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NIPPECRAFT LTD

INITIATING COVERAGE

(AMENDED VERSION)
30/03/2005

PRICE S$0.09

Buy

This copy supercedes the previous copy loaded on 31/03/2005
(errors made on operating profit for FY04-6 in P&L table on page 1)

Key Stock Statistics

NRA EPS Est. 2005 (cts)	1.16
P/E on NRA Est. 2005	7.8
NRA EPS Est. 2006 (cts)	1.32
P/E on NRA Est. 2006	6.8
Dividend/Share (cts)	0.25
Dividend yield (%)	2.8%
Shs. Outstg. (m)	351.4
Market capitalisation ($m)	31.6
Avg. daily vol (m)	0.0698
Book Value/Share (cts)	16.9
Shareholders:	
APP Printing (Holding) Pte Ltd	63.7%

Per share data

Year:	2002	2003	2004	2005F	2006F
Book Value (cts)	13.8	15.5	16.9	17.9	19.0
Cash Flow (cts)	1.4	1.2	1.8	1.9	2.1
Earnings (cts)	0.8	0.6	1.1	1.2	1.3
Dividend (cts)	0	0	0.25	0.25	0.25
Payout Ratio	0.0%	0.0%	19.1%	17.3%	15.2%
PER (x)	12.0	15.7	8.6	7.8	6.8
P/CF (x)	6.4	7.4	5.2	4.7	4.3
P/BV (x)	1.1	0.9	0.5	0.5	0.5
Dividend yield %	0.0%	0.0%	2.8%	2.8%	2.8%
ROE (%)	5.5%	3.7%	6.2%	6.5%	6.9%

P&L analysis ($m)

	2002	2003	2004	2005F	2006F
Revenue	60.3	63.9	66.8	74.2	80.9
Operating Profit	7.0	6.7	8.1	8.3	8.8
Depreciation	2.3	2.2	2.5	2.6	2.7
Interest Expense	1.2	0.8	0.6	0.4	0.3
Pretax Profit	2.5	3.8	5.4	5.7	6.3
Effective tax rate	-4.8%	46.6%	31.5%	28.0%	26.0%
Net Profit	2.7	2.0	3.7	4.1	4.6
Margins					
Operating	11.6%	10.4%	26.6%	24.8%	23.9%
Pre tax	4.2%	5.9%	8.1%	7.6%	7.7%
Net	4.4%	3.2%	5.5%	5.5%	5.7%

Nippecraft set to grow by expanding into new markets with its premium brands

- Nippecraft owns the global lifetime rights to well-known brands such as "Collins" and "Debden" -, which enables it to command a sizeable 70% and 35% market share of the retail diaries market in Australia and the United Kingdom respectively. These two market segments account for 87% of the group's revenue in FY04.
- Despite a challenging environment that has experienced a 2% decline in value globally, Nippecraft has managed to retain a stronghold in Australia and UK. It achieved a CAGR of 2.8% in revenue in the last 3 years and it is moving to expand into other markets where it has developed awareness of its premium brands. Good management enabled the group to achieve a CAGR of 18% in net profit in the last 2 years.
- Whilst USA will be a rapidly expanding market segment, the group is stepping up efforts to penetrate the European markets targeting the top end of the market.
- It targets a 5% growth for its established markets and double-digit growth for the US market in FY05.
- The group is in a strong financial position and its business generates a healthy cashflow - Cashflow per share improved by 45% to 1.75 cts in FY 04. Net cash per share is 3.1 cts and NAV and NTA per share is 17 cts and 12 cts respectively.
- With projected earnings growth rates of 10% and 14% for FYs 05 and 06, we value the stock at 10x its FY06 PER and arrive at a target price of $0.13.
- We are optimistic that the group is able to benefit from a full play of its premium brand names in the new geographical markets. We are initiating coverage with a Buy.

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Background

Nippecraft was founded in 1977 and has evolved from an OEM manufacturer of basic stationery and commodities to a vertically integrated global niche player in providing personal and business organizing tools. Its extensive line of products comprises 1,600 different products and includes a wide range of paper-based diaries, stationery, business accessories and related products.

It was listed on the SGX in 1994 and Asia Pulp & Paper acquired majority ownership of the company from its Australian founder in 1997. APP currently holds 63.7% of Nippecraft.

Business Model

Its business can be broadly divided into consumer brands (such as Collins, Debden, Top Grade, Elite, Essential, Innoviz, etc) forming about 75% of revenue; corporate gifts 10% and value-added services 15%. Its vertical-integrated business involves the full range of services commencing from material procurement, manufacturing, supply chain, sales and distribution to end customer.

It owns the global lifetime rights to well-known brands "Collins" and "Debden" which enables it to command a sizeable market share of the retail diaries market in the United Kingdom and Australia. Currently, it has a 70% share of the diaries and organizers market in Australia and in UK, it has 35% of the diaries market. Its challenge ahead is innovating a stagnant industry through penetration into new geographical markets, brand building, strategic alliances and expanding its product range.

Geographical segments

Revenue	**2002**	**2003**	**2004**
Singapore	1.6	1.5	1.5
Europe	26.3	26.5	28.3
Australia	25.3	29.6	29.9
North America	6.0	5.3	6.3
China / Hong Kong	0.4	0.3	0.1
Others	0.7	0.7	0.7
Total	60.3	63.9	66.8

Operating Profit	**2002**	**2003**	**2004**
Singapore	0.3	0.4	0.4
Europe	0.4	(0.4)	(0.3)
Australia	1.3	2.8	3.3
North America	1.1	1.4	1.9
China / Hong Kong	0.1	0.1	0.0
Others	0.3	0.1	0.3
Total	3.5	4.4	5.6

Australia is the major revenue and profit contributor to the group. It contributed 45% to revenue and 59% to operating profit in FY04. The Europe segment, currently coming from UK, made up 42% of group revenue in FY04 but contributed a loss because of amortization of intangible assets amounting to $2.3m a year. The intangible assets comprise the Collins brand and the amortization will continue for another 6 years.

As its branded "dated" retail diaries form a major source of revenue, the group has a highly seasonal operation with an approximate revenue split of 30:70 between 1H and 2H. Whilst orders for its branded "dated" diaries are secured in the early part of the fiscal year and production commences during the 1H, the sales for such products are completed and recognized in the 2H. As a result, 1H's operating results typically show about 30% of annual turnover and losses at the bottomline.

The group introduced a new product, digital writing solutions, that is marketed under the host brand Innoviz. They are aimed to provide a bridge for users wanting their writing, sketches, etc, instantaneously captured on both paper and PDAs or PCs as they write. Electronics form only 1.5% of revenue but it represents an early stage of diversification from a paper-based industry as well as an innovative way to reach a wider customer base. The new product, however, needs market leaders like Nokia and Sony Ericsson to create market acceptance of such products before it can contribute significantly to the group.

Branding

The company acquired "Collins" in 1995 for £10m. It was established since 1819 with 185 years of history. It has a strong heritage associated to making diaries for the Queen of England and other members of the nobility. The brand name is well recognized in the UK and Australia as an upper middle-class brand for diaries and organizers. Its competitor for organizers in the UK is Filofax.

"Debden" was launched in Australia since 1978 with close to 30 years of history. It is the top brand in Australia followed by Collins.

With these two brands, the group is strong in English-speaking countries. Australia and United Kingdom are the cornerstones of the group's operations.

Besides Collins and Debden, the group also owns Top Grade, Elite and Essential. About 75% of its revenue is generated by its reputable consumer brands.

Cost and Production Facilities

Raw material accounts for 30% of total cost, the rest goes towards labour, overheads, logistics, sales and marketing. Paper, which contributes about half of the total material cost, is sourced mainly from Indonesia, Thailand and Taiwan. Major shareholder, APP, provides 50-60% of the group's paper needs. Cost of paper has been on the uptrend during the last two years but improving gross margin reflects higher operating efficiency by the management. The recent decline of the US$ against the S$ will help to offset the rise in paper prices. The group's policy in material procurement is to buy as per requirement to control cost more effectively. This requires an efficient supply chain management.

It has its own in-house design and manufacturing facilities located in Jurong, Singapore for detailed and skilled works to ensure high quality for its branded products while bulk manufacturing is carried out at its plant in Malaysia. Lower value products are outsourced for production. Currently 80% of production is still carried out in Singapore, 10% in Malaysia and the remaining 10% outsourced from Korea, India and China.

Challenges and Future Plans

The industry for retail diaries and related products is declining on a global basis. It is estimated that there is a 2% decline in value terms because of modernization which has seen the advent of PDAs and PDA-based mobile phones. Despite the challenging environment, Nippecraft has managed to retain a stronghold in Australia and UK with a CAGR of 2.8% in revenue in the last 3 years and it is moving to expand into other markets where it had developed awareness of its premium brands. Good management enabled the group to achieve a CAGR of 18% in net profit in the last 2 years.

While Nippecraft's brand names for premium corporate diaries is dominant and well established in Australia and the UK, it has not fully leveraged on the strength of its brand names in other countries. The management sees robust demand for premium corporate diaries in the USA and European markets. It envisaged a 5% growth for its established markets and double-digit growth for the US market in FY05.

The group started making inroads into the US market two years ago and it currently commands 2-3% market share in North America. The US market achieved a growth rate of 19% in FY04 and will remain a high growth area for the group.

The group is stepping up efforts to secure new customers and markets such as France, Scandinavia, Russia and Japan. This follows success from preliminary efforts made in France about one and a half years ago and in Scandinavia last year. It has established contact with a local distributor in Europe to assist the group in marketing the products. A new range of designer corporate diaries is specially designed to cater to this new market segment.

FY04 Results and Prospects

Profit & Loss (S$m)

YE Dec 31	2002	2003	2004	2005F	2006F
Revenue	60.3	63.9	66.8	74.2	80.9
Cost of sales	(38.1)	(39.0)	(39.3)	(45.2)	(50.1)
Gross profit	22.2	24.9	27.5	28.9	30.8
Other income	1.7	0.9	0.4	0.3	0.2
Selling expenses	(11.3)	(12.0)	(12.2)	(12.8)	(13.3)
Administrative expenses	(6.4)	(7.1)	(7.7)	(8.3)	(8.9)
Other operating expenses	(1.5)	(2.2)	(2.4)	(2.5)	(2.7)
Operating profit	4.7	4.4	5.6	5.7	6.1
Finance income	0.2	0.2	0.3	0.4	0.5
Finance costs	(1.2)	(0.8)	(0.6)	(0.4)	(0.3)
Exceptional items	(1.2)	-	-	-	-
Profit before tax	2.5	3.8	5.4	5.7	6.3
Taxation	0.1	(1.8)	(1.7)	(1.6)	(1.6)
Net profit	2.7	2.0	3.7	4.1	4.6

Group turnover in FY04 grew 4.5% y-o-y due mainly to higher sales in Europe and US. Gross profit margin improved from 39% in FY03 to 41% in FY04. As most of its revenue is derived from Australia and the UK while raw material cost is priced in US$, the stronger A$ and £ and lower US$ contributed to the improvement in the results.

A reduction of interest expense and taxation also helped lift the net profit from $2.0m to $3.7m in FY04.

In FY05, we are projecting a double-digit growth in revenue as the group is expected to penetrate into new markets. However, earnings are not likely to grow proportionally as a result of the size of orders in established markets grow as well as increased competition in those markets.

Investment Risk

The group operates in a challenging market that faces declining growth prospects as a result of intense competition from China, Indonesia, India and Korea.

"Dated" diaries form a major source of revenue. However, stock obsolescence is relatively low. In the last 2 years, provision for stock obsolescence has stayed at 2.2% of annual sales and after write backs, the stock obsolescence rate is even lower. This shows a sophisticated inventory management by the group.

Foreign currency fluctuations have an impact on the group. Major revenue sources from Australia and the UK are translated to S$ for reporting results and therefore fluctuations of A$ and the £ will have an impact on its financial statement. As raw material cost of paper is priced in US$, the fluctuation of US$ vis-à-vis S$ will affect the group's profit margin. Currency movements in recent months have been beneficial for the group with the firm A$, slightly stronger £ and Euros and the weaker US$.

Valuation

Comparables

	Country Of Origin	Currency	Price	Market Cap	EPS	PE	ROE
Climax	Hong Kong	HK$	0.03	118.3	0.001	30.0	3.5
Samson	Hong Kong	HK$	0.81	429.3	0.123	6.6	9.5
PaperlinX	Australia	A$	4.18	1,864.90	0.247	16.9	6.3
Craft Print	Singapore	S$	0.10	11.2	0.0089	11.2	6.2
Nippecraft	Singapore	S$	0.09	31.6	0.0105	8.6	6.2

Source: Bloomberg

There is no direct listed comparables for Nippecraft. Among listed companies in the similar trade, the stock trades at the low end of the price earnings range of 6.6 - 30.0x. With projected earnings growth rates of 10% and 14% for FYs 05 and 06, we value the stock at 10x its PERs on FY06 earnings and arrive at target price of $0.13.

Financials

The group is in a strong financial position and its business generates a healthy cashflow. In recent years, it has been reducing its debt levels to improve its cashflow. During FY04, the group reduced its total bank borrowings from $8.9m to $6.4m, paring gearing from 16% to 11% and improving its net cash position from $4.3m to $10.8m as at the end of Dec 04. Net cash per share works out to 3.1 cts. It's NAV and NTA per share is 17 cts and 12 cts respectively. Cashflow per share improved by 45% from 1.21 cts to 1.75 cts.

It made a dividend payout of 0.25 cts per share, giving a decent gross yield of 2.8%.

The group's intangible assets consist of the "Collin" brand. The management has increased the annual amortization amount by reducing the remaining amortization period from 15 to 10 years commencing from FY03. The amortization sum which was $2.32m (£750,000) last year and accounts for 8.4% of the group's gross profit will end in FY 2011.

We are optimistic that the group is able to benefit from a full play of its premium brand names in the new geographic markets. We initiate coverage with a buy.

Balance Sheet & Other Fin. Data ($m)

December	2002	2003	2004
Property, plant & equipment	30.6	28.6	26.5
Intangible assets	20.6	20.0	18.3
Deferred tax assets	0.4	0.7	0.8
Current assets	45.9	48.8	54.7
Current liabilities	45.4	38.9	35.1
Non-current liabilities	3.6	4.9	5.8
Shareholders equity	48.5	54.3	59.5
Net debt	6.1	Net cash	Net cash
Gearing	34.9%	16.3%	10.8%
Ratio Analysis			
Inventory Turnover (x)	4.1	5.2	4.6
Average Collection Period (days)	114.3	121.5	114.0
Fixed Assets Turnover (x)	2.0	2.2	2.5
Total Assets Turnover (x)	1.3	1.3	1.2