



Adrian Fung  
Senior Analyst  
Tel: (852) 2156-8205  
adrianfung@polariscapital.net

Jeffrey Lau  
Analyst  
Tel: (852) 2156-8335  
jeffreylau@polariscapital.net

# New Focus Auto Tech

17 July 2009

Price: HK\$1.10

Stock codes: 360.HK / 360 HK

Company visit

Hong Kong

HSI (17/07/09): 18805

## Charging up

- **China auto parts aftermarket to grow at a 08-11 CAGR of 14%.** Chinese auto parts producers have their pricing advantage and are improving product quality. They are in the position to benefit from the outsourcing trend by global auto parts brand names. China's auto parts aftermarket sales are expected to reach US\$42.2bn by 2011, a 2008-11 CAGR of 14%.
- **Greater China market driving net profit growth.** New Focus Auto Tech's (NFA) strategy is to focus on the Greater China market in its manufacturing business and open more large self-owned shops in its retail chain business. We expect Greater China sales to accelerate and account for 51% of total sales in FY09 (from 40% in FY08). We forecast FY09 recurring net profit of Rmb20m, and will have explosive earnings growth thereafter.
- **Target price at HK\$1.46, based on FY09 price-to-book of 2x.** New Focus is currently trading at a FY09 PER of 39.6x (or pre-exceptional FY09 PER of 21.6x) and 1.5x FY09 price-to-book. The company is trading at the low-end of its historic price-to-book ratio. With fundamentals improving, we believe that the company's fair value should be at 2.0x FY09 price-to-book, close to its historic average. This implies a target price of HK\$1.46, a potential upside of 33% from the current level.

### Earnings highlights

Year-end 31 Dec	2006*	2007	2008	2009F	2010F	2011F
Sales (Rmb m)	533.3	763.5	707.4	679.5	834.6	991.5
Growth (%)	5.1	43.2	(7.3)	(3.9)	22.8	18.8
Net profit (Rmb m)	(3.1)	17.8	10.9	11.5	30.1	40.9
Growth (%)	n.a.	n.a.	(38.8)	5.2	162.1	35.7
Fully diluted EPS (HK\$)	(0.009)	0.046	0.027	0.028	0.073	0.099
Growth (%)	n.a.	n.a.	(40.3)	1.3	162.1	35.7

Note\*: FY06 has been restated  
Source: Company, Polaris Capital

### Valuations & ratings

Year-end 31 Dec	2006	2007	2008	2009F	2010F	2011F
FD PER (x)	n.a.	23.9	40.1	39.6	15.1	11.1
EV/EBITDA (x)	27.0	8.6	8.1	8.4	5.3	4.1
Price/Book value (x)	1.9	1.5	1.5	1.5	1.4	1.2
Operating margin (%)	(1.1)	1.0	2.8	5.6	6.6	7.4
ROE (%)	(1.4)	7.3	3.9	3.9	9.5	11.3
Total debt/Equity (%)	26.9	64.6	62.6	29.9	26.8	23.4
Cash dividend yield (%)	0.0	0.0	0.0	0.0	0.0	0.0

Source: Company, Polaris Capital

## Outperform

Current price (17/07/09):	HK\$1.10
Fair value:	HK\$1.46
Potential downside:	32.7%

### Share information

52-wk hi/low:	HK\$1.51/HK\$0.70
Total outstanding shares:	450m
Current market cap:	HK\$494m (US\$64m)
Avg 52-wk daily vol:	HK\$55k (US\$7k)

### Major shareholders (%)

Company management	56.8%
Institutional investors	1.7%
Public	41.5%

### Sales breakdown (%)

Year-end 31 Dec	2008	2009F
Manufacturing business	69%	61%
Retail chain business	31%	39%
<b>Total (Rmb m)</b>	<b>707.4</b>	<b>679.5</b>

### Share price performance



Source: Bloomberg

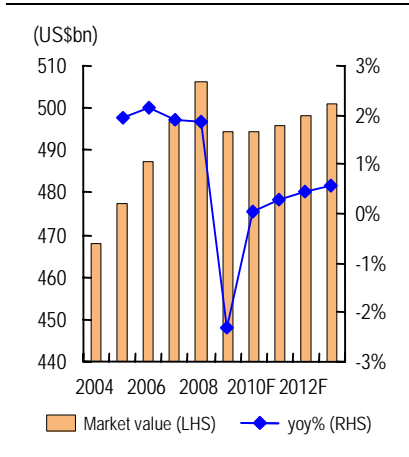
## Table of Contents

---

<b>Industry Analysis .....</b>	<b>3</b>
Global auto aftermarket to drop 2%.....	3
US auto aftermarket more resilient .....	3
China auto aftermarket – still stellar .....	3
China auto parts – continue to grow .....	3
Taiwanese makers bottomed out.....	3
<b>Company &amp; Financial Analysis .....</b>	<b>4</b>
A provider of aftermarket auto parts .....	4
Manufacturing - weak overseas sales .....	4
Retail chain – taking shape .....	4
G. China & direct exports are drivers.....	5
Margin expansion to lift profits .....	5
FY09 core NP forecast of Rmb20m.....	5
CB cancellation - positive to NFA .....	6
Gearing at a manageable level.....	6
OP cashflow turned positive in FY08.....	6
<b>Valuations &amp; PER comparables .....</b>	<b>7</b>
NFA - a unique player in auto parts .....	7
TP at HK\$1.46, based on 2x P/B.....	7

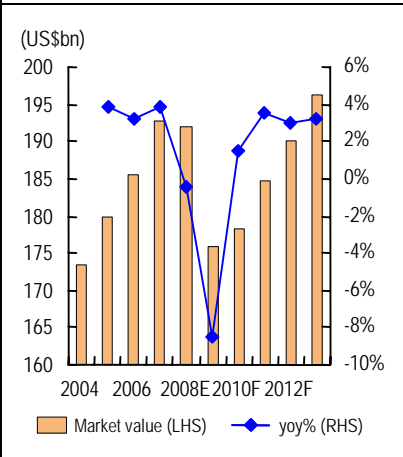
# Industry Analysis

Figure 1: Market value of Global auto aftermarket (2004-13F)



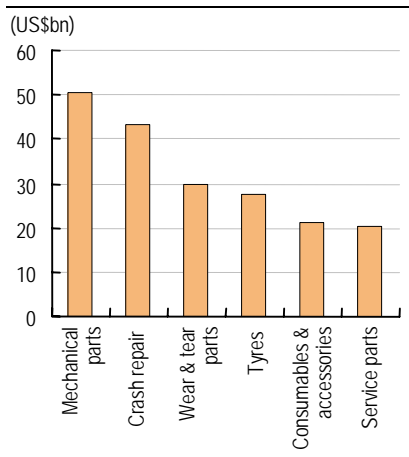
Source: Datamonitor

Figure 2: Market value of US auto aftermarket (2004-13F)



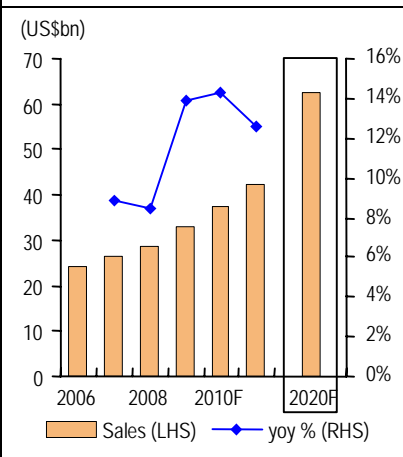
Source: Datamonitor, Polaris Capital estimates

Figure 3: US auto aftermarket sector breakdown (2008)



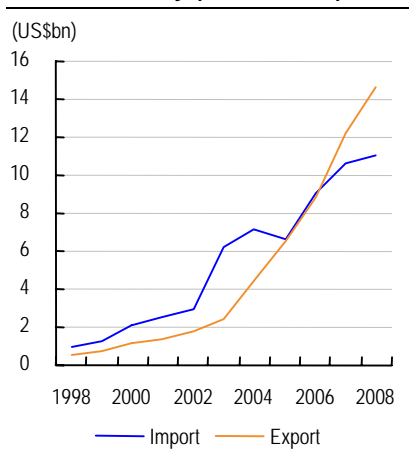
Source: Datamonitor

Figure 4: Market value of China auto aftermarket (06-11F, 20F)



Source: China Statistic Bureau, Boston Consulting Company

Figure 5: China's trade in auto parts industry (1998 - 2008)



Source: World Trade Atlas

Figure 6: Monthly sales of Taiwan's auto parts producers<sup>(1)</sup>

	NT\$m	yoy (%)	qoq (%)
2006	54,281	2.5%	
2007	59,916	10.4%	
2008	56,987	-4.9%	
4Q08	11,996	-23.5%	-15.4%
1Q09	11,955	-21.3%	-0.3%
2Q09	12,815	-18.0%	7.2%

Note (1): 21 companies covered in this analysis  
Source: TEJ

## Global auto aftermarket to drop 2%

According to Datamonitor, global auto aftermarket has been growing at a steady pace of 2% pa over the last 5 years. In 2008, the global auto aftermarket generated sales of US\$506bn (+2% yoy). With the global economic downturn, sales in 2009 are expected to drop 2% yoy to US\$494bn (Fig 1).

## US auto aftermarket more resilient

According to industry source, US auto retail sales slumped 36% yoy in 1H09, and the estimated car sales this year are expected to reach 10m units only, down 38% yoy. US auto aftermarket, though, is more resilient because auto repair and changes of wear and tear parts are inevitable despite a downturn. We expect aftermarket sales to drop 8.5% yoy to US\$176bn in 2009, and will see a recovery of 1.5% in 2010 (Fig 2).

## China auto aftermarket – still stellar

The global economic downturn had limited impact on China's auto industry. 1H09 statistics revealed that China auto sales rose 18% yoy to 6.1m units, and we expect sales this year could reach 11m units (+17% yoy). China's auto aftermarket is also an out-performer. Boston Consulting Company forecasts it to reach US\$32.8bn this year, up 14% yoy, and US\$42.2bn in 2011, representing a 08-11 CAGR of 14% (Fig 4).

## China auto parts – continue to grow

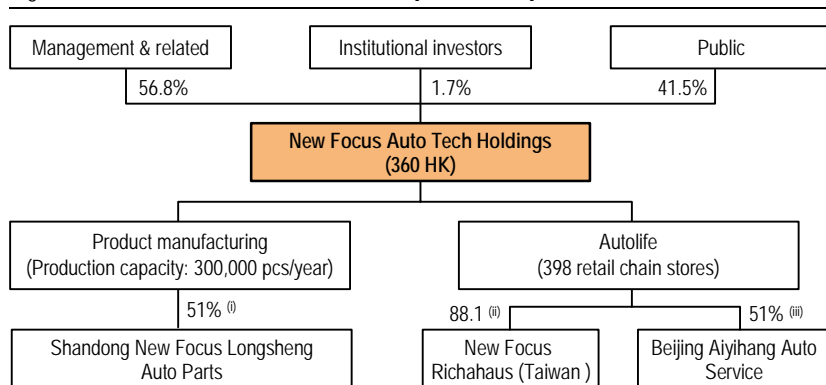
China exported US\$14.6bn of auto parts in 2008, up 20% yoy. Its trade surplus expanded to US\$3.5bn (Fig 5). The Chinese auto parts producers are benefiting from the outsourcing trend by global auto parts brand names. We expect trade surplus will continue to be widened given Chinese products' pricing advantage and improving product quality.

## Taiwanese makers bottomed out

Taiwanese auto parts makers have plants located in China and their major customers are from China and US. Therefore, sales from these Taiwanese players provide some indication for the auto parts industry. Monthly sales of Taiwan-listed auto part manufacturers showed that 4Q08 sales fell a painful 24% yoy, or 15% qoq. However, the magnitude of decline has slowed to 21% in 1Q09 and 18% yoy in 2Q09. In fact, on a qoq basis, 2Q09 rebounded 7% (Fig 6). This may hint that the worst is over for the auto parts makers.

## Company & Financial Analysis

Figure 7: New Focus Auto Tech's simplified corporate structure



Note: (i) The other 49% is indirectly held by third party Mr. Liu Yuan Qiang; (ii) The other 11.9% was held by third party Tsai Ming Hui; (iii) The other 49% of Beijing Aiyihang Auto Service is indirectly held by third-party Mr. Xing Ai Yi

Source: Company

Figure 8: New Focus Auto Tech's consolidated profit and loss (Rmb m)

Year-end 31 Dec	2006*	2007	2008	2009F	2010F	2011F
<i>Sales breakdown (%):</i>						
Manufacturing business	89%	76%	69%	61%	56%	52%
Retail chain business	11%	24%	31%	39%	44%	48%
<b>Total consolidated sales</b>	<b>533.3</b>	<b>763.5</b>	<b>707.4</b>	<b>679.5</b>	<b>834.6</b>	<b>991.5</b>
<i>Cost of sales:</i>						
Depreciation	(12.8)	(23.8)	(20.2)	(22.3)	(27.0)	(33.2)
Others COGS	(446.1)	(599.2)	(521.6)	(479.0)	(577.7)	(675.5)
Total COGS	(458.9)	(623.1)	(541.8)	(501.3)	(604.7)	(708.7)
<b>Gross profit</b>	<b>74.4</b>	<b>140.4</b>	<b>165.6</b>	<b>178.3</b>	<b>229.9</b>	<b>282.8</b>
- Manufacturing business gross profit		82.5	79.3	75.1	85.0	94.0
- Retail chain business gross profit		57.9	86.3	103.2	144.8	188.8
Operating expenses	(80.2)	(132.8)	(145.8)	(140.1)	(174.7)	(209.0)
<b>Operating profit</b>	<b>(5.8)</b>	<b>7.6</b>	<b>19.8</b>	<b>38.2</b>	<b>55.2</b>	<b>73.8</b>
Interest income	1.0	3.7	1.2	0.7	0.6	0.6
Interest expense	(2.2)	(8.7)	(15.6)	(10.0)	(6.7)	(6.7)
<b>Pretax profit</b>	<b>(7.1)</b>	<b>2.5</b>	<b>5.4</b>	<b>28.9</b>	<b>49.1</b>	<b>67.7</b>
Taxation	(4.2)	(1.1)	(5.0)	(5.7)	(13.8)	(19.7)
Minority interests	(1.3)	(3.5)	(1.9)	(3.0)	(5.2)	(7.1)
<b>Recurring net profit</b>	<b>(12.7)</b>	<b>(2.1)</b>	<b>(1.5)</b>	<b>20.2</b>	<b>30.1</b>	<b>40.9</b>
Exceptionals	9.6	19.9	12.4	(8.7)	0.0	0.0
<b>Net profit</b>	<b>(3.1)</b>	<b>17.8</b>	<b>10.9</b>	<b>11.5</b>	<b>30.1</b>	<b>40.9</b>
<b>Major ratios:</b>						
Sales growth (%)	5.1	43.2	(7.3)	(3.9)	22.8	18.8
Recurring net profit growth (%)	n.a.	(83.8)	(28.8)	n.a.	49.2	35.7
Net profit growth (%)	n.a.	n.a.	(38.8)	5.2	162.1	35.7
Gross margin (%)	13.9	18.4	23.4	26.2	27.5	28.5
Operating profit margin (%)	(1.1)	1.0	2.8	5.6	6.6	7.4
Net margin (%)	(2.4)	(0.3)	(0.2)	3.0	3.6	4.1
Tax rate (%)	--	4.8	28.1	28.1	28.1	29.1
<b>Major drivers:</b>						
Number of self-owned super stores	10	23	33	45	65	100
Retail chain sales growth	121.6%	222.9%	19.5%	18.0%	40.0%	30.0%
Greater China sales growth	43.0%	287.9%	(17.0%)	21.9%	37.3%	28.8%
Overseas sales growth	(0.2%)	(5.3%)	0.5%	(21.3%)	7.8%	5.6%

Note\*: FY06 has been restated

Source: Company, Polaris Capital estimates

### A provider of aftermarket auto parts

New Focus Auto Tech (NFA, 360.HK) is a leading electronic auto parts and accessories manufacturer with a retail chain. NFA mainly produces environmental electronic auto parts such as inverters, power-packs, chargers, jumpstarters, cables, coolers/warmers, and high-intensity discharge (HID) headlights for the aftermarket. Listed on the HKSE in Feb05, NFA's business mainly divided into two divisions: 1) auto products manufacturing, and 2) retail service chain for automobiles. Under the manufacturing business, NFA's products are sold in the domestic market under the label "NFA" and "VOT" in the overseas markets. Its products are sold at overseas chain stores such as *Walmart*, *Autozone*, *Canadian Tire*, *Carrefour* and *Costco*. It is also the OEM for a number of domestic automakers and overseas customers. Under its retail chain business, NFA operates a franchise of retail shops under the name of *Autolife*. As of Jun09, NFA had 398 stores in Taiwan and cities such as Beijing, Shanghai, Chengdu, Tianjin and provinces of Zhejiang, Jiangsu, and Guangdong in China.

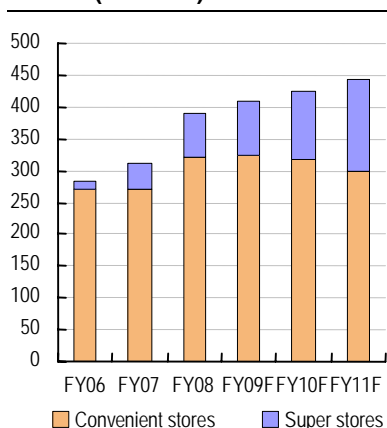
### Manufacturing - weak overseas sales

Affected by global economic downturn, manufacturing sales recorded a 16% yoy drop in FY08 to Rmb485m. In response to the sales drop, NFA adjusted its product strategy: i) changed its product mix by selling more high-margin products, ii) implemented costs control by moving production of lower-margin products from Shanghai to its Shandong for cost-saving, and iii) more direct sale to end-customers. However, the new product strategy was not enough to offset weak overseas sales in FY09. We expect FY09 manufacturing sales to drop further by 14% yoy to Rmb417m, but should return to growth in FY10.

### Retail chain – taking shape

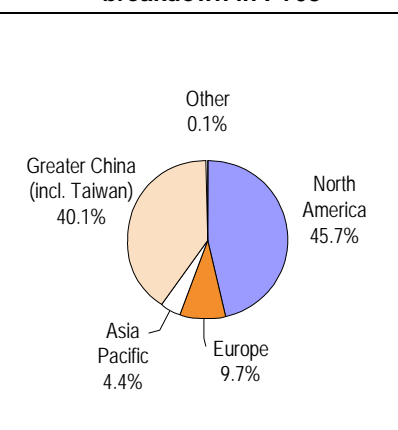
NFA operates a network of retail stores under the name of *Autolife* in China and *Richahaus Autolife* in Taiwan. These chain stores provide auto care and maintenance services. Without much success in the past, *Autolife* adapted a new 5-year strategic plan in 2008. The plan is to establish more self-owned large-sized retail shops (ie. super stores) and shut down those underperforming small shops (ie. convenient stores). In FY08, *Autolife* recorded sales of Rmb222m (+20% yoy) and a turnaround with segmental profit of Rmb1.9m.

Figure 9: Number of Autolife stores (06 – 11F)



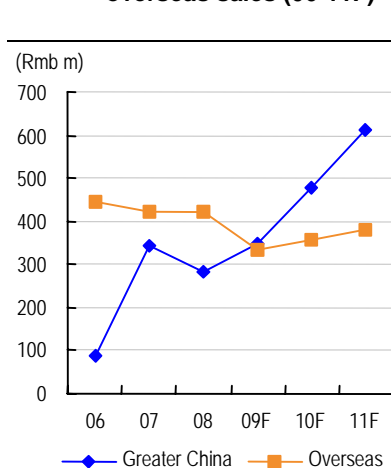
Source: Company, Polaris Capital estimates

Figure 10: Geographical sales breakdown in FY08



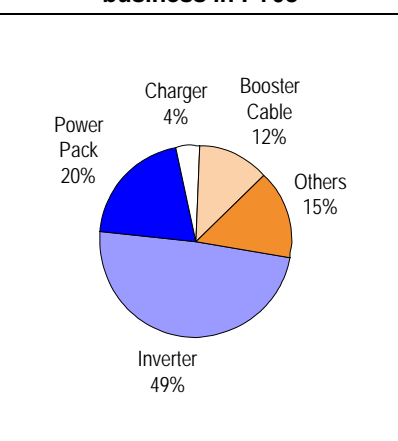
Source: Company, Polaris Capital

Figure 11: NFA's Greater China and overseas sales (06-11F)



Source: Company, Polaris Capital Estimates

Figure 12: Product sales breakdown under manufacturing business in FY08



Source: Company, Polaris Capital

Figure 13: NFA's sales, gross profit, and segment profit breakdown

	FY06	FY07	FY08	FY09F	FY10F	FY11F
<b>Manufacturing</b>						
Sales	475.7	577.4	485.1	417.2	467.2	513.9
Gross profit	n.a.	82.5	79.3	75.1	85.0	94.0
Segment profit	20.4	33.9	30.6	33.4	38.3	43.7
<b>Retail chain</b>						
Sales	57.6	186.0	222.4	262.4	367.3	477.5
Gross profit	n.a.	57.9	86.3	103.2	144.8	188.8
Segment profit	(14.6)	(4.8)	1.9	3.7	12.4	23.4
<b>Aggregate</b>						
Sales	533.3	763.5	707.4	679.5	834.6	991.5
Gross profit	n.a.	140.4	165.6	178.3	229.9	282.8
Segment profit	5.8	29.1	32.5	37.0	50.7	67.1
<b>Gross margin:</b>						
Manufacturing		14.3%	16.3%	18.0%	18.2%	18.3%
Retail chain		31.1%	38.8%	39.3%	39.4%	39.5%
Aggregate		18.4%	23.4%	26.2%	27.5%	28.5%
<b>Segment margin:</b>						
Manufacturing	4.3%	5.9%	6.3%	8.0%	8.2%	8.5%
Retail chain	(25.3%)	(2.6%)	0.9%	1.4%	3.4%	4.9%
Aggregate	1.1%	3.8%	4.6%	5.5%	6.1%	6.8%

Note: Segment profit equals operating profit before net unallocated income/expenses

Source: Companies, Polaris Capital estimates

## G. China & direct exports are drivers

NFA was hit by a double whammy in FY08 as overseas product sales turned weak and domestic sales had its trouble during its product re-alignment. FY08 overall sales were Rmb707m (-7% yoy). For FY09, NFA will focus on Greater China sales. The company will target to open 12 new self-owned super stores and strengthen its distribution. With this new strategy in place, we expect Greater China sales to accelerate and account for 51% of total sales in FY09 (vs. 40% in FY08). This implies Greater China sales will grow by 22% in value terms. Another segment under NFA's manufacturing business is its direct export to end customers. Although this segment only accounted for 1% of manufacturing sales in FY08, with increasing effort in direct selling, this ratio is expected to jump to 5% in FY09 and over 20% in FY10. In light of the weak overseas sales, we project FY09 overall sales to shrink 4% to Rmb680m, but will return to a growth of 23% in FY10.

## Margin expansion to lift profits

NFA uses currency swap to hedge currency fluctuation and the company's products have little pricing power. However, historical figures indicated that NFA's overall gross margin has been resilient and on the up-trend. FY08 overall gross profit margin was up 500bps to 23.4%, with gross profit for manufacturing and retail chain business of 16.3% and 38.8% respectively. More importantly, its retail chain business broke even and made a profit on the operating level. For FY09, overall gross margin is expected to further improve to 26.2% (GM for manufacturing at 18.0% and GM for retail chain business at 39.3%) (Fig 13).

## FY09 core NP forecast of Rmb20m

In FY08, NFA reported a net profit of Rmb10.9m. Adjusted for the effects of its CBs, related exchange loss and interest costs, NFA recorded a core net profit of Rmb7.8m.

For FY09, we estimate NFA to report a net profit of Rmb11.5m. FY09 bottom line is primarily distorted by an accounting loss of Rmb8.7m from its CB cancellation. Stripping out this exceptional item, NFA is expected to make Rmb20.2m in recurring net profit. This, in fact, is a huge improvement on the company's core operation. NFA declared stock dividend in FY06 & FY07, but did not declare any in FY08. To be prudent, we assume the same going forward.

Figure 14: New Focus Auto Tech's consolidated cashflow (Rmb m)

Year-end 31 Dec	2006*	2007	2008	2009F	2010F	2011F
Net profit	(3.1)	17.8	10.9	11.5	30.1	40.9
Depreciation & amortization	12.8	23.8	20.2	22.3	27.0	33.2
Others	0.0	1.0	2.0	0.0	0.0	0.0
Total non-cash items	12.8	24.8	22.2	22.3	27.0	33.2
<b>Gross operating cash flow</b>	<b>9.7</b>	<b>42.7</b>	<b>33.2</b>	<b>33.8</b>	<b>57.1</b>	<b>74.1</b>
Working capital changes	(11.9)	(55.0)	(14.7)	13.8	(14.9)	(40.6)
<b>Cash from operations</b>	<b>(2.2)</b>	<b>(12.3)</b>	<b>18.4</b>	<b>47.5</b>	<b>42.2</b>	<b>33.5</b>
<b>Investing Activities</b>						
Fixed assets, net	(17.4)	(29.8)	(64.6)	(30.0)	(40.0)	(52.5)
Investment & others, net	(4.6)	(12.3)	0.9	(0.1)	0.3	0.3
<b>Financing Activities</b>						
Issue of shares	5.5	0.1	0.0	0.0	0.0	0.0
Net change in borrowings	20.4	123.6	30.5	(89.3)	0.0	0.0
Dividends & others	(10.5)	(21.7)	(1.7)	3.0	5.2	7.1
<b>Change in net cash</b>	<b>(8.7)</b>	<b>47.5</b>	<b>(16.5)</b>	<b>(68.9)</b>	<b>7.6</b>	<b>(11.6)</b>
Affect of exchange rates	0.0	22.1	(0.9)	0.0	0.0	0.0
Cash b/f	74.6	65.9	113.1	95.7	26.9	34.4
<b>Cash c/f</b>	<b>65.9</b>	<b>135.5</b>	<b>95.7</b>	<b>26.9</b>	<b>34.4</b>	<b>22.8</b>

Note\*: FY06 has been restated  
Source: Company, Polaris Capital estimates

Figure 15: New Focus Auto Tech's consolidated balance sheet (Rmb m)

Year-end 31 Dec	2006*	2007	2008	2009F	2010F	2011F	
Trade debtors	89.4	120.0	78.5	101.9	125.2	148.7	
Stocks	85.1	126.8	125.7	108.7	125.2	148.7	
Cash and near cash	65.9	135.5	95.7	26.9	34.4	22.8	
Pledged time deposits	1.1	3.3	1.9	1.9	1.9	1.9	
Other current assets	47.6	60.0	61.5	61.5	61.5	61.5	
Current assets	289.2	445.8	363.3	300.9	348.2	383.6	
Trade creditors	138.6	150.7	110.7	134.1	150.2	148.6	
Debt	38.4	87.3	96.4	20.0	20.0	20.0	
Other current liabilities	37.0	43.9	40.0	36.9	45.5	53.6	
Current liabilities	214.0	281.9	247.1	191.0	215.7	222.2	
<b>Net current assets/(liabilities)</b>	<b>75.2</b>	<b>163.8</b>	<b>116.2</b>	<b>109.9</b>	<b>132.5</b>	<b>161.4</b>	
Fixed assets, net	96.7	106.5	150.4	158.1	171.2	190.5	
Other LT assets	56.3	101.6	104.1	104.1	104.1	104.1	
Long-term debt	18.0	16.5	14.3	70.0	70.0	70.0	
CB	0.0	76.0	68.6	0.0	0.0	0.0	
Other LT liabilities	10.1	32.7	34.9	37.9	43.3	50.7	
<b>Total net asset value</b>	<b>200.2</b>	<b>246.7</b>	<b>252.8</b>	<b>264.3</b>	<b>294.4</b>	<b>335.3</b>	
Capital	43.0	46.4	47.4	47.4	47.4	47.4	
Reserves	157.2	200.3	205.5	217.0	247.1	288.0	
<b>Shareholders' funds &amp; MI</b>	<b>200.2</b>	<b>246.7</b>	<b>252.8</b>	<b>264.3</b>	<b>294.4</b>	<b>335.3</b>	
<b>Major ratios:</b>							
A/R turnover (days)	52	50	51	48	50	50	
Inventory turnover (days)	59	65	88	89	74	74	
A/P turnover (days)	77	82	92	97	87	78	
Net cash/(debt) (Rmb m)	10	(44)	(84)	(63)	(56)	(67)	
Net gearing (%)		Net cash	15.9	29.2	21.0	16.5	17.5
Total debt/Equity (%)	26.9	64.6	62.6	29.9	26.8	23.4	
NAV per share (Rmb)	0.5	0.6	0.6	0.6	0.7	0.8	

Note\*: FY06 has been restated  
Source: Company, Polaris Capital estimates

Figure 16: New Focus Auto Tech's ROE evolution

Year-end 31 Dec	2006	2007	2008	2009F	2010F	2011F	Comment
EBIT margin (%)	0.4	3.1	4.3	3.9	6.0	6.7	Margin recovery from FY09 by changing product mix & costs control
Capital turnover ratio (x)	2.1	2.0	1.4	1.5	1.9	2.0	Continuous improvement in domestic market and service sales
Financial cost ratio (x)	0.5	0.8	0.5	0.6	0.9	0.9	Cancellation of CBs in Apr09 lowered cash level but eases interest burden
Financial structure ratio (x)	1.2	1.6	1.8	1.6	1.4	1.4	Prudent capex plan lower gearing ratio
Tax effect ratio (x)	(2.8)	0.9	0.7	0.7	0.7	0.7	Effective tax rate is expected to be stable between FY09 & FY10
ROE (%)	(1.4)	7.3	3.9	3.9	9.5	11.3	ROE is low but sees improvement starting FY10
ROIC (%)	(2.6)	5.9	4.2	3.8	7.7	9.1	ROIC fall below WACC of 9.8%, the company is not creating value

Source: Company, Polaris Capital estimates

## CB cancellation - positive to NFA

In Apr07, NFA issued US\$12m of 3-year convertible bonds with a coupon rate of 5.2% to institutional investor ARCH. As share price of NFA had been on a downtrend, the company recorded Rmb10-15m valuation gain from it in each of FY07 and FY08. In Apr09, ARCH requested NFA to cancel its CBs. NFA agreed to repay ARCH US\$11.3m (6% discount to its face value). The CB cancellation will give rise to a net loss of Rmb8m, being the difference between the price paid and its book value at end-FY08. We see this as a one-off item. In our view, this move is positive as it not only eliminates potential share dilution but also alleviates NFA's interest burden.

## Gearing at a manageable level

As of end-FY08, NFA had cash of Rmb96m, total debt of Rmb179m (including Rmb96m of short-term debt, Rmb14m of long-term debt, and Rmb69m of CBs). Its net gearing stood at 29%. The CB cancellation reduced the company's cash level. However, given that NFA's operating cashflow is positive, we estimate NFA will have Rmb27m of cash-on-hand and total debt of Rmb90m by the end of FY09. NFA still has about Rmb200m of unutilized line of credit.

## OP cashflow turned positive in FY08

In FY08, NFA recorded a cash inflow of Rmb18m at its operating level. This is the first time that the company had operating cash inflow. With strong earnings growth going forward, we expect operating cashflow to increase to over Rmb30m pa. NFA recorded a capex of Rmb68m in FY08. Capex was mainly spent on the expansion of its retail network. With the assumptions of an average investment cost of Rmb1.5m for a super store, we project NFA's total capex to be approx. Rmb30m in FY09. Capex will gradually step up as NFA speeds up its retail network expansion.

## Valuations & PER comparables

Figure 17: New Focus Auto Tech's historic price-to-book chart



Source: Bloomberg, Consensus estimates, Polaris Capital estimates

Figure 18: New Focus Auto Tech's peer group description

Company	Ticker	Principle business
Depo Auto Parts Ind	6605 TT	Manufactures auto lamps and other auto parts for aftermarket
Launch Tech	8196 HK	Manufactures auto diagnostic equip and operates auto shops in China
Minth Group	425 HK	Manufactures exterior automobile body parts
Tong Yang Industry	1319 TT	Manufactures auto parts such as bumpers, windshields, and fenders
TYC Brother Industrial	1522 TT	Manufactures auto lights for both original and aftermarket
Weichai Power	2338 HK	Manufactures high-speed heavy-duty diesel engines
Xinyi Glass	868 HK	Produces processed glass products for auto and household
Autobacs Seven	9832 JP	Retails auto related products and services through its stores in Japan
Autozone	AZO US	Retails auto replacement parts and accessories through its stores
Denso	6902 JP	Manufactures auto electronic parts
G-7 Holdings	7508 JP	Retails auto parts and accessories

Source: Bloomberg, Company, Polaris Capital

Figure 19: New Focus Auto Tech's global peer group comparison

Companies <sup>(i)</sup>	Market cap (US\$m)	FY08 OP margin (%)	FY09F OP margin (%)	FY08 NP growth (%)	FY09F NP growth (%)	FY08 PER <sup>(ii)</sup> (x)	FY09F PER <sup>(ii)</sup> (x)	FY09F yield (%)	FY08 Price/Bk (x)	FY09F Price/Bk (x)	FY09F ROE (%)
<b>Greater China peers</b>											
Depo Auto Parts Ind	318	13.1	18.5	(39.7)	4.2	10.5	10.5	5.8	1.4	-	-
Launch Tech	49	23.7	-	49.2	-	4.5	-	-	0.6	-	-
Minth Group	911	24.0	21.8	17.9	14.9	14.7	12.7	2.2	1.9	1.7	13.7
<b>New Focus Auto Tech</b>	<b>64</b>	<b>2.8</b>	<b>5.6</b>	<b>(38.8)</b>	<b>5.2</b>	<b>40.1</b>	<b>39.6</b>	<b>0.0</b>	<b>1.5</b>	<b>1.5</b>	<b>3.9</b>
Tong Yang Industry	495	5.1	11.6	(46.0)	75.5	29.3	15.3	1.7	1.8	1.6	11.0
TYC Brother Industrial	173	6.0	7.7	(57.1)	154.4	29.0	11.1	3.3	1.2	1.1	-
Weichai Power	3,354	9.5	9.6	(4.3)	(7.6)	11.9	12.8	0.7	2.9	2.4	19.6
Xinyi Glass	1,423	18.4	19.7	5.7	37.2	14.8	10.8	4.3	2.4	2.2	21.0
<b>Greater China average</b>	<b>848</b>	<b>12.8</b>	<b>13.5</b>	<b>(14.1)</b>	<b>40.6</b>	<b>19.4</b>	<b>16.1</b>	<b>2.6</b>	<b>1.7</b>	<b>1.7</b>	<b>13.9</b>
<b>R.O.W. peers</b>											
Autobacs Seven	1,348	2.1	3.4	-	-	na	7.5	-	0.8	-	2.1
AutoZone	8,482	17.3	17.4	6.2	3.4	14.9	12.9	0.0	-	10.0	-
Denso	23,369	1.3	(1.5)	-	-	na	na	1.0	1.1	1.1	(2.0)
G-7 Holdings	56	2.1	-	(37.8)	-	18.3	-	-	0.6	-	-
<b>R.O.W. peers average</b>	<b>8,314</b>	<b>5.7</b>	<b>6.4</b>	<b>(15.8)</b>	<b>3.4</b>	<b>16.6</b>	<b>10.2</b>	<b>0.5</b>	<b>0.8</b>	<b>5.6</b>	<b>0.0</b>
<b>Aggregate average</b>	<b>3,337</b>	<b>10.4</b>	<b>11.4</b>	<b>(14.5)</b>	<b>35.9</b>	<b>18.8</b>	<b>14.8</b>	<b>2.1</b>	<b>1.5</b>	<b>2.7</b>	<b>9.9</b>

Source: Bloomberg, Companies, Consensus estimates, Polaris Capital estimates

Notes: (i) All ratios are calendarised, (ii) na under PER means loss-making

### NFA - a unique player in auto parts

Most auto parts producers are OEMs and do not have their own retail chains. In our view, there is no exact comparables to NFA. We believe that HK-listed Launch Tech is NFA's closest comparable. It is a diagnostic equipment producer with retail shops in China. However, this small company is not on most investors' radar screen. We have also included some Taiwan-listed aftermarket auto parts makers. These Taiwanese companies have production facilities in China, and their products are sold through distributors in China and overseas. We argue that NFA's has built its strong brandname and its retail chain business is unique, which is a valuable asset to the company. Despite that *Autolife* currently gives little profit contribution to the company, it is expected to be increasingly significant in the longer term. We therefore believe that NFA deserves to trade at premium to its Hong Kong and Taiwanese peers.

### TP at HK\$1.46, based on 2x P/B

NFA is currently trading at 39.6x FY09 PER (or pre-exceptional FY09 PER of 21.6x) and 1.5x FY09 price-to-book. Although it may look expensive on a PE basis, NFA is trading at the low-end of its historic price-to-book ratio. With fundamentals improving, we believe that the company's fair value should be at 2.0x FY09 price-to-book, close to its historic P/B average. This implies a target price (TP) of HK\$1.46, a potential upside of 33% from the current level.

Polaris Capital (Asia) Ltd

Hong Kong  
Units 6503-06, The Center,  
99 Queen's Road, Central,  
Hong Kong.  
Tel: (852) 2156-8222  
Fax: (852) 2869-5572

Taiwan  
2/F, No. 420,  
Fusing N. Road, Taipei,  
Taiwan.  
Tel: (8862) 2515-8200  
Fax: (8862) 2515-9179

Shanghai  
12H Majesty Building,  
138 Pudong Avenue, Shanghai,  
China.  
Tel: (8621) 5887-1122  
Fax: (8621) 5882-9778

Research contacts

**Adrian Fung**  
Senior Analyst  
Tel: (852) 2156-8205  
adrianfung@polariscapital.net

**Jeffrey Lau**  
Analyst  
Tel: (852) 2156-8335  
jeffreylau@polariscapital.net

Sales contacts

**Mego Cheng**  
Executive Director  
Tel: (852) 2156-8333  
megocheng@polariscapital.net

**Michael Liu**  
Managing Director  
Tel: (852) 2156-8200  
michaelliu@polariscapital.net

**Fu Hung Man**  
Director  
Tel: (852) 2156-8319  
manfu@polariscapital.net

IMPORTANT LEGAL INFORMATION

This report is produced by Polaris Capital (Asia) Limited ("Polaris Capital"), an affiliate of Polaris Securities Group. Polaris Capital is licensed by the Securities and Futures Commission for types 1 and 6 regulated activities pursuant to the Securities and Futures Ordinance.

In relation to recipients of this report in the United Kingdom, this report is directed only at persons having professional experience in matters relating to investments or are persons falling within Article 49(2)(a) to (d) ("high net worth companies etc") of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001 (all such persons together being referred to as "relevant persons"). This report must not be acted on or relied upon by persons who are not relevant persons. Any investment or investment activity to which this report may relate is available only to relevant persons.

INFORMATION PURPOSES ONLY

This report is for information purposes only. This report is not intended as advice or a recommendation to conclude any transaction and should not be treated as such. It should not be construed as an offer to sell or the solicitation of an offer to buy any security or financial instrument in any jurisdiction where such an offer or solicitation would be illegal. This report is not intended to be published or made available to any person in any jurisdiction where doing so would result in violation of any applicable laws or regulations.

The information contained in this report is not intended to provide professional, investment or any advice or recommendation and should not be relied upon in that regard. This report does not take into account the investment objectives, financial position or needs of any particular person. Before acting on any information in this report you should consider whether it is suitable for your particular circumstances and you should consult your own legal, financial, tax, accounting or other professional advisors to ensure that any decision made is suitable to your investment objectives, financial position and any other relevant circumstances.

The price and value of the securities and financial instruments referred to in this report and the income derived from them may go down as well as up, and under certain circumstances an investor may sustain a total loss of investment or be exposed to liabilities greater than your original investment. The securities and financial instruments discussed in this report may not be suitable for all investors. In particular, options, derivative products and futures are not suitable for all investors, and trading in these instruments is considered risky. Past performance is not a guide to future performance. Future returns are not guaranteed, and a loss of original capital may occur.

LIMITATION OF LIABILITY

This report is based on information (including, in certain circumstances, information obtained from relevant issuers) we consider to be reliable and accurate as at the date indicated. It is not intended to be a complete statement or summary of the securities, financial instruments, markets or developments referred to in this report and it should not be treated as such. Polaris Capital may not update this report or correct any inaccuracy, which subsequently becomes apparent and is under no obligation to do so. Opinions, estimates and other information in this report may be changed or withdrawn without notice to you.

Indicative price quotations, disclosure materials or analyses in this report may have been prepared based on assumptions and/or parameters made/selected by us in good faith and do not constitute forecasts by us. The assumptions and parameters used are not the only ones that might reasonably have been selected and therefore no guarantee is given as to the accuracy, completeness, or reasonableness of any such quotations, disclosure or analyses. No representation or warranty is made that any indicative performance or return indicated will be achieved in the future.

This report is derived from information, which includes information prepared by Polaris Capital or its/their related bodies corporate. None of Polaris Capital, its/their related bodies corporate or the directors, officers, employees or agents, of those entities gives any representation or warranty as to the reliability, completeness, timeliness, accuracy or fitness for any purpose of this report, nor does any of them accept any responsibility or liability for any loss or damage arising in any way (including by reason of negligence) out of errors or misstatements in, omissions from, or the reliance of any person on, this report.

DISCLOSURE OF INTERESTS

Polaris Capital, its/their related bodies corporate or persons associated with those entities (including but not limited to directors, officers, employees and clients) may maintain long or short positions in all securities or financial instruments referred to in this report, or in other securities or financial instruments of the issuers named in this report, or in related derivatives. Polaris Capital may act or have acted as market-maker in the securities or other financial instruments discussed in this report. Furthermore, Polaris Capital may have or have had a relationship with or may provide or has provided investment banking, capital markets and/or other financial services to the relevant issuers. Employees of Polaris Capital may serve or have served as officers or directors of the relevant issuers.

COPYRIGHT

Copyright of this report is owned by Polaris Capital. This report may not be reproduced, published, distributed or transmitted (in whole or in part) to any other person or incorporated in any way into another document or other material without the written consent of Polaris Capital and Polaris Capital accepts no liability whatsoever for the actions of third parties in this respect.