

Malaysia Company Guide

Inari Amertron Bhd

Version 15 | Bloomberg: INRI MK | Reuters: INAR.KL

Refer to important disclosures at the end of this report

DBS Group Research . Equity

2 Jan 2018

HOLD (Upgrade from Fully Valued)

Last Traded Price (29 Dec 2017): RM3.40 (KLCI : 1,796.81)
Price Target 12-mth: RM3.00 (-12% downside) (Prev RM2.25)

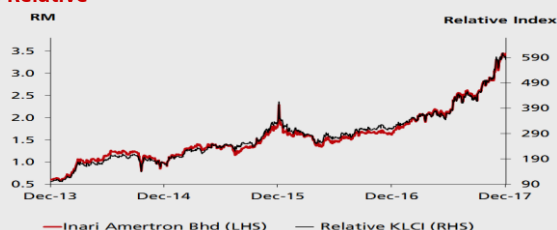
Analyst

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What's New

- Strong growth for RF division in 2018 as premium smartphones adopt Gigabit LTE technology
- Commercialisation of 5G starting 2019 will underpin medium-term growth
- Raise FY18-20 EPS by 12-25%
- Upgrade to HOLD with higher RM3.00 TP after rolling valuation base to FY19 (18x PE)

Price Relative



Forecasts and Valuation

FY Jun (RM m)	2017A	2018F	2019F	2020F
Revenue	1,176	1,421	1,628	1,746
EBITDA	310	364	440	474
Pre-tax Profit	241	285	350	378
Net Profit	228	268	329	355
Net Pft (Pre Ex.)	207	268	329	355
Net Pft Gth (Pre-ex) (%)	53.7	17.7	22.8	8.0
EPS (sen)	11.4	13.4	16.5	17.8
EPS Pre Ex. (sen)	10.4	13.4	16.5	17.8
EPS Gth Pre Ex (%)	34	30	23	8
Diluted EPS (sen)	11.0	13.0	15.9	17.2
Net DPS (sen)	8.30	10.1	12.4	13.4
BV Per Share (sen)	43.8	47.1	51.2	55.7
PE (X)	29.8	25.3	20.6	19.1
PE Pre Ex. (X)	29.8	25.3	20.6	19.1
P/Cash Flow (X)	21.8	22.5	17.8	15.7
EV/EBITDA (X)	20.5	17.6	14.5	13.4
Net Div Yield (%)	2.4	3.0	3.6	3.9
P/Book Value (X)	7.8	7.2	6.6	6.1
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	29.3	29.6	33.6	33.3
Earnings Rev (%):		12	24	25
Consensus EPS (sen):		13.6	15.6	16.3
Other Broker Recs:		B: 6	S: 1	H: 6

Source of all data on this page: Company, AllianceDBS, Bloomberg Finance L.P

Solid growth ahead

Upgrade to Hold with higher RM3.00 TP. We expect Inari to record significant RF content growth in 2018 as more premium smartphones start to adopt Gigabit LTE technology for faster speed. This is reflected in the on-going capacity expansion at Inari's P13B plant, which we have updated in our model and led to 12-25% revision to our FY18-20 forecasts. Beyond 2018, the commercialisation of 5G starting 2019 should underpin medium-term growth for the RF division, notwithstanding contribution from other divisions such as IIS and IR LED as well. Upgrade to HOLD with revised RM3.00 TP (based on 18x FY19 PE). We believe the stock is fairly valued at 20.6x FY19 EPS and offers decent dividend yield of 3-4%.

Where we differ – higher earnings forecasts due to RF. Our FY19-20F earnings are higher than consensus as we assume higher capacity expansion for the RF division.

Potential Catalysts. Faster ramp-up of new testers capacity at IIS and higher volume loading for IR LED will drive further earnings growth for Inari, apart from RF. Securing new businesses or customers for its plants in Batu Kawan is also another key re-rating catalyst.

Valuation:

Our RM3.00 TP is based on 18x FY19 EPS, which is at a premium relative to the Malaysia tech sector average given Inari's strong earnings growth.

Key Risks to Our View:

Significant slowdown in demand for smartphones. This could affect sales for the RF segment. However, the impact may not be as severe because of the rising RF content in smartphones.

At A Glance

Issued Capital (m shrs)	2,036
Mkt. Cap (RMm/US\$m)	6,921 / 1,704
Major Shareholders (%)	
Insas Berhad	27.8
KWAP	6.9
Employee Provident Fund	6.4
Free Float (%)	72.2
3m Avg. Daily Val (US\$m)	6.3

ICB Industry : Technology / Technology Hardware & Equipment

WHAT'S NEW**Solid growth driven by RF**

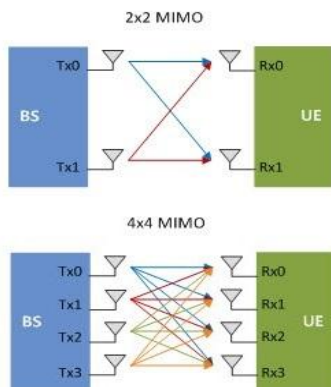
Significant expansion for RF segment. Inari has expanded the capacity of its radio frequency (RF) segment quite significantly in 1HFY18, reaching 1,000 tester units by end Dec 2017 (from 760 testers in end-FY17). This is supported by the increased floor space in plant P13B (additional 60k sq ft) where Phase 2 expansion is also currently underway to add another 120k sq ft of floor space by May 2018.

Driven by premium smartphones moving to Gigabit LTE.

We believe demand for RF filters is still rising as RF architecture design is getting more complex in order to support faster LTE speeds. Currently, the mobile industry is moving towards Gigabit LTE where the theoretical peak download speed could reach up to 1Gbps. To achieve this, a phone will need to: 1) Support at least three-channel carrier aggregation (combining different spectrum to make one broad 'highway'); and 2) Have four physical antennas to enable 4x4 MIMO (multiple-input multiple-output).

As of now, only a handful of high-end Android smartphones (for e.g. Samsung Galaxy S8 and Note 8) is capable of Gigabit LTE, but the list is expected to grow further in 2018. We believe new iPhone models in 2018 is likely to be one of them, as Apple is said to be upgrading its antenna design to support 4x4 MIMO standard, per recent newsflow in the supply chain. For comparison, current iPhone models (both 8 and X) are only capable of 2x2 MIMO standard.

Being the leading RF chipmaker in the market, we expect Broadcom to benefit from this especially given that it already has a three-year supply agreement with Apple which lasts till 2018. In fact, in its latest quarterly conference call in Dec, Broadcom said it is positive about the 2018 outlook for its wireless division given **significant increase in FBAR content driven by the need for additional filtering at the antenna.**

2x2 vs 4x4 MIMO technology

Sources: 3GPP, AllianceDBS

Higher volume loading for IR LED. Capacity for the production of infrared LED (for iris scanner) has increased to 16m units/month after complete transfer of capacity from Osram in Nov 2017. Although volume loading was soft in Sep/Oct, this has picked up in Dec 17 where current production is running close to 10m units, likely in anticipation of new flagship smartphone launch by Samsung in early 2018. Going forward, we believe potential volume upside for IR LED will be driven by the adoption of iris scanning features in Chinese smartphones and mid-range Samsung smartphone once production costs become cheaper over time (yield improvement, economies of scale, etc.)

Expansion at IIS on track. Inari Integrated System (IIS) turned profitable in 1QFY18 and is expected to expand to 52 mixed-signal testers by end-Dec 17 (from 30 units previously). Capex for the equipment will be funded through internal cash as well as the RM100m matching grant from MIDA (Malaysia Investment Development Authority). In Dec 2017, a simpler structure for the grant has been agreed and signed where: 1) RM80m matching grant to be disbursed within 3 years and carries 2% annual fee for 10 years; and 2) RM20m matching grant to be disbursed as soft loan with 2-3% interest and payable at the end of 6th year.

Capex. We expect Inari to spend up to RM150m for capex in FY18 for the expansion of its RF division, IR LED and IIS. Beyond that, there could be additional capex spending for its land in Batu Kawan to build three new plants (up to 600k sq ft in total) to serve different product portfolios and/or new customers starting FY19.

Raise FY18-20 EPS by 12-25%. We raise our FY18-20 earnings forecasts by 12-25% after updating our tester unit assumptions for the RF division to 1,000-1,200 testers (from 810-910 previously). We are comfortable to forecast higher unit addition in FY19-20 as 5G is expected to start commercial launch in 2019, which should lead to higher demand for RF filters.

Valuation base rolled over to FY19; upgrade to HOLD with RM3.00 TP. Post earnings adjustment, we raise our TP to RM3.00 after rolling forward our valuation year to FY19 (from CY18) with unchanged target PE of 18x. Upgrade to HOLD (from Fully Valued).

CRITICAL DATA POINTS TO WATCH

Critical Factors

Riding on Broadcom's strong lead in RF. The key customer in Inari's RF division is US-listed Broadcom (formerly Avago), one of the top RF chipmakers in the world. Inari's RF segment has grown at a 5-year CAGR of 39% since listing in 2011, underpinned by strong orders from Broadcom. We expect demand for Broadcom's RF content in smartphones to continue to grow rapidly in the medium term, driven by three key factors: 1) rising adoption of 4G LTE; 2) smartphone variant consolidation; and 3) further integration of RF modules

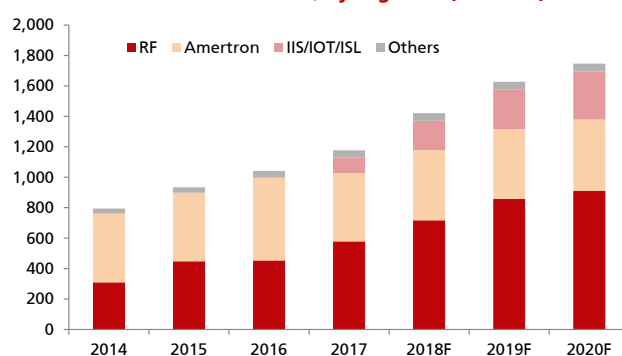
Significant capacity expansion for RF. To prepare for the increase in RF sales volumes in the coming years, Inari doubled floor space at its Penang facility with a new P13 plant since 2015. It has also expanded capacity of its RF segment further by 30% during 2HCY16, and may still require to build or lease another plant within the next 12 months. However, the significant capacity expansion has nudged down overall utilisation rate at the RF segment to 70-80% in FY16-17 (from 85-90% in previous years), as the incremental wafer volume from Broadcom will be staggered.

Stable growth at Amertron. Amertron's growth was relatively stable at 5-6% in FY16-17. We expect growth rate to be similar in FY18-19F.

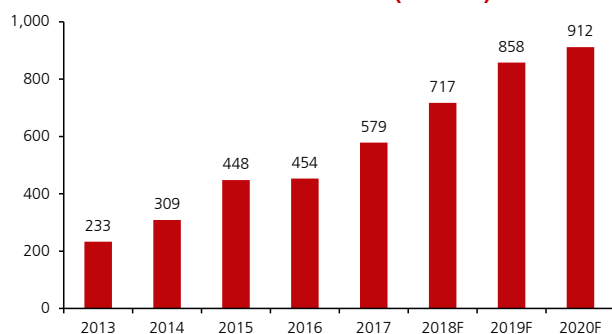
Moderation in margins. After consolidating Amertron in FY14, Inari's net margins fell to 12.5% because of lower profitability at Amertron, before recovering in FY15. After the dip in FY16, margins have recovered to around 19% in FY17 due to the favourable exchange rate and better economies of scale from higher volumes. We expect margins to moderate slightly in FY18F given the initial gestation period for new businesses (IIS and IOT).

Benefiting from strong USD. While most of Inari's sales are denominated in USD, only 50% of its costs (mainly raw material costs) are priced in the greenback. As such, the company will be a net beneficiary of a strong USD, all things being equal.

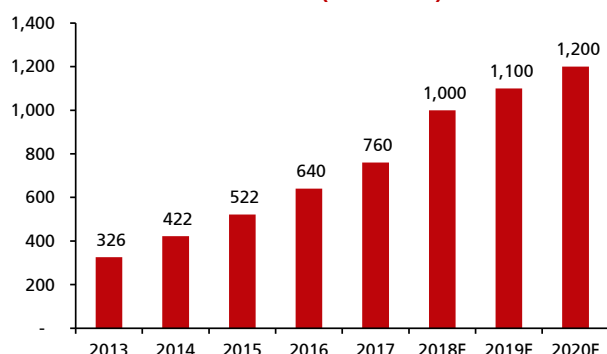
Revenue breakdown, by segment (in RM m)



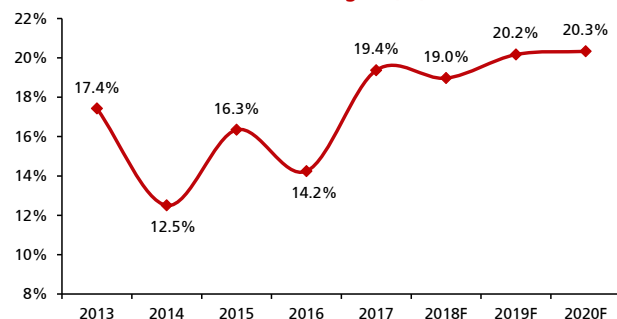
Inari RF division revenue (in RM m)



No. of testers (RF division)



Inari net margins (%)

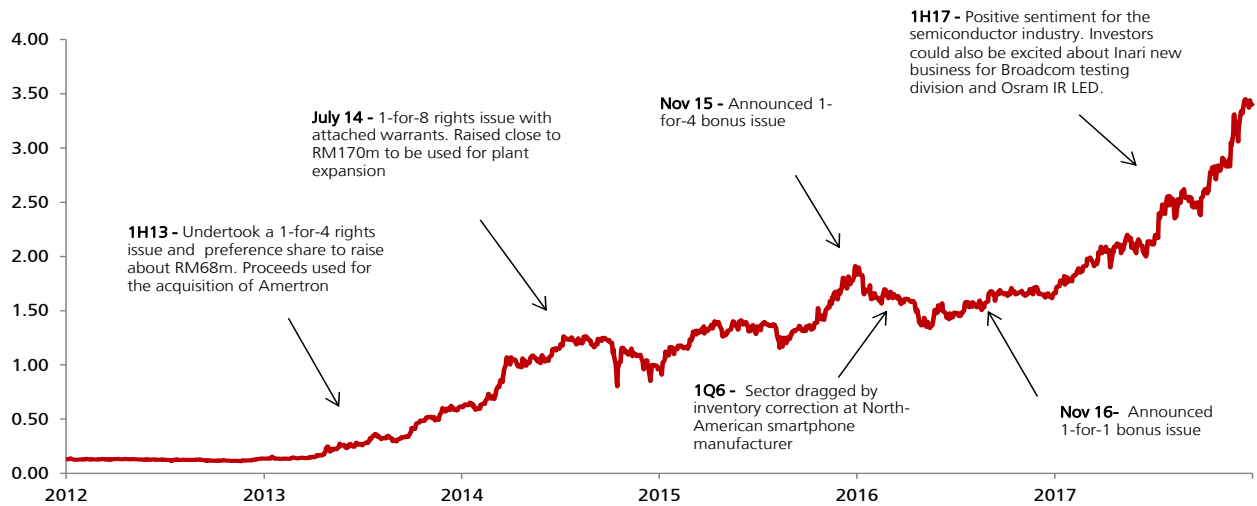


Source: Company, AllianceDBS

Inari Amertron Bhd

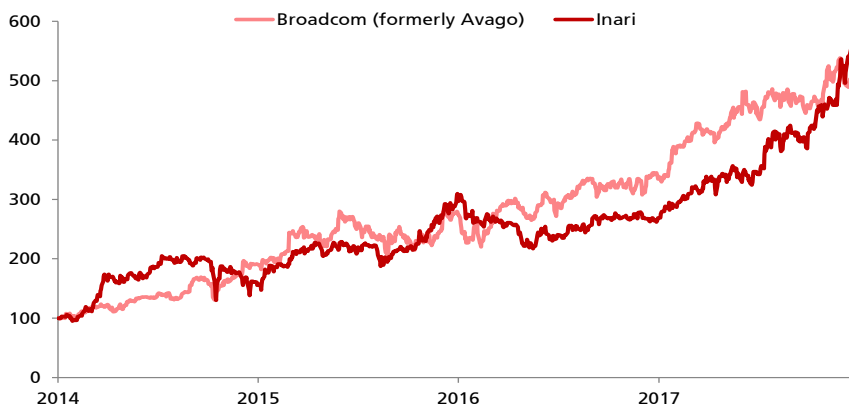
Appendix 1: A look at Inari Amertron’s listed history – what drives its share price?

Factors driving historical share price performance



Sources: AllianceDBS Research, Bloomberg Finance L.P

Share price performance of Inari vs. Broadcom (2014=100)



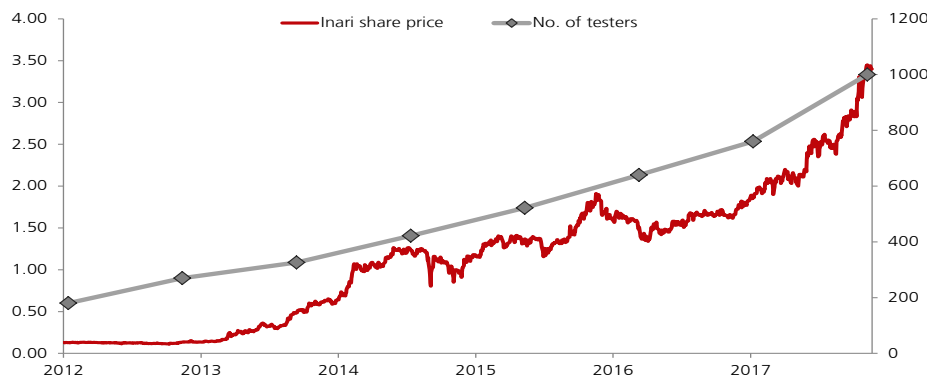
Sources: AllianceDBS Research, Bloomberg Finance L.P

Remarks

Broadcom is a key customer of Inari and contributes >80% of the latter’s revenue.

As such, there is a strong correlation between Broadcom’s performance and Inari’s. This is especially true given that Inari is a key OSAT supplier for the RF segment, the main product driving Broadcom’s success.

Inari share price vs. no. of RF testers machine



Sources: AllianceDBS Research, Bloomberg Finance L.P

Remarks

The no. of testers gives a rough gauge of capacity expansion at Inari to serve Broadcom.

These machines are consigned by Broadcom, which means future sales are relatively more secured when new capacity is added.

Balance Sheet:

Net cash position. Despite rapid expansion over the years, Inari has been able to maintain a net cash position because of cash proceeds from warrant conversion and two rights issues. As at 30 Sep 2017, the company had RM414m net cash.

Stable capex spending. There is no cutback on capex spending and expansion of manufacturing facilities will take place in FY18-19 to cater to higher orders from Broadcom and new business initiatives. Inari spent RM120m capex in FY17 for the purchase/construction of a new plant, additional equipment, and automation processes.

Share Price Drivers:

Rising LTE adoption will drive Broadcom's growth, and in turn, Inari's, as Broadcom is the dominant supplier of high-band frequency (>2.0 GHz) RF products, thanks to its superior film bulk acoustic resonator (FBAR) filters.

Broadcom's guidance and capex plan. As demand continues to outstrip supply, we understand Broadcom's current FBAR production is on an allocation basis only to its main customers. To resolve this, Broadcom is planning to double its FBAR filter capacity over the next one or two years. In turn, Inari also needs to expand its manufacturing capacity to prepare for the increase in RF sales volumes from Broadcom.

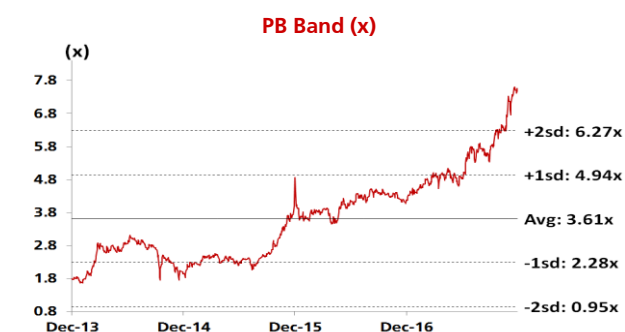
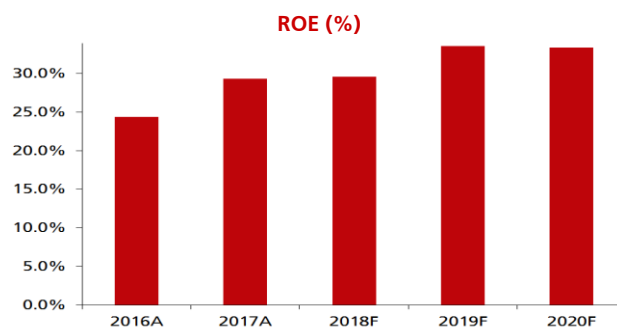
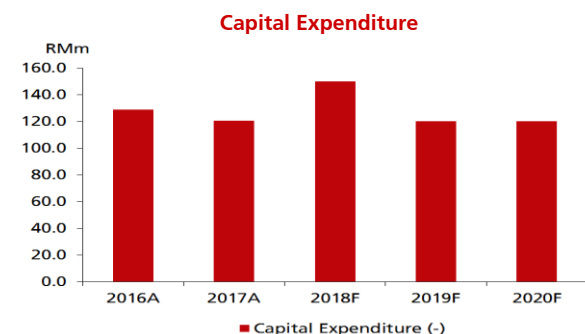
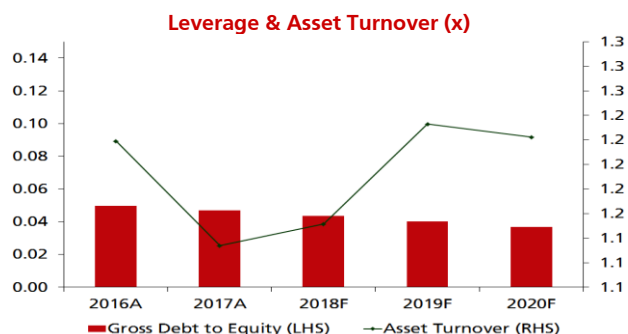
Key Risks:

Slower demand for smartphones. A significant slowdown in demand for smartphones could affect sales at the RF segment. However, the impact may not be as severe because of rising RF content in smartphones

Single customer risk. Risk factors that could affect Broadcom's RF sales (such as introduction of better technology by peers) are also risks for Inari. Nevertheless, this risk is mitigated by continuous high-level R&D spending by Broadcom to improve and maintain the competitive edge of its FBAR filters.

Company Background

Inari is principally involved in back-end semiconductor packaging services, which comprise mainly back-end wafer processing, package assembly and RF final testing.



Source: Company, AllianceDBS

Key Assumptions

FY Jun	2016A	2017A	2018F	2019F	2020F
No. of testers (RF division)	640	760	1,000	1,100	1,200
Utilisation rate (%)	70.0	80.0	85.0	90.0	90.0
Amertron (y-o-y growth)	3.00	0.0	3.00	2.00	2.00
RM vs. USD	4.10	4.20	4.20	4.10	4.10

Income Statement (RMm)

FY Jun	2016A	2017A	2018F	2019F	2020F
Revenue	1,041	1,176	1,421	1,628	1,746
Cost of Goods Sold	(827)	(889)	(1,041)	(1,170)	(1,253)
Gross Profit	214	287	379	458	493
Other Opng (Exp)/Inc	(56.0)	(44.2)	(92.3)	(106)	(114)
Operating Profit	158	243	287	352	380
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(5.3)	(2.2)	(2.1)	(2.1)	(2.1)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	153	241	285	350	378
Tax	(6.0)	(12.1)	(17.1)	(21.0)	(22.7)
Minority Interest	1.16	(0.9)	0.40	0.40	0.40
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	148	228	268	329	355
Net Profit before Except.	148	228	268	329	355
EBITDA	207	310	364	440	474
Growth					
Revenue Gth (%)	11.6	13.0	20.8	14.6	7.3
EBITDA Gth (%)	8.4	49.8	17.6	20.8	7.7
Opg Profit Gth (%)	0.6	53.4	18.1	22.6	7.9
Net Profit Gth (Pre-ex) (%)	(2.8)	53.7	17.7	22.8	8.0
Margins & Ratio					
Gross Margins (%)	20.6	24.4	26.7	28.1	28.2
Opg Profit Margin (%)	15.2	20.7	20.2	21.6	21.7
Net Profit Margin (%)	14.2	19.4	18.9	20.2	20.4
ROAE (%)	24.4	29.3	29.6	33.6	33.3
ROA (%)	17.4	22.0	21.7	24.9	24.9
ROCE (%)	22.1	28.0	28.3	32.1	32.0
Div Payout Ratio (%)	54.2	72.6	75.0	75.0	75.0
Net Interest Cover (x)	30.2	111.8	140.1	171.8	185.5

Source: Company, AllianceDBS

Quarterly / Interim Income Statement (RMm)

FY Jun	1Q2017	2Q2017	3Q2017	4Q2017	1Q2018
Revenue	282	275	274	346	373
Cost of Goods Sold	(222)	(218)	(201)	(248)	(273)
Gross Profit	59.7	56.6	73.0	97.9	99.8
Other Oper. (Exp)/Inc	(9.4)	8.12	(22.4)	(40.9)	(25.7)
Operating Profit	50.3	64.8	50.5	56.9	74.1
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(0.4)	(0.4)	(0.3)	(1.1)	(0.5)
Exceptional Gain/(Loss)	0.0	0.0	4.07	16.4	0.0
Pre-tax Profit	50.0	64.4	54.3	72.2	73.7
Tax	(1.8)	(2.0)	(2.1)	(6.2)	(5.0)
Minority Interest	(0.2)	0.69	(1.0)	(0.4)	(0.3)
Net Profit	48.0	63.1	51.2	65.6	68.4
NET profit bef Except.	48.0	63.1	47.1	49.3	68.4
EBITDA	64.1	79.6	66.9	78.5	97.3

Record quarterly sales and profit

Growth

Revenue Gth (%)	10.4	(2.3)	(0.4)	26.1	7.9
EBITDA Gth (%)	13.3	24.3	(16.0)	17.3	24.0
Opg Profit Gth (%)	19.9	28.7	(22.0)	12.7	30.2
Net Profit Gth (Pre-ex) (%)	20.3	31.3	(25.3)	4.6	38.8

Margins

Gross Margins (%)	21.2	20.6	26.6	28.3	26.7
Opg Profit Margins (%)	17.9	23.5	18.4	16.5	19.9
Net Profit Margins (%)	17.0	22.9	18.7	19.0	18.3

Balance Sheet (RMm)

FY Jun	2016A	2017A	2018F	2019F	2020F
Net Fixed Assets	274	332	405	436	462
Invt in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other LT Assets	50.7	14.5	14.5	14.5	14.5
Cash & ST Invt	210	455	405	420	464
Inventory	165	169	203	233	249
Debtors	172	231	237	271	291
Other Current Assets	1.18	0.91	0.91	0.91	0.91
Total Assets	873	1,202	1,265	1,375	1,482
ST Debt	16.0	16.1	16.1	16.1	16.1
Creditor	136	231	227	255	273
Other Current Liab	11.1	50.5	50.5	50.5	50.5
LT Debt	17.8	24.8	24.8	24.8	24.8
Other LT Liabilities	10.9	6.80	6.80	6.80	6.80
Shareholder's Equity	681	873	940	1,022	1,110
Minority Interests	0.0	0.0	0.0	0.0	0.0
Total Cap. & Liab.	873	1,202	1,265	1,375	1,482
Non-Cash Wkg. Capital	191	119	163	199	218
Net Cash/(Debt)	176	414	364	379	423
Debtors Turn (avg days)	63.0	62.4	60.0	57.0	58.8
Creditors Turn (avg days)	72.0	81.3	86.6	81.3	83.2
Inventory Turn (avg days)	72.7	74.1	70.4	73.5	75.9
Asset Turnover (x)	1.2	1.1	1.2	1.2	1.2
Current Ratio (x)	3.4	2.9	2.9	2.9	3.0
Quick Ratio (x)	2.3	2.3	2.2	2.1	2.2
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	380.5	294.3	366.3	293.0	293.0
Z-Score (X)	21.5	14.1	14.1	14.3	13.4

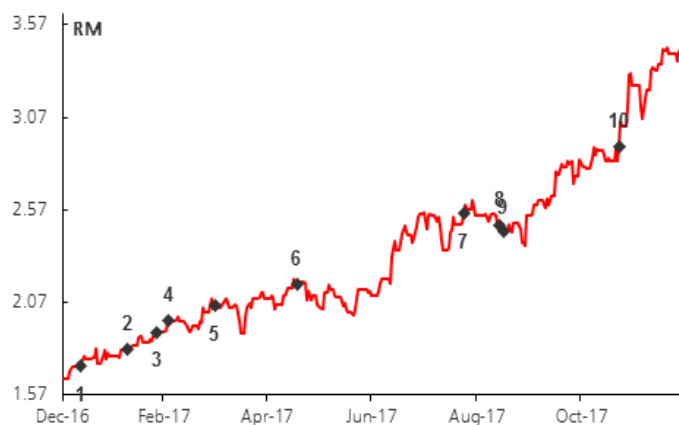
Source: Company, AllianceDBS

Cash Flow Statement (RMm)

FY Jun	2016A	2017A	2018F	2019F	2020F
Pre-Tax Profit	153	241	285	350	378
Dep. & Amort.	48.5	66.8	77.3	88.3	94.3
Tax Paid	(6.4)	(8.1)	(17.1)	(21.0)	(22.7)
Assoc. & JV Inc/(loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	(41.8)	37.8	(43.9)	(35.7)	(18.5)
Other Operating CF	11.6	(26.7)	0.0	0.0	0.0
Net Operating CF	165	311	301	381	431
Capital Exp.(net)	(129)	(121)	(150)	(120)	(120)
Other Invts.(net)	0.0	0.0	0.0	0.0	0.0
Invts in Assoc. & JV	0.0	0.0	0.0	0.0	0.0
Div from Assoc & JV	0.0	0.0	0.0	0.0	0.0
Other Investing CF	(44.9)	67.9	0.0	0.0	0.0
Net Investing CF	(173)	(52.7)	(150)	(120)	(120)
Div Paid	(75.8)	(95.3)	(201)	(247)	(267)
Chg in Gross Debt	(33.5)	7.15	0.0	0.0	0.0
Capital Issues	68.5	73.1	0.0	0.0	0.0
Other Financing CF	(41.3)	0.0	0.0	0.0	0.0
Net Financing CF	(82.1)	(15.0)	(201)	(247)	(267)
Currency Adjustments	2.10	3.24	0.0	0.0	0.0
Chg in Cash	(88.4)	246	(49.9)	14.5	44.2
Opg CFPS (sen)	10.8	13.7	17.3	20.9	22.5
Free CFPS (sen)	1.91	9.53	7.58	13.1	15.6

Source: Company, AllianceDBS

Target Price & Ratings History



Note: Share price and Target price are adjusted for corporate actions.

S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	10 Jan 17	1.73	2.00	BUY
2:	07 Feb 17	1.82	2.15	BUY
3:	24 Feb 17	1.91	2.15	BUY
4:	03 Mar 17	1.97	2.15	BUY
5:	30 Mar 17	2.05	2.15	HOLD
6:	17 May 17	2.17	2.15	HOLD
7:	23 Aug 17	2.55	2.25	HOLD
8:	13 Sep 17	2.49	2.25	HOLD
9:	15 Sep 17	2.45	2.25	HOLD
10:	22 Nov 17	2.91	2.25	FULLY VALUED

Source: AllianceDBS

Analyst: Woo Kim TOH

AllianceDBS recommendations are based on an Absolute Total Return* Rating system, defined as follows:
STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)
BUY (>15% total return over the next 12 months for small caps, >10% for large caps)
HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)
FULLY VALUED (negative total return i.e. > -10% over the next 12 months)
SELL (negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame)

Share price appreciation + dividends

Completed Date: 1 Jan 2018 14:40:13 (MYT)
Dissemination Date: 2 Jan 2018 08:27:07 (MYT)

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