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Market Insights

Quammentary: Higher household net worth boosts consumption

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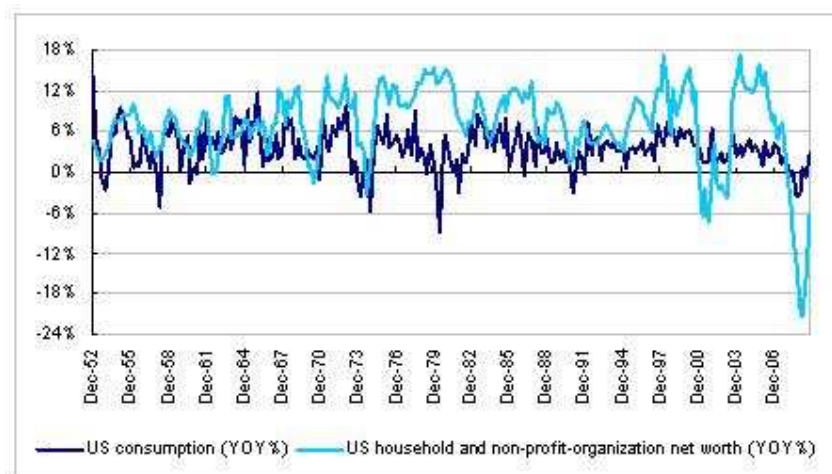
US 3Q household net worth increased

US 3Q09 household & non-profit organization net wealth rose by US\$2,666B resulting from higher stock prices and home values, coupled with a reduction of household debt by US\$255B. The net worth means households' and non-profit organizations' assets minus their liabilities, and the concept is equivalent to equity for a corporation. When households' net worth rises, they likely increase their consumption.

Exhibit 1 shows the net worth growth has moved in tandem with the consumption growth over the past half-century. It is not hard to understand given when consumers see stock or home prices rally or reduce their debt, they will feel more comfortable spending money. It's somehow contrary to the presumption that debt reduction will necessarily reduce consumption. In addition to liabilities, we need to take assets into account as well. US households tend to reduce debt, and if the stock and housing market continues to revive, it will underpin consumption growth.

Exhibit 1: US consumption growth moves in tandem with household net worth growth

US consumption growth vs Household & non-profit organization net worth growth



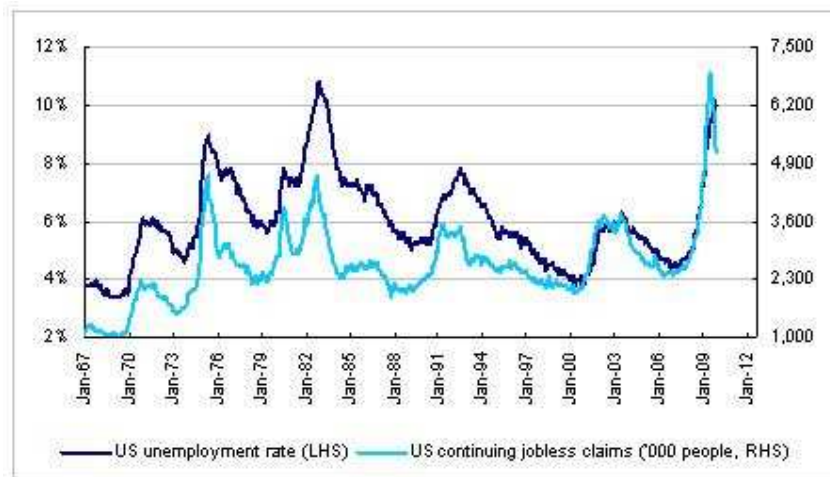
Source: US census bureau

US continuing jobless claims dropped by 303,000 last week

US continuing jobless claims recoded a significant decline of 303,000 people last week, implying more jobs were created. The continuing jobless claims, or insured unemployment, is an actual number of US citizens who are unemployed and are currently receiving unemployment benefits. They are those who files for unemployment benefits for at least two weeks. The continuing and initial jobless combined constitute the total unemployment in the US. What's important is the continuing jobless claims often lead the US unemployment rate, as illustrated in Exhibit 2. The former is a leading indicator of the US unemployment situation. Continuing jobless claims in fact have declined substantially since late Jun 09 by 1.7M. The persistent decline soothes our worries about the US unemployment situation.

Exhibit 2: Continuing jobless claims lead unemployment rate

US unemployment rate vs Continuing jobless claims



Source: US Department of Labor

Company flash

Alco (328): Earnings to improve

Alco Holdings, an audio and video electronic product manufacturer, announced interim results ended 30 Sep 2009. Revenue dropped 21.5% YOY to HK\$2,219M. Operating profit dropped 8.4% YOY to HK\$103M. Reported net profit was up 3.4% YOY to HK\$93M, attributable to decrease in finance costs and exchange gain. Excluding exchange gain, recurring net profit was down 23% YOY to HK\$82M. Alco declared a final dividend of HK\$0.09/shr (1H03/09 interim dividend: HK\$0.09/shr).

The company's major markets of North America and Europe were hard hit by the global financial crisis that swept the world last year. Revenue from North America was HK\$1,693M, down 21.1% YOY. Revenue from Europe dropped 35.6% YOY to HK\$260M. Revenue from Asia dropped 1.5% YO to HK\$191M.

Alco's earnings are expected to improve on recovery of US and EU consumer market. We expect **recurring net profit to reach HK\$175M in FY03/10, down 20.7% YOY; and reach HK\$201M in FY03/11, up 15% YOY**. Priced at **HK\$2.85**, Alco is trading at **prospective FY03/10 and FY03/11 P/Es of 9.1x and 7.9x**, respectively. Valuation is undemanding. We maintain **ACCUMULATE and HIGH RISK** ratings. Major risks slow recovery of US and EU consumer market and losing orders from major customers due to failing competitiveness. **This counter is not suitable for conservative investors. Risk-taking investors who consider this counter should limit exposures to no more than 3% of portfolio.**

Tungtex (518): Suffered from Deteriorated Exports

Tungtex, a garment manufacturer and retailer, announced its interim results for the six months ended 30th September 2009. Revenue fell by 30.5% YOY, to HK\$754M, which was mainly attributable to the weak demand from the U.S. market. Gross margin remained relatively stable owing to the efforts of discontinued operation in the Philippines. As a result, gross profit was HK\$166M, down 31.8% YOY, in line with the revenue drop. Despite falls in operating costs, operating profit plunged by 80.8% YOY, to HK\$9.4M and wholly related to the decrease in gross profit. With the help of a tax credit received as well as positive minority interests, reported net profit arrived at HK\$12.1M, down 59.8% YOY. Excluding disposal and fair value gains/losses, recurring net profit dropped by 60.5% YOY, to HK\$11.9M. The company proposed to declare an interim dividend of HK\$0.035/share, down 17.6% YOY.

The recovering demand from the U.S. market as well as substantial fall in staff numbers (1HFY10: 5,600; FY09: 7,300) might help the company to promote mild earnings growth in 2HFY10E. **Therefore, we expect the company's recurring net profit for FY10E to be approximately HK\$35.9M, down 23.4% YOY only but rebound to about HK\$56M in FY11E, up 56% YOY.**

At **HK\$1.6/share**, the company trades at a **historical FY09 recurring P/E of 12x and prospective FY10E and FY11E recurring P/E of 15.7x and 10x**, respectively. Even for a dividend cut in 1HFY10 and possible cut in 2HFY10E as well, dividend yield might still achieve a high 6.3%. However, with respect to fair valuation and uncertainties of revenue rebound, we maintain **HOLD and HIGH RISK** ratings on this counter only. **This counter is not suitable for conservative investors. Risk-taking investors who consider this counter may prefer accumulating the share at price weakness only and should limit exposure to no more than 2% of portfolio.** Major risks are further economic downturn of the U.S market affecting the company's orders and lower-than-expected gross margin improvement. Detailed analysis will follow.

Disclosure: WONG Kin Sing Allen (ARE058), the author of this document declares that as at the date of the publication of this report, he doesn't hold an interest in 328 or 518.