

Comeback kid HTL International

HOCK LOCK SIEW

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EVERY once in a while, there comes a company which helps restore investors' faith in a market weighed down by earnings disappointments, corporate scandals and distracting controversies.

HTL International appears to be just such a company.

About three weeks ago, the mainboard-listed tanner and luxury sofa manufacturer announced a full-year net profit of \$48.3 million for FY2009, a striking rebound from a FY2008 net loss of \$20.3 million.

This turnaround was the result of a concerted restructuring which saw the company slashing costs, shutting down unproductive facilities in Asia, closing down and relocating underperforming stores in Europe and the United States, re-calibrating its forex risks and building up cash reserves.

The result: an 11.9 per cent fall in sales, marketing and distribution expenses to \$137.5 million; a net foreign exchange gain of \$14.5 million, versus a net loss of \$12.6 million for 2008; and a \$6.45 million or 87 per cent fall in other operating expenses to \$967,000 (2008 included a \$7 million restructuring cost); gross margin rising from 30 per cent to 37 per cent; and gearing down

to 0.1x, from 0.2x a year earlier.

This is quite a remarkable achievement for a company which sank into the red to the tune of \$20.3 million in 2008, after posting a net profit of \$10.2 million in 2007. The losses in 2008 were largely due to "mark-to-market" loss on its outstanding forex options and forward contracts it used to hedge against forex exposure. It was hit particularly hard by derivative losses from forex options it entered into to hedge the US unit against currencies such as the euro, the yen and the Singapore dollar.

The stumble was uncharacteristic for a 33-year-old company which, thanks to astute management and global vision, had become a world beater in its game.

Run by brothers Phua Yong Tat, Phua Yong Pin and Phua Yong Sin, the company designs sofas in its Jurong plant and makes them in its factories in China and Malaysia. Over 99 per cent of the products are exported to over 40 countries including Germany, Japan and the US. An average of 500,000 sofa sets are exported each year.

As managing director Phua Yong Tat put it, HTL chooses to focus on larger, international markets to leverage economies of scale.

"It is better to be a mid-sized player in a

big market than a big player in Singapore," he said. "We cannot afford to be distracted by the smaller markets."

HTL demonstrated this in 1981 when it broke into tough markets such as Japan by collaborating with German furniture maker Laauser GmbH & Co. It then clawed its way further up the global value chain by buying upmarket German furnishing retailer and franchiser Domicil Moebel in 2005.

Then the sub-prime crisis of 2008 happened.

Still, the current turnaround has not gone unnoticed in the market. DBS Vickers, which over the past year has earned a reputation for spotting winners early, re-initiated coverage on HTL last week, citing the company's strong balance sheet, solid cashflow, attractive dividend payout and potential earnings growth of some 15 per cent per annum.

The investment house tagged a "buy" on the stock, with a target price of \$1.09. At the time HTL was trading at 68 cents. It has risen to just above 80 cents since.

But a more recent development seems to

suggest that DBS Vickers may even have been somewhat conservative on its price target for HTL.

Man Wah Holdings, a furniture maker which delisted from the Singapore bourse, just completed its initial public offering in Hong Kong last Wednesday. Man Wah offered its shares at HK\$6.80 per share, translating into around S\$1.24 per share.

In its report, DBS Vickers said peer comparisons for HTL are somewhat difficult, given most others are loss-making or have diversified. But it did cite Man Wah as the closest peer. If so, the valuation gap between the two companies appears glaring.

HTL, which made \$48 million in FY09, is trading at 83 cents or 5.5 times earnings. Its market cap is \$352 million. Man Wah, which made a net profit of just over \$40 million in FY2009, was offered at the equivalent of \$1.24 or 11 times earnings. This gives it a market cap of some \$1.1 billion.

HTL is benefiting not just from its restructuring and a strong recovery in its key markets in Europe, US and Asia, but is also picking up market-share left by a hollowing out of the industry.

Even if HTL were to rise to \$1.10, this would translate into just seven times its prospective FY2011 earnings. This is quite a huge upside gap. Given its track record and growth trajectory, HTL should be able to fill this gap sooner rather than later. After all, this stock was well above \$1.20 in 2007.

HTL is benefiting not just from its restructuring and a strong recovery in its key markets in Europe, US and Asia, but is also picking up market-share left by a hollowing out of the industry after many of its global competitors fell by the wayside during the past two years.

Comeback kids are few and far between in this market, where investors' faith in penny stocks has been sapped by a slew of corporate scandals and disappointments over the past couple of years.

But then again, HTL isn't your average company. And it is unlikely to remain a penny stock for long.