and 38% to HK\$82mn and HK\$85mn respectively.
- **Valuation:** SCC is now trading at 8.5x recurring FY04 PER. Without stronger earnings growth prospects over the next two years, we have revised down our target price to HK\$0.80 based on 10x FY05 PER. The current yield of 5% should provide some support to the share price.
Downgrade to Hold.

HK\$1 = Rmb1.06

KEY DATA

<i>Sector</i>	<i>Auto parts</i>
<i>Share price</i>	<i>HK\$0.70</i>
<i>Stock code</i>	<i>103</i>
<i>Shares O/S</i>	<i>1.026bn</i>
<i>Mkt. Cap</i>	<i>HK\$718mn</i>
<i>52wks High-Low</i>	<i>HK\$0.61-1.18</i>
<i>NAV per share</i>	<i>HK\$0.63</i>
<i>Major Shareholders</i>	<i>Shougang (HK)(42%) Morgan Stanley (6.9%)</i>

Price Performance



Source: Bloomberg

Earnings Summary

Year-end 31 Dec	FY02A	FY03A	FY04A	FY05F	FY06F
Turnover (HK\$'mn)	234.9	297.3	427.9	501.4	530.2
EBITDA (HK\$'mn)	71.7	98.9	112.4	115.4	124.1
Net profit (HK\$'mn)	42.5	66.1	148.1	82.0	84.9
EPS (HK\$)	0.056	0.075	0.145	0.080	0.083
EPS (% YoY)	111.8	35.1	93.7	(44.6)	3.5
DPS (HK\$)	0.000	0.035	0.035	0.035	0.035
Yield (%)	0.0	5.0	5.0	5.0	5.0
PER (x)	12.6	9.3	4.8	8.7	8.4

Source: company information, FSSL

Results comments

Fiscal year ended 31 Dec								
HK\$mn	1H03	2H03	1H04	2H04	FY03	FY04	YoY (%)	Comments
Turnover	137.4	159.9	192.0	235.9	297.3	427.9	43.9	
- Steel cord	106.5	112.0	112.4	153.9	218.5	266.3	21.9	2H04 growth driven by capacity expansion in June 2004
- Copper & brass products	30.6	47.1	79.2	80.4	77.7	159.7	105.5	
- Others	0.2	0.9	0.4	1.5	1.1	1.9	76.4	
Cost of sales	(88.1)	(108.3)	(131.1)	(184.6)	(196.4)	(315.6)	60.7	
Gross profit	49.2	51.7	60.9	51.3	100.9	112.2	11.2	Gross margin of steel cords squeezed by rising material costs and competition, despite volume growth, and overall gross margin fall also due to higher turnover
Other operating income	0.2	2.9	0.4	5.4	3.1	5.8	84.2	growth in copper & brass segment with lower margins
Distribution costs	(0.6)	(0.7)	(0.7)	(1.3)	(1.3)	(2.0)	53.9	
Administrative expenses	(13.4)	(12.7)	(13.5)	(16.1)	(26.1)	(29.7)	13.6	
Other operating expenses	(0.0)	(1.0)	(1.1)	(1.3)	(1.0)	(2.4)	127.9	
(Allowance for) Recovery of bad debts	3.9	3.8	(0.4)	(2.8)	7.7	(3.2)	(142.1)	
Operating profit	39.3	44.0	45.6	35.1	83.3	80.7	(3.1)	A decrease in operating profit partly due to the absence of write-back of bad debts
Finance costs	(0.8)	(2.4)	(1.5)	(2.9)	(3.2)	(4.5)	40.4	
Exceptions due to disposals	0.0	0.0	0.0	67.2	0.0	67.2	n.a.	Disposal gains from subsidiaries and a JC entity in 2H04, boosting the bottom line
Profit from JCs	3.0	3.9	2.7	5.2	6.8	7.8	14.4	
Profit from an associate	2.9	2.4	1.7	2.9	5.3	4.6	(13.1)	
Profit before tax	44.3	47.9	48.4	107.5	92.2	155.9	69.1	
Taxation	(4.9)	(3.6)	(4.0)	(3.8)	(8.5)	(7.8)	(8.3)	
Profit after tax	39.5	44.3	44.4	103.7	83.7	148.1	76.9	
M.I.	(11.2)	(6.4)	0.0	0.0	(17.6)	0.0	(100.0)	no M.I. After the acquisition of the 28% stake in Jiaying Eastern
Net profit	28.2	37.9	44.4	103.7	66.1	148.1	124.1	
EPS (HK\$ cents)								
Basic	3.68	3.82	4.35	10.2	7.50	14.53	93.7	
Diluted	3.65	3.35	3.90	9.29	7.00	13.19	88.4	

	1H03	2H03	1H04	2H04	FY03	FY04	Comments
Turnover (HK\$mn)							
- Steel cord	106.5	112.0	112.4	153.9	218.5	266.3	
- Copper & brass products	30.6	47.1	79.2	80.4	77.7	159.7	
- Others	0.2	0.9	0.4	1.5	1.1	1.9	
Total	137.4	159.9	192.0	235.9	297.3	427.9	
Gross profit (HK\$mn)							
- Steel cord	47.3	47.7	49.0	46.0	95.0	95.0	
- Copper & brass products	1.8	3.7	11.6	5.0	5.5	16.6	
- Others	0.2	0.2	0.1	0.5	0.4	0.6	
Total	49.3	51.6	60.7	51.5	100.9	112.2	
Gross profit margin (%)							
- Steel cord	44.4	42.6	43.6	29.9	43.5	35.7	Gross margin of steel cords plummeted to 30% in 2H04 from 44% in 1H04
- Copper & brass products	5.8	7.9	14.6	6.2	7.0	10.4	
- Others	97.1	19.5	32.3	32.0	36.3	32.1	

Source: company information, FSSL

Earnings Summary

YE Dec (HK\$ mn)	FY02A	FY03A	FY04A	FY05F	FY06F
Turnover	234.9	297.3	427.9	501.4	530.2
- Steel cord	177.7	218.5	266.3	307.8	307.8
- Copper & brass products	56.7	77.7	159.7	191.6	220.4
- Others	0.5	1.1	1.9	2.0	2.0
Cost of sales	(159.3)	(196.4)	(315.6)	(393.8)	(411.9)
Gross profit	75.6	100.9	111.7	107.7	118.3
EBITDA	71.7	98.9	112.4	115.4	124.1
Depreciation/Amortization	(23.6)	(26.0)	(28.4)	(36.8)	(36.7)
Net interest income (exp)	(1.8)	(2.8)	(4.5)	(4.3)	(7.0)
Exceptional items/Bad debt recovery	6.2	9.9	64.0	0.0	0.0
JC/Associates	11.7	12.1	12.4	16.1	19.5
Profit/(loss) before tax	64.2	92.2	155.9	90.3	99.9
Taxation	(1.3)	(8.5)	(7.8)	(8.4)	(15.0)
Profit/(loss) before M.I.	62.9	83.7	148.1	82.0	84.9
Minority interests	(20.4)	(17.6)	0.0	0.0	0.0
Net profit/(loss)	42.5	66.1	148.1	82.0	84.9
EPS (HK\$)	0.056	0.075	0.145	0.080	0.083
DPS (HK\$)	0.0	0.035	0.035	0.035	0.035

Source: company information, FSSL

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