Singapore Industry Focus

Spotlight on Technology

DBS Group Research . Equity

1 Apr 2020

Reality bytes

- Tech companies hit on both supply and demand front
- Expect semiconductor to fare better as it forms part of the essential goods supply chain – BUY calls on AEM, UMS, Frencken
- Valuations more attractive now; strong balance sheet and cashflow, all net cash position
- 13/10% cuts in FY20F/FY21F earnings. Expect Venture (BUY) to emerge stronger; downgrade FUYU to HOLD

Supply and demand affected. The COVID-19 pandemic has hit the business world at an unprecedented scale and speed. It has caused the closures of businesses, the stoppage of factory outputs and disruption to global supply networks. The issue is compounded with the lockdown orders and the restriction in movements, leading to a demand crisis. Technology companies are hit on both fronts, at the supply and demand side.

Semiconductor faring better so far. The February semiconductor equipment billing, which has accounted for the shutdown in China amidst the outbreak of the COVID-19, was still positive but we expect the data to taper down going forward. The dampened economic outlook is likely to weigh on end-consumer demand. We continue to expect AEM and UMS to register growth but at a slower pace.

Valuations more attractive now. Stock prices under our coverage has fallen by c.30% from their recent peak. PE valuations are now near or below their average 5-year forward PE band for the mid and downstream players – Venture, Hi-P, Frencken and FUYU. For the upstream semiconductor plays – AEM and UMS, PE has retraced from near +2SD level to between average to +1SD level.

All are in net cash position. Venture and AEM have negligible debts while FUYU is debt free. Cashflow is strong for all; cash accounts for c.50% of market capitalization for FUYU, Frencken and Hi-P; c.20% for Venture and AEM.

13/10% cuts in FY20F/FY21F earnings. We have revised down our FY20F and FY21F earnings forecasts for stocks under our coverage by an average of 10-13%, mainly on supply disruptions, weaker demand and margin pressure. We also downgrade FUYU to HOLD from BUY as we expect lower revenue across all segments except Medical .

Potential M&A, privatisation candidate. FUYU's strong cash level with no debt, coupled with strong operating cash flows make it an attractive M&A or privatisation candidate. Meanwhile, Hi-P could be either a prey or predator.

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STOCKS

	Price S$	Mkt Cap US$m	12-mth Target Price S$	Performance (%) 3 mth	12 mth	Rating
AEM Holdings Ltd	1.67	317	2.29	(17.3)	45.2	BUY
Frencken Group	0.58	172	0.74	(37.8)	6.5	BUY
Fu Yu Corp Ltd	0.20	105	0.21	(22.4)	(1.0)	HOLD
Hi-P International	0.85	481	0.85	(44.4)	(44.4)	HOLD
UMS Holdings	0.63	236	0.77	(39.3)	(13.8)	BUY
Venture Corporation	13.57	2,753	15.80	(16.2)	(24.4)	BUY

Source: DBS Bank, Bloomberg Finance L.P.
Closing price as of 31 Mar 2020

Revision to recommendation, target price and earnings

Company	Recommendation Curr.	Prev.	Target Price (S$) New	% cut	% cut in Earnings FY20F	FY21F
AEM	BUY	BUY	2.29	9	-	-
Frencken	BUY	BUY	0.74	30	16	15
Fu Yu	HOLD	BUY	0.21	40	25	28
Hi-P	HOLD	HOLD	0.85	38	21	10
UMS	BUY	BUY	0.77	31	11	11
Venture	BUY	BUY	15.80	15	5	3
Average				27	13	10

Source: DBS Bank

ed: TH/ sa: JC, PY, CS, contributed by CWL

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Impact of COVID-19

Supply and demand affected. The COVID-19 pandemic has hit the business world at an unprecedented scale and speed. It has caused the closures of businesses, the stoppage of factory outputs, and the disruption to global manufacturing industries and their supply networks. The issue is compounded with the lockdown orders and the restriction in movements, leading to a demand crisis.

Even with the resumption of production, companies are slow to resume their normal productions due to various factors. These include the shortage of parts; the shortage of workers, the stringent requirements for companies to establish adequate protective measures, and the slow recovery of transportation network capacity.

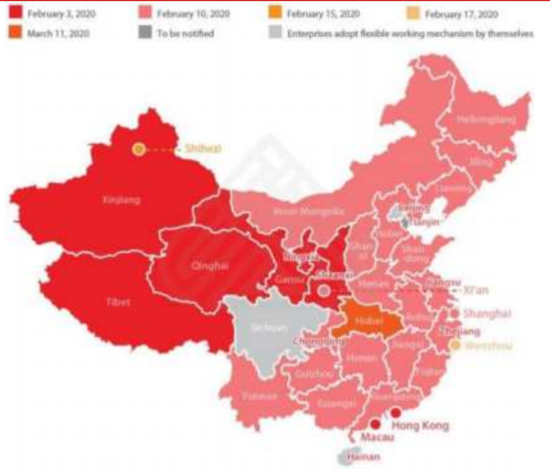
Companies are finding alternative solutions, including shifting orders to secondary suppliers to make up for the missed delivery from their primary suppliers and moving some orders to their factories in other regions less affected by the virus.

China and Malaysia shut down non-essential businesses

The escalation of the coronavirus (COVID-19) in China and Malaysia has resulted in these two countries temporarily shutting down all non-essential businesses.

China: Most factories resumed operations on 10 February (following a three-week shutdown). On 27 January, China's State Council announced a one-week extension of the Lunar New Year holiday. The revised holiday period was 24 January to 2 February. However, depending on the severity of the situation in each province, provincial governments could delay the resumption of non-essential business activities. Most provincial governments extended the shutdown to 9 February.

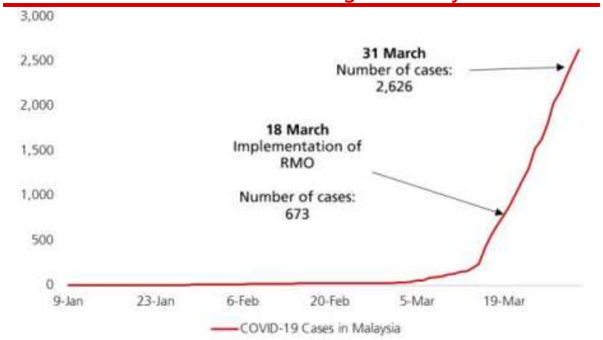
China COVID-19 Business Resumption by Province



Source: Asia Briefing Ltd

Malaysia: Implements Movement Control Order (MCO) for four weeks. On 16 March, in a bid to combat the rising number of COVID-19 cases in Malaysia, the Malaysian government initially implemented a two-week MCO which restricted inbound and outbound movement and the temporary closure of non-essential business operations from 18-31 March. However, despite the measures, the number of cases in Malaysia continued to soar and the Malaysian government has extended the MCO until 14 April.

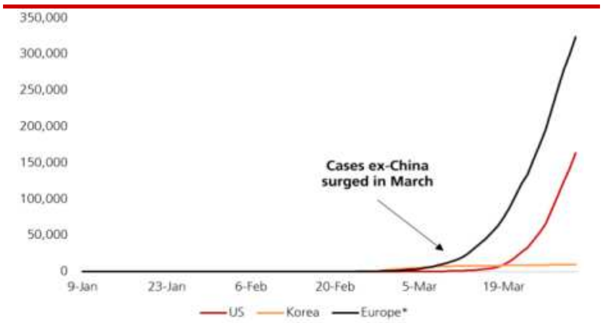
COVID-19 cases continue to surge in Malaysia



Source: CNA, DBS Bank

From epidemic to pandemic in March; supply chains disrupted. In March, the number of COVID-19 cases began to rise globally, outside of China. The total case count in the US, Europe, and Korea had reached 496,411 as of 31 March.

COVID-19 cases surged in the US, Europe, and Korea from March



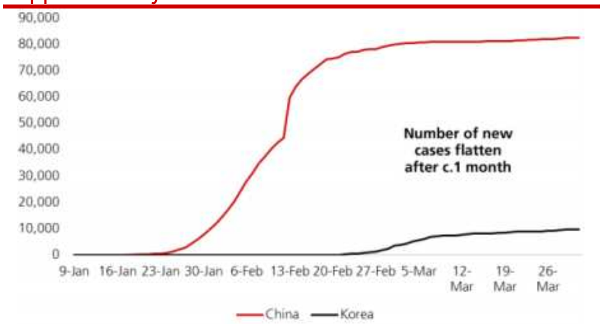
Source: CNA, DBS Bank
**Only includes Germany, UK, France, Italy, and Spain*

As such, the US has implemented a 15-day shutdown of non-essential businesses.

According to the Semiconductor Industry Association (SIA) and the World Semiconductor Trade Statistics (WSTS), the US accounted for 45% of the global semiconductor market share in 2018.

Silver lining – Relief from the flattening of cases in China and Korea after approximately one month. China and Korea were previously reporting double-digit growth in new cases for weeks. However, both countries took drastic measures which included rapidly testing potential cases, disinfecting streets, and the locking down of provinces yielded results as the number of new cases begun to flatten out after c.1 month from the surge in new cases. China has since gradually resumed normal business activities across provinces, with the most recent being the lifting of its lockdown on Hubei province. This provides us with some relief that the US and Europe can potentially contain the spread of the virus in mid-to-late April.

COVID-19 cases flatten in China and Korea after approximately one month



Source: CNA, DBS Bank

Location of plants and revenue contribution for stocks under our coverage

Location of plants

AEM	Frencken	Fu Yu	Hi-P	UMS	Venture
Singapore	Singapore	Singapore	Singapore	Singapore	Singapore
China - Suzhou	The Netherlands	China - Dongguan, Suzhou, Zhuhai, and Chongqing	China - Shanghai, Chengdu, Xiamen, Suzhou and Nantong	Malaysia - Penang	Malaysia - Johor, Penang
Malaysia - Penang	Malaysia	Malaysia - Johor, Penang	Thailand	US	China - Shanghai, Pudong
	Thailand		Poland		US - Milpitas

Revenue contribution (%)

Company	China	Msia	Spore	Thai	Other ASEAN	USA	Europe	Others	Assumption
AEM	27	34	1	-	20	14	2	1	based on FY18 location of customers
Frencken	13	10	9	18	1	5	44*	-	based on FY18 location of customers
Fu Yu	57	19	24	-	-	-	-	-	based on FY18 revenue from customers
Hi-P	51	1	1	3	6	31	7	2	based on FY18 revenue from customers
UMS	-	4	55	-	21	19	-	2	based on FY18 location of customers
Venture	10	75	10	-	-	5	-	-	Estimate based on number of plants in each location

Note: **include Netherlands 23%, Germany 8%* *Source: Company; DBS Bank*

Not all is doom for the technology sector: Work-from-home drives demand for servers and storage

Work-from-home drives demand for server DRAM, processors, and storage. Amidst the COVID-19 outbreak, governments are stepping up measures to minimise contact among individuals and companies are implementing a work-from-home option/policy for its employees. This has shifted face-to-face meetings to teleconferencing and the demand for unified communications and collaboration (UC&C) solutions such as Zoom, Webex, Microsoft Teams, and Skype, has spiked. Cisco, which operates Webex, saw a 22-fold increase in the amount of network traffic in February.

To handle the surge in concurrent users, more computing power and storage capacity are required for these UC&C solution companies. TrendForce has raised its forecast for 2Q20 server DRAM price trend from a 15% q-o-q increase to 20%.

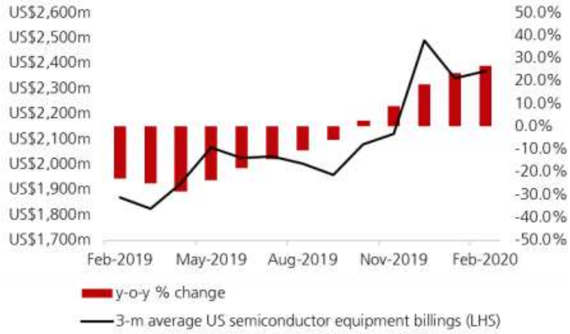
Semiconductor – Faring better so far but disruption to supply chain inevitable

No slowdown in February despite the epidemic. SEMI recently published its preliminary reading of the 3-month moving average of the worldwide billings for North American-based semiconductor equipment manufacturers in February 2020 and the figure (US$2.4bn; +26.2% y-o-y) highlighted the continued recovery in the semiconductor industry. This growth was despite the shutdown in China amidst the COVID-19 outbreak.

Downside risk prevails; outlook muted. However, going forward, though the factories for the semiconductor players were allowed to operate partially in countries affected by the lockdown, production will still be at a sub-par level. End-demand is also expected to be weaker on the back of a slower global economy with some countries, including Singapore, expected to fall into a recession in 2020. Hence, we expect the semiconductor equipment billings data to taper down. However, on a y-o-y basis it could still record positive growth given a weak 1H2019.

Overall, we expect the semiconductor sector to fare better than others in the technology value chain, as it forms part of the essential goods supply chain.

US semiconductor equipment billings continued to rise in February 2020



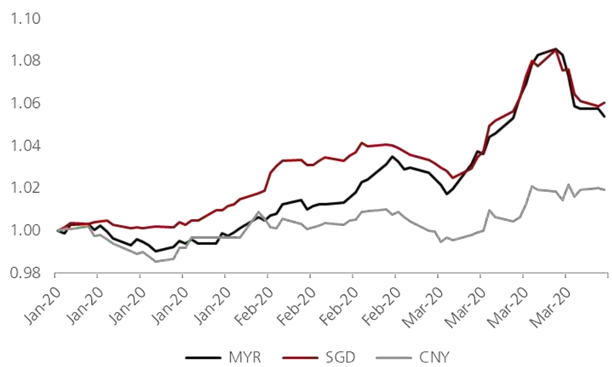
Source: CNA, DBS Bank

Impact on technology companies

Technology companies are hit on both fronts, the supply and demand side. The shortages of raw materials, components, workers and slow recovery of logistic network have disrupted the supply chain while job losses, slower wage growth and possibly recession in certain countries lead to weaker end-demand.

Beneficiary of strong USD. The COVID-19 crisis has also led to the strengthening of the USD against local currencies like CNY, SGD and RM. The strengthening of the USD is beneficial to technology companies as most of their revenues are in USD while costs are mainly in local currencies. YTD, USD has strengthened c. 2-6% against RMB, SGD and RM.

USD strengthens against CNY, SGD and RM



Source: Thomson Reuters; DBS Bank

13/10% cuts in FY20F/FY21F earnings. In terms of earnings forecasts, we have revised down FY20F and FY21F figures for stocks under our coverage by an average of 10-13%, mainly on supply disruptions, weaker demand and margin pressure. FUYU and Hi-P saw a steeper cut in FY20F earnings of 25% and 21% respectively. We expect lower revenue across all segments for FUYU, except Medical. Hi-P is mainly on weaker mobile phone sales and margin pressure. Our target prices are cut by 27% on average. We have also downgraded Fu Yu to HOLD from BUY.

Revision to recommendation, target price and earnings

Company	Recommendation		Target Price (S$)		% cut in Earnings	
	Curr.	Prev.	New	% cut	FY20F	FY21F
AEM	BUY	BUY	2.29	9	-	-
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Source: DBS Bank

AEM: Revise TP to S$2.29; no change to FY2020F/21F earnings; maintain BUY.

No changes to FY2020F sales guidance. AEM released a statement announcing that its FY2020F revenue guidance of S$360-380m remains unchanged. It is also expecting a record sale of S$135-145m in 1Q20, which is 38-48% higher than its last record quarter in 2Q19 (S$98m).

Malaysia factories unlikely to be fully shut down. The MCO issued by the Malaysian government requires all non-essential businesses to be shut down until 14 April. AEM has one factory located in Malaysia (Penang) and c.34% of its revenue in FY2018 was from Malaysia. However, we believe that with a portion of Intel's chips used in mission-critical medical applications, AEM's factory in Malaysia should still be able to operate, albeit at a reduced capacity. We estimate AEM's Malaysia factory to be operating at 30-40% production capacity.

Intel's factories are still in operation; company cites uncertainty in outlook. On 19 March, Intel's CEO announced that its business as usual for Intel's vast manufacturing operations despite the shutdown in the US. He said that it is fulfilling more than 90% of orders on time. However, he also believes that there could be a financial impact on the company's business due to a slowdown in the global economy.

Working from home raises demand for server processors. With more companies implementing a work-from-home policy for its employees amidst the COVID-19 outbreak, the demand for laptops and server capacity has surged. The use of remote working applications such as Zoom, Webex, and Skype has increased dramatically. Cisco saw a 22-fold increase in the amount of network traffic in February. More computing power is required for these communication companies to cater to the increased users and as a result, server chip demand has risen.

Maintain BUY with a lower TP of S$2.29 on the back of a negative economic sentiment. No change to FY2020/21F earnings as we continue to believe that AEM is well positioned to benefit greatly from its key customer's requirement for more test handlers, a structural increase in test times, and a diversification of revenue through new projects and customers. As there is some negativity on global sentiment, we are lowering our 12-month forward PE peg from 11.2x (+2SD) to 10.0x (+1.5SD). We are maintaining our BUY call with a lower TP of S$2.29 (previously S$2.52).

Frencken: Revise TP to S$0.74; 16%/15% cuts to FY2020F/21F earnings; maintain BUY.

Factories in Malaysia partially affected; China plants have resumed operations. FRKN has received approval from the authorities in Malaysia to continue with its mechatronics manufacturing operations in Bangi, but with a reduced number of employees during the MCO period. Its factories for the IMS division in Sungai Buloh and Johor remain closed during this period.

In China, the Group's five factories in Wuxi, Chuzhou, Tianjin and Zhuhai (Jinding and Nanshui) have resumed normal operations and are fulfilling orders from customers.

Exposure to Medical segment an added advantage in this pandemic crisis. For the Medical division, FRKN is involved in components and sub-assembly for CV (cardiovascular) patient tables, histopathology digital scanners, X-ray gantry and telescopic tubes and micro motors for heart implants. Exposure to the Medical segment could be an added advantage during this pandemic crisis as some countries like Italy and Spain have already reached their limits on medical resources.

Expect better performance for Semiconductor. We expect the Semiconductor sector to fare better than others in the technology value chain, as it forms part of the essential goods supply chain. FRKN has c.20% exposure to this segment.

FUYU: Revise TP to S$0.21; 25/28% cuts to FY2020F/21F earnings; cut to HOLD

Shutdown of Malaysia factories, Singapore factories' production capacity not impacted. To comply with the MCO issued by the Malaysian government, two of FUYU's factories in Malaysia will be temporarily shut down. We believe that the four-week shutdown is unlikely to have a significant impact on the FUYU's revenue (c.2%).

Anticipate higher revenue in the medical segment. The medical industry is facing a stress test as the number of COVID-19 cases increase globally. Italy and Spain have reached their limits on their medical resources and are forced to triage their patients. FUYU's medical business segment accounted for 16% of its FY2018 revenue (latest available) and we are anticipating a 15% y-o-y growth in FY2020.

Lower revenues across all other segments in FY2020F. While we may see growth in its medical segment, we foresee a contraction across its other business segments. As businesses are unable to function normally and unemployment rises, we could see weakened demand across all other business segments (Printing & Imaging, Networking & Communications, Consumer, and Automotive & Power Tools) as companies and consumers cut back on spending.

Cut to HOLD with a lower TP of S$0.21 on the back of lower FY2020F/21F revenues and gross profit margins. We have reduced our FY2020F/21F revenue forecasts by 10/13% due to a weakening of the global economy and supply chain disruptions. We have also cut gross profit margins for FY2020F from 22.3% to 18.8% on the back of lower utilisation levels and shutdown in factory operations in China and Malaysia. Overall, our FY2020F/21F earnings forecasts are lowered by 25/28% and we derive a lower TP based on its 12-month forward PE of 13.7x.

Hi-P: Revise TP to S$0.85; 21%/10% cuts to FY2020F/21F earnings; Maintain HOLD

Weaker mobile phone sales partly mitigated by the less volatile Consumer Electronics. Apple's iPhone shipments in China plunged more than 60% in February, when the coronavirus outbreak first started. With the widespread of the virus to the rest of the world, iPhone sales in 2020 is expected to be weak. Apple is now unable to meet the revenue guidance it provided for the March quarter. Apple had forecast revenue of US$63-67bn for 2Q FY September 2020, vs revenue of US$58bn in 2Q19.

The Consumer Electronics segment, which accounts for the bulk of about 40% of total revenue, is less volatile. We are now expecting flat-to-lower single-digit negative growth, vs our previous expectation of stable single-digit growth.

Company may see small loss in 1Q20. With more than half of its factories in China affected by the shutdown, 1QFY20F performance would be weak. Though the Group is drawing down on its inventory to tide over this period, the whole supply chain, including Hi-P's customers, are affected. Thus, Hi-P could register a small loss in 1QFY20F.

Continues to divest its operations out of China and is actively on the lookout for M&A targets. Note that the Group has cut its dividends for FY19 to 2.8 Scts, from 5 Scts in FY18, partly to be prudent and also for potential M&A.

On the M&A front, targets would include companies that are strong in the technology know-how, and can complement Hi-P's existing business.

Hi-P could also be an attractive target for global companies looking to build a base in Asia. Hi-P's free float in the market is small, as Executive Chairman and Chief Executive Officer, Mr. Yao Hsiao Tung, now owns about 84% of the company. Furthermore, there is still no concrete succession plan in place.

We continue to believe that with its entrenched relationship with key customers, which include some of the world's biggest names in mobile phones, tablets, household and personal care appliances, Hi-P could be an attractive target.

UMS: Revise TP to S$0.77; 11%/11% cuts to FY2020F/21F earnings; Maintain BUY

Update on factory closure. Its Penang factory will remain closed until 14 April 2020, in compliance with the Malaysian Government's announcement on 25 March 2020 to extend its MCO nationwide to contain the COVID-19 outbreak.

The Group's factory in California, US will stay closed in compliance with the California State's "Stay at Home" Executive Order in the US issued on 19 March 2020, until further notice.

However, its production facilities in Singapore will remain in operation.

Key customer toning down guidance. Key customer Applied Materials (AMAT) has recently withdrawn its business outlook for 2Q FY October 2020 because the COVID-19 pandemic is affecting its supply chain and manufacturing operations. AMAT had previously provided a bullish guidance for 2Q FY2020, expecting revenue to surge by c.23% y-o-y and earnings to jump 50% y-o-y, during the release of its 1Q FY2020 results in February.

With c.90% of its revenue attributed to AMAT, we have trimmed our earnings forecasts for FY2020F and FY2021F by 11% each. Accordingly, our TP is reduced to S$0.77, pegged to +0.5SD valuation (vs +2SD previously) or 11.6x on FY2020F earnings.

Venture: Revise TP to S$15.80; 5%/3% cuts to FY2020F/21F earnings; maintain BUY

Factories affected by shutdown. As most of Venture's factories are in Malaysia, it is affected by the MCO. The resumption of production in its China plants and the Singapore plants remaining in operation should help to mitigate some of the negative impact from its Malaysia plants.

New product introductions to cushion impact. In FY2020, Venture will be supporting new product introductions from its existing partners across multiple selected technology domains, such as Life Science, Healthcare & Wellness, Instrumentation and Networking & Communications. It also expects to gain momentum with several new partners in the Life Science & Genomics and Healthcare & Wellness domains with growing contributions beyond 2020.

Exposure to Medical segment an added advantage in this pandemic crisis. Venture's business segments include Medical Devices and Equipment, Healthcare & Wellness Technology, and also Life Science, Genomics and Molecular Diagnostics, which can be in high demand during this pandemic crisis. Some countries like Italy and Spain have already reached their limits on their medical resources. Furthermore, if R&D is required, Venture can tie up with its customers to perform R&D together. Venture is not new to this kind of collaborations with customers in manufacturing new products. The company has been working with industry leaders in the various segments to develop new products. These include working with a leading laboratory analytical instrument company to manufacture their next-generation mass spectrometry instrument, and also in the Life Science domain, collaborating on a partnership with an emerging leader to develop next-generation equipment.

Venture to emerge stronger. Given Venture's expertise and its entrenched relationship with the industry leaders in the various technology domains, coupled with its balance sheet strength, we expect the company to emerge stronger from the current crisis.

Key statistics

Company	Price (S$) 27 Mar	Target Price (S$)	Target Return	Mkt Cap (S$m)	Rcmd	PER 19 (x)	PER 20 (x)	PER 21 (x)	EPS Gth 20 (%)	EPS Gth 21 (%)	Div Yield 19 (%)	Div Yield 20 (%)	P/BV 19 (x)	Net Debt / Equity 20
AEM	1.64	2.29	40%	442	BUY	8.4	7.2	7.0	17.0	3.0	3.1	3.6	3.3	cash
Frencken	0.57	0.74	30%	242	BUY	5.7	6.4	5.8	-19.1	9.8	5.3	4.7	0.8	cash
Fu Yu	0.205	0.21	2%	154	HOLD	12.2	9.7	10.0	25.0	-3.1	7.8	7.8	0.9	cash
Hi-P	0.83	0.85	2%	669	HOLD	8.3	10.7	9.2	-22.0	17.0	3.4	1.9	1.1	cash
UMS	0.64	0.77	20%	341	BUY	10.2	9.6	8.4	6.0	14.0	6.3	6.3	1.4	cash
Venture	13.96	15.80	13%	4,027	BUY	11.1	11.1	10.3	1.0	8.0	5.0	5.0	1.6	cash

Source: DBS Bank

Cashflow and Balance Sheet Strength

Net cash with >20% dividend payout. All the technology stocks under our coverage are in a net cash position (as at FY December 2019). Venture and AEM have negligible debt while Fu Yu is debt free. For UMS, the debts are mainly unsecured short-term bank loans. Hi-P's debts are mainly for general working capital and capital expenditure purposes. These are mainly short-term bank loans with a fixed interest rate (2.65% as at December 2018). The bulk of the debt is unsecured. Frencken's debts are mainly short term in nature and more than half are secured.

High net cash level for FUYU an attractive M&A target. FUYU's net cash of S$88.5m represent 57% of its market capitalisation. Couple with its strong operating cash flows of S$27m and no debt, we believe it is an attractive takeover or privatisation candidate.

Valuations more attractive now. Stock prices under our coverage has fallen by c.30% from their recent peak. PE valuations are now near or below their average 5-year forward PE band for the mid and downstream players – Venture, Hi-P, Frencken and FUYU. For the upstream semiconductor plays – AEM and UMS, PE has retraced from near +2SD level to between average to +1SD level.

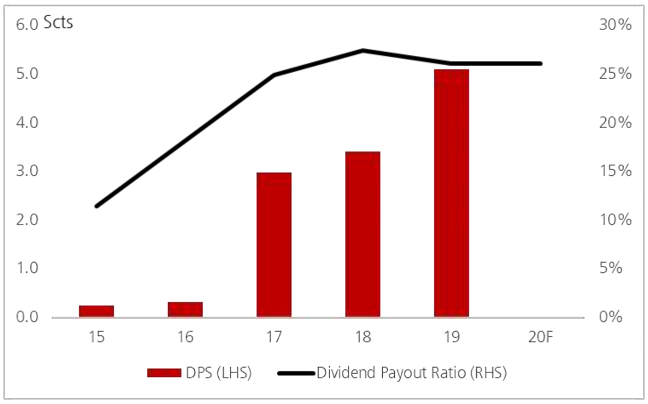
Cashflow and balance sheet strength

Matrix	AEM	Frencken	Fu Yu	Hi-P	UMS	Venture
Net Debt/ Equity (x)	cash	cash	cash	cash	cash	cash
Total Debt (S$m)	0.05	53.2	0	122.7	9.3	1.1
Cash (S$m)	108	122	88.5	329.6	34.4	714.5
- % of mkt cap	24.4	50.4	57	49	10.1	17.7
P/BV (x)	3.3	0.8	0.9	1.1	1.4	1.6
Cashflow from operation (S$m)	67.7	94.9	27.3	250.8	53.6	229.7
Dividend Payout Ratio (%)	26.1	30	94.9	28	64	56

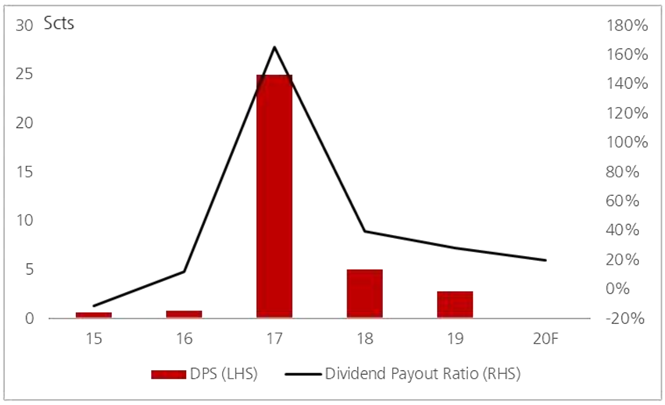
Note: balance sheet and cashflow data as at end-December 2019
Source: DBS Bank, Company

DPS and Dividend Payout Ratio

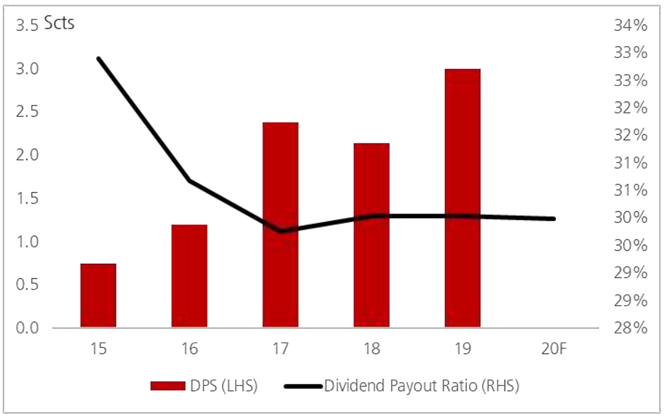
AEM



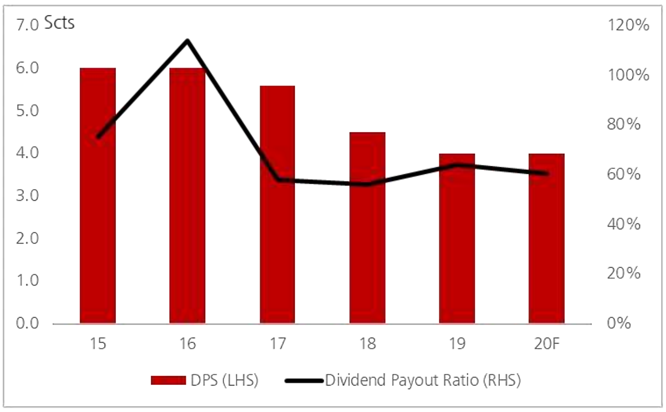
Hi-P



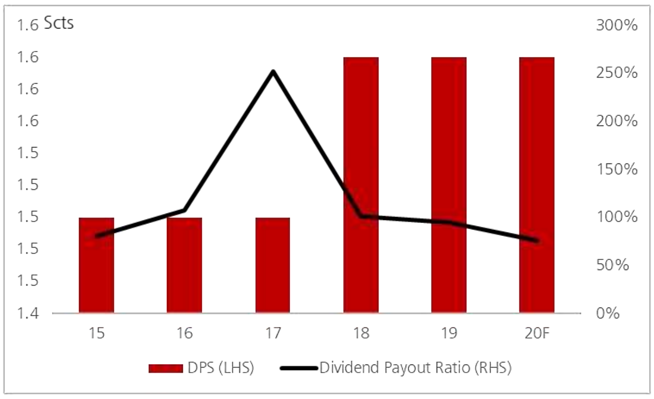
Frencken



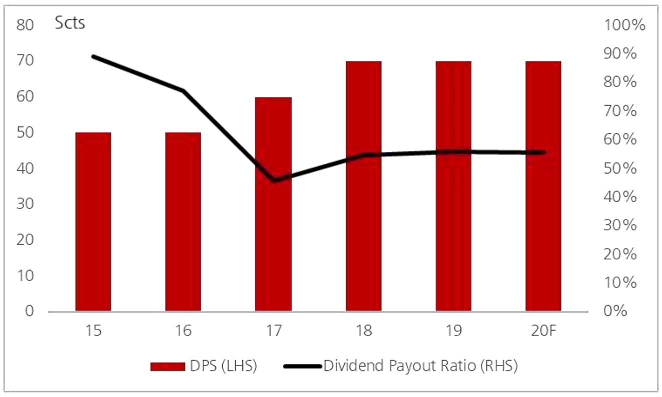
UMS



Fu Yu



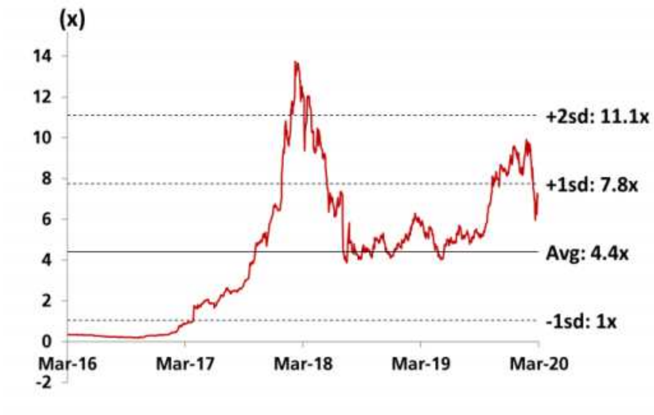
Venture



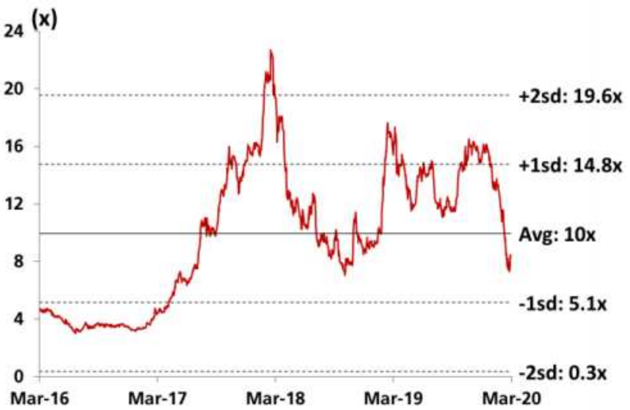
Source: DBS Bank

Valuation Charts – Forward PE

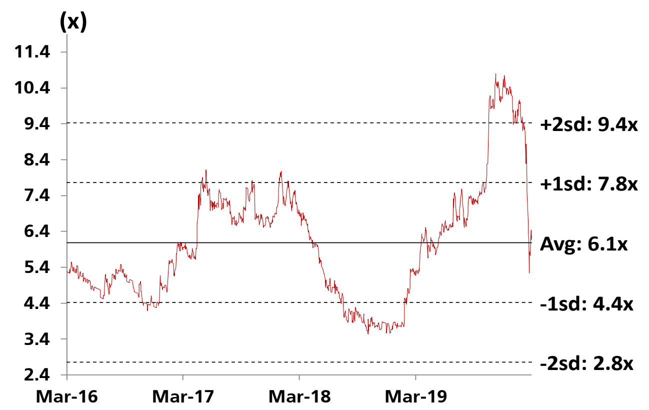
AEM Forward PE



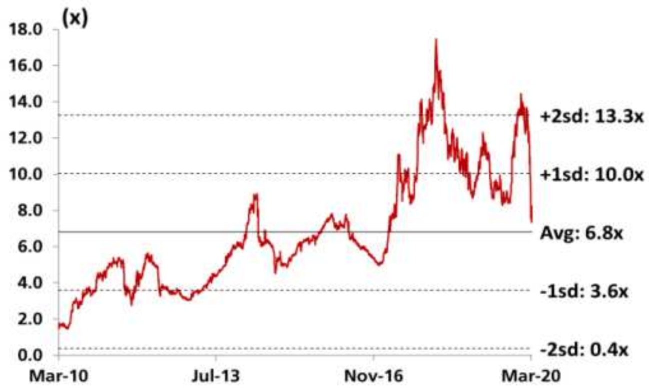
Hi-P Forward PE



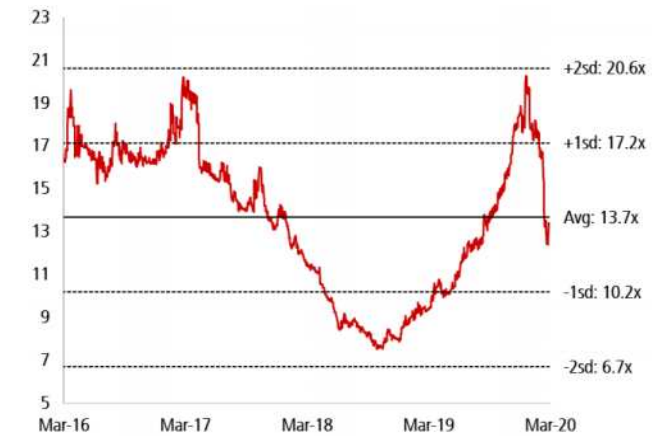
Frencken Forward PE



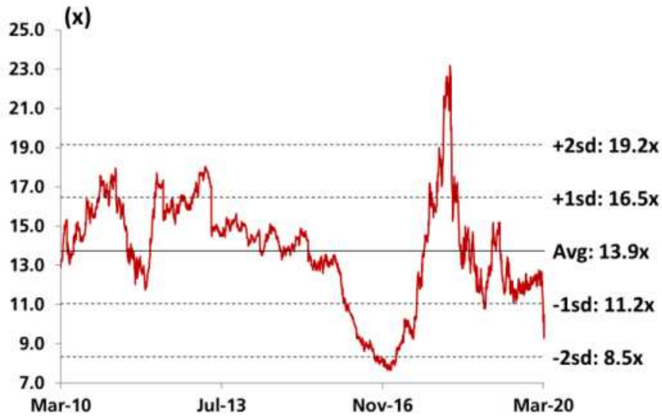
UMS Forward PE



Fu Yu Forward PE



Venture Forward PE

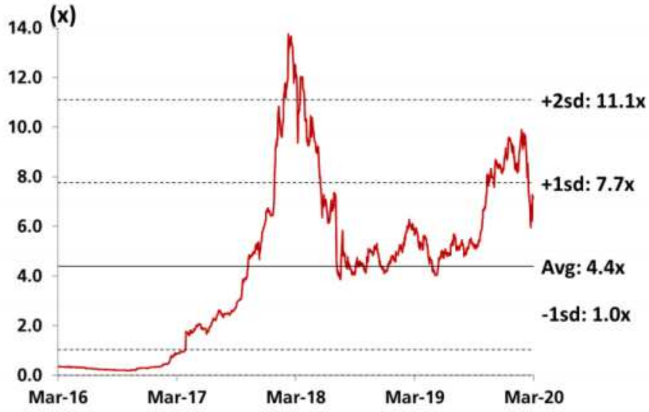


Note: 5-yr chart used instead of 10-yr due to losses in earlier years or data not comparable

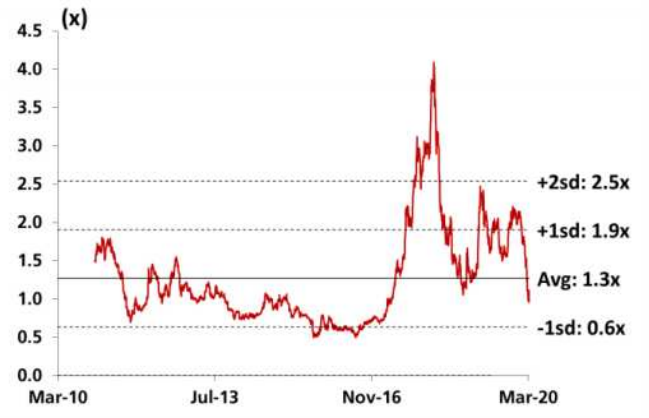
Source: DBS Bank

Valuation Charts – PBV

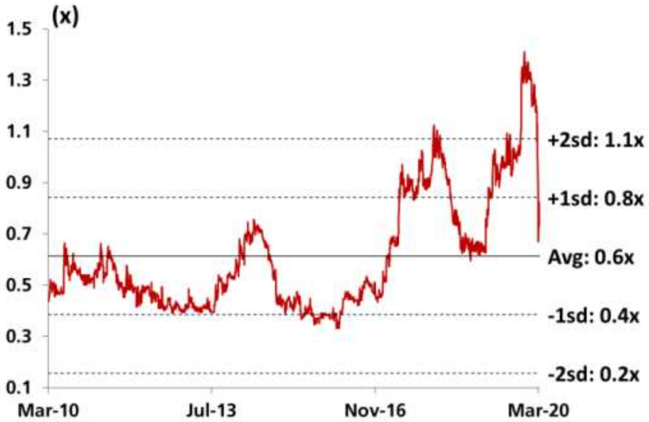
AEM PBV



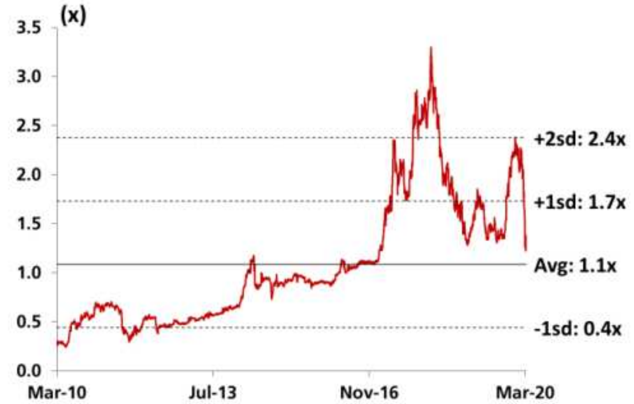
Hi-P PBV



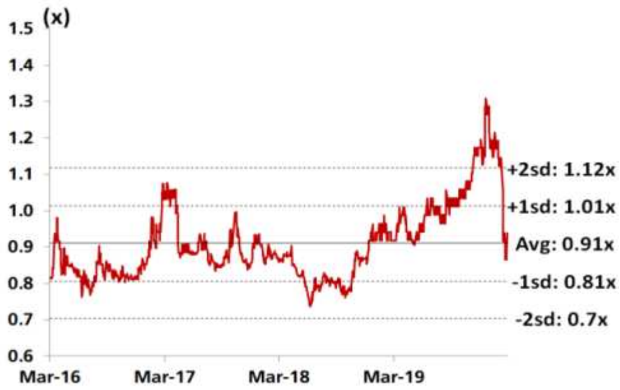
Frencken PBV



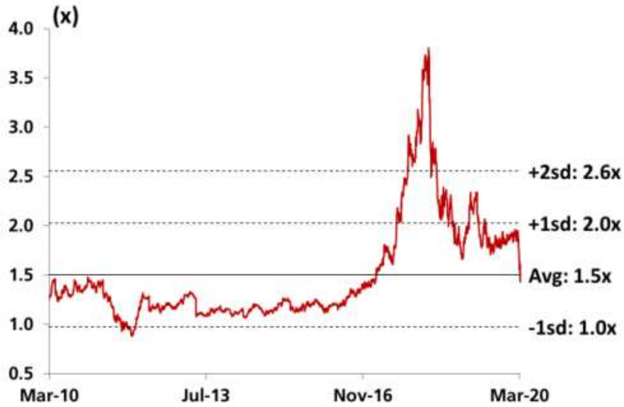
UMS PBV



Fu Yu PBV



Venture PBV



Source: DBS Bank

Company Guides

Singapore Company Guide

AEM Holdings Ltd

Version 3 | Bloomberg: AEM SP | Reuters: AEM.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

1 Apr 2020

DBS is supported by the Research Talent Development Grant Scheme which aims to groom research talent to expand research coverage of small-mid cap SGX listed companies

BUY

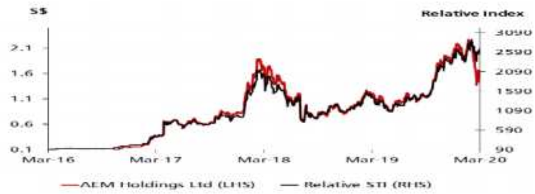
Last Traded Price (31 Mar 2020): S$1.67 (**STI :** 2,481.23)
Price Target 12-mth: S$2.29 (37% upside) (Prev S$2.52)

Analyst
Lee Keng LING +65 6682 3703 leekeng@dbs.com
Singapore Research Team equityresearch@dbs.com..

What's New

- FY2020F sales guidance unchanged; record-high revenue expected for 1Q20
- No disruption to Intel's business operations
- Work from home drives server chip demand
- Maintain BUY with a lower TP of S$2.29

Price Relative



Forecasts and Valuation

FY Dec (S$m)	2018A	2019A	2020F	2021F
Revenue	262	323	378	412
EBITDA	41.6	69.5	76.5	79.0
Pre-tax Profit	40.0	63.7	74.2	76.5
Net Profit	33.5	52.8	61.6	63.5
Net Pft (Pre Ex.)	33.5	52.8	61.6	63.5
Net Pft Gth (Pre-ex) (%)	4.1	57.5	16.7	3.1
EPS (S cts)	12.4	19.6	22.8	23.5
EPS Pre Ex. (S cts)	12.4	19.6	22.8	23.5
EPS Gth Pre Ex (%)	(75)	57	17	3
Diluted EPS (S cts)	12.4	19.6	22.8	23.5
Net DPS (S cts)	3.41	5.10	5.96	6.14
BV Per Share (S cts)	33.3	49.8	66.7	84.1
PE (X)	13.4	8.5	7.3	7.1
PE Pre Ex. (X)	13.4	8.5	7.3	7.1
P/Cash Flow (X)	13.2	6.7	5.3	6.5
EV/EBITDA (X)	9.4	4.9	3.6	2.9
Net Div Yield (%)	2.0	3.1	3.6	3.7
P/Book Value (X)	5.0	3.4	2.5	2.0
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	45.5	47.1	39.2	31.2
Earnings Rev (%):			0	0
Consensus EPS (S cts):			17.8	17.5
Other Broker Recs:		B: 4	S: 0	H: 0

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

This year is still clear

Expecting record revenue in 1Q20 (+38-48% from last record quarter), FY2020F's revenue guidance unchanged. On 19 March, AEM announced that it is confident in maintaining its full-year sales guidance of S$360-380m and is expecting 1Q20 to be a record quarter for its sales (S$135-145m). This is 38-48% higher than its previous record quarter in 2Q19 (S$98m) and represents a 156-175% increase y-o-y. While we previously believed that there could be further upward revisions in its sales guidance, this could now be muted in FY2020F.

No disruption to Intel's business. Intel has announced that despite the impact from COVID-19, it is still able to maintain its production capacity and meet more than 90% of its orders on time. We believe that the demand for Intel's server processors could surge in the near term as working from home drives unified communications and collaboration (UC&C) solutions demand.

Where we differ: We are more bullish on AEM's earnings in FY2020F/21F and believe an uptick in equipment billings should drive a re-rating in its forward PE.

Potential catalysts: Stronger semiconductor equipment billings, increased sales guidance, acquisitions, new revenue streams.

Valuation:

Maintain BUY with a lower TP of S$2.29, pegged to 10.0x FY2020F PE, +1.5 SD to its historical average. We lower our forward PE peg from 11.2x (+2SD) to 10.0x (+1.5SD) on the deferred recovery.

Key Risks to Our View:

Single-customer concentration risk, escalation or continued protraction of geopolitical events, and FX risk.

At A Glance

Issued Capital (m shrs)	270
Mkt. Cap (Sm/USm)	451 / 317
Major Shareholders (%)	
Aberdeen Standard Investments	8.0
Toh Ban Leng	7.5
Morgan Stanley	5.8
Free Float (%)	78.7
3m Avg. Daily Val (US$m)	13.1

GIC Industry : Information Technology / Technology Hardware &

ed: TH/ sa: AS, PY, CS, contributed by CWL

WHAT'S NEW

FY2020F remains intact

Update on the impact from COVID-19

Management's FY2020F sales guidance intact; expecting record revenue in 1Q20. Due to the uncertainty surrounding the COVID-19 outbreak, AEM released an announcement on 19 March (after Malaysia's MCO announcement), stating that its FY2020F revenue guidance of S$360-380m remains unchanged. This represents a y-o-y increase of 11-18%. It is also expecting record-high sales of S$135-145m in 1Q20, which is 38-48% higher than its last record quarter in 2Q19 (S$98m).

Malaysia factories unlikely to be fully shut down. The Movement Control Order (MCO) issued by the Malaysian government requires all non-essential businesses to be shut down until 14 April. AEM has one factory located in Malaysia (Penang) and c.34% of its revenue in FY2018 was from Malaysia. However, we believe that with a portion of Intel's chips used in mission-critical medical applications, AEM's factory in Malaysia should still be able to operate, albeit at a reduced capacity. Based on channel checks, AEM's Malaysia factory is operating at c.30-40% production capacity during this period.

Outlook: FY2020F remains intact

Intel's factories are still in operation; cites uncertainty in outlook. Foundries and integrated device manufacturers (IDMs) are able to maintain their production capacity due to 1) their high degree of industrial automation, and 2) their critical importance in our daily operations.

On 19 March, Intel's CEO announced that it is business as usual for Intel's vast manufacturing operations despite the shutdown in the US. He said that it is filling more than 90% of orders on time. However, it also believes that there could be a financial impact on its business due to a slowdown in the global economy.

Working from home drives demand for server processors. Governments and companies are implementing social distancing among their citizens and employees, advising them against face-to-face meetings. The US, Australia, India, Malaysia, Italy, and China (previously) are among countries that have shutdown business operations to curtail the spread of the virus. Companies are increasingly requiring their employees to work from home. As a result, meetings have moved to unified communications and collaboration (UC&C) solutions such as Zoom, Webex, Microsoft Teams, and Skype. These platforms are witnessing a spike in their users with Cisco (Webex) seeing a 22-fold increase in its network traffic in February.

To support the increased usage, these platforms require more computing power (processors). This will further drive the near-term demand for server chips, which is already facing a supply drought for the whole of 2020. There could be a shift in Intel's production mix to cater to the higher demand from its data-centric business (DCG).

Beneficiary of the semiconductor recovery. We continue to believe that AEM is well positioned to benefit greatly from its key customer's requirement for more test handlers, a structural increase in test times, and diversification of revenue through new projects and customers.

Recommendation: Maintain BUY with a lower TP of S$2.29

Maintain BUY with a lower TP of S$2.29 on the deferred recovery. We are maintaining our FY2020F earnings forecast as management has indicated that its FY2020F's sales guidance remains unchanged. In our opinion, Intel's business in FY2020F will be supported by the strong demand for server processors. We are lowering our 12-month forward PE peg from 11.2x (+2SD) to 10.0x (+1.5SD) on the deferred recovery. Maintain BUY with a lower TP of S$2.29 (previously S$2.52).

CRITICAL DATA POINTS TO WATCH

Critical Factors

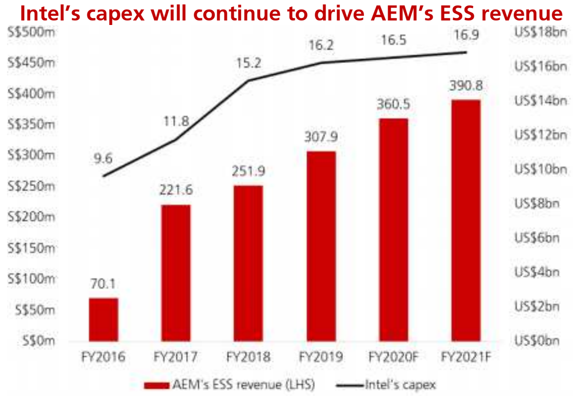
Intel's capital expenditure guidance. More than 90% of its revenue is currently derived from its key customer, Intel, and is captured in Intel's capex. Most of its revenue from Intel is classified under revenue from its Equipment Systems Solutions (ESS). In its 4Q19 earnings presentation, Intel had guided for capex of US$17bn in FY2020F, which will be used to increase their fab space and purchase 7-nm and 5-nm equipment. Intel is optimistic on its fast-growing total addressable market (TAM) and is currently building inventories to more normalised levels to deal with spikes in demand. Working closely as a sticky key supplier to Intel, we believe that AEM's ESS revenue will grow in tandem in FY2020F.

US semiconductor equipment billings. AEM's 12-month rolling forward PE correlates closely to the 3-month rolling US semiconductor equipment billings. We remain positive on the industry's recovery and expect equipment billings to trend upwards in the near term on the back of higher demand for server chips. We believe this will continue to drive a re-rating of AEM's forward PE.

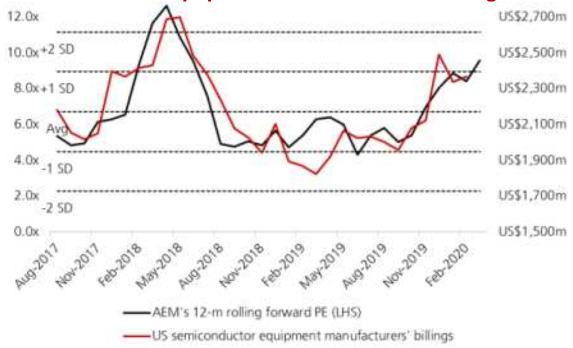
AEM's sales mix. AEM's Consumables and Services generally have slightly higher margins as compared to Tools and Machines. AEM's gross profit margin increased from 34.0% in FY2018 to 40.5% in FY2019 largely due to revenue from the early development phase of its projects with regards to its equipment. As of 3Q19, Intel had sufficient test handlers from AEM to meet its existing production capacity. However, Intel has guided that it will be increasing the production capacities of its 14-nm and 10-nm chips by 25% each in 2020. We believe Intel will continue to procure more test handlers from AEM, allowing the latter to maintain its gross profit margin.

Inventory levels of top chip makers as well as equipment suppliers in the US. Inventory levels of chip makers and equipment suppliers are a function of anticipated demand and current demand. Chip makers and equipment suppliers have built up their inventory levels ahead of the anticipated recovery in the semiconductor cycle. As the US-China trade situation improved from aggressive tariffs to a trade-deal standstill, inventory levels fell in 3Q19. This is likely due to an overall recovery in the sector as well as an uplift in business activity following the slight easing of the US-China trade war. We believe inventory levels will decline slightly or remain at the same level as demand for server chips picks up in FY2020F.

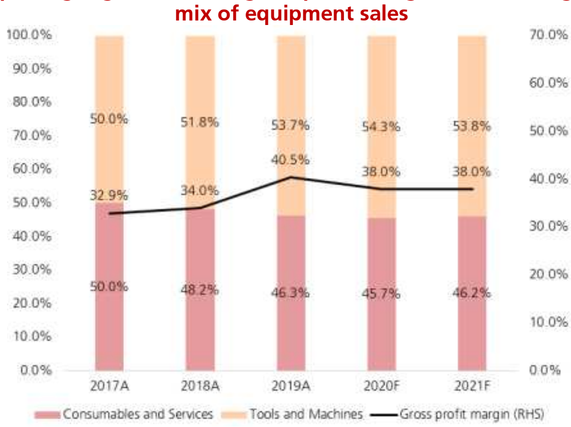
Intel's capex will continue to drive AEM's ESS revenue



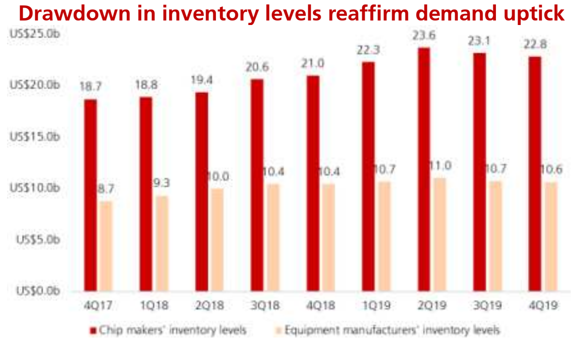
US semiconductor equipment manufacturers' billings trend up



Expecting slight decline in gross profit margins due to a higher mix of equipment sales



Drawdown in inventory levels reaffirm demand uptick



Source: Company, DBS Bank

Balance Sheet:

Net cash position with no debt. As of FY2019, AEM had a cash balance of S$107.7m and no borrowings. In the last five years, AEM had close to negligible debt levels and had been financing its operations and acquisitions through its own cashflow. It is currently on the lookout for potential acquisitions that could create synergies with its existing business.

Share Price Drivers:

US 3-month semiconductor billings. AEM's share price and forward PE correlate closely to the US 3-month semiconductor billings. We believe that the recovery and end-demand driven by server chips in the near term will drive semiconductor billings and re-rate AEM's forward PE.

Order book and sales guidance. Management provides guidance on its revenue which is estimated from its order book. In FY2019, AEM raised its sales guidance four times, which resulted in its share price increasing by an average of 4.0% on each announcement day.

Key Risks:

Single-customer concentration risk. Around 90% of AEM's revenue is derived from Intel. Out of this, c.50% is from sales of equipment, which is lumpy in nature and dependent on Intel's need to replace existing machines or increase its production capacity.

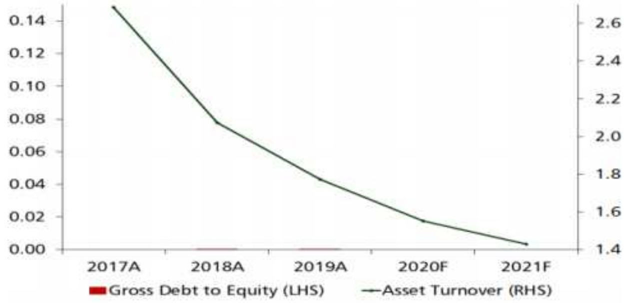
Prolonged COVID-19 situation. The COVID-19 pandemic has disrupted global supply chains in China and dampened economic outlook. If the outbreak escalates and is prolonged, it may weigh on the recovery of the semiconductor cycle.

Re-escalation of the US-China trade war. The US-China trade war weighed heavily on the global manufacturing cycle, reducing the demand for semiconductor end-products as well as disrupting the supply chain. A re-escalation of the trade war could hamper the recovery of the semiconductor industry.

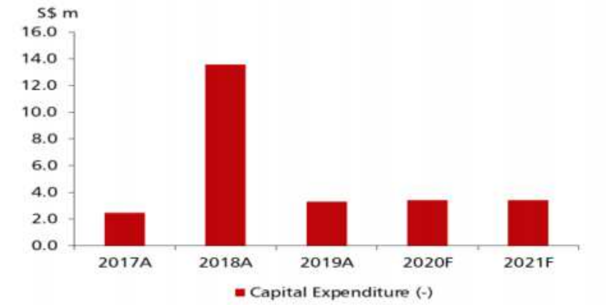
Company Background

AEM is a solutions provider for the back-end testing of the semiconductor manufacturing process. It works closely with its key customer, Intel, to design, engineer, and manufacture the test handlers. AEM then provides field support and post-sales replacements.

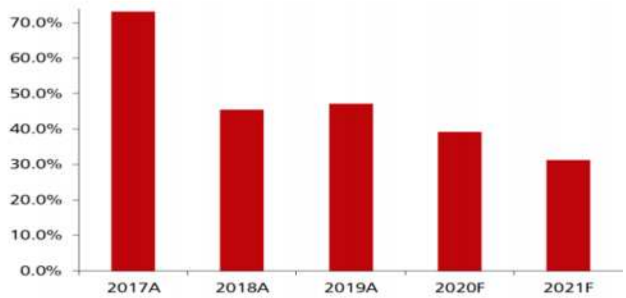
Leverage & Asset Turnover (x)



Capital Expenditure

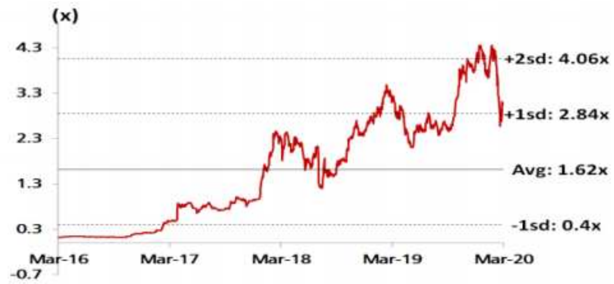


ROE (%)



Forward PE Band (x)

PB Band (x)



Source: Company, DBS Bank

Income Statement (S$m)

FY Dec	2017A	2018A	2019A	2020F	2021F
Revenue	222	262	323	378	412
Cost of Goods Sold	(149)	(173)	(192)	(231)	(255)
Gross Profit	**73.0**	**89.1**	**131**	**148**	**156**
Other Opng (Exp)/Inc	(35.4)	(49.4)	(67.9)	(74.0)	(80.5)
Operating Profit	**37.6**	**39.8**	**62.9**	**73.6**	**75.9**
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	(0.1)	0.0	0.46	0.0	0.0
Net Interest (Exp)/Inc	0.04	0.26	0.36	0.60	0.60
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	**37.5**	**40.0**	**63.7**	**74.2**	**76.5**
Tax	(5.4)	(6.5)	(11.0)	(12.6)	(13.0)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	**32.2**	**33.5**	**52.8**	**61.6**	**63.5**
Net Profit before Except.	32.2	33.5	52.8	61.6	63.5
EBITDA	38.2	41.6	69.5	76.5	79.0
Growth					
Revenue Gth (%)	216.0	18.4	23.2	17.1	8.7
EBITDA Gth (%)	449.5	8.9	67.0	10.1	3.3
Opg Profit Gth (%)	474.5	5.7	58.3	16.9	3.1
Net Profit Gth (Pre-ex) (%)	575.3	4.1	57.5	16.7	3.1
Margins & Ratio					
Gross Margins (%)	32.9	34.0	40.5	39.0	38.0
Opg Profit Margin (%)	17.0	15.2	19.5	19.4	18.4
Net Profit Margin (%)	14.5	12.8	16.3	16.3	15.4
ROAE (%)	73.1	45.5	47.1	39.2	31.2
ROA (%)	39.0	26.5	29.0	25.2	22.1
ROCE (%)	72.4	44.7	46.3	39.0	31.2
Div Payout Ratio (%)	24.9	27.4	26.1	26.1	26.1
Net Interest Cover (x)	NM	NM	NM	NM	NM

Source: Company, DBS Bank

Quarterly / Interim Income Statement (S$m)

FY Dec	4Q2018	1Q2019	2Q2019	3Q2019	4Q2019
Revenue	39.4	52.7	97.9	83.9	88.7
Cost of Goods Sold	(22.8)	(32.6)	(62.8)	(52.2)	(44.9)
Gross Profit	**16.6**	**20.2**	**35.2**	**31.7**	**43.8**
Other Oper. (Exp)/Inc	(12.2)	(12.3)	(16.3)	(15.3)	(24.0)
Operating Profit	**4.35**	**7.82**	**18.9**	**16.4**	**19.8**
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	0.25	0.09	0.05	0.08	0.25
Net Interest (Exp)/Inc	0.09	0.08	0.07	0.07	0.14
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	**4.68**	**7.98**	**19.0**	**16.6**	**20.2**
Tax	(0.3)	(1.4)	(3.3)	(2.9)	(3.5)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Net Profit	**4.39**	**6.60**	**15.7**	**13.7**	**16.7**
Net profit bef Except.	4.39	6.60	15.7	13.7	16.7
EBITDA	4.59	7.91	18.9	16.5	20.1
Growth					
Revenue Gth (%)	(53.5)	34.0	85.7	(14.4)	5.7
EBITDA Gth (%)	(66.4)	72.1	139.3	(12.8)	21.5
Opg Profit Gth (%)	(68.2)	79.8	141.4	(13.0)	20.6
Net Profit Gth (Pre-ex) (%)	(61.4)	50.2	138.1	(12.7)	22.0
Margins					
Gross Margins (%)	42.1	38.2	35.9	37.8	49.4
Opg Profit Margins (%)	11.0	14.8	19.3	19.6	22.3
Net Profit Margins (%)	11.2	12.5	16.0	16.4	18.9

Balance Sheet (S$m)

FY Dec	2017A	2018A	2019A	2020F	2021F
Net Fixed Assets	3.62	5.73	6.27	8.48	10.5
Invts in Associates & JVs	4.13	4.15	4.57	4.57	4.57
Other LT Assets	3.45	17.8	19.1	17.5	15.8
Cash & ST Invts	46.1	58.9	108	174	224
Inventory	35.8	27.4	57.5	25.6	28.3
Debtors	23.6	18.0	28.0	24.9	28.1
Other Current Assets	0.0	4.49	4.86	4.86	4.86
Total Assets	**117**	**136**	**228**	**260**	**316**
ST Debt	0.01	0.0	0.0	0.0	0.0
Creditor	52.2	33.1	73.1	58.4	67.1
Other Current Liab	6.04	10.6	18.2	19.2	19.5
LT Debt	0.0	0.05	0.05	0.05	0.05
Other LT Liabilities	0.59	3.21	2.30	2.30	2.30
Shareholder's Equity	57.8	89.5	134	180	227
Minority Interests	0.0	0.0	0.0	0.0	0.0
Total Cap. & Liab.	**117**	**136**	**228**	**260**	**316**
Non-Cash Wkg. Capital	1.10	6.22	(1.0)	(22.2)	(25.4)
Net Cash/(Debt)	46.1	58.8	108	174	224
Debtors Turn (avg days)	34.0	28.9	25.9	25.5	23.5
Creditors Turn (avg days)	85.1	90.9	104.1	105.3	90.9
Inventory Turn (avg days)	65.7	67.4	83.2	66.5	39.0
Asset Turnover (x)	2.7	2.1	1.8	1.6	1.4
Current Ratio (x)	1.8	2.5	2.2	3.0	3.3
Quick Ratio (x)	1.2	1.8	1.5	2.6	2.9
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	34,971.4	27,632.7	6,751.0	6,975.5	6,975.5

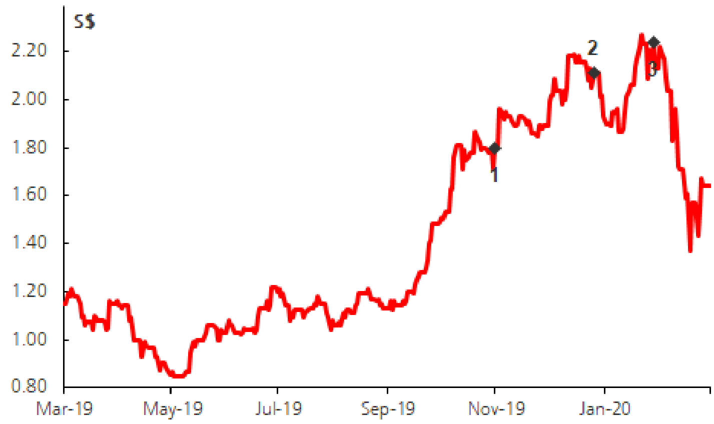
Source: Company, DBS Bank

Cash Flow Statement (S$m)

FY Dec	2017A	2018A	2019A	2020F	2021F
Pre-Tax Profit	37.5	40.0	63.7	74.2	76.5
Dep. & Amort.	0.70	1.87	6.08	2.89	3.08
Tax Paid	(0.3)	(5.2)	(6.7)	(11.6)	(12.6)
Assoc. & JV Inc/(loss)	0.11	0.04	(0.5)	0.0	0.0
Chg in Wkg.Cap.	10.1	(4.7)	(2.2)	20.2	2.84
Other Operating CF	1.74	2.02	7.20	0.0	0.0
Net Operating CF	**49.9**	**34.1**	**67.7**	**85.7**	**69.8**
Capital Exp.(net)	(2.5)	(13.5)	(3.3)	(3.4)	(3.4)
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	0.07	0.30	0.52	0.0	0.0
Net Investing CF	**(2.4)**	**(13.2)**	**(2.8)**	**(3.4)**	**(3.4)**
Div Paid	(4.5)	(8.4)	(10.5)	(16.1)	(16.6)
Chg in Gross Debt	(0.1)	(0.3)	(0.2)	0.0	0.0
Capital Issues	0.15	0.0	0.0	0.0	0.0
Other Financing CF	(2.0)	(0.6)	(4.5)	0.0	0.0
Net Financing CF	**(6.4)**	**(9.2)**	**(15.2)**	**(16.1)**	**(16.6)**
Currency Adjustments	(1.4)	1.17	(0.9)	0.0	0.0
Chg in Cash	39.8	12.8	48.8	66.2	49.8
Opg CFPS (S cts)	60.7	14.4	25.9	24.3	24.8
Free CFPS (S cts)	72.4	7.64	23.9	30.5	24.6

Source: Company, DBS Bank

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	29 Nov 19	1.80	2.38	BUY
2:	24 Jan 20	2.11	2.38	BUY
3:	27 Feb 20	2.24	2.52	BUY

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

Source: DBS Bank

Analyst: Lee Keng LING

Singapore Research Team

Frencken Group Limited

Version 6 | Bloomberg: FRKN SP | Reuters: FREN.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

1 Apr 2020

BUY

Last Traded Price (31 Mar 2020): S$0.575 (**STI :** 2,481.23)
Price Target 12-mth: S$0.74 (28% upside) (Prev S$1.06)

Analyst
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What's New

- Factories in Malaysia partially affected; China plants resumed operations
- Exposure to Medical segment an added advantage during pandemic crisis
- Expect better performance for Semiconductor
- Maintain BUY with a lower TP of S$0.74

Price Relative

Forecasts and Valuation

FY Dec (S$m)	2018A	2019A	2020F	2021F
Revenue	626	659	628	676
EBITDA	61.4	80.5	69.9	76.1
Pre-tax Profit	40.2	53.9	48.0	52.6
Net Profit	30.0	42.4	37.7	41.4
Net Pft (Pre Ex.)	33.9	46.5	37.7	41.4
Net Pft Gth (Pre-ex) (%)	47.7	37.1	(19.1)	9.8
EPS (S cts)	7.12	9.99	8.88	9.75
EPS Pre Ex. (S cts)	8.05	11.0	8.88	9.75
EPS Gth Pre Ex (%)	46	36	(19)	10
Diluted EPS (S cts)	7.12	9.99	8.88	9.75
Net DPS (S cts)	2.14	3.00	2.66	2.92
BV Per Share (S cts)	62.8	69.6	75.8	82.7
PE (X)	8.1	5.8	6.5	5.9
PE Pre Ex. (X)	7.1	5.2	6.5	5.9
P/Cash Flow (X)	9.7	2.6	4.1	4.7
EV/EBITDA (X)	4.0	2.2	2.1	1.7
Net Div Yield (%)	3.7	5.2	4.6	5.1
P/Book Value (X)	0.9	0.8	0.8	0.7
Net Debt/Equity (X)	0.0	CASH	CASH	CASH
ROAE (%)	11.3	14.3	11.7	11.8
Earnings Rev (%):			(16)	(15)
Consensus EPS (S cts):			10.5	11.0
Other Broker Recs:		B: 4	S: 0	H: 0

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

Diversification helps

Presence across wide variety of industries to cushion impact. Frencken's (FRKN) factories in Malaysia are partially affected by the Movement Control Order while its plants in China have resumed normal operations. However, with the disruption to the supply chain and weaker demand, we have cut FY20F/FY21F earnings by 16%/15% on lower revenue and margin pressure.

FRKN's strong presence across a wide variety of industries and business segments should help to cushion the impact. Furthermore, FRKN has exposure (c.13% FY19 revenue) to the Medical segment, which is an added advantage during this pandemic crisis. We also expect the Semiconductor sector to fare better than others in the technology value chain, as it forms part of the essential goods supply chain. FRKN has c.20% exposure to this segment.

At 6.5x FY20F and 5.9x FY21F earnings, FRKN is trading at about a 40% discount to its peers' average of 10.4x PE. In our view, this discount is too steep. The stock is supported by a dividend yield of about 4.7% based on a 30% payout ratio.

Where we differ: We are optimistic that FRKN can tide over this period of extreme volatility given its diversified exposure.

Potential catalysts: 1) Recovery of supply chain; 2) Further positive developments on US-China trade war front; 3) Better operational efficiency to improve margins

Valuation:

Maintain BUY with revised TP of S$0.74. Our TP is pegged to 8.3x (vs 10x previously) FY20F PE, which is at a 20% discount to peers' average given FRKN's smaller scale. Maintain BUY.

Key Risks to Our View:

Dependence on global market conditions. FRKN has exposure to customers in the US, European Union (EU) and Asia. A broad global economic slowdown could impact demand and earnings.

At A Glance

Issued Capital (m shrs)	425
Mkt. Cap (Sm/USm)	244 / 172
Major Shareholders (%)	
Micro Compact (M) Sdn. Bhd.	6.2
Precico Holdings	6.2
Micro Compact Sdn Bhd	6.2
Free Float (%)	87.5
3m Avg. Daily Val (US$m)	0.88
GIC Industry : Industrials / Capital Goods	

ed: JS/ sa: YM, PY, CS

WHAT'S NEW

COVID-19 impact – Diversification to help cushion impact

Supply and demand affected. The COVID-19 pandemic has hit the business world at an unprecedented scale and speed. It has led to closures of businesses, stoppage of factory outputs, and disruption to global manufacturing industries and their supply networks. The issue is compounded with the lockdown orders and movement restrictions, leading to a demand crisis.

Factories in Malaysia partially affected; China plants have resumed operations. FRKN has received approval from the authorities in Malaysia to continue with its mechatronics manufacturing operations in Bangi, but with a reduced number of employees during the period of the Movement Control Order. Its factories for the Integrated Manufacturing Services (IMS) division in Sungai Buloh and Johor remained closed during this period.

In China, the Group's five factories in Wuxi, Chuzhou, Tianjin and Zhuhai (Jinding and Nanshui) have resumed normal operations and are fulfilling orders from customers.

Guided for positive 1QFY2020 outlook for Semiconductor and Medical segments
Together with the release of FY19 results in February, FRKN has guided for a positive outlook in 1QFY20, compared to 1QFY19 for the Semiconductor and the Medical segments. These two segments accounted for 37.6% of FY19 revenue in the Mechatronics division, and 30.7% of Group revenue. It expects weaker results for the Industrial Automation, Automotive and Analytical segments.

Exposure to Medical segment an added advantage in this pandemic crisis. For the Medical division, FRKN is involved in components and sub-assembly for CV (cardiovascular) patient tables, histopathology digital scanners, X-Ray gantry, and telescopic tubes and micro motors for heart implants. Exposure to the Medical segment is an added advantage during this pandemic crisis as some countries, like Italy and Spain, have already reached the limit on their medical resources.

Expect better performance for Semiconductor. We expect the Semiconductor sector to fare better than others in the technology value chain, as it forms part of the essential goods supply chain. FRKN has c.20% exposure to this segment.

Maintain BUY with a lower TP of S$0.74, pegged to 8.3x FY20F PE. With the disruption to supply chains and weaker demand, we have cut FY20F/FY21F earnings by 16%/15% on lower revenue and margin pressure.

FRKN's strong presence across a wide variety of industries and business segments - Automotive, Analytical & Life Science, Medical, Semiconductor and Industrial & Industrial Automation - should help to cushion any extreme negative impact from any segment.

CRITICAL DATA POINTS TO WATCH

Critical Factors

Technology advancements and ongoing transformation. The accelerating technological advancements and market trends in cloud computing, big data, artificial intelligence (AI), augmented reality (AR), virtual reality (VR), proliferation of connected devices and Internet of Things (IOT), as well as the transformation of the automotive industry and advances in the analysis of biotech and genomics are drivers for FRKN's various business divisions. Among the rising trends are electric cars and connectivity technologies (e.g. smart Wi-Fi systems). FRKN collaborates closely with existing and new customers to develop the next generation of products and technology.

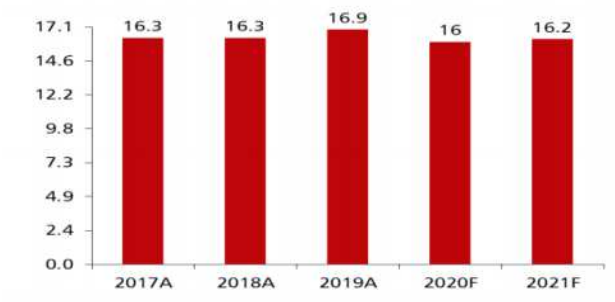
Diversification provides greater resilience and stability. The diversification helps to buffer the Group from adverse impact from a cyclical downturn in any industry and in turn brings resilience and stability to the Group. With its diverse exposure, FRKN can participate in the various segments, via collaboration with its partners. In terms of revenue breakdown for FY19, contribution from each segment ranges from 10% to 30%. We expect this diversification to continue.

Exposure to high-growth segments. Among FRKN's five key business segments, we expect the Analytical & Life Sciences and Industrial & Industrial Automotive segments to be the main growth drivers in the long term. Near term, the turnaround in the Semiconductor industry, where FRKN has a c.20% revenue exposure, should benefit the Group.

FRKN is in a sweet spot with its exposure to evolving technologies, especially in the Analytical & Life Sciences and Industrial & Industrial Automotive segments. We expect revenue contribution from these two segments to be >20% each in 2020 and 2021.

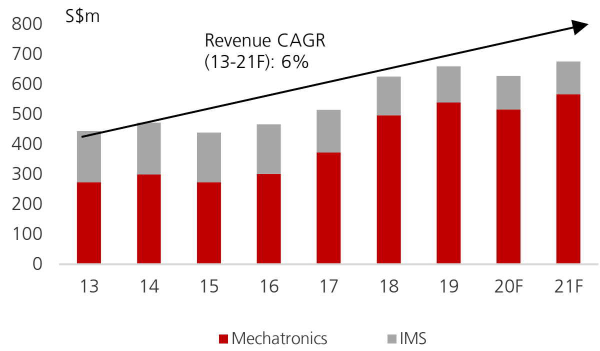
Operational efficiencies to drive margins. FRKN's earnings recovered strongly in FY16, after a prolonged period of negative earnings growth from FY11-FY15. During this period, besides challenging market conditions, the Group was also hit by impairment losses for subsidiaries and deferred development costs. An optimisation exercise was undertaken and some subsidiaries were wound up for a leaner structure. A sustainable and improvement of its earnings momentum should continue to re-rate the stock. We expect net margins to remain around 6% in FY20F and FY21F, from average of 4.9% during the FY16-FY18 period.

Gross Margin %

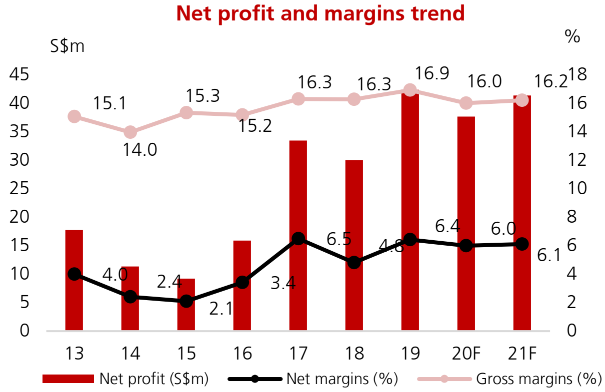


% of SGA

Revenue trend



Net profit and margins trend



Source: Company, DBS Bank

Balance Sheet:

Return to net cash position. The bulk of FRKN's borrowings is in the form of short-term borrowings and is an integral part of the Group's cash management. The borrowings are mainly denominated in Euro (EUR), US Dollar (USD), Singapore Dollar (SGD), Indonesian Rupiah (INR) and Malaysian Ringgit (MYR) at interest rates of 1.36-11.75% (for FY18). FRKN swung back to a net cash position as at end 4Q19.

Share Price Drivers:

Revenue and earnings momentum. FRKN's revenue registered a CAGR of 6% in FY12-FY19. Earnings recovered strongly in FY16, after a prolonged period of negative earnings growth in FY11-FY15 due to challenging market conditions. The Group was also hit by impairment losses for subsidiaries and deferred development costs. Optimisation exercises were undertaken and some subsidiaries were wound up for a leaner structure. A sustainable and improved earnings momentum should continue to re-rate the stock.

Key Risks:

Dependence on global market conditions. FRKN has exposure to customers in the US, EU and Asia. A broad global economic slowdown could have an impact on FRKN's operations due to its vulnerability to business cycles. Political and policy risks could also affect FRKN's business in these regions. A case in point is the ongoing US-China trade war.

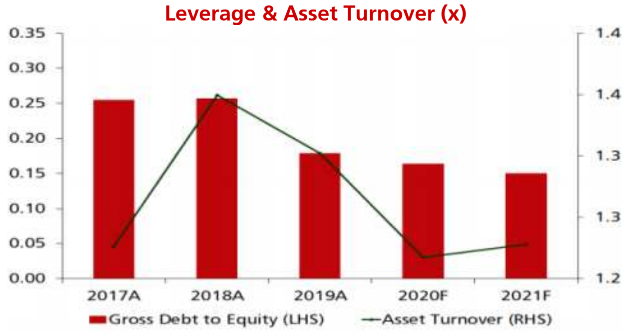
Forex exposure. A weakening USD against SGD, Renminbi (RMB) and MYR could impact FRKN's earnings but should be minimal. Our sensitivity analysis shows that every 5% appreciation of USD against SGD, RMB and MYR will increase FRKN's net profit by 2%.

Vulnerable to industry cycles. Some industries that FRKN is exposed to, like the semiconductor industry, are cyclical in nature. A sudden swing in the cycle could affect FRKN's operations, especially its inventory level and profitability.

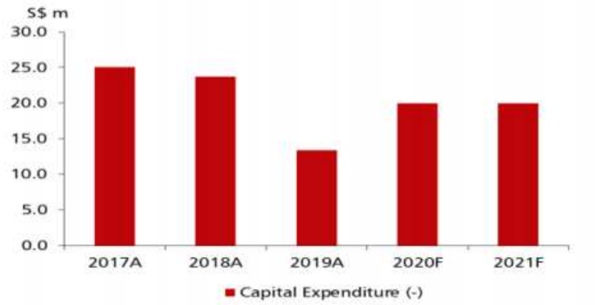
Company Background

FRKN Group Limited (FRKN) provides end-to-end solutions across the entire customer value chain. It offers comprehensive original design, original equipment and diversified integrated manufacturing solutions for world-class multinational companies in the automotive, healthcare, industrial, life sciences and semiconductor industries.

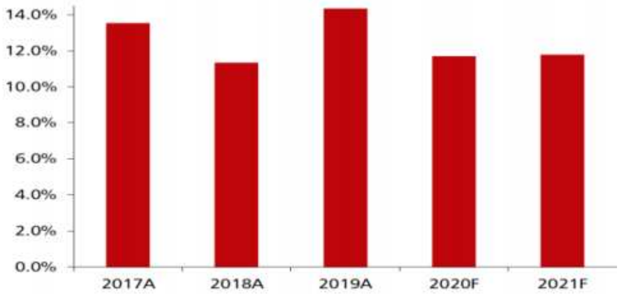
Leverage & Asset Turnover (x)



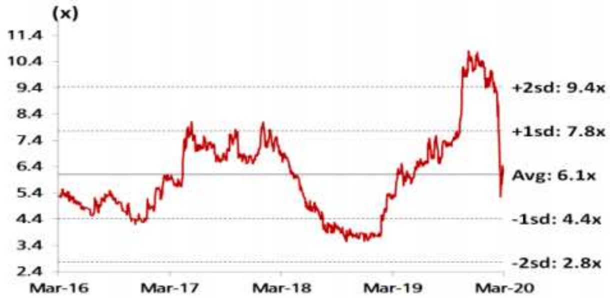
Capital Expenditure



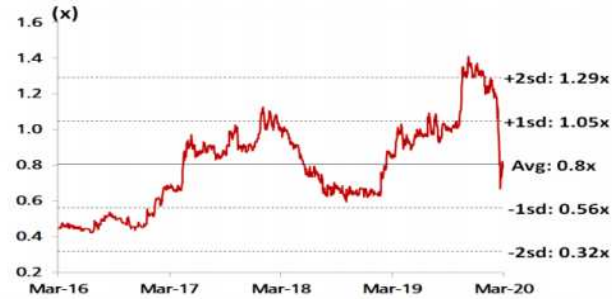
ROE (%)



Forward PE Band (x)



PB Band (x)



Source: Company, DBS Bank

Key Assumptions

FY Dec	2017A	2018A	2019A	2020F	2021F
Gross Margin %	16.3	16.3	16.9	16.0	16.2
% of SGA	11.6	9.80	8.83	9.12	9.12

Segmental Breakdown

FY Dec	2017A	2018A	2019A	2020F	2021F
Revenues (S$m)					
Mechatronics	373	497	540	516	567
IMS	142	129	120	111	109
Total	515	626	659	628	676
Operating profit (EBIT)					
Mechatronics	19.0	30.3	46.9	43.2	41.3
IMS	2.97	1.95	0.81	1.82	1.67
Total	21.9	32.3	47.7	45.0	43.0
Operating profit (EBIT) Margins (%)					
Mechatronics	5.1	6.1	8.7	8.4	7.3
IMS	2.1	1.5	0.7	1.6	1.5
Total	4.3	5.2	7.2	7.2	6.4

Income Statement (S$m)

FY Dec	2017A	2018A	2019A	2020F	2021F
Revenue	515	626	659	628	676
Cost of Goods Sold	(431)	(524)	(548)	(527)	(567)
Gross Profit	83.9	102	111	100	110
Other Opng (Exp)/Inc	(59.9)	(61.3)	(58.2)	(57.3)	(61.7)
Operating Profit	23.9	40.4	53.3	43.2	47.9
Other Non Opg (Exp)/Inc	6.35	4.64	6.08	6.08	6.08
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(0.3)	(1.0)	(1.3)	(1.3)	(1.3)
Exceptional Gain/(Loss)	10.5	(3.9)	(4.2)	0.0	0.0
Pre-tax Profit	40.4	40.2	53.9	48.0	52.6
Tax	(6.6)	(9.8)	(11.3)	(10.1)	(11.1)
Minority Interest	(0.4)	(0.3)	(0.2)	(0.2)	(0.2)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	33.4	30.0	42.4	37.7	41.4
Net Profit before Except.	23.0	33.9	46.5	37.7	41.4
EBITDA	45.2	61.4	80.5	69.9	76.1
Growth					
Revenue Gth (%)	10.4	21.5	5.3	(4.8)	7.7
EBITDA Gth (%)	19.6	35.9	31.0	(13.2)	8.9
Opg Profit Gth (%)	52.0	68.8	31.8	(19.0)	10.9
Net Profit Gth (Pre-ex) (%)	44.5	47.7	37.1	(19.1)	9.8
Margins & Ratio					
Gross Margins (%)	16.3	16.3	16.9	16.0	16.2
Opg Profit Margin (%)	4.6	6.5	8.1	6.9	7.1
Net Profit Margin (%)	6.5	4.8	6.4	6.0	6.1
ROAE (%)	13.5	11.3	14.3	11.7	11.8
ROA (%)	8.0	6.5	8.4	7.3	7.5
ROCE (%)	7.1	9.6	12.3	9.2	9.4
Div Payout Ratio (%)	29.8	30.0	30.0	30.0	30.0
Net Interest Cover (x)	70.8	40.5	41.2	33.4	37.0

Gains from disposal of subsidiary

Impairment losses for goodwill attributable to its plant in Netherlands

Source: Company, DBS Bank

Quarterly / Interim Income Statement (S$m)

FY Dec	4Q2018	1Q2019	2Q2019	3Q2019	4Q2019
Revenue	176	159	164	170	166
Cost of Goods Sold	(146)	(134)	(136)	(143)	(134)
Gross Profit	**29.3**	**25.1**	**28.0**	**27.0**	**31.3**
Other Oper. (Exp)/Inc	(14.7)	(13.5)	(13.5)	(12.6)	(16.6)
Operating Profit	**14.6**	**11.6**	**14.5**	**14.4**	**14.7**
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)	(0.4)	(0.3)	(0.2)
Exceptional Gain/(Loss)	0.14	0.0	0.0	0.0	0.0
Pre-tax Profit	**14.4**	**11.2**	**14.1**	**14.1**	**14.5**
Tax	(3.2)	(2.6)	(2.9)	(2.6)	(3.2)
Minority Interest	(0.1)	0.0	(0.1)	(0.1)	0.00
Net Profit	**11.0**	**8.60**	**11.1**	**11.4**	**11.2**
Net profit bef Except.	10.9	8.60	11.1	11.4	11.2
EBITDA	18.5	16.9	19.9	19.5	20.0
Growth					
Revenue Gth (%)	7.2	(9.5)	3.3	3.5	(2.7)
EBITDA Gth (%)	13.2	(9.0)	17.8	(1.6)	2.6
Opg Profit Gth (%)	21.0	(20.5)	24.6	(0.7)	2.4
Net Profit Gth (Pre-ex) (%)	16.9	(20.9)	29.2	2.9	(1.7)
Margins					
Gross Margins (%)	16.7	15.8	17.0	15.9	18.9
Opg Profit Margins (%)	8.3	7.3	8.8	8.4	8.9
Net Profit Margins (%)	6.3	5.4	6.8	6.7	6.8

Balance Sheet (S$m)

FY Dec	2017A	2018A	2019A	2020F	2021F
Net Fixed Assets	93.9	97.4	92.1	91.9	90.3
Invts in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other LT Assets	32.1	26.9	39.3	42.6	43.1
Cash & ST Invts	68.2	67.1	122	151	171
Inventory	112	145	141	114	123
Debtors	100	116	97.6	102	110
Other Current Assets	13.5	11.9	14.1	14.1	14.1
Total Assets	**420**	**464**	**506**	**516**	**551**
ST Debt	61.7	67.5	53.1	53.1	53.1
Creditor	61.9	79.2	87.8	66.8	71.8
Other Current Liab	39.9	42.8	49.5	53.3	54.3
LT Debt	1.87	1.21	0.17	0.17	0.17
Other LT Liabilities	5.25	5.47	17.5	17.5	17.5
Shareholder's Equity	247	265	295	322	351
Minority Interests	2.34	2.63	2.78	3.00	3.23
Total Cap. & Liab.	**420**	**464**	**506**	**516**	**551**
Non-Cash Wkg. Capital	124	150	115	110	120
Net Cash/(Debt)	4.55	(1.6)	69.2	97.9	118
Debtors Turn (avg days)	71.1	67.6	54.1	59.1	59.1
Creditors Turn (avg days)	54.3	56.9	60.9	48.1	48.1
Inventory Turn (avg days)	98.3	104.0	97.5	82.2	82.2
Asset Turnover (x)	1.2	1.3	1.3	1.2	1.2
Current Ratio (x)	1.8	1.8	2.0	2.2	2.3
Quick Ratio (x)	1.0	1.0	1.2	1.5	1.6
Net Debt/Equity (X)	CASH	0.0	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	0.0	CASH	CASH	CASH
Capex to Debt (%)	39.4	34.5	25.2	37.6	37.6

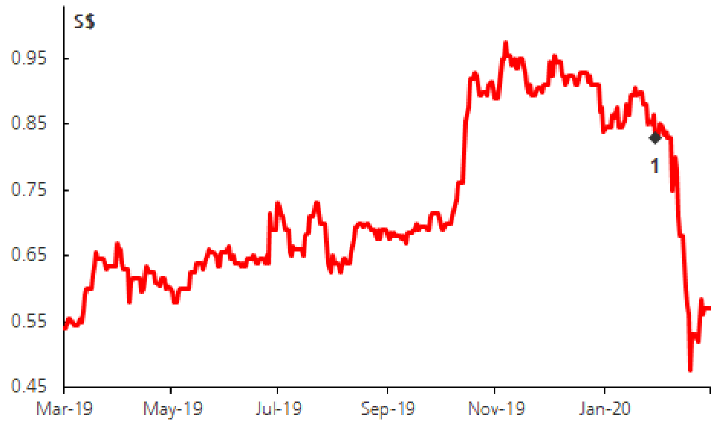
Source: Company, DBS Bank

Cash Flow Statement (S$m)

FY Dec	2017A	2018A	2019A	2020F	2021F
Pre-Tax Profit	40.4	40.2	53.9	48.0	52.6
Dep. & Amort.	14.9	16.4	21.1	20.6	22.2
Tax Paid	(6.6)	(9.8)	(11.3)	(10.1)	(11.1)
Assoc. & JV Inc/(loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	(5.6)	(26.8)	26.0	1.54	(11.4)
Other Operating CF	(8.3)	5.10	5.10	0.0	0.0
Net Operating CF	**34.9**	**25.1**	**94.9**	**60.0**	**52.4**
Capital Exp.(net)	(25.1)	(23.7)	(13.4)	(20.0)	(20.0)
Other Invts.(net)	0.0	0.0	0.0	0.0	0.0
Invts in Assoc. & JV	38.6	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	0.70	0.56	1.66	0.0	0.0
Net Investing CF	**14.2**	**(23.2)**	**(11.7)**	**(20.0)**	**(20.0)**
Div Paid	(5.0)	(10.1)	(9.1)	(11.3)	(12.4)
Chg in Gross Debt	9.83	7.33	(10.6)	0.0	0.0
Capital Issues	1.91	0.95	0.0	0.0	0.0
Other Financing CF	0.0	0.0	0.56	0.0	0.0
Net Financing CF	**6.77**	**(1.8)**	**(19.1)**	**(11.3)**	**(12.4)**
Currency Adjustments	(1.3)	0.34	0.53	0.0	0.0
Chg in Cash	54.6	0.46	64.5	28.7	20.0
Opg CFPS (S cts)	9.72	12.3	16.2	13.8	15.0
Free CFPS (S cts)	2.35	0.32	19.2	9.44	7.63

Source: Company, DBS Bank

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:	28 Feb 20	0.83	1.06	BUY

Source: DBS Bank

Analyst: Lee Keng LING

Singapore Company Guide

Fu Yu Corp

Version 3 | Bloomberg: FUYU SP | Reuters: FUYU.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

1 Apr 2020

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HOLD (Downgrade from BUY)

Last Traded Price (31 Mar 2020): S$0.198 (STI : 2,481.23)
Price Target 12-mth: S$0.21 (6% upside) (Prev S$0.35)

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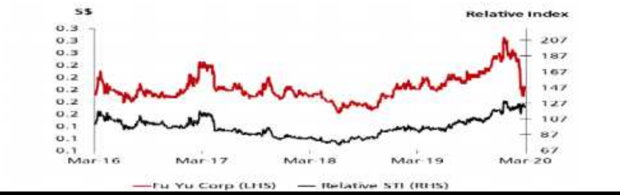
What's New

- COVID-19 weighs on global growth and manufacturing activities
- Expect all segments to contract; except medical
- Cut FY2020/21F earnings by 25/28%
- Downgrade to HOLD with a lower TP of S$0.21

Price Relative



Forecasts and Valuation

FY Dec (S$m)	2018A	2019A	2020F	2021F
Revenue	198	194	157	171
EBITDA	21.3	32.2	23.9	28.4
Pre-tax Profit	15.9	16.2	20.0	17.6
Net Profit	11.9	12.7	15.9	14.0
Net Pft (Pre Ex.)	11.9	17.1	10.3	14.0
Net Pft Gth (Pre-ex) (%)	165.5	44.1	(39.6)	35.0
EPS (S cts)	1.58	1.69	2.11	1.85
EPS Pre Ex. (S cts)	1.58	2.27	1.37	1.85
EPS Gth Pre Ex (%)	165	44	(40)	35
Diluted EPS (S cts)	1.58	1.69	2.11	1.85
Net DPS (S cts)	1.60	1.60	1.60	1.60
BV Per Share (S cts)	21.8	21.7	22.2	22.5
PE (X)	12.5	11.7	9.4	10.7
PE Pre Ex. (X)	12.5	8.7	14.4	10.7
P/Cash Flow (X)	6.4	5.5	4.4	6.2
EV/EBITDA (X)	3.1	1.9	1.9	1.4
Net Div Yield (%)	8.1	8.1	8.1	8.1
P/Book Value (X)	0.9	0.9	0.9	0.9
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	7.2	7.7	9.6	8.3
Earnings Rev (%):			(25)	(28)
Consensus EPS (S cts):			1.80	1.80
Other Broker Recs:		B: 2	S: 0	H: 1

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

Manufacturing catches COVID-19

Malaysia's shutdown resulting in c.2% loss in revenue. We estimate the four-week shutdown due to the nationwide Movement Control Order (MCO) in Malaysia could translate into a revenue loss of up to c.2%. FUYU's operations in Malaysia mainly serve local customers which accounted for c.22% of its FY2019 revenue.

Cut FY2020F/21F earnings by 25/28% on the back of a dampened economic outlook. While we are expecting higher sales from its medical segment, a contraction across all other segments is likely to outweigh that positive impact. Our earnings cut arises mainly due to global supply chain disruptions and an economic slowdown.

M&A becomes more attractive. FUYU is currently trading at 2.5x trailing 12-month EV/EBITDA, and its cash levels represent 57% of its market capitalisation. The company has strong operating cash flows of c.S$20m and no debt.

Where we differ: We are more positive on its gross profit margins from cost-efficiency initiatives.

Potential catalysts: Improvement in the COVID-19 situation and manufacturing activity, M&A.

Valuation:

Downgrade to HOLD with a lower TP of S$0.21. We have cut FY2020F/21F earnings by 25/28%. We are lowering our 12-m rolling forward PE peg to 13.4x (4-year average) on a slowdown in manufacturing activity. We revise our TP down to S$0.21, from S$0.35 previously.

Key Risks to Our View:

Prolonged COVID-19 outbreak, increased competition, escalation of the US-China trade war.

At A Glance

Issued Capital (m shrs)	753
Mkt. Cap (Sm/USm)	149 / 105
Major Shareholders (%)	
Tam Wai	12.9
Ho Nee Kit	12.9
Ching Heng Yang	11.8
Free Float (%)	62.4
3m Avg. Daily Val (US$m)	0.58
GIC Industry : Industrials / Capital Goods	

WHAT'S NEW

Caught the pandemic

Update on the impact from COVID-19

Shutdown of Malaysia factories; Singapore factories' production capacity not impacted. FUYU announced that its factories in Malaysia will be temporarily shut down to comply with the MCO issued by the Malaysian government. Its factories in Malaysia primarily serve local customers which accounted for c.22% of its FY2019 revenue. It has a ready workforce in the event the shutdown is lifted and has made arrangements for its Malaysian employees working in Singapore. It does not foresee the MCO to have a significant impact on the production capacity of its factories in Singapore.

Outlook: Global demand weighed down by COVID-19

We are anticipating higher revenue in the medical segment. The medical industry is facing a stress test as the number of COVID-19 cases increase globally. Italy and Spain have reached the limit on their medical resources and are forced to triage their patients. FUYU manufactures plastic parts for its medical customers and we could see an uplift in products from this segment. Its medical business accounted for 16% of its FY18 revenue (latest available) and we are anticipating a 15% y-o-y growth in FY20F. This is higher than the initially projected growth rate for the plastic injection moulding (medical equipment) segment of c.7% over the next five years.

Lower revenue across all other segments; Group revenue down 19% y-o-y in FY20F. As businesses are unable to function normally and the unemployment rises, we could see a weakened demand across all other business segments (Printing & Imaging, Networking & Communications, Consumer, and Automotive & Power Tools) as companies and consumers cut back on spending. On a Group basis, we are expecting this decline to outweigh the growth in its medical business. FY20F sales are projected to decline 19% y-o-y.

Recommendation: Downgrade to HOLD with a lower TP of S$0.21

Downgrade to HOLD with a lower TP of S$0.21 on the back of lower FY20F/ 21F revenue, gross profit margins, and PE peg. The rapid spread of the COVID-19 has weighed on economic activity and affected supply chains. The dampened economic outlook is likely to weigh on end-consumer demand in FY20F, which will affect manufacturing activity at FUYU. At this current juncture, we are not expecting the pandemic to last till next year and are expecting a slightly recovery in FY21F.

Key revised assumptions:

- **Lowered revenue estimates –** We are cutting our FY2020F revenue estimates to S$157m (previously S$175m) on the back of a weaker global economy.
- **Lowered gross profit margins –** Reducing FY20F's gross profit margins to 18.8% (Previous: 22.3%) due to lower utilisation levels from the reduced demand and shutdown of factories in China and Malaysia.
- **Lowered 12-month forward PE multiple peg –** We have lowered our 12-month forward PE multiple from 16.4x (+1SD) to 13.7x (4-year average) on a disruption in earnings growth momentum and negative economic sentiment.

Overall impact on FY20F/ 21F earnings is a 25%/28% cut to previous estimates. We are downgrading our call to HOLD (previously BUY) and lowering our TP to S$0.21 (previously S$0.35). Our TP is pegged to the average 12-month forward PE of 13.7x.

M&A: More attractive at the current price level

With its share price falling c.30% from its high of S$0.285 in January to S$0.20, FUYU has become a more attractive M&A target.

Attractive traits:

- It is currently trading at 2.5x trailing 12-month EV/EBITDA
- Its cash represents 57% of its market capitalisation
- Zero debt
- Strong operating cash flows of c.S$20m

CRITICAL DATA POINTS TO WATCH

Critical Factors

Manufacturing activity in China plunges in February. The latest purchasing managers' index (PMI) in China plunged to 35.7 in February. The sharp drop was mainly due to the shutdown of business operations in China to contain the COVID-19 outbreak. According to the National Bureau of Statistics, as of 25 February, 79% of large and mid-sized enterprises nationwide had resumed operations.

Shift in product mix towards higher growth industries. FUYU is focusing on shifting its product mix towards the faster-growing industries (consumer, medical, and automotive & power tools). Various market research firms have projected plastic injection moulding within these industries to grow at high single digits in the next few years. This compares with the lower c.5% growth in the printing & imaging and general plastic injection moulding industries. This shift in product mix is favourable and should drive revenue growth for FUYU.

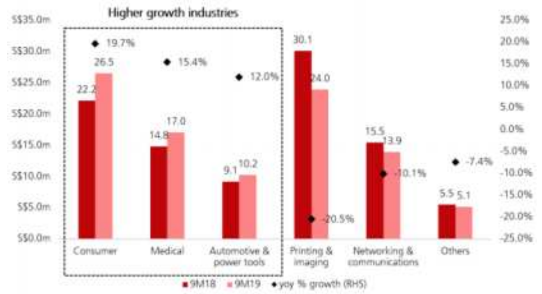
Operational efficiencies to improve margins. The consolidation of its factory operations in China and in Singapore have lifted margins. As FUYU gradually transfers its operations from its Shanghai factory to its factory in Suzhou, the streamlining of operations has resulted in normalised gross profit margins improving to 21.9% in FY2019. The factory officially ceased operations in 1Q20 and we are expecting FY20F performance to benefit from the consolidation. We are expecting a slight decline in FY20F gross profit margins due to lower utilisation levels.

With the redevelopment of its premises at 9 Tuas Drive scheduled to complete in 4Q20, we are expecting a further improvement in gross profit margins in FY21F through operational efficiencies. The new layout facilitates a seamless workflow across its operations and will consist of newer and more advanced equipment.

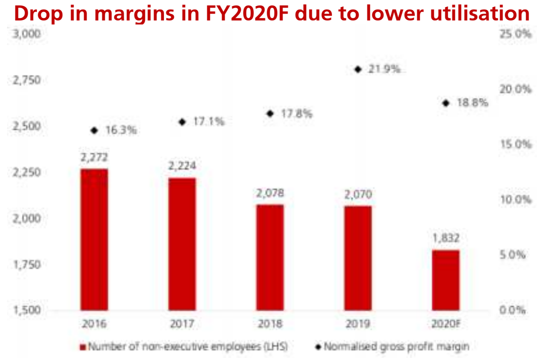
USDSGD movement could affect earnings. A significant portion of FUYU's trade transactions are denominated in USD and it retains its excess funds in USD. As its reporting currency is in SGD, it will record an FX translation gain/(loss) based on the movement of the USDSGD currency pair. Based on historical translations, we estimate that every percentage point gain/(loss) in the USDSGD is equivalent to an FX gain/(loss) of S$0.5m. The USDSGD exchange rate movements could imply an FX gain in 1Q20.

Plunge in manufacturing activity in China in February

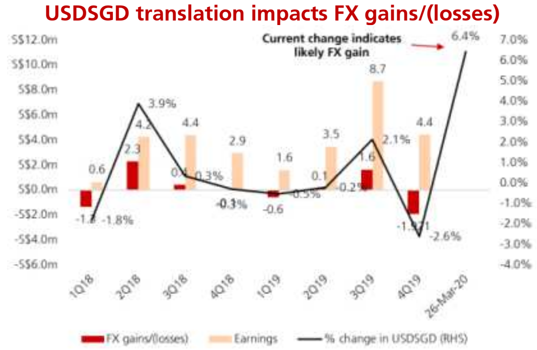
Shift in product mix towards higher growth industries



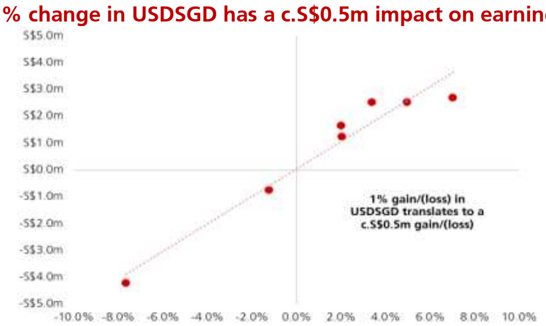
Drop in margins in FY2020F due to lower utilisation



USDSGD translation impacts FX gains/(losses)



1% change in USDSGD has a c.S$0.5m impact on earnings



Source: Company, DBS Bank

Balance Sheet:

Net cash position. FUYU has cash of S$88.5m and no debt. Its cash level is equivalent to 40.4% of its total assets and 57% of its market capitalisation. We believe that it will remain in a net cash position with its current level of cash and cash-generating business.

Increasing return on equity (ROE). FUYU's business strategy in recent years has been to focus on more sustainable products and enhance productivity and efficiency. This has led to earnings and margin expansion, driving normalised ROE from 4.6% in FY2017 to 10.9% in FY2019.

Share Price Drivers:

Stable dividends, attractive yield. FUYU paid dividends of 1.5 Scts/share from FY2015 to FY2017 and 1.6 Scts/share in FY2018 and FY2019. FUYU's dividends of 1.6 Scts/share represents an attractive yield of c.8%.

Delayed upturn in manufacturing activity. Before the onset of COVID-19, manufacturing activities in Singapore, China, and Malaysia were turning up. A protraction of the outbreak could further delay the recovery in the manufacturing sector.

Operating margin expansion. FUYU has consolidated part of its factory operations in China and redeveloped its factory in Singapore. Its lean management and automation are part of its initiatives to drive operating margins.

Key Risks:

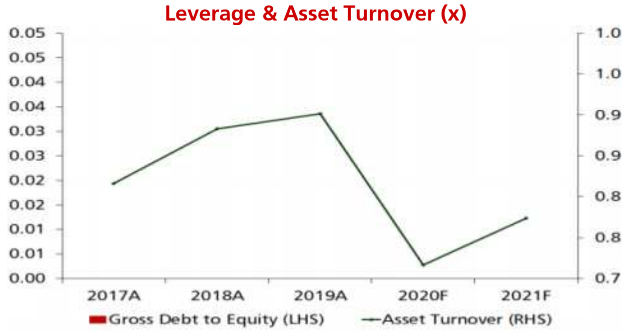
Prolonged COVID-19 outbreak. The escalation of COVID-19 in late January 2020 has disrupted supply chains in China and slowed manufacturing activities. A prolonged outbreak could further impact FUYU's earnings.

Resumption of the US-China trade war. A resumption of the US-China trade war will dampen consumer demand and impede the recovery of the manufacturing sector.

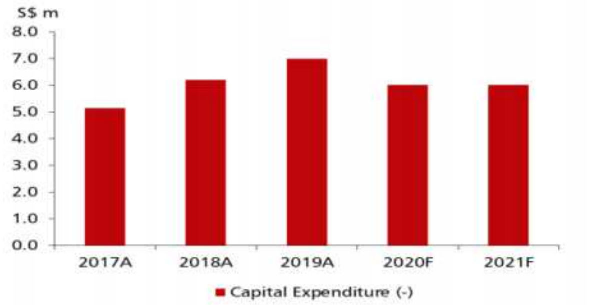
Company Background

Fu Yu Corporation Limited (FUYU) is one of the largest manufacturers of high precision plastic parts and moulds in Asia. It offers a one-stop solution by providing vertically integrated services for the manufacturing of precision plastic components and the fabrication of precision moulds and dies. It is specialised in mechanical modules, computer peripherals, medical equipment, telecommunications, and consumer electronics.

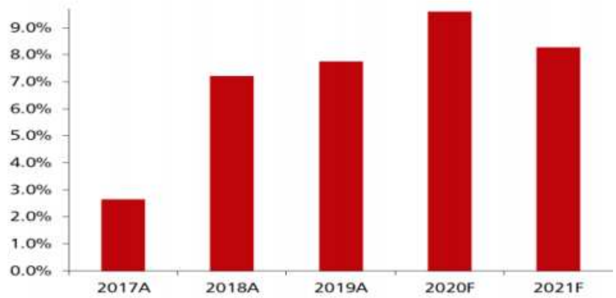
Leverage & Asset Turnover (x)



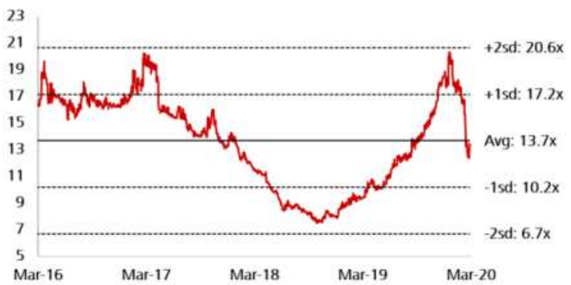
Capital Expenditure



ROE (%)



Forward PE Band (x)



PB Band (x)

Source: Company, DBS Bank

Income Statement (S$m)

FY Dec	2017A	2018A	2019A	2020F	2021F
Revenue	195	198	194	157	171
Cost of Goods Sold	(162)	(162)	(152)	(127)	(136)
Gross Profit	**33.3**	**35.3**	**42.4**	**29.5**	**34.2**
Other Opng (Exp)/Inc	(31.8)	(26.3)	(27.1)	(23.5)	(23.9)
Operating Profit	**1.53**	**9.00**	**15.3**	**6.01**	**10.3**
Other Non Opg (Exp)/Inc	5.73	6.12	5.44	5.44	5.44
Associates & JV Inc	(0.7)	(0.8)	(0.2)	0.0	0.0
Net Interest (Exp)/Inc	1.76	1.60	1.25	1.59	1.88
Exceptional Gain/(Loss)	0.0	0.0	(5.6)	7.00	0.0
Pre-tax Profit	**8.32**	**15.9**	**16.2**	**20.0**	**17.6**
Tax	(2.9)	(3.7)	(3.5)	(4.2)	(3.7)
Minority Interest	(1.0)	(0.3)	0.0	0.0	0.0
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	**4.48**	**11.9**	**12.7**	**15.9**	**14.0**
Net Profit before Except.	4.48	11.9	17.1	10.3	14.0
EBITDA	14.3	21.3	32.2	23.9	28.4
Growth					
Revenue Gth (%)	(1.8)	1.4	(1.8)	(19.2)	8.8
EBITDA Gth (%)	(37.5)	49.5	51.2	(25.8)	18.8
Opg Profit Gth (%)	(75.1)	488.7	70.2	(60.8)	71.1
Net Profit Gth (Pre-ex) (%)	(57.5)	165.5	44.1	(39.6)	35.0
Margins & Ratio					
Gross Margins (%)	17.1	17.8	21.9	18.8	20.0
Opg Profit Margin (%)	0.8	4.6	7.9	3.8	6.0
Net Profit Margin (%)	2.3	6.0	6.5	10.1	8.2
ROAE (%)	2.6	7.2	7.7	9.6	8.3
ROA (%)	1.9	5.3	5.9	7.3	6.3
ROCE (%)	3.3	7.7	10.9	6.8	8.9
Div Payout Ratio (%)	252.3	101.4	94.9	75.8	86.4
Net Interest Cover (x)	NM	NM	NM	NM	NM

Source: Company, DBS Bank

Quarterly / Interim Income Statement (S$m)

FY Dec	4Q2018	1Q2019	2Q2019	3Q2019	4Q2019
Revenue	48.1	46.7	50.1	51.3	46.1
Cost of Goods Sold	(39.4)	(38.4)	(40.4)	(38.6)	(34.3)
Gross Profit	8.69	8.26	9.66	12.7	11.8
Other Oper. (Exp)/Inc	(6.4)	(7.5)	(6.5)	(4.9)	(8.5)
Operating Profit	2.24	0.80	3.15	7.75	3.28
Other Non Opg (Exp)/Inc	1.44	1.35	1.31	1.26	1.52
Associates & JV Inc	(0.2)	(0.1)	(0.1)	0.0	0.0
Net Interest (Exp)/Inc	0.39	0.40	0.41	0.45	0.33
Exceptional Gain/(Loss)	0.0	0.0	0.0	(4.8)	(0.8)
Pre-tax Profit	3.82	2.48	4.76	4.65	4.32
Tax	(0.9)	(0.9)	(1.3)	(0.7)	(0.6)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Net Profit	2.94	1.59	3.46	3.91	3.74
Net profit bef Except.	2.94	1.59	3.46	8.71	4.54
EBITDA	5.13	5.10	7.35	12.0	7.45
Growth					
Revenue Gth (%)	(8.3)	(2.8)	7.2	2.4	(10.1)
EBITDA Gth (%)	(29.8)	(0.6)	44.2	62.7	(37.7)
Opg Profit Gth (%)	(61.2)	(64.2)	292.1	146.3	(57.7)
Net Profit Gth (Pre-ex) (%)	(33.2)	(45.9)	117.6	152.0	(47.9)
Margins					
Gross Margins (%)	18.1	17.7	19.3	24.8	25.6
Opg Profit Margins (%)	4.7	1.7	6.3	15.1	7.1
Net Profit Margins (%)	6.1	3.4	6.9	7.6	8.1

Balance Sheet (S$m)

FY Dec	2017A	2018A	2019A	2020F	2021F
Net Fixed Assets	46.0	44.8	54.0	47.6	40.9
Invts in Associates & JVs	1.49	0.71	0.50	0.50	0.50
Other LT Assets	9.93	8.82	8.03	8.03	8.03
Cash & ST Invts	98.8	83.9	88.5	105	111
Inventory	17.6	16.9	16.4	14.0	15.0
Debtors	59.0	54.0	50.0	42.0	45.7
Other Current Assets	3.44	2.38	1.73	1.73	1.73
Total Assets	236	212	219	218	222
ST Debt	0.0	0.0	0.0	0.0	0.0
Creditor	46.2	43.0	40.9	35.2	37.7
Other Current Liab	3.94	3.48	5.73	7.02	6.51
LT Debt	0.0	0.0	0.0	0.0	0.0
Other LT Liabilities	0.62	0.95	8.79	8.79	8.79
Shareholder's Equity	165	164	164	167	169
Minority Interests	20.2	0.0	0.0	0.0	0.0
Total Cap. & Liab.	236	212	219	218	222
Non-Cash Wkg. Capital	30.0	26.8	21.4	15.5	18.1
Net Cash/(Debt)	98.8	83.9	88.5	105	111
Debtors Turn (avg days)	108.6	104.3	97.8	107.0	93.8
Creditors Turn (avg days)	108.5	104.7	109.4	121.0	107.6
Inventory Turn (avg days)	39.8	40.6	43.4	48.2	42.7
Asset Turnover (x)	0.8	0.9	0.9	0.7	0.8
Current Ratio (x)	3.6	3.4	3.4	3.8	3.9
Quick Ratio (x)	3.1	3.0	3.0	3.5	3.5
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	N/A	N/A	N/A	N/A	N/A

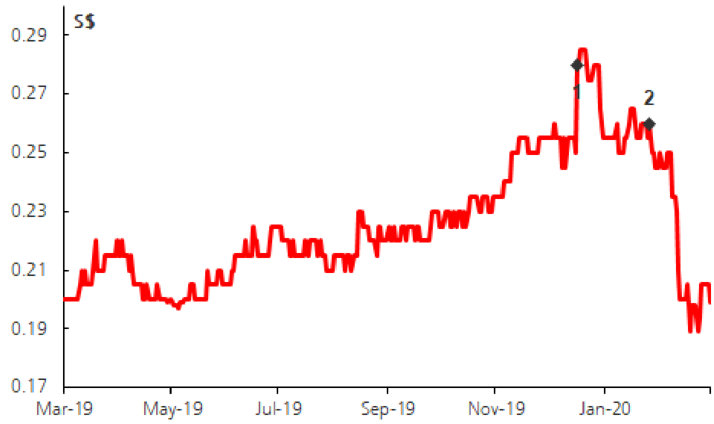
Source: Company, DBS Bank

Cash Flow Statement (S$m)

FY Dec	2017A	2018A	2019A	2020F	2021F
Pre-Tax Profit	8.32	15.9	16.2	20.0	17.6
Dep. & Amort.	7.70	6.99	11.7	12.4	12.7
Tax Paid	(2.1)	(2.1)	(2.3)	(2.9)	(4.2)
Assoc. & JV Inc/(loss)	0.70	0.80	0.21	0.0	0.0
Chg in Wkg.Cap.	(6.1)	3.09	2.64	4.66	(2.2)
Other Operating CF	(2.6)	(1.4)	(1.1)	0.0	0.0
Net Operating CF	5.93	23.3	27.3	34.3	23.9
Capital Exp.(net)	(5.1)	(6.2)	(7.0)	(6.0)	(6.0)
Other Invts.(net)	(0.6)	(0.3)	3.59	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	1.76	1.60	1.70	0.0	0.0
Net Investing CF	(3.9)	(4.9)	(1.7)	(6.0)	(6.0)
Div Paid	(12.2)	(12.0)	(12.0)	(12.0)	(12.0)
Chg in Gross Debt	0.0	0.0	0.0	0.0	0.0
Capital Issues	0.0	0.0	0.0	0.0	0.0
Other Financing CF	0.06	(21.3)	(5.0)	0.0	0.0
Net Financing CF	(12.1)	(33.3)	(17.1)	(12.0)	(12.0)
Currency Adjustments	(0.1)	(0.2)	(0.4)	0.0	0.0
Chg in Cash	(10.2)	(15.1)	8.15	16.2	5.89
Opg CFPS (S cts)	1.59	2.68	3.28	3.93	3.47
Free CFPS (S cts)	0.11	2.27	2.70	3.75	2.38

Source: Company, DBS Bank

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	15 Jan 20	0.28	0.35	BUY
2:	25 Feb 20	0.26	0.35	BUY

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

Source: DBS Bank

Analyst: Lee Keng LING

Singapore Research Team

Singapore Company Guide

Hi-P International

Version 13 | Bloomberg: HIP SP | Reuters: HIPI.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

1 Apr 2020

HOLD

Last Traded Price (31 Mar 2020): S$0.85 (**STI :** 2,481.23)
Price Target 12-mth: S$0.85 (0%) (Prev S$1.37)

Analyst
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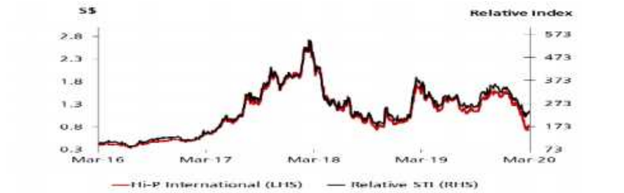
What's New

- Weaker mobile phone sales partly mitigated by the less volatile Consumer Electronics
- May see small loss in 1Q20; strong USD to cushion impact
- Cut FY20F/FY21F earnings by 21%/10% on lower revenue and margin assumptions
- Maintain HOLD with lower S$0.85 TP

Price Relative



Forecasts and Valuation

FY Dec (S$m)	2018A	2019A	2020F	2021F
Revenue	1,402	1,368	1,238	1,489
EBITDA	193	177	147	174
Pre-tax Profit	124	104	80.7	94.7
Net Profit	101	80.3	62.3	73.0
Net Pft (Pre Ex.)	101	80.3	62.3	73.0
Net Pft Gth (Pre-ex) (%)	(16.9)	(20.4)	(22.4)	17.2
EPS (S cts)	12.5	9.97	7.73	9.06
EPS Pre Ex. (S cts)	12.5	9.97	7.73	9.06
EPS Gth Pre Ex (%)	(17)	(20)	(22)	17
Diluted EPS (S cts)	11.3	9.00	6.98	8.18
Net DPS (S cts)	5.00	2.80	1.55	1.81
BV Per Share (S cts)	70.0	73.8	80.0	87.2
PE (X)	6.8	8.5	11.0	9.4
PE Pre Ex. (X)	6.8	8.5	11.0	9.4
P/Cash Flow (X)	4.1	2.7	5.2	5.2
EV/EBITDA (X)	2.9	2.7	3.4	2.8
Net Div Yield (%)	5.9	3.3	1.8	2.1
P/Book Value (X)	1.2	1.2	1.1	1.0
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	18.5	13.9	10.1	10.8
Earnings Rev (%):			(21)	(10)
Consensus EPS (S cts):			12.0	12.0
Other Broker Recs:		B: 0	S: 1	H: 1

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

Supply disruption + margin pressure

Cut FY20F/FY21F earnings by 21%/10%; maintain HOLD with lower TP of S$0.85. With more than half of its factories in China, Hi-P's production is affected by the temporary shutdown. Thus, Hi-P could register a small loss in 1QFY20F. Though the situation in China has improved, the worsening of the COVID-19 outbreak has affected the global supply chain. Coupled with a weaker demand, we have cut our FY20F/FY21F earnings by 21%/10%.

Beneficiary of strong USD. The USD vs RMB and SGD has strengthened c.2% to 6% YTD. Hi-P is a beneficiary of a strong USD as the bulk of its revenues are in USD while overheads are in local currencies.

Diversification of operations; explore M&A. Hi-P continues to divest its operations out of China and is actively on the lookout for M&A targets. Note that the group has cut its dividends for FY19, partly to be prudent and also for potential M&A.

Where we differ: We continue to expect Hi-P to generate decent volumes amid challenges in the market and working towards enhancing operational efficiencies to improve margins.

Potential catalysts: 1) Better operational efficiency to improve margins, 2) Strengthening of USD, 3) Positive outcome from US-China trade deal, 4) Potential M&A, 5) Recovery of the supply chain.

Valuation:

Maintain HOLD with a lower TP of S$0.85. On the back of the lower revenue and margins assumptions, our TP is reduced to S$0.85 (previously S$1.37), pegged to a lower peers' average of 11x vs 14x previously, in line with the de-rating, on FY20F earnings.

Key Risks to Our View:

Volatile industry with shorter product life cycle. This poses risks on margins and inventories.

Forex exposure. The bulk of revenues are in USD but overheads are mainly in RMB and the reporting currency is SGD.

At A Glance

Issued Capital (m shrs)	805
Mkt. Cap (Sm/USm)	685 / 481
Major Shareholders (%)	
Yao Hsiao Tung	84.3
Free Float (%)	15.7
3m Avg. Daily Val (US$m)	2.9

GIC Industry : Information Technology / Technology Hardware &

WHAT'S NEW

COVID-19 impact – Production disruption to factories in China; weaker mobile phone sales

Supply and demand affected. The COVID-19 pandemic has hit the business world at an unprecedented scale and speed. It has caused the closures of businesses, the stoppage of factory outputs, and the disruption to global manufacturing industries and their supply networks. The issue is compounded with the lockdown orders and the restriction in movements, leading to a demand crisis.

Weaker mobile phone sale partly mitigated by the less volatile Consumer Electronics. Apple's iPhone shipments in China plunged more than 60% in February, when the coronavirus outbreak first started. With the widespread of the virus to the rest of the world, iPhone sales in 2020 is expected to be weak. Apple is now unable to meet the revenue guidance it provided for the March quarter. Apple had forecast revenue of US$63-67bn for 2Q FY Sep 2020, vs revenue of US$58bn in 2Q19.

The Consumer Electronics segment, which accounts for the bulk of about 40% of total revenue, is less volatile. We are now expecting flat-to-lower single-digit negative growth, vs our previous expectation of stable single-digit growth.

Company may see small loss in 1Q20. With more than half of its factories in China affected by the shutdown, 1QFY20F performance would be weak. Though the group is drawing down on its inventory to tide over this period, the whole supply chain, including Hi-P's customers, are affected. Thus, Hi-P could register a small loss in 1QFY20F.

Continues to divest its operations out of China and is actively on the lookout for M&A targets. Note that the group has cut dividend for FY19 to 2.8 Scts, from 5 Scts in FY18, partly to be prudent and also for potential M&A.

On the M&A front, targets would include companies that are strong in the technology know-how and can complement Hi-P's existing business.

Hi-P could also be an attractive target for global companies looking to build a base in Asia. Hi-P's free float in the market is small, as Executive Chairman and Chief Executive Officer, Mr. Yao Hsiao Tung, now owns about 84% of the company. Furthermore, there is still no concrete succession plan in place.

We continue to believe that with its entrenched relationship with key customers, which include some of the world's biggest names in mobile phones, tablets, household and personal care appliances, Hi-P could be an attractive target.

Cut FY20F/FY21F earnings by 21%/10%; maintain HOLD with lower TP of S$0.85. We have cut FY20F/FY21F earnings by 21%/10%, on lower revenue and weaker margin assumptions. Our TP is reduced to S$0.85 (previously S$1.37), pegged to a lower peers' average of 11x vs 14x previously, in line with the de-rating, on FY20F earnings.

Beneficiary of strong USD. The USD vs RMB and SGD have strengthened c.2-6% YTD. Hi-P is a beneficiary of a strong USD as the bulk of its revenues are in USD while overheads are in local currencies.

CRITICAL DATA POINTS TO WATCH

Critical Factors

Performance of key customers
Hi-P's performance is dependent on its key customers, to a certain extent. Its key customer in the mobile segment, which contributes c. 20% to top line, is now unable to meet the revenue guidance it provided for the March quarter of an 8.6-15.5% y-o-y increase for 2QFY2020.

The Consumer Electronics segment, which accounts for the bulk of about 40% of total revenue, is less volatile. We are now expecting flat-to-lower single-digit negative growth, vs our previous expectation of stable single-digit growth.

Industry trend and consumer sentiment. Mobile sales are expected to be weak amid a weaker global economy. The more stable Consumer Electronics segment, with a longer product life cycle, should help to cushion the impact from the more volatile Smartphone and IoT segments.

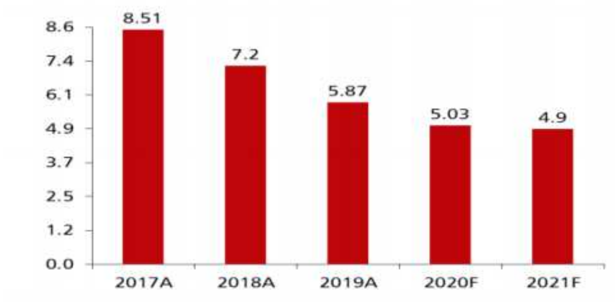
Operational efficiency and cost-control measures to improve margins. Hi-P strives to drive operational efficiency and strengthen its business model to improve margins. Despite the challenging environment, total operating expenses as a percentage of sales has been trending down, from about 12% in FY10 to 6.6% in FY19 and is expected to hover around 7% amid the trade war uncertainties and the COVID-19 impact.

M&A activities. Hi-P could be a takeover/privatisation target as its free float in the market is small. Executive Chairman and Chief Executive Officer, Mr. Yao Hsiao Tung, now owns about 84% of the company. Furthermore, there is still no concrete succession plan in place.

We continue to believe that with its entrenched relationship with key customers, which include some of the world's biggest names in mobile phones, tablets, household and personal care appliances, Hi-P could be an attractive target for global companies looking to build a base in Asia.

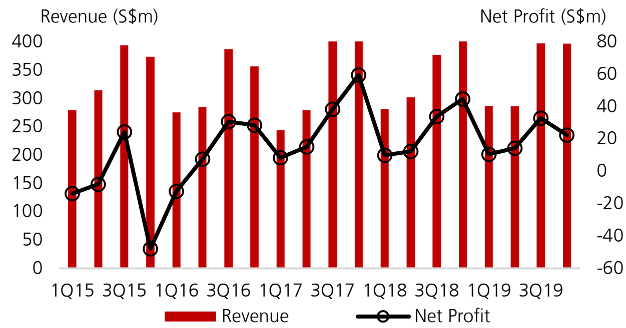
Meanwhile, Hi-P is actively on the lookout for suitable M&A opportunities which can complement its business model and plans. Its targets include those with facilities out of China and non-US customer base. Hi-P has recently announced the acquisition of South East Asia Moulding Company (SEAMCO), a manufacturer of high-volume and high-precision engineering plastic components with its production facility in Singapore, that is earnings accretive and can complement the group's business.

Net margin

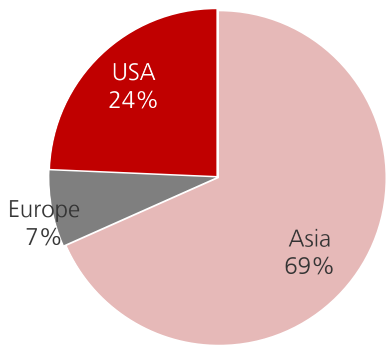


SGA as % of sales

Quarterly Revenue and Net Profit Trend



Geographical markets based on FY18 revenue



Source: Company, DBS Bank

Balance Sheet:

Strong operating cash flow; net cash position. Hi-P continues to generate strong positive operating cash flows amounting to S$250.8m for FY19. This contributed to a strengthening financial position with net cash position improving to S$210.6m from S$120.2m in FY18.

Share Price Drivers:

Earnings momentum slowing down. The worsening of the COVID-19 outbreak has affected the global supply chain. The issue is compounded with the lockdown orders and the restriction in movements, leading to a demand crisis. Expect weak earnings in FY20F, and a gradual recovery in FY21F. Together with the release of the FY19 results in mid-February, Hi-P announced that it expects a weaker 1H2020, both on revenue and profit basis, as compared to 1H2019, and 2H2020 to be stronger than 1H2020. Overall, FY2020 is expected to register higher revenue but lower profit compared to FY2019. With the worsening of the COVID-19 situation, Hi-P could lower its guidance.

Expansion of customer base and targeting new products. Hi-P's existing customers are mainly from the Wireless (smartphones), Consumer Electronics and Computer Peripherals (IoT) segments. A successful penetration into other product fields like automotive and medical through organic or inorganic ways, could help to diversify and reduce customer concentration risk, and to smoothen out the seasonality effect, especially for smartphones.

Key Risks:

Volatile industry with shorter product life cycle. The Wireless (smartphones) segment is getting more competitive with shorter product life cycles, and poses risks on margins and inventories.

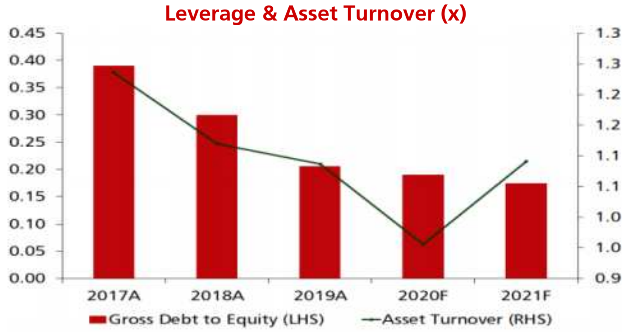
Forex exposure. About 90% of Hi-P's total revenues are in USD, but overheads are mainly in RMB and the reporting currency is SGD.

Macroeconomic uncertainty. Any prolonged macroeconomic uncertainty would postpone consumer consumption, which would in turn drive down revenue further.

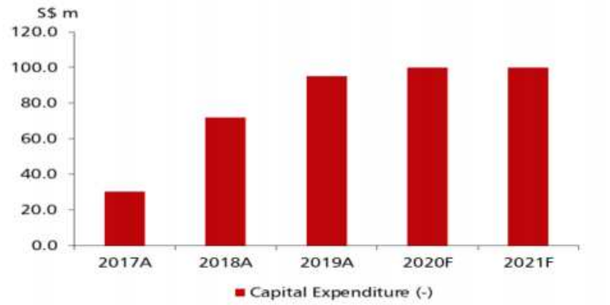
Company Background

Hi-P provides one-stop solutions - from product development, component manufacturing to complete product assembly - to customers in various industries. Hi-P's products can be classified into three broad categories: Wireless (smartphones), Computer Peripherals (Internet of Things [IoT]) and Consumer Electronics.

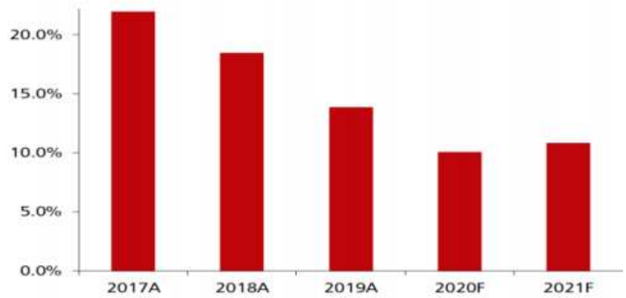
Leverage & Asset Turnover (x)



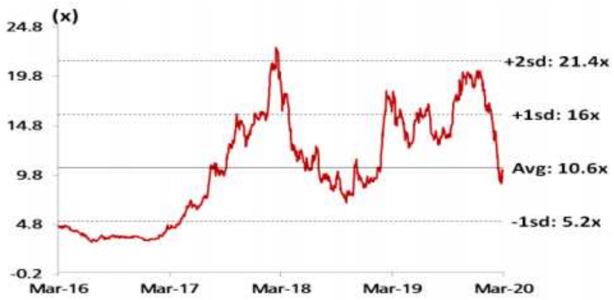
Capital Expenditure



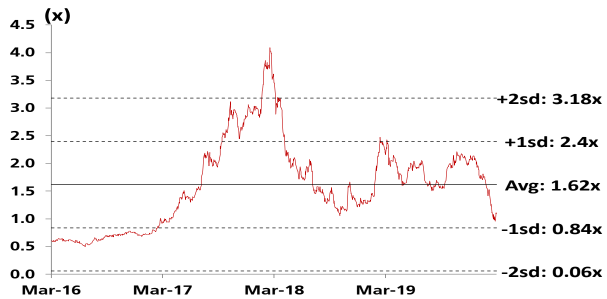
ROE (%)



Forward PE Band (x)



PB Band (x)



Source: Company, DBS Bank

Key Assumptions

FY Dec	2017A	2018A	2019A	2020F	2021F
Net margin	8.52	7.20	5.87	5.03	4.90
SGA as % of sales	6.76	6.88	6.61	7.30	7.20

Disruption to supply chain to affect margins

Income Statement (S$m)

FY Dec	2017A	2018A	2019A	2020F	2021F
Revenue	1,427	1,402	1,368	1,238	1,489
Cost of Goods Sold	(1,194)	(1,198)	(1,180)	(1,074)	(1,295)
Gross Profit	233	204	188	164	195
Other Opng (Exp)/Inc	(86.5)	(79.3)	(79.7)	(80.4)	(97.2)
Operating Profit	146	125	108	83.5	97.4
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	0.00	0.0	(1.3)	0.0	0.0
Net Interest (Exp)/Inc	(0.1)	(0.7)	(2.8)	(2.8)	(2.8)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	146	124	104	80.7	94.7
Tax	(24.8)	(23.6)	(23.8)	(18.4)	(21.6)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	121	101	80.3	62.3	73.0
Net Profit before Except.	121	101	80.3	62.3	73.0
EBITDA	219	193	177	147	174
Growth					
Revenue Gth (%)	9.3	(1.7)	(2.5)	(9.5)	20.3
EBITDA Gth (%)	38.3	(11.7)	(8.4)	(17.0)	18.2
Opg Profit Gth (%)	97.4	(14.7)	(13.4)	(22.8)	16.7
Net Profit Gth (Pre-ex) (%)	122.8	(16.9)	(20.4)	(22.4)	17.2
Margins & Ratio					
Gross Margins (%)	16.3	14.6	13.7	13.2	13.1
Opg Profit Margin (%)	10.3	8.9	7.9	6.7	6.5
Net Profit Margin (%)	8.5	7.2	5.9	5.0	4.9
ROAE (%)	22.0	18.5	13.9	10.1	10.8
ROA (%)	10.5	8.1	6.4	4.8	5.3
ROCE (%)	17.0	13.6	11.2	8.3	9.1
Div Payout Ratio (%)	165.8	39.9	28.1	20.0	20.0
Net Interest Cover (x)	2,761.7	169.7	39.0	30.1	35.2

Source: Company, DBS Bank

Special DPS of 19 Scts declared and paid after a strong set of 2Q17 results, and a subsequent 2 Scts in 3Q17 and 4 Scts in 4Q17

Quarterly / Interim Income Statement (S$m)

FY Dec	4Q2018	1Q2019	2Q2019	3Q2019	4Q2019
Revenue	442	287	286	398	397
Cost of Goods Sold	(363)	(251)	(247)	(341)	(342)
Gross Profit	**78.4**	**36.2**	**39.8**	**56.5**	**55.3**
Other Oper. (Exp)/Inc	(22.4)	(20.7)	(19.2)	(15.2)	(25.3)
Operating Profit	**56.0**	**15.6**	**21.2**	**41.3**	**30.0**
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	(0.1)	(0.9)	(0.3)	0.30	(0.4)
Net Interest (Exp)/Inc	(0.7)	(0.7)	(0.6)	(0.8)	(0.7)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	**55.2**	**14.0**	**20.2**	**40.9**	**29.0**
Tax	(10.4)	(3.3)	(5.9)	(8.0)	(6.6)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Net Profit	**44.8**	**10.7**	**14.4**	**32.9**	**22.4**
Net profit bef Except.	44.8	10.7	14.4	32.9	22.4
EBITDA	72.8	31.8	39.5	58.8	48.0
Growth					
Revenue Gth (%)	17.2	(35.1)	(0.1)	38.8	(0.1)
EBITDA Gth (%)	23.4	(56.3)	24.3	48.8	(18.3)
Opg Profit Gth (%)	36.3	(72.2)	36.2	94.7	(27.3)
Net Profit Gth (Pre-ex) (%)	32.5	(76.2)	34.9	128.6	(31.8)
Margins					
Gross Margins (%)	17.7	12.6	13.9	14.2	13.9
Opg Profit Margins (%)	12.7	5.4	7.4	10.4	7.6
Net Profit Margins (%)	10.1	3.7	5.0	8.3	5.6

Balance Sheet (S$m)

FY Dec	2017A	2018A	2019A	2020F	2021F
Net Fixed Assets	315	294	297	334	357
Invts in Associates & JVs	0.0	21.6	23.6	23.6	23.6
Other LT Assets	44.6	38.5	109	152	152
Cash & ST Invts	278	287	330	305	321
Inventory	179	177	158	143	172
Debtors	445	396	362	328	394
Other Current Assets	18.4	11.5	12.4	12.4	12.4
Total Assets	**1,280**	**1,225**	**1,292**	**1,298**	**1,433**
ST Debt	207	169	123	123	123
Creditor	420	357	400	362	436
Other Current Liab	113	126	143	137	140
LT Debt	0.03	0.0	0.0	0.0	0.0
Other LT Liabilities	10.8	8.87	31.3	31.3	31.3
Shareholder's Equity	529	564	594	644	703
Minority Interests	0.97	0.0	0.0	0.0	0.0
Total Cap. & Liab.	**1,280**	**1,225**	**1,292**	**1,298**	**1,433**
Non-Cash Wkg. Capital	109	102	(11.1)	(16.6)	2.18
Net Cash/(Debt)	71.1	118	207	183	199
Debtors Turn (avg days)	103.2	109.5	101.1	101.7	88.4
Creditors Turn (avg days)	108.1	125.4	124.5	137.7	119.5
Inventory Turn (avg days)	52.3	57.4	55.0	54.3	47.1
Asset Turnover (x)	1.2	1.1	1.1	1.0	1.1
Current Ratio (x)	1.2	1.3	1.3	1.3	1.3
Quick Ratio (x)	1.0	1.0	1.0	1.0	1.0
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	14.6	42.5	77.6	81.5	81.5
Z-Score (X)	3.3	3.4	3.3	3.3	3.3

Source: Company, DBS Bank

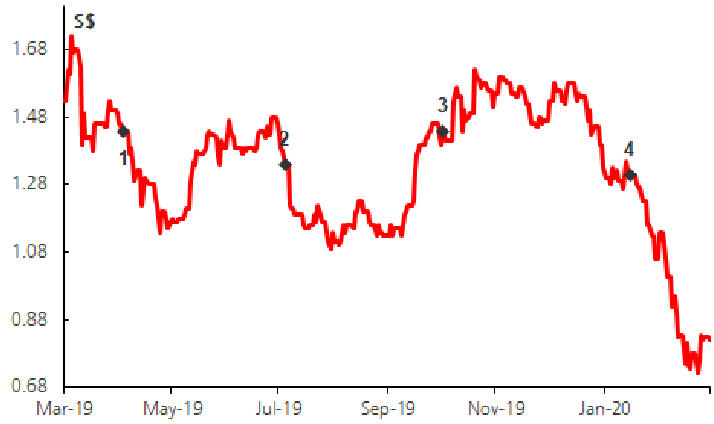
Cash Flow Statement (S$m)

FY Dec	2017A	2018A	2019A	2020F	2021F
Pre-Tax Profit	146	124	104	80.7	94.7
Dep. & Amort.	72.3	68.1	70.0	63.4	76.3
Tax Paid	(11.9)	(21.6)	(21.7)	(24.3)	(18.4)
Assoc. & JV Inc/(loss)	0.0	0.0	1.30	0.0	0.0
Chg in Wkg.Cap.	51.7	(6.1)	83.4	11.4	(22.0)
Other Operating CF	1.81	2.48	13.7	0.0	0.0
Net Operating CF	**260**	**167**	**251**	**131**	**130**
Capital Exp.(net)	(30.3)	(71.9)	(95.2)	(100.0)	(100.0)
Other Invts.(net)	0.0	0.0	0.0	(43.0)	0.0
Invts in Assoc. & JV	(4.6)	0.0	(4.0)	0.0	0.0
Div from Assoc & JV	0.0	0.15	0.0	0.0	0.0
Other Investing CF	5.30	12.0	2.03	0.0	0.0
Net Investing CF	**(29.6)**	**(59.7)**	**(97.2)**	**(143)**	**(100.0)**
Div Paid	(173)	(40.3)	(38.5)	(12.5)	(14.6)
Chg in Gross Debt	110	(39.7)	(45.6)	0.0	0.0
Capital Issues	0.0	0.0	0.0	0.0	0.0
Other Financing CF	0.69	(12.2)	(20.3)	0.0	0.0
Net Financing CF	**(62.3)**	**(92.2)**	**(104)**	**(12.5)**	**(14.6)**
Currency Adjustments	(1.4)	(6.8)	(6.4)	0.0	0.0
Chg in Cash	167	8.74	42.9	(24.3)	15.9
Opg CFPS (S cts)	25.9	21.5	20.8	14.9	18.9
Free CFPS (S cts)	28.5	11.9	19.3	3.87	3.78

Higher capex for Suzhou and Thailand plants.

Source: Company, DBS Bank

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:	03 May 19	1.44	1.41	HOLD
2:	02 Aug 19	1.34	1.32	HOLD
3:	31 Oct 19	1.44	1.39	HOLD
4:	14 Feb 20	1.31	1.37	HOLD

Source: DBS Bank

Analyst: Lee Keng LING

UMS Holdings

Version 22 | Bloomberg: UMSH SP | Reuters: UMSH.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

1 Apr 2020

BUY

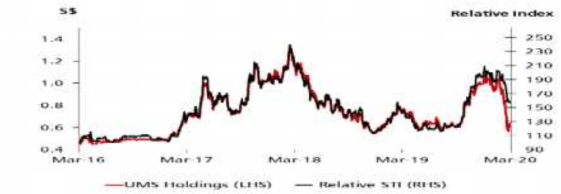
Last Traded Price (31 Mar 2020): S$0.625 (**STI :** 2,481.23)
Price Target 12-mth: S$0.77 (23% upside) (Prev S$1.12)

Analyst
Lee Keng LING +65 6682 3703 leekeng@dbs.com

What's New

- Semiconductor more resilient, as it forms part of the essential goods supply chain
- Expect weaker semiconductor billing data ahead despite strong February number, but still post positive y-o-y growth
- Maintain BUY with lower TP of S$0.77; UMS remains a beneficiary of capital equipment spending

Price Relative



Forecasts and Valuation

FY Dec (S$m)	2018A	2019A	2020F	2021F
Revenue	128	132	142	157
EBITDA	51.6	43.0	44.1	49.3
Pre-tax Profit	45.5	35.5	37.6	42.9
Net Profit	43.1	33.6	35.6	40.5
Net Pft (Pre Ex.)	43.1	33.6	35.6	40.5
Net Pft Gth (Pre-ex) (%)	(17.2)	(22.1)	6.1	13.8
EPS (S cts)	8.03	6.26	6.64	7.55
EPS Pre Ex. (S cts)	8.03	6.26	6.64	7.55
EPS Gth Pre Ex (%)	(17)	(22)	6	14
Diluted EPS (S cts)	8.03	6.26	6.64	7.55
Net DPS (S cts)	4.50	4.00	4.00	4.00
BV Per Share (S cts)	42.6	45.3	48.0	51.5
PE (X)	7.8	10.0	9.4	8.3
PE Pre Ex. (X)	7.8	10.0	9.4	8.3
P/Cash Flow (X)	8.7	6.3	10.4	8.7
EV/EBITDA (X)	6.6	7.3	7.0	6.1
Net Div Yield (%)	7.2	6.4	6.4	6.4
P/Book Value (X)	1.5	1.4	1.3	1.2
Net Debt/Equity (X)	0.0	CASH	CASH	CASH
ROAE (%)	19.4	14.2	14.2	15.2
Earnings Rev (%):			(11)	(11)
Consensus EPS (S cts):			7.80	9.00
Other Broker Recs:		B: 3	S: 0	H: 0

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

Growing at slower pace

Semiconductor more resilient; maintain BUY with lower TP of S$0.77.
Despite the positive semiconductor equipment billing data published by SEMI for February 2020, which has accounted for the shutdown in China amidst the outbreak of the COVID-19, we expect data to taper down going forward. Supply disruption and weaker demand persist. However, on a y-o-y basis, it could still record positive growth given a weak 1H2019.

Overall, we expect the semiconductor sector to fare better than others in the technology value chain, as it forms part of the essential goods supply chain.

Maintain BUY; UMS remains a beneficiary of capital equipment spending, driven by new technologies and 5G, though growth momentum is much muted now.

Where we differ: We remain positive on the semiconductor outlook.

Potential catalysts: Stronger recovery in semiconductor equipment sales, memory chips; client diversification, earnings-accretive M&As.

Valuation:

Maintain BUY with lower TP of S$0.77 pegged to 11.6x FY20F, +0.5SD. We have revised down our FY20F and FY21F earnings forecasts by 11% each, on supply disruption and weaker demand. TP is lowered to S$0.77, pegged to +0.5SD valuation (vs +2SD previously) or 11.6x FY20F earnings.

Key Risks to Our View:

Key client risk. Historically, c.90% of UMS's revenues on average were attributed to Applied Materials (AMAT). Disruptions to the relationship or weakness in AMAT's end-demand could significantly weigh on UMS's performance.

At A Glance

Issued Capital (m shrs)	533
Mkt. Cap (Sm/USm)	333 / 234
Major Shareholders (%)	
Luong Andy	20.6
Free Float (%)	79.4
3m Avg. Daily Val (US$m)	3.8
GIC Industry : Information Technology / Semiconductors &	

ed: TH/ sa: YM, PY, CS

WHAT'S NEW

COVID-19 impact – growing at slower pace now

Supply and demand affected. The COVID-19 pandemic has hit the business world at an unprecedented scale and speed. It has caused the closures of businesses, the stoppage of factory outputs, and the disruption to global manufacturing industries and their supply networks. The issue is compounded with the lockdown orders and the restriction in movements, leading to a demand crisis.

Key customer toning down guidance. Key customer Applied Materials (AMAT) has recently withdrawn its business outlook for 2Q FY October 2020 because the COVID-19 pandemic is affecting its supply chain and manufacturing operations. AMAT had previously provided a bullish guidance for 2Q FY20, expecting revenue to surge by c.23% y-o-y and earnings to jump 50% y-o-y, during the release of its 1Q FY20 results in February.

With c.90% of its revenue attributed to AMAT, we have trimmed our earnings forecasts for FY20F and FY21F by 11% each. Accordingly, TP is reduced to S$0.77, pegged to +0.5SD valuation (vs +2SD previously) or 11.6x on FY20F earnings. For FY20F, we now expect single-digit growth for revenue and earnings of 8% and 6% respectively, vs 15% and 19% previously, as we have also lower gross margin to 51% from 52.5% due to shortages of some components.

Maintain BUY; UMS remains a beneficiary of capital equipment spending, driven by new technologies and 5G, though growth momentum is much muted now.

Update on factory closure. Its Penang factory will remain closed until 14 April 2020, in compliance with the Malaysian Government's announcement on 25 March 2020 to extend its movement control order (MCO) nationwide to address the COVID-19 outbreak.

The Group's factory in California, US will stay closed in compliance with the California State's "Stay at Home" Executive Order in the US issued on 19 March 2020, until further notice.

Production facilities in Singapore will remain in operation

Maintain BUY with lower TP of S$0.77 pegged to 11.6x FY20F, +0.5SD. We have revised down our FY20F and FY21F earnings forecasts by 11% each, on supply disruption and weaker demand. TP is lowered to S$0.77, pegged to +0.5SD valuation (vs +2SD previously) or 11.6x FY20F earnings.

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CRITICAL DATA POINTS TO WATCH

Critical Factors

Downside risk prevail; expect slower growth
Despite the positive semiconductor equipment billing data published by SEMI for February 2020 which has accounted for the shutdown in China amidst the outbreak of the COVID-19, we expect data to taper down going forward. Supply disruption and weaker demand persist. However, on a y-o-y basis, it could still record positive growth given a weak 1H2019.

Overall, we expect the semiconductor sector to fare better than others in the technology value chain, as it forms part of the essential goods supply chain.

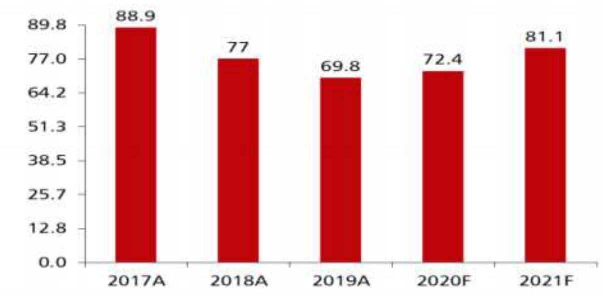
UMS, which is at the forefront of the technology value chain, remains a beneficiary of capital equipment spending, driven by new technologies and 5G, though growth momentum is much muted now.

Leveraging on key customer Applied Materials (AMAT). Key customer AMAT has recently withdrawn its business outlook for 2Q FY October 2020 because the COVID-19 pandemic is affecting its supply chain and manufacturing operations. AMAT had provided a bullish guidance for 2Q FY20, expecting revenue to surge by c.23% y-o-y and earnings to jump 50% y-o-y, during the release of its 1Q FY20 results in February. About 90% of its revenue is attributed to AMAT.

Still attractive dividends. Despite the lower DPS of 4 Scts in FY19 (down from 4.5 Scts in FY18) and an average of 6 Scts paid annually from FY13-FY17, dividend yield is still attractive at c.4%. Going forward, we are projecting a 4-Sct DPS for FY20F-21F, or dividend yield of c.6%.

Diversification into other businesses could bear fruit in the longer term. UMS has invested in JEP Holding, which is in the precision engineering business; Starke Singapore, a non-ferrous metal specialist; Kalf Engineering, a water and chemical engineering solutions company; and All Star Fortress, an aerospace component manufacturer. These investments provide the group with alternative growth opportunities and diversification from the cyclical semiconductor business.

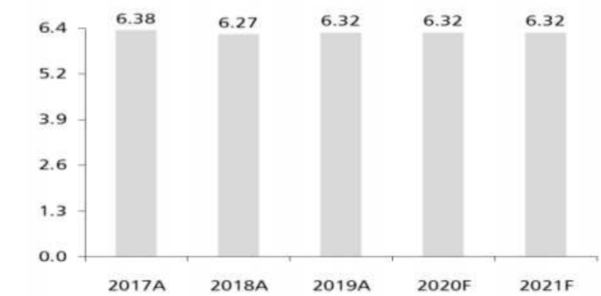
Gross Profit (S$ m)



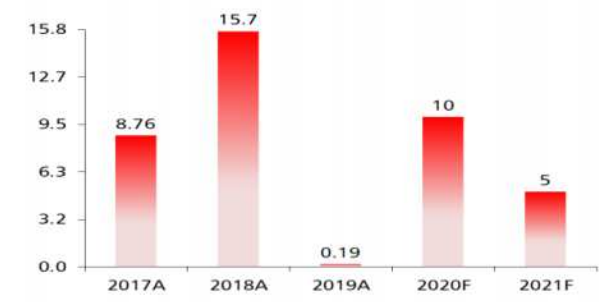
Revenue Growth (%)

Operating Profit Margin (%)

Effective Tax Rate (%)



Capex (S$ m)



Source: Company, DBS Bank

Balance Sheet:

Healthy cash level. UMS invested S$6.9m to raise its equity stake in JEP Holdings from 29% to 39% in 2Q19. Even after making an additional investment in JEP and paying dividends of S$10.7m, the group's net cash had risen to S$25m by end-4Q19, reversing from a net debt of S$1.4m as at end-4Q18.

Share Price Drivers:

A sustainable recovery in semiconductor industry. Industry bodies like SEMI and Worldwide Semiconductor Trade Statistics (WSTS) are forecasting a return to growth for the semiconductor industry in 2020. A sustainable recovery should drive earnings, and thus push its share price higher.

M&A opportunities. UMS continues to be on the lookout for diversification opportunities (outside of the semiconductor industry) with good long-term growth potential. New avenues of growth outside the semiconductor space could help drive re-rating of its share price.

Potential takeover target. UMS has only one large shareholder, with a 20% stake. With its entrenched relationship with AMAT, consistently strong cash flows and net cash position, we see UMS as an attractive takeover target.

Key Risks:

Key client risk – AMAT. UMS's performance is closely tied to that of AMAT. About 90% of UMS's revenues are attributable to AMAT.

Disruptions to the relationship (i.e. loss of market share) or weakness in AMAT's end-demand could significantly weigh on UMS's performance.

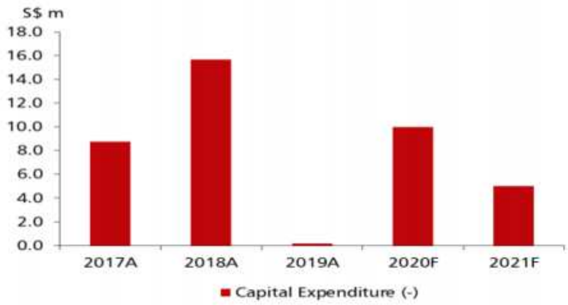
Underlying demand for semiconductor manufacturing equipment. As demand for semiconductor manufacturing equipment is largely driven by capex cycles of chipmakers and foundries, an extension of the life cycle of existing systems or a slowdown in the global economy could result in deferments in their planned capital investments.

Company Background

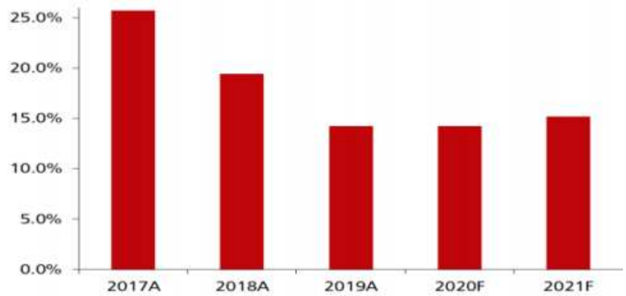
UMS Holdings (UMSH SP) is an integrated OEM for front-end semiconductor equipment manufacturing, providing both component manufacturing and sub-assembly services, primarily to key client, Applied Materials (AMAT).

Leverage & Asset Turnover (x)

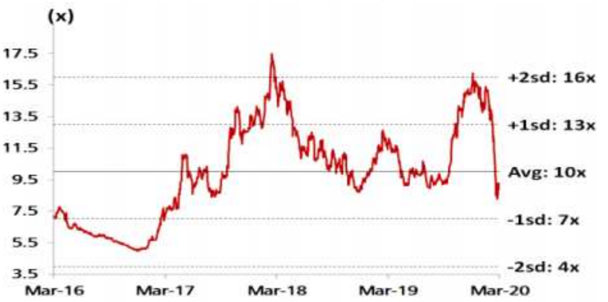
Capital Expenditure



ROE (%)



Forward PE Band (x)



PB Band (x)

Source: Company, DBS Bank

Key Assumptions

FY Dec	2017A	2018A	2019A	2020F	2021F
Gross Profit (S$ m)	88.9	77.0	69.8	72.4	81.1
Revenue Growth (%)	55.9	(21.3)	3.11	7.61	10.9
Operating Profit Margin	34.3	33.6	27.4	24.4	25.3
Effective Tax Rate (%)	6.38	6.27	6.32	6.32	6.32
Capex (S$ m)	8.76	15.7	0.19	10.0	5.00

Segmental Breakdown

FY Dec	2017A	2018A	2019A	2020F	2021F
Revenues (S$m)					
Components	73.0	76.4	61.9	65.0	70.2
Semiconductor Integrated	87.4	46.6	58.8	63.5	71.1
Others	2.10	4.94	11.2	13.5	16.1
Total	162	128	132	142	157

Income Statement (S$m)

FY Dec	2017A	2018A	2019A	2020F	2021F
Revenue	162	128	132	142	157
Cost of Goods Sold	(73.6)	(50.9)	(62.1)	(69.6)	(76.4)
Gross Profit	**88.9**	**77.0**	**69.8**	**72.4**	**81.1**
Other Opng (Exp)/Inc	(33.2)	(34.0)	(33.7)	(37.8)	(41.3)
Operating Profit	**55.7**	**43.0**	**36.2**	**34.6**	**39.8**
Other Non Opg (Exp)/Inc	(0.4)	2.36	(2.7)	0.0	0.0
Associates & JV Inc	0.0	0.53	2.57	2.57	2.57
Net Interest (Exp)/Inc	0.0	(0.4)	(0.6)	0.43	0.46
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	**55.2**	**45.5**	**35.5**	**37.6**	**42.9**
Tax	(3.5)	(2.9)	(2.2)	(2.4)	(2.7)
Minority Interest	0.32	0.42	0.34	0.35	0.36
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	**52.0**	**43.1**	**33.6**	**35.6**	**40.5**
Net Profit before Except.	52.0	43.1	33.6	35.6	40.5
EBITDA	59.6	51.6	43.0	44.1	49.3
Growth					
Revenue Gth (%)	55.9	(21.3)	3.1	7.6	10.9
EBITDA Gth (%)	98.4	(13.4)	(16.7)	2.6	11.8
Opg Profit Gth (%)	89.7	(22.7)	(15.9)	(4.2)	15.0
Net Profit Gth (Pre-ex) (%)	130.3	(17.2)	(22.1)	6.1	13.8
Margins & Ratio					
Gross Margins (%)	54.7	60.2	52.9	51.0	51.5
Opg Profit Margin (%)	34.3	33.6	27.4	24.4	25.3
Net Profit Margin (%)	32.0	33.7	25.4	25.1	25.7
ROAE (%)	25.7	19.4	14.2	14.2	15.2
ROA (%)	22.2	16.1	11.9	12.1	13.0
ROCE (%)	24.2	17.2	12.6	13.3	14.3
Div Payout Ratio (%)	57.7	56.0	63.9	60.3	52.9
Net Interest Cover (x)	55,695.0	107.3	57.1	NM	NM

Source: Company, DBS Bank

Quarterly / Interim Income Statement (S$m)

FY Dec	4Q2018	1Q2019	2Q2019	3Q2019	4Q2019
Revenue	25.9	28.6	30.0	32.9	40.4
Cost of Goods Sold	(10.1)	(13.4)	(14.1)	(14.9)	(19.8)
Gross Profit	**15.8**	**15.2**	**15.9**	**18.1**	**20.6**
Other Oper. (Exp)/Inc	(8.3)	(8.1)	(7.9)	(8.9)	(9.1)
Operating Profit	**7.46**	**7.06**	**7.98**	**9.18**	**11.6**
Other Non Opg (Exp)/Inc	1.33	0.01	0.0	0.24	(2.5)
Associates & JV Inc	0.24	0.46	0.83	0.65	0.64
Net Interest (Exp)/Inc	(0.2)	(0.2)	(0.2)	(0.2)	(0.1)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	**8.87**	**7.37**	**8.57**	**9.89**	**9.63**
Tax	0.41	(0.6)	(0.6)	(0.8)	(0.3)
Minority Interest	0.31	0.23	0.15	0.05	(0.1)
Net Profit	**9.59**	**7.05**	**8.09**	**9.18**	**9.24**
Net profit bef Except.	9.59	7.05	8.09	9.18	9.24
EBITDA	10.7	9.22	10.5	11.8	11.4
Growth					
Revenue Gth (%)	(11.5)	10.4	4.8	9.8	22.7
EBITDA Gth (%)	2.5	(14.1)	13.9	12.4	(3.4)
Opg Profit Gth (%)	(5.4)	(5.3)	13.0	15.0	26.2
Net Profit Gth (Pre-ex) (%)	26.3	(26.5)	14.7	13.4	0.8
Margins					
Gross Margins (%)	60.9	53.2	53.1	54.9	51.1
Opg Profit Margins (%)	28.8	24.7	26.6	27.9	28.6
Net Profit Margins (%)	37.0	24.6	27.0	27.9	22.9

Change in product mix towards lower-margin component sales

Balance Sheet (S$m)

FY Dec	2017A	2018A	2019A	2020F	2021F
Net Fixed Assets	38.8	53.4	52.3	55.4	53.6
Invts in Associates & JVs	0.0	29.5	39.4	42.0	44.5
Other LT Assets	87.7	87.6	87.3	87.3	87.3
Cash & ST Invts	59.6	18.9	34.4	35.2	47.2
Inventory	49.6	70.4	51.7	53.4	58.6
Debtors	23.4	15.1	22.1	27.2	30.2
Other Current Assets	0.0	0.0	0.0	0.0	0.0
Total Assets	**259**	**275**	**287**	**301**	**321**
ST Debt	19.0	20.3	9.33	9.33	9.33
Creditor	18.1	14.1	18.8	18.7	20.5
Other Current Liab	3.29	3.72	4.42	4.04	4.38
LT Debt	0.0	0.0	0.0	0.0	0.0
Other LT Liabilities	4.99	6.43	9.81	9.81	9.81
Shareholder's Equity	215	229	243	257	276
Minority Interests	(1.3)	1.91	1.62	1.27	0.91
Total Cap. & Liab.	**259**	**275**	**287**	**301**	**321**
Non-Cash Wkg. Capital	51.7	67.7	50.6	57.9	63.9
Net Cash/(Debt)	40.6	(1.4)	25.0	25.9	37.9
Debtors Turn (avg days)	49.8	55.0	51.5	63.4	66.6
Creditors Turn (avg days)	91.3	129.9	108.7	109.0	102.9
Inventory Turn (avg days)	214.4	484.3	403.9	306.0	294.0
Asset Turnover (x)	0.7	0.5	0.5	0.5	0.5
Current Ratio (x)	3.3	2.7	3.3	3.6	4.0
Quick Ratio (x)	2.1	0.9	1.7	1.9	2.3
Net Debt/Equity (X)	CASH	0.0	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	0.0	CASH	CASH	CASH
Capex to Debt (%)	46.1	77.2	2.0	107.1	53.6
Z-Score (X)	8.7	9.2	8.7	8.6	8.5

Source: Company, DBS Bank

Cash Flow Statement (S$m)

FY Dec	2017A	2018A	2019A	2020F	2021F
Pre-Tax Profit	55.2	45.5	35.5	37.6	42.9
Dep. & Amort.	4.32	5.67	6.87	6.87	6.87
Tax Paid	(2.1)	(3.6)	2.34	(2.8)	(2.4)
Assoc. & JV Inc/(loss)	0.04	(0.5)	(2.6)	(2.6)	(2.6)
Chg in Wkg.Cap.	(18.4)	(7.5)	12.9	(6.8)	(6.4)
Other Operating CF	0.02	(1.0)	(1.4)	0.0	0.0
Net Operating CF	39.2	38.7	53.6	32.3	38.4
Capital Exp.(net)	(8.8)	(15.7)	(0.2)	(10.0)	(5.0)
Other Invts.(net)	0.0	0.0	0.0	0.0	0.0
Invts in Assoc. & JV	(0.1)	(33.4)	(7.3)	0.0	0.0
Div from Assoc & JV	0.0	0.0	0.0	0.0	0.0
Other Investing CF	(2.1)	0.21	0.29	0.0	0.0
Net Investing CF	(11.0)	(48.8)	(7.2)	(10.0)	(5.0)
Div Paid	(26.8)	(29.5)	(18.8)	(21.5)	(21.5)
Chg in Gross Debt	18.8	(0.3)	(10.9)	0.0	0.0
Capital Issues	0.0	0.0	0.0	0.0	0.0
Other Financing CF	(0.4)	(0.6)	(0.9)	0.0	0.0
Net Financing CF	(8.5)	(30.5)	(30.7)	(21.5)	(21.5)
Currency Adjustments	(2.8)	0.0	(0.3)	0.0	0.0
Chg in Cash	17.0	(40.6)	15.4	0.88	12.0
Opg CFPS (S cts)	10.7	8.60	7.59	7.30	8.35
Free CFPS (S cts)	5.67	4.29	9.96	4.16	6.23

Assume higher investments in Malaysia

Source: Company, DBS Bank

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:	14 May 19	0.65	0.55	FULLY VALUED
2:	16 May 19	0.63	0.45	FULLY VALUED
3:	16 Aug 19	0.60	0.49	FULLY VALUED
4:	24 Oct 19	0.74	0.87	BUY
5:	13 Nov 19	0.86	1.00	BUY
6:	24 Jan 20	1.03	1.16	BUY
7:	26 Feb 20	0.94	1.12	BUY

Source: DBS Bank

Analyst: Lee Keng LING

Singapore Company Guide
Venture Corporation

Version 21 | Bloomberg: VMS SP | Reuters: VENM.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

1 Apr 2020

BUY

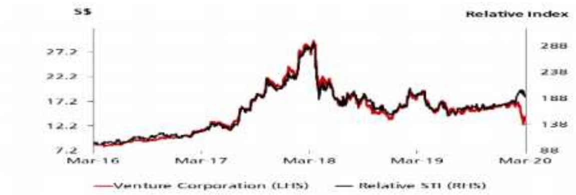
Last Traded Price (31 Mar 2020): S$13.57 (**STI :** 2,481.23)
Price Target 12-mth: S$15.80 (16% upside) (Prev S$18.50)

Analyst
Lee Keng LING +65 6682 3703 leekeng@dbs.com

What's New

- Factories in Malaysia and China affected by temporary shutdown
- New product introductions and new customers to cushion impact
- Exposure to Medical segment an added advantage in this pandemic crisis
- Maintain BUY; to emerge stronger on its entrenched relationship with customers and balance sheet strength

Price Relative



Forecasts and Valuation

FY Dec (S$m)	2018A	2019A	2020F	2021F
Revenue	3,485	3,633	3,689	3,845
EBITDA	465	459	462	495
Pre-tax Profit	433	420	426	459
Net Profit	370	363	365	393
Net Pft (Pre Ex.)	370	363	365	393
Net Pft Gth (Pre-ex) (%)	2.4	(1.9)	0.6	7.7
EPS (S cts)	128	125	126	136
EPS Pre Ex. (S cts)	128	125	126	136
EPS Gth Pre Ex (%)	1	(2)	1	8
Diluted EPS (S cts)	128	125	126	136
Net DPS (S cts)	70.0	70.0	70.0	70.0
BV Per Share (S cts)	813	862	918	983
PE (X)	10.6	10.8	10.8	10.0
PE Pre Ex. (X)	10.6	10.8	10.8	10.0
P/Cash Flow (X)	15.4	17.1	15.1	13.1
EV/EBITDA (X)	6.9	7.0	7.0	6.4
Net Div Yield (%)	5.2	5.2	5.2	5.2
P/Book Value (X)	1.7	1.6	1.5	1.4
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	16.4	15.0	14.2	14.3
Earnings Rev (%):			(5)	(3)
Consensus EPS (S cts):			128	133
Other Broker Recs:		B: 4	S: 2	H: 7

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

To emerge stronger

Maintain BUY; expect Venture to emerge strong from the pandemic crisis. We continue to expect a stronger 2H2020 vs 1H2020, supported by new product introductions and new partners coming on stream. We have tweaked earnings for FY20F/FY21F down by 5%/3% to account for the temporary shutdown of most of its Malaysia factories and to a lesser extend, its China plants. The disruption to the global supply chain could also impact margins. We have lowered net margins to 9.9% for FY20F, and expect a gradual improvement to 10.2% in FY21F.

Given Venture's expertise and its entrenched relationships with the industry leaders in the various technology domains, coupled with its balance sheet strength, we expect Venture to emerge stronger from the current pandemic crisis.

Where we differ: We remain positive on VMS's ability to continue to invest into expanding its differentiating capabilities within its ecosystems of interest. This will further strengthen its existing partnerships and secure new customers.

Potential catalysts: New products and continued expansion into non-traditional markets with higher margins, and new customers. New business opportunities from customer mergers and acquisitions (M&As) amid the US-China trade war.

Valuation:

Reiterate BUY with lower TP of S$15.80. Our TP is pegged to 12.5x on FY20F earnings, which is VMS's -0.5SD to its 10-year average PE.

Key Risks to Our View:

Weakening client or global growth prospects. A broad global slowdown is likely to impact VMS due to its vulnerability to business cycles. Potential weakening of clients' end-demand and/or the US Dollar (USD) could dampen revenue growth.

At A Glance

Issued Capital (m shrs)	288
Mkt. Cap (Sm/USm)	3,914 / 2,747
Major Shareholders (%)	
Wong Ngit Liong	7.0
Schroders Plc	7.0
Blackrock	5.0
Free Float (%)	81.0
3m Avg. Daily Val (US$m)	18.1

GIC Industry : Information Technology / Technology Hardware &

WHAT'S NEW

COVID-19 impact – To emerge stronger from current crisis

Supply and demand affected. The COVID-19 pandemic has hit the business world at an unprecedented scale and speed. It has caused the closures of businesses, the stoppage of factory outputs, and the disruption to global manufacturing industries and their supply networks. The issue is compounded with the lockdown orders and the restriction in movements, leading to a demand crisis.

Factories affected by shutdown. As most of Venture's factories are in Malaysia, it is affected by the movement control order (MCO). The resumption of production in its China plants and the Singapore plants remaining in operation should help to mitigate some of the negative impact from its Malaysia plants.

New product introductions to cushion impact. In FY2020, Venture will be supporting new product introductions from its existing partners across multiple selected technology domains, such as Life Science, Healthcare & Wellness, Instrumentation and Networking & Communications. It also expects to gain momentum with several new partners in the Life Science & Genomics and Healthcare & Wellness domains with growing contributions beyond 2020.

Exposure to Medical segment an added advantage in this pandemic crisis. Venture's business segments include Medical Devices and Equipment, Healthcare & Wellness Technology, and also Life Science, Genomics and Molecular Diagnostics, which can be in high demand during this pandemic crisis. Some countries, like Italy and Spain have already reached the limit on their medical resources. Furthermore, if R&D is required, Venture can tie up with its customers to perform R&D together. Venture is not new to this kind of collaborations with customers in manufacturing new products. Venture has been working with industry leaders in the various segments to develop new products. These include working with a leading laboratory analytical instrument company to manufacture their next-generation mass spectrometry instrument, and also in the Life Science domain, collaborating on a partnership with an emerging leader in the development of next-generation equipment.

Strong cash position. Net cash position as at end-4Q19 is strong at S$713.4m (vs S$711.0m in 4Q18), driven by strong operating cash flows. This works out to S$2.46 per share or c.15% of its current market capitalisation. Venture's strong net cash position should support expectations that the 70-Sct DPS can be sustained going forward. This represents 4.2% yield based on its current share price.

Maintain BUY; expect Venture to emerge strong from the crisis. We have tweaked our earnings for FY20F/FY21F down by 5%/3% to account for the temporary shutdown of most of its Malaysia factories and to a lesser extend, its China plants. The disruption to the global supply chain could also impact margins. We have lowered net margins to 9.9% for FY20F, and expect a gradual improvement to 10.2% in FY21F. As such, TP is lowered to S$15.80 (previously S$18.50), pegged to 12.5x on FY20F earnings, which is VMS's 10-year -0.5SD PE from average, down from the average PE peg, on increasingly uncertainties ahead. Maintain BUY.

Given Venture's expertise and its entrenched relationship with the industry leaders in the various technology domains, coupled with its balance sheet strength, we expect Venture to emerge stronger from the current crisis.

CRITICAL DATA POINTS TO WATCH

Critical Factors

Net margin critical in driving share price, well supported by changing business mix. According to our critical factor analysis, VMS's net margins have a direct correlation with its share price. Its evolving business mix, with increasing contribution from the Test & Measurement, Medical & Devices and Life Science clusters and declining contribution from Computer Peripherals and Printing, is likely to improve its margins.

We believe that the specialised nature of the Medical and Life Science segment permits VMS to realise better margins on contracts. Coupled with higher operational efficiencies, this should continue to drive margins higher ahead.

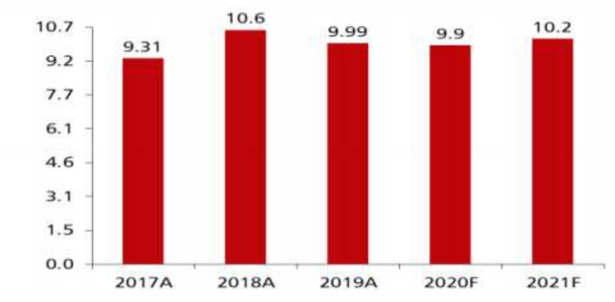
Growing exposure to attractive, high-growth end-markets. Some of these high-end segments include Test & Measurement, Medical & Devices and Life Science. VMS has established strong relationships with companies researching on genome sequencing, which could see healthy growth over the medium term with increasing investments and use of medical technologies (MedTech).

An increased focus on lower-cost technologies in healthcare is likely to boost the Test & Measurement, Medical & Devices and Life Science segments. This cluster has contributed strongly to the group's top line in recent years, which helped offset the weak performance from the Computer Peripherals & Data Storage segments. Growing exposure to these high-growth segments should lead to higher earnings growth.

Investments in R&D. A key differentiating factor for VMS from its peers is its strong research and development (R&D) capabilities. It has been pursuing innovation and technical competencies, building depth and density in engineering and R&D, as well as manufacturing operations and processes to create distinct differentiators in its technology services, products and solution offerings.

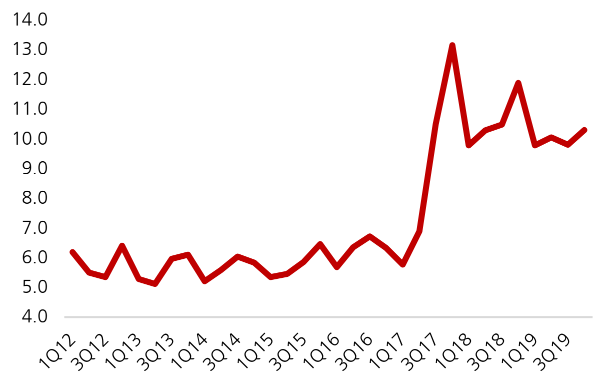
Acquisition of new sites for future expansion. VMS has acquired a freehold site in Milpitas (California) within the Silicon Valley. This will further enhance its ability to cater to its US customer cluster and creates opportunities for future growth. VMS has also acquired a plot of land with an industrial building in Tebrau, Johor in Malaysia. This will fortify the group's strong foothold in Southeast Asia.

Net margin (%)

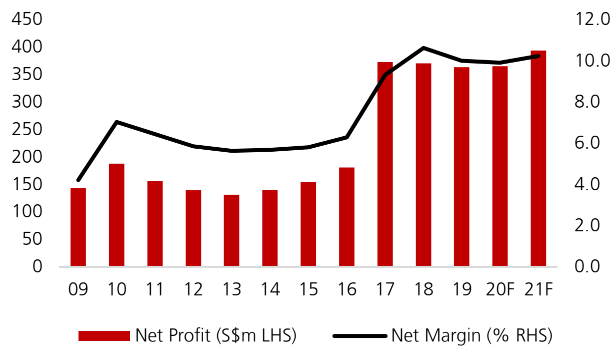


% of SGA (%)

Quarterly net margin trend (%)



Net profit and margins trend



Source: Company, DBS Bank

Balance Sheet:

Strong balance sheet. VMS's net cash position had at least tripled since FY15 to c.S$713.4m as at end-4Q19, which should support its 70-Sct DPS going forward

Share Price Drivers:

Expect more volatility ahead. With the cloudy outlook and shortened visibility from the ongoing trade war, and now, the COVID-19 outbreak, we expect more volatility for VMS's share price. The ability to sustain net margins above the 10% level is one of the key factors to watch out for.

VMS will be supporting several partners in their new and key product launches over the next 12 months. That should help to drive earnings higher. The group's strategy of pursuing the more resilient Test & Measurement, Medical & Devices and Life Science clusters has been successful in generating revenue and profits. We believe this strategy should buffer VMS from subdued or zero growth in other technology domains.

Key Risks:

Dependent on global market conditions. With exposure to customers in the US, European Union (EU) and Asia, a broad global slowdown is likely to impact VMS due to its vulnerability to business cycles. A possible weakness in the Eurozone arising from political instability or restrictive trading policies by the US could weaken global growth prospects. We note that most electronic products do not carry tariffs in the US. Deterioration in the world economy could affect corporate spending and adversely impact VMS's results.

Weak USD could affect top line. A weakening USD against the Singapore Dollar (SGD) and a prolonged accommodative monetary policy could impact VMS's earnings. Our sensitivity analysis shows that every 1% appreciation of USD against SGD will increase VMS's net profit by ~1.9%.

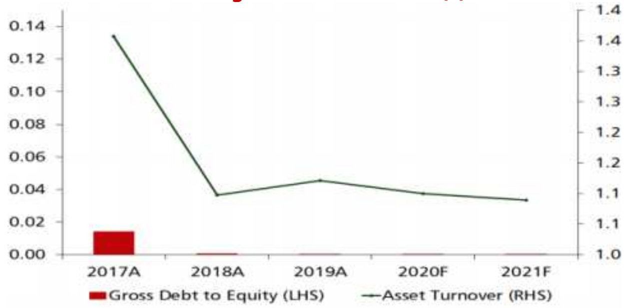
Environment, Social, Governance:

VMS issued its first sustainability report in 2017. Although its environmental, social and governance (ESG) score is below its peers, improving its sustainability performance is an ongoing process. In FY18, VMS introduced several sustainability initiatives, such as the launch of the Learning Management System, investing in energy efficiency solutions and enhancing policies and practices to safeguard confidential information.

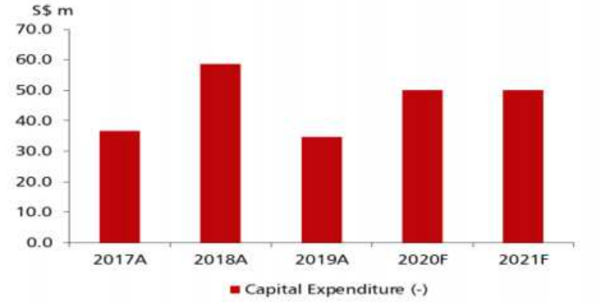
Company Background

Venture Corporation (VMS) is a global provider of technology products and solutions. It is best known for its superior capabilities in Original Design Manufacturing (ODM) and providing high-mix, high-value and complex manufacturing.

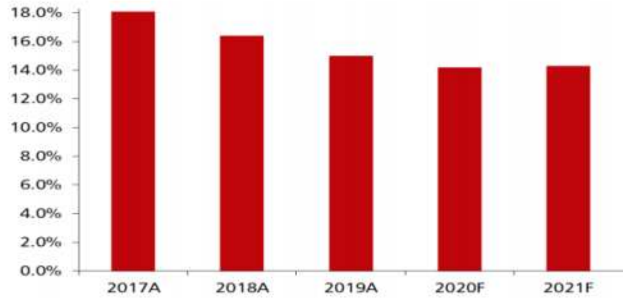
Leverage & Asset Turnover (x)



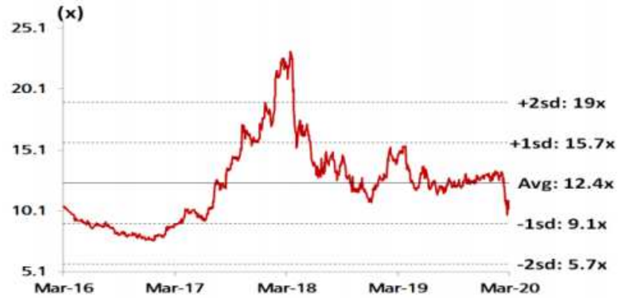
Capital Expenditure



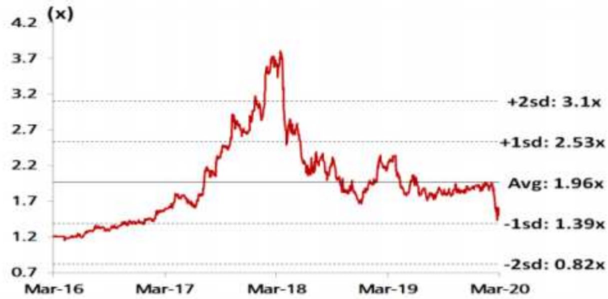
ROE (%)



Forward PE Band (x)



PB Band (x)



Source: Company, DBS Bank

Key Assumptions

FY Dec	2017A	2018A	2019A	2020F	2021F
Net margin (%)	9.31	10.6	9.99	9.90	10.2
% of SGA (%)	13.5	15.2	13.7	13.5	13.4

Segmental Breakdown

FY Dec	2017A	2018A	2019A	2020F	2021F
Revenues (S$m)					
Advanced Manufacturing & Design Solutions (AMDS)	3,205	2,600	2,775	2,831	2,944
Technology Products & Design Solutions (TPS)	800	885	858	858	901
Total	4,005	3,485	3,633	3,689	3,845

Income Statement (S$m)

FY Dec	2017A	2018A	2019A	2020F	2021F
Revenue	4,005	3,485	3,633	3,689	3,845
Cost of Goods Sold	(3,039)	(2,531)	(2,727)	(2,778)	(2,884)
Gross Profit	**965**	**954**	**907**	**911**	**961**
Other Opng (Exp)/Inc	(537)	(529)	(497)	(497)	(514)
Operating Profit	**428**	**425**	**410**	**414**	**447**
Other Non Opg (Exp)/Inc	3.80	9.21	11.0	11.0	11.0
Associates & JV Inc	1.67	(0.1)	0.04	0.04	0.04
Net Interest (Exp)/Inc	(1.0)	(1.0)	(0.5)	0.0	0.0
Exceptional Gain/(Loss)	11.4	0.0	0.0	0.0	0.0
Pre-tax Profit	**444**	**433**	**420**	**426**	**459**
Tax	(71.1)	(62.9)	(56.6)	(59.5)	(64.1)
Minority Interest	0.12	0.0	(0.3)	(0.3)	(0.3)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	**373**	**370**	**363**	**365**	**393**
Net Profit before Except.	361	370	363	365	393
EBITDA	480	465	459	462	495
Growth					
Revenue Gth (%)	39.3	(13.0)	4.3	1.5	4.2
EBITDA Gth (%)	82.3	(3.2)	(1.2)	0.7	7.1
Opg Profit Gth (%)	103.1	(0.7)	(3.6)	1.1	7.9
Net Profit Gth (Pre-ex) (%)	100.1	2.4	(1.9)	0.6	7.7
Margins & Ratio					
Gross Margins (%)	24.1	27.4	25.0	24.7	25.0
Opg Profit Margin (%)	10.7	12.2	11.3	11.2	11.6
Net Profit Margin (%)	9.3	10.6	10.0	9.9	10.2
ROAE (%)	18.1	16.4	15.0	14.2	14.3
ROA (%)	12.6	11.7	11.2	10.9	11.1
ROCE (%)	16.9	15.9	14.5	13.7	13.8
Div Payout Ratio (%)	45.7	54.7	55.8	55.5	51.5
Net Interest Cover (x)	422.9	432.6	783.0	39,121.6	42,228.2

Source: Company, DBS Bank

Quarterly / Interim Income Statement (S$m)

FY Dec	4Q2018	1Q2019	2Q2019	3Q2019	4Q2019
Revenue	906	929	903	869	932
Cost of Goods Sold	(662)	(702)	(678)	(652)	(694)
Gross Profit	**244**	**227**	**225**	**217**	**238**
Other Oper. (Exp)/Inc	(122)	(118)	(115)	(116)	(122)
Operating Profit	**122**	**104**	**103**	**95.6**	**107**
Other Non Opg (Exp)/Inc	2.88	2.48	2.66	3.15	2.71
Associates & JV Inc	0.0	0.0	0.04	0.0	0.0
Net Interest (Exp)/Inc	(0.2)	(0.1)	(0.1)	(0.2)	(0.2)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	**124**	**106**	**105**	**98.6**	**110**
Tax	(16.8)	(15.4)	(14.5)	(13.2)	(13.6)
Minority Interest	0.0	0.0	(0.1)	(0.2)	0.0
Net Profit	**108**	**90.9**	**90.8**	**85.2**	**96.3**
Net profit bef Except.	108	90.9	90.8	85.2	96.3
EBITDA	134	117	116	111	123
Growth					
Revenue Gth (%)	17.6	2.5	(2.7)	(3.8)	7.2
EBITDA Gth (%)	13.6	(12.7)	(0.9)	(4.6)	10.8
Opg Profit Gth (%)	14.7	(14.8)	(1.1)	(7.0)	12.3
Net Profit Gth (Pre-ex) (%)	33.3	(15.6)	(0.1)	(6.2)	13.0
Margins					
Gross Margins (%)	27.0	24.5	24.9	24.9	25.5
Opg Profit Margins (%)	13.4	11.2	11.4	11.0	11.5
Net Profit Margins (%)	11.9	9.8	10.1	9.8	10.3

Balance Sheet (S$m)

FY Dec	2017A	2018A	2019A	2020F	2021F
Net Fixed Assets	198	231	232	245	259
Invts in Associates & JVs	0.79	0.73	0.76	0.80	0.83
Other LT Assets	669	667	696	696	696
Cash & ST Invts	752	713	714	722	770
Inventory	700	808	706	717	747
Debtors	766	736	899	1,025	1,131
Other Current Assets	58.3	49.2	25.8	25.8	25.8
Total Assets	**3,144**	**3,205**	**3,274**	**3,432**	**3,630**
ST Debt	30.8	1.80	1.06	1.06	1.06
Creditor	591	529	490	485	493
Other Current Liab	352	320	264	264	264
LT Debt	0.0	0.0	0.0	0.0	0.0
Other LT Liabilities	1.72	2.06	20.4	20.4	20.4
Shareholder's Equity	2,166	2,350	2,496	2,659	2,849
Minority Interests	2.31	2.23	2.40	2.40	2.40
Total Cap. & Liab.	**3,144**	**3,205**	**3,274**	**3,432**	**3,630**
Non-Cash Wkg. Capital	580	745	877	1,018	1,147
Net Cash/(Debt)	722	711	713	721	768
Debtors Turn (avg days)	67.4	78.6	82.1	95.2	102.3
Creditors Turn (avg days)	66.0	81.8	69.2	65.0	62.7
Inventory Turn (avg days)	80.7	110.1	102.8	94.7	93.8
Asset Turnover (x)	1.4	1.1	1.1	1.1	1.1
Current Ratio (x)	2.3	2.7	3.1	3.3	3.5
Quick Ratio (x)	1.6	1.7	2.1	2.3	2.5
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	119.2	3,261.4	3,281.9	4,725.9	4,725.9
Z-Score (X)	5.7	6.1	5.7	5.7	5.7

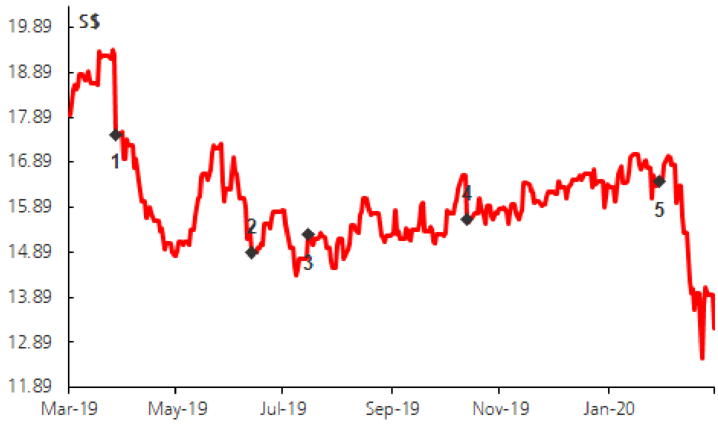
Source: Company, DBS Bank

Cash Flow Statement (S$m)

FY Dec	2017A	2018A	2019A	2020F	2021F
Pre-Tax Profit	444	433	420	425	458
Dep. & Amort.	46.4	30.7	38.7	36.3	36.3
Tax Paid	(50.3)	(56.3)	(61.5)	(59.5)	(64.1)
Assoc. & JV Inc/(loss)	(1.7)	0.06	0.0	0.0	0.0
Chg in Wkg.Cap.	13.8	(147)	(157)	(142)	(129)
Other Operating CF	(3.4)	(5.9)	(10.7)	0.0	0.0
Net Operating CF	449	254	230	260	301
Capital Exp.(net)	(36.7)	(58.6)	(34.7)	(50.0)	(50.0)
Other Invts.(net)	(15.3)	1.31	(1.4)	(0.3)	(0.3)
Invts in Assoc. & JV	31.6	0.0	0.0	0.0	0.0
Div from Assoc & JV	1.08	0.03	0.0	0.0	0.0
Other Investing CF	5.36	8.74	11.4	0.0	0.0
Net Investing CF	(14.0)	(48.6)	(24.7)	(50.3)	(50.3)
Div Paid	(141)	(230)	(202)	(203)	(203)
Chg in Gross Debt	(56.3)	11.3	(0.7)	0.0	0.0
Capital Issues	70.7	(18.1)	5.52	0.0	0.0
Other Financing CF	(25.0)	0.0	(8.1)	0.0	0.0
Net Financing CF	(151)	(237)	(205)	(203)	(203)
Currency Adjustments	(30.5)	(8.6)	1.67	0.0	0.0
Chg in Cash	253	(39.6)	1.64	7.13	47.9
Opg CFPS (S cts)	153	139	133	139	148
Free CFPS (S cts)	145	67.7	67.3	72.5	86.6

Source: Company, DBS Bank

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	26 Apr 19	17.52	21.70	BUY
2:	12 Jul 19	14.90	18.60	BUY
3:	13 Aug 19	15.28	18.60	BUY
4:	11 Nov 19	15.63	17.20	HOLD
5:	28 Feb 20	16.45	18.50	BUY

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

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Source: DBS Bank

Analyst: Lee Keng LING

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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 share price catalysts within this time frame)

**Share price appreciation + dividends*

Completed Date: 1 Apr 2020 07:16:18 (SGT)
Dissemination Date: 1 Apr 2020 08:03:21 (SGT)

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