

**Analyst: Vincent Leung**

## Main Board Listing – Research

**Neo-Neon Holdings Limited [Stock Code: 1868] 真明麗控股有限公司**

**Joint Global Coordinators, Joint Bookrunners, Joint Sponsors and Joint Lead Managers** : Deutsche Bank ICEA

**Sector** : Industrial

**Business** : R&D, design, manufacturing and distribution of lighting products

<p><b>Total share offer:</b> <u>200,000,000</u> shares (26.3% of the enlarged share capital)</p> <p><b>Public Offer:</b> 20,000,000 shares (10%)</p> <p><b>Placing:</b> *180,000,000 shares (90%)</p> <p><b>Greenshoe:</b> #30,000,000 shares</p> <p><i>*Comprising 140,000,000 New Shares and 40,000,000 Sale Shares</i></p> <p><i>#Entirely Sale Shares if exercised</i></p>	<p><b><u>Business of Neo-Neon Holdings</u></b></p> <p>Founded in Taiwan in 1981, Neo-Neon is one of the world's leading decorative lighting manufacturers. It engages in the research &amp; development, design, manufacturing and distribution of incandescent-based decorative lighting products, LED-based decorative lighting products and entertainment lighting products. Its product range covers more than 10,000 models of lighting products.</p> <p>The Group's customers are from (i) the retail industry including leading retailers and chain stores such as Home Depot, Canadian Tire and Target, and (ii) the commercial industry including hotels, casinos, architecture companies, decorative lighting stores, trading agents and distributors. As an exporter, the Group derives over 90% of its total revenue from overseas sales.</p> <p>In 1989, the Group moved its factory from Taiwan to Heshan, Guangdong Province, occupying more than 282,000 m<sup>2</sup> GFA with a gross land area of 380,000 m<sup>2</sup>. In 2005, it had a production capacity of 4.8 billion units of miniature light bulbs and 242 million units of LED light bulbs. The Group is in the process of building a new production plant with a GFA of 60,000 m<sup>2</sup>, which is expected to commence operation in 1Q 2007. Currently, the Group's production capacity for LED light bulbs is fully utilised.</p>
<p><b>Price:</b> HK\$5.50 – HK\$6.90 per share</p> <p><b>Market Cap:</b> HK\$4,180 million – HK\$5,244 million</p> <p><b>Pro-forma FY2006E P/E:</b> 16.5x – 20.7x</p> <p><b>Adjusted NTA per share:</b> HK\$2.12 – HK\$2.41</p> <p><b>Staffing:</b> 16,308 (as of 30<sup>th</sup> June 2006)</p>	
<p><b>Book opens:</b> 27<sup>th</sup> November 2006</p> <p><b>Book closes:</b> 7<sup>th</sup> December 2006</p> <p><b>HK Public Offer period:</b> 4<sup>th</sup> December 2006 – 7<sup>th</sup> December 2006 noon</p> <p><b>Receiving banks:</b> HSBC, ICBC Asia</p> <p><b>Share registrar:</b> Tricor Investor Services Limited</p> <p><b>Listing date:</b> 15<sup>th</sup> December 2006</p>	

### **Major Shareholders after Listing** (Assuming the over-allotment option is not exercised)

Mr. Ben Fan (Founder and chairman of the Group)	46.2%
(1)10 employees of the Group	7.9%
Transpac Capital Pte Limited (investment manager of Transpac Industrial)	10.6%
Transpac Industrial Holdings Limited (a Singapore-listed investment holding company)	9.0%
	<u>73.7%</u>

*Note (1): The 10 employees include the chairman's brother, wife and brothers-in-law as well as other six employees un-related to the chairman.*

*This report has been prepared solely for information purposes and we are not soliciting any action based upon it. Neither this document nor its contents shall be construed as an offer, invitation, advertisement, inducement or representation of any kind or form whatsoever. The information is based upon information, which we consider reliable, but accuracy or completeness is not guaranteed. Opinions expressed herein are subject to change without notice. At time of this report, East Asia Securities Company Limited has no position in securities of the company or companies mentioned herein, while its group companies may from time to time have interests in securities of the company or companies mentioned herein.*

**Use of Proceeds (Based on information provided by sponsor)**

Net proceeds from the offer are estimated to be HK\$925 million (Assuming the over-allotment option is not exercised, and at an issue price of HK\$6.20 each, being the midpoint of the indicative price range)

	HK\$ million
For expansion of the Group's production facilities such as acquisition of land and construction of production plant	442
For purchase of production equipment	283
For research and development	130
For general working capital	70

**Financial Highlights**

	Year ended 31 <sup>st</sup> December			Six months ended 30 <sup>th</sup> June
	2003	2004	2005	2006
	HK\$ million	HK\$ million	HK\$ million	HK\$ million
Turnover	648.2	834.0	971.3	381.6
Gross profit	195.7	275.9	339.1	144.4
Operating profit	87.1	91.8	167.9	63.8
<b>Net profit</b>	<b>88.3</b>	<b>42.9</b>	<b>142.9</b>	<b>60.6</b>
Gross margin	30.2%	33.1%	34.9%	37.8%
Operating margin	13.4%	11.0%	17.3%	16.7%
Net margin	13.6%	5.2%	14.7%	15.9%

**Turnover Breakdown by Product Category (% of Total Turnover)**

	Year ended 31 <sup>st</sup> December			Six months ended 30 <sup>th</sup> June
	2003	2004	2005	2006
	%	%	%	%
Incandescent-based decorative lighting	80.4%	64.4%	55.5%	36.9%
LED-based decorative lighting	2.7%	14.5%	23.7%	31.1%
Entertainment Lighting	13.8%	15.4%	17.4%	30.0%
Others	3.1%	5.7%	3.4%	2.0%
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

**Turnover Breakdown by Geographical Region (% of Total Turnover)**

	Year ended 31 <sup>st</sup> December			Six months ended 30 <sup>th</sup> June
	2003	2004	2005	2006
	%	%	%	%
Americas	33.9%	28.6%	30.1%	30.7%
Europe	34.8%	34.3%	36.3%	39.3%
Asia	22.7%	27.6%	26.2%	21.2%
China	8.3%	9.1%	6.9%	8.4%
Others	0.3%	0.4%	0.5%	0.4%
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

**Strengths/Opportunities**

- ✓ According to industry forecasts, the market for LEDs in illumination applications will surge from US\$244 million in 2005 to US\$876 million in 2010, representing a CAGR of 29.1%. Neo-Neon has consistently deployed R&D resources for LED lighting applications since 1998 and commenced mass production of these products in 2003. Leveraging on its technology and manufacturing know-how of LED decorative lighting, the Group stands to capture the strong growth prospects of the LED application market.
- ✓ The Group has been enjoying high and widening gross margins on increasing contribution from higher-margin LED-based products (52.0% gross margin vs incandescent-based product's 32.2% in 2005). Continued shifting of its focus to this segment would further enhance the Group's already-high margin (34.9% gross margin in 2005).
- ✓ The Group has a diversified clientele covering 80 countries in Europe, the Americas, the Middle East, Southeast Asia and China. Its top 5 customers represented 20.3% and 28.0% of its total revenue in 2005 and the first half of 2006 respectively.
- ✓ Pricing at 16.5x-20.7x FY2006E P/E, valuation of Neo-Neon is attractive when compared with both international lighting peers and LED lighting peers. Lighting peers are trading at an average FY2006E P/E of 20.4x while LED lighting manufacturers are trading at 36.3x. Pure LED player Color Kinetics (stock code: CLRK US) is even trading at a rich 71.8x FY2006E P/E.

**Weaknesses/Threats**

- × The LED chips, which are used in the Group's LED-related products, are sourced from two Taiwanese suppliers. Should these two suppliers be unable to provide sufficient LED chips on a timely basis or unable to comply with the Group's required standards and specifications, the continued success and development of the Group's LED-based lighting product segment may be adversely affected.
- × Entry barriers of lighting products are not high given its low-technology nature and undemanding initial capital requirement. In fact, more players are entering the LED-based lighting product market, and intensifying competitions would be a major concern.
- × Price fluctuations of the major raw materials required for Neo-Neon's products, including copper, PVC and DOP oil would have adverse effect on its production costs and hence its profitability.
- × Over 90% of the Group's sales are derived from exports. Further appreciation of RMB would have a negative impact on the competitiveness of its products. In addition, while the Group plans to expand its presence in China and had just commenced its China strategy at the end of 2005, it may not be able to capture the strong growth of the PRC market in the short term.

**Recommendation:    Trading Buy**



## **Important Disclosure / Analyst Certification / Disclaimer**

This document is published by East Asia Securities Company Limited, a wholly-owned subsidiary of The Bank of East Asia, Limited (BEA). At time of this report, East Asia Securities Company Limited has no position in securities of the company or companies mentioned herein the report, while BEA and / its associated or affiliated companies may from time to time have interests in securities of the company or companies mentioned herein.

The research analyst primarily responsible for the content of this report, in part or in whole certifies that the views on the companies and their securities mentioned in this report accurately reflect his/her personal views. The analyst also certifies that no part of his/her compensation was, is, or will be, directly, or indirectly, related to specific recommendations or views expressed in this report.

This report has been prepared solely for information purposes and has no intention whatsoever to solicit any action based upon it. Neither this report nor its contents shall be construed as an offer, invitation, advertisement, inducement or representation of any kind or form whatsoever. The information is based upon information, which East Asia Securities Company Limited considers reliable, but accuracy or completeness is not guaranteed. Opinions expressed herein are subject to change without notice. Any recommendation contained in this report does not have regard to the specific investment objectives, financial situation and the particular needs of any specific addressee. This report is not to be taken in substitution for the exercise of judgment by respective readers of this report, who should obtain separate legal or financial advice. East Asia Securities Company Limited and / or The BEA Group accepts no liability whatsoever for any direct or consequential loss arising from any use of this report or further communication given in relation to this report.

At time of this report, East Asia Securities Company Limited has no position in securities of the company or companies mentioned herein the report, while BEA along with its affiliates and/or persons associated with any of them may from time to time have interests in the securities mentioned in this report. BEA and its associates, its directors, and/or employees may have positions in, and may effect transactions in securities mentioned herein and may also perform or seek to perform broking, investment banking and other banking services for these companies.

BEA and/or any of its affiliates may beneficially own a total of 1% or more of any class of common equity securities of the subject company or companies mentioned in this report and may, within the past 12 months, have received compensation and/or within the next 3 months seek to obtain compensation for investment banking services from the subject company or companies mentioned in the report.