

# CDW eyes Japanese market

## Precision-components assembler gears up for major acquisition



Japan Tomoike (whose factory in Matsusaka City, Mie, Japan is shown here) is pursuing more opportunities with Sharp and Hitachi for its LCD TV business

BY DENISE WEE

**C**DW Holding Ltd has its roots in Hong Kong, where it started out as a small private trading company founded by CDW's current CEO, Kunikazu Yoshimi, in 1991. But over the years, this Japanese-managed company has spread its wings, shifting its production base to the People's Republic of China, where it operates six factories from Suzhou to Shanghai.

Now, the low-profile company, which listed on the Mainboard in January last year, looks poised to make its first major acquisition. Its purchase of Tomoike Industrial Co Ltd (Japan Tomoike) could give its earnings a fillip going forward, especially with Japan Tomoike's growing exposure to liquid crystal display (LCD) TVs.

Today, CDW continues to run a sales and administrative office out of Shatin, in the New Territories of Hong Kong. CDW assembles precision components that go into making gamebox equipment, mo-

bile phones and digital cameras. Some of its biggest customers are giant Japanese multinational corporations (MNCs) like Sharp, Hitachi, Konica and Pioneer.

In its first quarter ended March 2006, CDW's net profit grew 60.2% to US\$2.2 million (\$1 approx US\$0.63) while its revenue grew 43.4% to US\$44 million, compared with 4Q2005. The growth was largely driven by higher sales from its LCD backlight units with the completion of a plant in Dongguan China.

With the proposed acquisition of Japan Tomoike, a company founded by Yoshimi's father in 1959, CDW is looking to deepen its exposure to Japan, where most of its customers are based. Japan Tomoike, which sources for raw materials and semi-finished LCD goods, is a key supplier to CDW. For the financial years 2003, 2004 and 2005, CDW's purchases from Japan Tomoike made up about 36%, 22% and 28% of CDW's cost of sales, respectively.

By acquiring its Japan-based supplier, CDW hopes to strengthen its relation-

ship with Japanese MNCs, and perhaps garner a more important role in servicing them. "The Japanese MNCs want to be more streamlined and centralised on vendors," says Edward Lai, executive director of CDW, in an interview in Hong Kong. "If your company can serve both Japan and overseas, you have more opportunity to become a core supplier." Japan Tomoike has a chain of sales offices in Japan, from Tokyo to Hiroshima and Osaka to Nara.

Aside from that, CDW believes the integration will bring about cost savings for both companies. And, since Japan Tomoike is a key supplier to the group, its acquisition ensures that CDW enjoys a reliable supply of raw materials and semi-finished goods.

Many of CDW's current customers were referred by Japan Tomoike and CDW can further leverage on Japan Tomoike's established relationship with Japanese MNCs. As an established vendor to Japanese MNCs, Japan Tomoike can also glean information on market trends in the mo-



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bile communications and consumer industries, which are subject to short product cycles.

#### Growth in LCD TVs

But aside from that, Japan Tomoike faces alluring growth prospects in one area — LCD TVs. About 90% of its sales and 80% of its gross profits come from its business of supplying LCD backlight units and related components, which go into making mobile phones and flat screen TVs. Although the company only recently started supplying components for LCD TVs, it is a segment that Yoshimi is clearly excited about.

"The focus of Japan Tomoike's business will be the backlight units for LCD TVs," he says. He notes that Japan Tomoike recently secured a new customer that makes and sells LCD panels for flat screen TVs.

Moreover, Japan Tomoike's two biggest customers — Sharp and Hitachi — are busy ramping up production of LCD TVs. Yoshimi notes that Sharp currently has two LCD TV factories in Japan. It is expected to launch production at a third factory in Japan before the Beijing 2008 Summer Olympics.

As for Hitachi, Yoshimi says that it currently churns out some 200,000 units of LCD TVs per month. By next year, this figure should increase to 300,000 units per month, he adds. "The LCD TV market should continue to grow until 2008," says Yoshimi. He adds that Japan Tomoike is pursuing more opportunities with Sharp and Hitachi for its LCD TV business.

At the same time, the recovering Japanese economy is expected to benefit Japanese MNCs and Japanese consumer spending. "Nowadays, Japanese corporations are

also very keen on investing in the domestic market," says Lai. "We believe this will bring in more business prospects for Japan Tomoike."

Japan Tomoike's LCD business is divided into two segments — small panels, which go into making products like mobile phones — and big panels, which go into making flat screen TVs. The production centres for small panels have already been moved to lower-cost locations like China, notes Lai. The main investment for the larger panels continues to be centred on Japan.

However, he anticipates that when LCD TV prices become competitive and when they evolve into a household item, the production base for big panels will likewise move to China. And, since CDW has a production base in China, it's likely to have first-mover advantage, he adds.

#### Mechanics of the deal

CDW's Yoshimi is deemed to have an interest in the proposed acquisition because he holds a combined 85% stake in Japan Tomoike, together with his wife and mother. Hence, he will not be voting on the proposed acquisition. CDW is proposing to acquire shares of Japan Tomoike in two tranches for a maximum of ¥1.4 billion (\$1 approx ¥72), or about \$19.7 million. The first tranche, which includes shares held by Yoshimi and other minority shareholders of Japan Tomoike, makes up about 51.37% of the capital of Japan Tomoike. It should be acquired later this year for about ¥642 million in cash.

The second tranche, which makes up 48.63% of the capital and is wholly owned by Yoshimi, is proposed to be acquired either by cash or CDW shares, or a combi-

nation of both. The issue price for CDW shares is 26 cents, a premium of 30% to CDW's closing price of 18 cents on June 12. Independent directors will decide on what percentage of the deal should be in cash or shares.

The acquisition price for the first tranche is worked out based on Japan Tomoike's FY May 2005 net profit of ¥261.3 million and a price-to-earnings ratio (PER) of 4.78 times. The price for the second tranche hasn't been fixed yet but it is capped at ¥758 million. It will be worked out by taking the lower of the average of Japan Tomoike's net profit for FY May 2006/07 and FY May 2007, multiplied by a PER of five and multiplied by 48.63%.

If Japan Tomoike reports a net loss, CDW will not be required to pay Yoshimi for the second tranche. In its FY ended May 2005, Japan Tomoike's net profit declined about 13% to ¥261.2 million, or around \$3.6 million. Ernst and Young Shih Nihon conducted an independent valuation exercise to work out the fair market value of Japan Tomoike's shares.

#### Cash-rich

CDW is flush with cash of about US\$20 million and the company also has low debt levels. And the acquisition of Japan Tomoike is expected to be earnings accretive, says Lai. In FY2005, CDW had a dividend payout of about 43% of earnings. The company plans to maintain the dividend payout for the current FY, he adds. "If we can consolidate Japan Tomoike's earnings, the bottom line will be bigger, which means that the dividend amount will be bigger," he says. Turnover from Japan Tomoike will be consolidated into CDW after the completion of the first tranche.

Another advantage of buying Japan Tomoike is that CDW's listed Japanese peers generally trade at higher PERs. By acquiring Japan Tomoike, perhaps investors will accord CDW a higher PER as well. CDW's comparables include South Korea's Raygen Co Ltd, which makes backlight units and assembles LCD products, and is trading at a PER of 7.7 times. Its Japanese peer Chiyoda Integre Co Ltd, which makes parts for office automation and audio visual equipment, is trading at a PER of about 22 times.

That aside, acquiring Japan Tomoike would mean less time-consuming compliance work for CDW. As a result of Yoshimi being CEO of CDW and a major shareholder in Japan Tomoike, comprehensive procedures constantly have to be implemented to ensure that transactions between the two companies are at arm's length. CDW sent out a circular to shareholders this month and will be holding a special general meeting on June 26 in relation to the proposed acquisition. **E**