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SG-AM Notes: Bank, Property, Tech, M1 & Qian Hu (20 Jul 2005)

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MARKETS

In an uncommon move, the Singapore government unveiled a number of property measures during normal trading hours, and investors liked these measures, pushing the STI to another new 5.5 years record high of 2292.43 yesterday. Banking and property stocks were the key beneficiaries, with the indices up 3.5% and 8.4% respectively (see below for more details). The STI added 45 points or 2.0% yesterday.

With yesterday's gains, the Finance index is now back in the black with year-to-date gain of 1.1% and the Property Index is up 23% for the year.

Within the STI, several component stocks hit new 52-week highs. The list included Allgreen Properties, CapitaLand, CapitaMall Trust, City Developments, Cosco, Great Eastern, Hongkong Land, Hyflux, Keppel Land, OCBC, UOB and Wing Tai.

In overnight trading, US stocks posted gains, reversing the losses of the previous session. Gains were due to better-than-expected earnings from International Business Machines (IBM). IBM rose US$1.89 or 2.3% and gave the Dow Jones Industrial Average a lift, which ended up 72 points or 0.7% to 10,646.56. The S&P 500 rose 8 points or 0.7% to 1229.35. The Nasdaq Composite Index gained 28 points or 1.3% to 2173.18.

After the close of trading, Intel announced its results, with a 16% rise in 2Q net income to US$2.04 billion or 33 cents a share. Sales rose 15% to US$9.23 billion, meeting market expectation. However, gross margin of 56.4% was lower than Intel's forecast of 57%. Disappointment over its margin caused the stock to fall 99 cents to US$27.72 in extended trading.

There could be some remaining buying from yesterday's property measures, but with disappointment over Intel's margin, the market is likely to be on the look-out for an excuse to lock in recent strong gains, especially since yesterday's gains were too fast and sharp. ***(Carmen Lee)***

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Property: The government announced yesterday a series of changes to housing policy. This is the 8th change to the housing policy since the bottom of the property market in 1998. In the current announcement, we see the most important aspect being the raising of loan to value limit for residential purchases from 80% to 90% and concurrently lowering the minimum cash payment from 10% to 5% of the property value.

The policy change is obviously an attempt to stimulate the lacklustre performance of the residential property market. However, even though the policy changes allow an easing in financing rules, the more critical element in determining buying is still sentiment (related to job security), expectation of capital appreciation (speculators) and more fundamentally, affordability (i.e. wages). So unless wages rise in tandem to support a higher level of debt, we do not see the policy change as having a material impact on the fundamental of affordability and hence demand. Our comments notwithstanding, we still expect to see a surge in demand in the short term (from speculators and marginal buyers). However, we believe this demand surge will eventually fall back again as fundamental affordability will not have been enhanced through higher wages (OIR expect wages to rise at the lower end of 4%-7%). We see the likely scenario not unlike the event post the policy change in 3Q02 when government relaxed the cash rules from 20% to 10% (see chart).

In so far as the residential segment that is most likely to benefit from these policy changes, we believe it would be the marginal buyers in

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the lower end of the market. This is because mid to high end buyers are likely to have much higher affordability and hence their buying decision is unlikely to be influenced by the proposed changes. Developers most exposed to the low-end segment as a proportion of their total residential exposure are **Allgreen Properties, MCL Land** and to a lesser degree **City Development** and **UOL.** ***(Winston Liew)***

For more information on the above, visit www.qian2yu.com for detailed report.

Banking/DBS: Banking stocks have in general been languishing for a while due to a lack of price drivers, especially in an environment of flattening yield curve. With the new property measures announced yesterday, this has given local banks more room to manoeuvre and offer higher financing options. Of the new changes in policy, one of the key measures is the increase in financing from 80% of property value to 90% of property value with immediate effect. This applies equally to both private residential properties as well as HDB units. Cash portion has also been similarly reduced, down from 10% to 5%. Overall, the net effect is positive for the banking environment.

In addition, the opening up of CPF policy for the purchase of properties with leases of 30-60 years is also deemed to be positive. This policy will also take place with immediate effect. Foreigners are also allowed to buy apartments in building of less than 6 levels in non-condominium developments without first obtaining approval.

Finance stocks, which have languished for the past few months, with the SES Finance Index down 2.3% as of Monday compared to +8.8% for the STI, rallied strongly after the announcement. With yesterday's gains of 3.5%, the finance index is up 1.1% for the year now.

Based on recent results, housing loans accounted for about 24-34% of banks' loans. The biggest player in this market is DBS ($24.4 billion), followed by OCBC ($17.7 billion) and UOB ($15.9 billion). At 24-34%, there is room for housing loans to grow further, although banks are unlikely to want to be overexposed to any one single sector. Currently, housing loans and loans to professional and individuals accounted for about 40-48% of total loan books of the three local banks. Loans-to-deposit ratios are still not optimal at this juncture, and banks can afford to grow this ratio further.

Recently, in our report dated 8 Jul 2005, we reiterated our pick for **DBS** as we expect any re-rating for the banking sector to benefit DBS the most. Yesterday, the stock spiked up after the announcement and DBS added 70 cents or 4.8% to $15.40 (OCBC added 60 cents to a new 52-week high of $12.50 and UOB added 40 cents to a new 52-week high of $14.80). At this level, the stock is still a BUY. However, with its 2Q results slated for release on 29 Jul 2005, there could be some short term profit taking ahead of the results. Our fair value estimate for DBS is $17.70. ***(Carmen Lee)***

MobileOne: MobileOne reported an expected set of results with net profit for the second quarter growing by just 1.5%YoY to S$40.1m, driven mostly by service revenue (i.e. pre paid segment and IDD). Operationally, post paid was flat or marginally down. For the interim, M1 has declared an interim dividend of 5 cents, but for the full year, we are expecting total dividend of 11.25 cents or 5.5% yield. In terms of recommendation, since our upgrade in 20 January 05, M1 has appreciated close to our fair value of S$2.08. At current levels, we do not see much upside, and we have accordingly downgraded our rating of M1 from BUY to **HOLD.** ***(Winston Liew)***

For more information on the above, visit www.qian2yu.com for detailed report.

Qian Hu: Qian Hu's sales dipped 13% YoY to S$15.6m in 2Q05. This was mainly attributed to the Fish Division's 18% YoY sales decline to S$7.8m in 2Q05, as a drought in early quarter resulted in Dragon Fish supply shortage. Accessories Division continued to have lacklustre sales, which was in its eighth straight quarter of QoQ sales decline to S$6.1m in 2Q05. Qian Hu's profit before tax margin dropped 0.6ppt QoQ to 3.8%, as both selling and distribution expenses and finance costs rose. Backed by the low concessionary tax rate in Singapore, net profit held steady on a QoQ basis at S$480,000 in 2Q05. Disappointingly, we have yet to see strong outsourcing demand from Qian Hu's OEM fish accessories partners, as well as evidence of a sustainable improvement in its retail operations. As such, our FY05 net profit estimate remains at S$2m. We retain our fair value estimate of S$0.32, and HOLD rating on Qian Hu. ***(Chong Wee Lee)***

For more information on the above, visit www.qian2yu.com for detailed report.

Technology - Motorola: Motorola reported a better than expected set of June quarter results last night. Sales rose 17% YoY to US$8.83 billion while earnings per share (EPS) jumped 52% YoY to US$0.38. Excluding some one-off items, EPS for the June quarter came in at US$0.26. These numbers beat consensus sales and EPS estimates of US$8.55 billion and US$0.247 respectively.

For the June quarter, Motorola shipped 33.9m handsets, up 41% YoY and 18% QoQ, respectively. With Samsung shipping only 24.4m units (flat sequentially) during the same period, Motorola increased its market share in the June quarter to an estimated 18.1% from 16.4% a quarter ago. Looking ahead, Motorola expects sales for the September quarter to be in the range of US$8.9b to US$9.1b, implying sequential growth of 0.8% to 3.1%. EPS is expected to come in between US$0.27 and US$0.29. These numbers are considerably higher than consensus estimates of sales and EPS of US$8.58b and US$0.253, respectively.

While Motorola's results were no doubt impressive, we believe the impact (in terms of order flow) varies widely among its locally listed suppliers. Motorola's stellar performance during the June quarter was in large part due to the brisk sales of its RAZR phones. We understand that **Jurong Tech (JTL)**, which derived close to 70% of its sales from Motorola, is involved in the assembly of PCBs for RAZR phones since May this year. Hence, we believe Motorola's strong results and outlook would likely provide a lift to JTL. As for the other component suppliers (i.e **Hi-P, MFS and Sunningdale Tech**), our understanding is that they are not involved in the RAZR program (at least not yet) and would thus not benefit as much in terms of order flow from Motorola. ***(Bryan Yeong)***

Technology - Seagate: Last night, Seagate posted another solid set of results with June quarter sales and earnings per share (EPS) of US$2.18 billion and US$0.55, respectively. Besides handily beating consensus estimates (sales: US$2.10b, EPS: US$0.507), Seagate's results were also higher than its own guidance (US$2.1b, US$0.50) which was given during its mid-quarter update in early June. More significantly, despite the June quarter being the industry's seasonally weakest quarter, Seagate's reported numbers represent sequential revenue and EPS growth of 11% (from US$1.97b) and 22% (from US$0.45) respectively.

Driving the stellar performance was robust demand for enterprise, mobile and consumer drives (for handheld, gaming and Digital Video Recorder applications) during the June quarter. Seagate shipped a total of 27.3m drives, up 49% YoY and 10% QoQ. As for pricing, while the erosion was slightly higher than the March quarter, it was still below historical norms and Seagate's initial expectations. On the whole, Seagate's average selling price (on blended basis) still rose US$1 from the prior quarter to US$80. Its gross margin also improved marginally to 24.8% from 24.2% a quarter ago. Finally, distribution channel inventory of Seagate desktop products stood at approximately 4.5 weeks at end June, suggesting little risk of an excess inventory situation. Looking ahead, Seagate expects its sales and earnings for the September quarter to be comparable to its June quarter results (US$2.18b, US$0.55). This would represent an increase of approximately 40% in revenue and 393% in operating income from the year-ago quarter. While largely in line with consensus estimates (US$2.2b, US$0.54), Seagate's guidance fell short of the highest sales and EPS forecast of US$2.3b and US$0.59 respectively. As a result, Seagate's share price fell US$0.60 to US$18.85 in extended trading.

While Seagate reported an impressive set of June quarter numbers, its rather muted guidance for the September quarter implies no seasonal pickup going into the second half of the year. We find this surprising and cannot rule out that management was just being conservative, similar to the previous quarter when it guided numbers that turned out to be much lower than the actual results. We would look to Seagate's mid quarter update in early September for more indications of market conditions in the September quarter. In the meantime, we believe Seagate's less than exciting guidance may prove to be a dampener for the share prices of its component suppliers, at least in the near term. These include **Cheung Woh (25-28% of revenue), Magnecomp (45-50%), MMI (65-70%), Seksun (45-50%) and Unisteel (20-25%)**. We see price weaknesses as opportunities to buy Unisteel and MMI with our estimated fair values being $1.89 and $0.57, respectively. ***(Bryan Yeong)***

Technology - Intel: Intel reported its second quarter numbers in line with consensus, as it continued to see strength in laptop microprocessors. For the quarter ended July 2, Intel reported net income of US$2 billion, or 33 US cents a share, on sales of $9.23 billion. Analysts had expected earnings of 32 US cents a share on sales of US$9.22 billion, on average. However, its shares fell after hours as investors focused on gross margins and sales. Gross margins for the quarter came up a little short of expectations, at 56.4% vs. forecasts of 57%. Intel did not raise its full-year margin targets. For the third quarter, Intel expects sales of between US$9.6 billion and US$10.2 billion and gross margins of 60%. Also, Intel boosted its capital budget for the year to US$5.9 billion from a previous range of US$5.4 billion to US$5.8 billion. This is unsurprising as supply constraints limited Intel's ability to fully meet healthy demand.

Overall, this is a good set of numbers indicating that demand for microprocessors for personal computing remain strong, especially on the back of robust notebook sales worldwide. However, this does not equate to similar growth numbers across the range of semiconductor products. For example, Philips, which produces ICs mainly for consumer products, recently said that it does not expect a rebound in the semiconductor market soon. Even Intel, in its latest reporting, indicated growing losses in its consumer products division. Similarly, we would not get too excited on prospects for **Chartered Semiconductor and STATS ChipPAC** in the near term, as their respective business mix exposes it to the less robust segments of the market. Any recovery is likely to be gradual. We retain our Hold recommendations on both counters. ***(Rohan Suppiah)***

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