Singapore Company Update

Nanofilm Technologies

Bloomberg: NANO SP | Reuters: NANO.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

9 Dec 2021

BUY (Upgrade from HOLD)

Last Traded Price (8 Dec 2021): S$3.99 (STI : 3,129.77)
Price Target 12-mth: S$4.96 (24% upside) (Prev S$4.05)

Analyst
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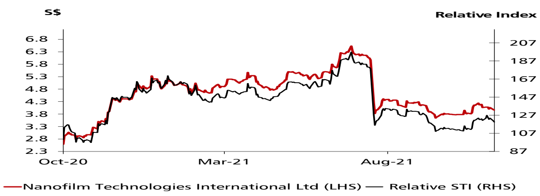
What's New

- Upgrade to BUY with higher TP of S$4.96 on anticipated supply chain recovery
- Stronger earnings execution should help the stock to re-rate and break out
- Expect smartphone segment to register strong growth; wearables to recover from weak 3Q21
- Growth for Nanofilm to outpace industry on market share gain and extension of product range

Price Relative



Forecasts and Valuation

FY Dec (S$m)	2020A	2021F	2022F	2023F
Revenue	218	249	333	387
EBITDA	90.3	86.7	129	150
Pre-tax Profit	70.3	67.3	97.1	113
Net Profit	57.6	55.6	80.2	93.4
Net Pft (Pre Ex.)	57.6	55.6	80.2	93.4
Net Pft Gth (Pre-ex) (%)	61.1	(3.5)	44.3	16.5
EPS (S cts)	8.75	8.44	12.2	14.2
EPS Pre Ex. (S cts)	8.75	8.44	12.2	14.2
EPS Gth Pre Ex (%)	61	(4)	44	16
Diluted EPS (S cts)	8.75	8.44	12.2	14.2
Net DPS (S cts)	1.44	1.69	2.44	2.84
BV Per Share (S cts)	65.4	72.2	81.9	93.3
PE (X)	45.6	47.2	32.7	28.1
PE Pre Ex. (X)	45.6	47.2	32.7	28.1
P/Cash Flow (X)	44.5	29.1	27.3	21.9
EV/EBITDA (X)	27.1	28.3	19.0	16.2
Net Div Yield (%)	0.4	0.4	0.6	0.7
P/Book Value (X)	6.1	5.5	4.9	4.3
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	20.9	12.3	15.8	16.2
Earnings Rev (%):		0	0	0
Consensus EPS (S cts):		9.70	12.6	15.1
Other Broker Recs:		B: 3	S: 1	H: 4

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

Buy ahead of supply chain recovery

Investment Thesis:

Earnings execution and recovery from 2H21 to drive share price recovery - upgrade to BUY! Nanofilm's share price fell by 30% in August on earnings miss and resignation of key executives but we believe the worst is over as 3Q21 could be the worst quarter on the supply front and earnings should recover going forward. We expect share price to break out as the company delivers stronger earnings in 2H21 and 44% EPS growth in 2022 as the supply chain recovers, coupled with the increasing adoption of nanotechnology. 2Q22 should see more broad-based improvement and the situation should normalise in 2023. Overall, we expect the growth for Nanofilm this year due to the supply disruptions to be delayed to next year. Firm earnings execution should also help allay market concerns over the management team.

Well positioned for multiple avenues of growth in the medium term. Growth could come from existing products and industries and also penetration of new markets, including the hydrogen economy, with maiden contribution expected in 2022. Growth is supported by a strong balance sheet with net cash of S$189m as at end June 2021, and the new Shanghai plant 2 which still has ample room for expansion.

Valuation:

Higher TP of S$4.96 on PEG valuation. Our TP is raised to S$4.96 (previously S$4.05), pegged to a higher PEG of 0.92x (vs 0.75 previously), which is still at a discount to peers on FY22F earnings, as the supply disruption situation, although shows some pockets of improvement, is not out of the woods yet.

Where we differ:

We value the stock on a PEG methodology, vs the conventional PE method, to capture the strong growth potential going forward.

Key Risks to Our View:

Ability to establish, maintain, and protect its proprietary intellectual property rights; Resurgence of COVID pandemic further aggravating supply chain.

At A Glance

Issued Capital (m shrs)	658
Mkt. Cap (Sm/USm)	2,626 / 1,922
Major Shareholders (%)	
Pearl Yard Holdings Inc	38.4
Harrymore Int	7.2
Venezio Investments Pte Ltd	7.2
Free Float (%)	56.2
3m Avg. Daily Val (US$m)	4.2
GIC Industry : Materials / Chemicals	

ed: AT/ sa: PY, CS

WHAT'S NEW

Buy ahead of anticipated supply chain recovery

Upgrade to BUY with higher TP of S$4.96; growth delayed to next year. We upgrade Nanofilm to BUY on anticipated improvement in the supply chain situation. We believe 3Q21 could be the worst quarter on the supply front, barring any worsening of the COVID-pandemic, as some pockets of improvement are already seen for some components. 2Q22 should see more broad-based improvement and the situation should normalise in 2023. Overall, we expect the delayed growth for Nanofilm this year due to the supply disruptions to move to next year. Hence, earnings for next year are projected to grow at a strong 44% and another 16% in FY23F.

At the current price, Nanofim is trading at a 32.8x PE on FY22F earnings, near its valuation when it was listed in October 2020, and is also below its -1SD of its average PE since listing.

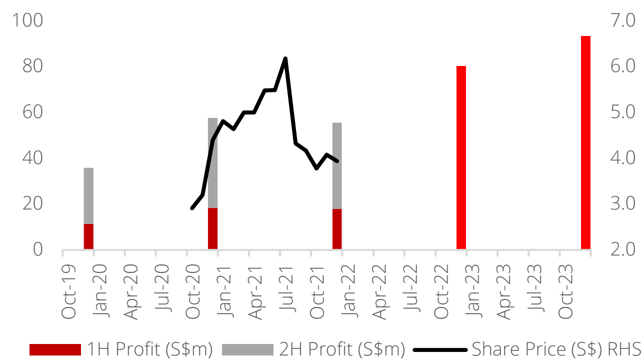
Business update

Sales delayed, not derailed, as demand remains strong. The supply chain disruptions globally, arising from components and chips shortages, coupled with the power crunch in China, have affected the fulfilment of orders for Nanofilm, especially for the Consumer Electronics, Communication, and Computers (3C) segment. While the underlying demand for the 3C segment remains strong, its typical peak season from June to October has been shifted due to the disruptions in the supply chain, to the last quarter of 2021, spilling into 1Q22. The bulk of the orders are pre-orders, and, hence, they need to be fulfilled.

Expect strong earnings growth in FY22F to drive share price recovery. Nanofilm reported a weak set of 1H21 results, affected by the supply chain disruptions and other operational issues. Coupled with the resignation of key executives denting investor confidence, share price plunged about 30%.

Going forward, with the anticipated recovery in the supply chain, we expect the group to book net profit of S$37.7m in 2H21, accounting for 68% of the full year earnings for 2021, similar to 2H20. For FY22F, we project strong earnings growth of 44%. Hence, we expect share price to break out of the current S$3.60-S$4.40 trading range as it tends to move ahead of earnings.

Net profit vs share price

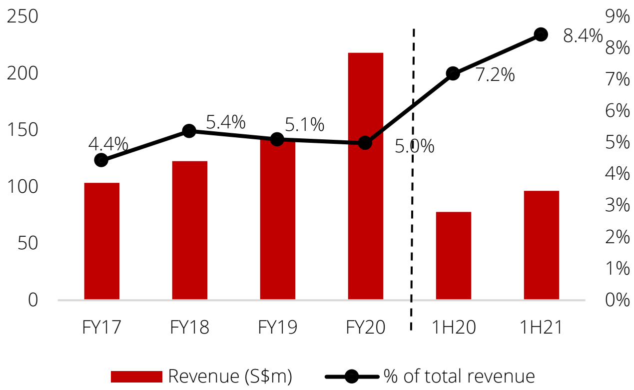


Note: Nanofilm was listed in October 2020

Source: DBS Bank; Company; Bloomberg Finance L.P.

On a longer term basis, the group has been investing in R&D to stay ahead of the curve. R&D and engineering expenses has increased to S$8.1m in 1H21 from S$5.6m in 1H20, accounting for 8.4% of total revenue, up from 7.2% in 1H20. Nanofilm's proprietary technology and nanotechnology solutions are the key differentiating factors from its peers.

R&D and engineering expenses trending higher



Source: DBS Bank; Company

Supply still tight now but expect more broad-based improvement in 2Q22 and likely normalisation in 2023. To address the shortage of chips, chip makers have planned for record levels of capex to boost production capacity. These new capacities are expected to come online in 2022/2023. Hence, we believe the chip shortage could extend into 2023, and 2Q22 should see some broader-based improvement on the supply front. 3Q21 could be the worst quarter, barring any worsening of the COVID-pandemic, as some pockets of improvement are already seen for some components.

Expect smartphone segment to register strong growth; wearables to recover. The smartphone segment is expected to extend its growth in 3Q21 on stable demand and coming from a lower base. Note that the smartphone segment only contributed 13% to total 3C revenue in 1H20 when the group last disclosed its segmental breakdown for the 3C division. Furthermore, the group can also obtain operational leverage from economies of scale.

Growth could resume for the Wearables & Accessories segment, after a decline in 3Q21, as the component shortage issues has improved from 3Q21. The computer segment could see muted growth after a strong 2020 due to the pandemic.

NPI from different divisions to drive growth. We expect more new product introduction (NPI) to go into mass production with the anticipated easing of the supply chain disruptions. Besides 3C, NPI from the Nanofabrication Business Unit (NFBU), including optical lens and sensory components, is expected to contribute significantly. In 3Q21, NFBU commenced mass production of its first micro-lens array (MLA) project for new-generation wearables. This is expected to contribute positively to the performance of NFBU. We expect growing contribution from this segment.

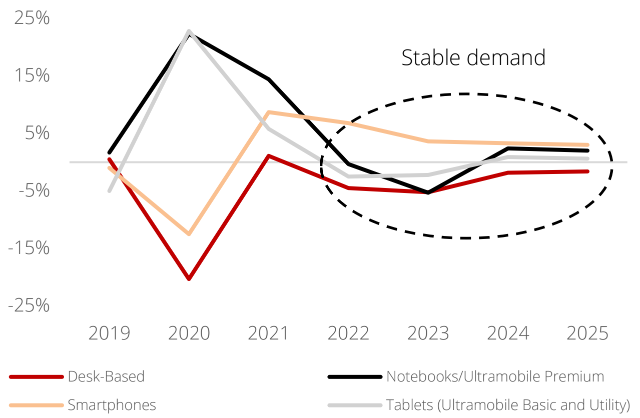
Performance of the 3C industry

Accounts for c.66% of total revenue. For the 9-month period, 3C contributed about 66% of the group's total revenue. The Smartphone category registered substantial growth, offsetting the declines in the Wearables & Accessories and Computer categories.

Growth for Nanofilm to outpace industry on market share gain and extension of product range. We expect Nanofilm to grow at a faster rate than the industry, as the group is able to gain more market share and also to extend the product range from customers, on increasing adoption of nano technology solutions.

Expect slower growth rate ahead for industry, due to cyclicality and shift in spending. We are anticipating the growth of the 3C market to moderate down from the high base in 2020 and 2021, propelled by COVID-19. We also believe that some of the growth could be redirected by a shift in consumer spending preferences towards leisure and hospitality as economies reopen. Nevertheless, with the increased digital penetration of economies, these elevated levels of demand should continue.

Y-o-Y Growth for Device Shipments



Source: DBS Bank; Company

Charts/graphics created by DBS Bank based on Gartner research. Source: Gartner, Inc., Forecast Analysis: PCs, Ultramobiles and Mobile Phones, Worldwide, Ranjit Atwal, et al, 13 October 2021; Forecast: Servers, All Countries, 2019-2025, 3Q21 Update, Kiyomi Yamada, et al, 24 September 2021

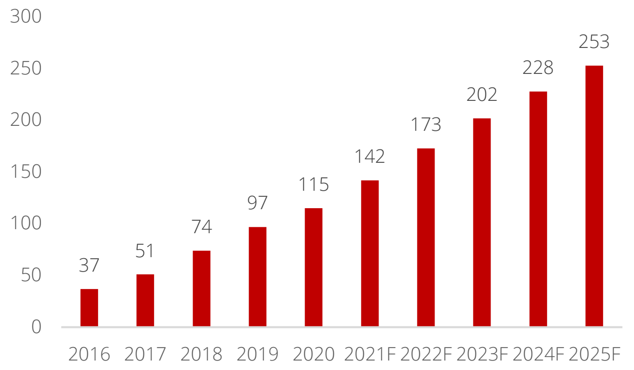
5G to drive demand for smartphone. 5G is expected to drive demand for smartphones. The transition to 5G has begun and it is currently still in the nascent stage of adoption. Gartner estimates that the percentage of 5G phones sold will rise from 16% in 2020 to 79% in 2025. With greater adoption going forward, this would in turn propel smartphone sales. The strong upgrades driven by 5G adoption and the buildup of upgrades due to pushback decisions early in 2020 is expected to lay the foundation for further growth.

However, this 5G smartphone increase will not be a growth driver across markets globally. Only markets already in the countrywide deployment of 5G or in the early stage of large-scale 5G deployment, including China, mature Asia/Pacific markets, North America, and Western Europe will see smartphone buyers preferring a 5G smartphone. Overall, smartphone shipment is projected to register average growth of 4.2% during the 2022-2025 period.

Structural change driving demand for PCs and tablets. As we pivoted work/school-from-home to manage the COVID-19 pandemic, the demand for PCs and tablets surged. We believe the installed base will remain high and expect demand to be driven by the normalisation of telecommuting and incorporation of flexible working arrangements. However, growth would be muted after the strong base in 2020 and 2021.

Wearables to grow at 5-year CAGR of 17%. According to Statista, worldwide smartwatch shipments is projected to register a 2020-2025 CAGR of 17%.

Smartwatch shipments forecast worldwide (mil units)



Source: Statista; DBS Bank

Maiden revenue contribution from Sydrogen in 2022; meaningful contribution only in medium term. Sydrogen has already commenced work in Shanghai and Singapore. To prepare for commercial opportunities in China, Sydrogen is commissioning and installing its initial pilot production line at the group's Shanghai Plant 2 for customer qualification in an automotive project involving a key component for a hydrogen fuel cell stack. Sydrogen is working towards a maiden revenue contribution in 2022. However, meaningful contribution can only be expected in the medium to long term.

Ample room for expansion with the new Shanghai plant 2. The Shanghai plants contribute about 80% of total production, with the bulk still from the existing plant 1. There is still a lot of room for expansion in plant 2, which is currently running at low utilisation rate, and has a much bigger production space of c.66,000 sqm, as compared to total gross floor area across all its production facilities of c.110,000 sqm.

Risks. The recent discovery of the new Omicron variant could further aggravate the already strained supply chain situation, which could lead to a much longer waiting time for chips and components, dampening demand and order fulfilment.

Earnings and Recommendation

PE valuation back to square one. The share price has been locked in a trading range since the c.30% plunge in August on the back of weak 1H21results and the resignation of key executives denting investor confidence. At current price, Nanofim is trading at a 32.8x PE on FY22F earnings, near its valuation when it was listed in October 2020 and is also below its -1SD of its average PE since listing.

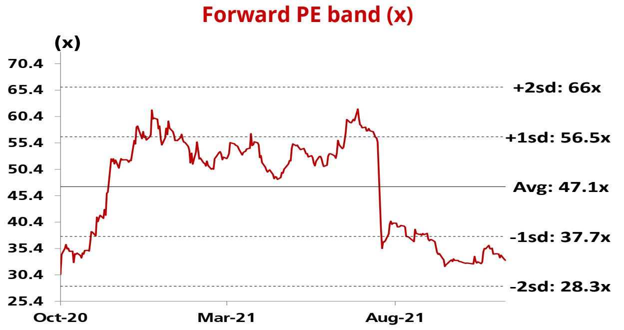
Upgrade to BUY on anticipated improvement in supply chain situation. On the back of the anticipated improvement in the supply chain situation, Nanofilm would be in a better position to fulfil its order backlog. Hence, we upgrade the stock to BUY from HOLD. We expect some of the current orders to flow to next year given the current tight supply situation. Overall, the group is projected to register strong earnings growth of 44% in FY22F and another 16% in FY23F.

TP raised to S$4.96. Our TP is raised to S$4.96 (previously S$4.05), pegged to a higher PEG of 0.92x (vs 0.75 previously), which is still at a 25% discount to peers on FY22F earnings, as the supply disruption situation, although shows some pockets of improvement, is not out of the woods yet. The implied PE for FY21F/FY22F/FY23F works out to 58.8x/40.7x/35x.

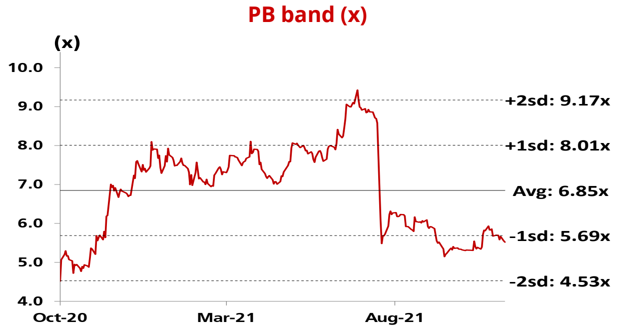
Company Background

Nanofilm is a leading provider of nanotechnology solutions in Asia, leveraging its proprietary technologies, core competencies in R&D, engineering, and production to provide technology-based solutions across a wide range of industries.

Historical PE and PB band



Source: Bloomberg Finance L.P., DBS Bank estimates



Source: Bloomberg Finance L.P., DBS Bank estimates

Key Assumptions

FY Dec	2019A	2020A	2021F	2022F	2023F
Revenue Growth (%)	16.3	52.8	13.8	33.9	16.3
EBITDA Margin (%)	40.0	44.4	44.6	45.8	46.0

Segmental Breakdown

FY Dec	2019A	2020A	2021F	2022F	2023F
Revenues (S$m)					
Advanced Materials	110	182	206	282	330
Nanofabrication	5.91	11.3	5.63	6.75	8.10
Industrial Equipment	27.4	24.6	36.9	44.3	48.7
Total	143	218	249	333	387

Income Statement (S$m)

FY Dec	2019A	2020A	2021F	2022F	2023F
Revenue	143	218	249	333	387
Cost of Goods Sold	(65.2)	(98.6)	(124)	(160)	(186)
Gross Profit	77.7	120	124	173	201
Other Opng (Exp)/Inc	(38.8)	(52.7)	(55.9)	(74.9)	(87.0)
Operating Profit	38.9	67.1	68.3	98.1	114
Other Non Opg (Exp)/Inc	1.91	4.18	0.0	0.0	0.0
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(0.9)	(1.1)	(1.1)	(1.1)	(1.1)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	39.9	70.3	67.3	97.1	113
Tax	(5.4)	(12.2)	(11.7)	(16.9)	(19.7)
Minority Interest	1.21	(0.5)	0.0	0.0	0.0
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	35.8	57.6	55.6	80.2	93.4
Net Profit before Except.	35.8	57.6	55.6	80.2	93.4
EBITDA	55.6	90.3	86.7	129	150
Growth					
Revenue Gth (%)	16.3	52.8	13.8	33.9	16.3
EBITDA Gth (%)	11.2	62.5	(4.0)	48.9	16.2
Opg Profit Gth (%)	9.5	72.8	1.8	43.6	16.3
Net Profit Gth (Pre-ex) (%)	22.0	61.1	(3.5)	44.3	16.5
Margins & Ratio					
Gross Margins (%)	54.3	54.9	50.0	52.0	52.0
Opg Profit Margin (%)	27.2	30.8	27.5	29.5	29.5
Net Profit Margin (%)	25.0	26.4	22.4	24.1	24.1
ROAE (%)	32.7	20.9	12.3	15.8	16.2
ROA (%)	16.9	14.7	9.6	12.4	12.7
ROCE (%)	20.5	17.0	10.8	14.2	14.7
Div Payout Ratio (%)	26.7	16.5	20.0	20.0	20.0
Net Interest Cover (x)	44.7	64.1	65.2	93.6	108.9

Source: Company, DBS Bank

Interim Income Statement (S$m)

FY Dec	1H2019	2H2019	1H2020	2H2020	1H2021
Revenue	55.2	87.7	77.8	141	96.6
Cost of Goods Sold	(26.7)	(38.6)	(36.9)	(61.6)	(52.1)
Gross Profit	28.6	49.1	40.9	78.9	44.6
Other Oper. (Exp)/Inc	(15.3)	(21.6)	(17.6)	(30.8)	(23.5)
Operating Profit	13.3	27.5	23.3	48.0	21.0
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)	(0.7)	(0.3)	0.20
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	12.9	27.0	22.6	47.7	21.2
Tax	(2.0)	(3.4)	(4.0)	(8.2)	(3.1)
Minority Interest	0.51	0.70	(0.2)	(0.3)	(0.2)
Net Profit	11.4	24.4	18.4	39.2	17.9
Net profit bef Except.	11.4	24.4	18.4	39.2	17.9
EBITDA	20.4	35.2	31.9	58.4	33.0
Growth					
Revenue Gth (%)	nm	58.7	(11.2)	80.5	(31.2)
EBITDA Gth (%)	nm	72.8	(9.3)	82.8	(43.5)
Opg Profit Gth (%)	nm	106.6	(15.2)	106.3	(56.2)
Net Profit Gth (%)	nm	114.2	(24.6)	113.4	(54.4)
Margins					
Gross Margins (%)	51.7	56.0	52.6	56.1	46.1
Opg Profit Margins (%)	24.1	31.3	29.9	34.2	21.8
Net Profit Margins (%)	20.6	27.8	23.6	27.9	18.5

Balance Sheet (S$m)

FY Dec	2019A	2020A	2021F	2022F	2023F
Net Fixed Assets	107	175	237	287	332
Invts in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other LT Assets	17.0	17.8	16.9	16.0	15.1
Cash & ST Invts	25.4	227	227	227	248
Inventory	14.7	15.8	19.2	24.7	28.8
Debtors	58.2	95.7	87.6	117	136
Other Current Assets	11.4	17.7	17.7	17.7	17.7
Total Assets	234	549	605	690	778
ST Debt	3.86	21.4	21.4	21.4	21.4
Creditor	37.0	47.2	53.1	68.2	79.3
Other Current Liab	14.4	19.1	25.0	30.2	33.0
LT Debt	49.9	18.3	18.3	18.3	18.3
Other LT Liabilities	1.33	2.46	2.46	2.46	2.46
Shareholder's Equity	121	431	475	539	614
Minority Interests	6.91	9.59	9.59	9.59	9.59
Total Cap. & Liab.	234	549	605	690	778
Non-Cash Wkg. Capital	32.9	62.9	46.5	61.3	70.5
Net Cash/(Debt)	(28.4)	188	187	187	208
Debtors Turn (avg days)	146.9	128.6	134.6	112.4	119.6
Creditors Turn (avg days)	228.2	193.0	172.6	171.8	179.5
Inventory Turn (avg days)	114.9	70.0	60.3	62.3	65.1
Asset Turnover (x)	0.7	0.6	0.4	0.5	0.5
Current Ratio (x)	2.0	4.1	3.5	3.2	3.2
Quick Ratio (x)	1.5	3.7	3.2	2.9	2.9
Net Debt/Equity (X)	0.2	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	0.2	CASH	CASH	CASH	CASH
Capex to Debt (%)	88.5	202.5	201.3	201.3	201.3

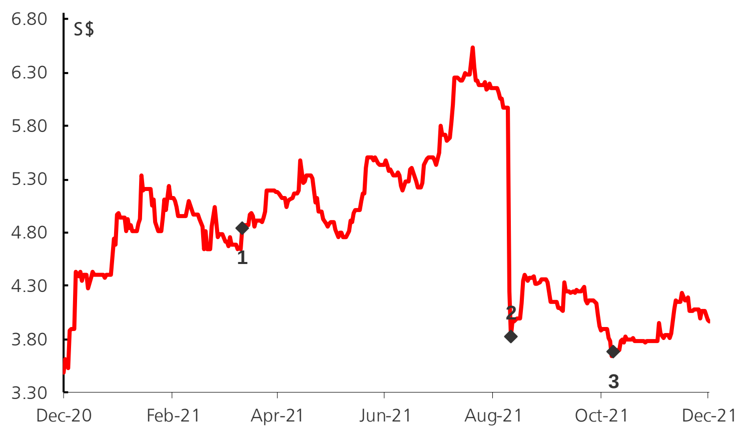
Source: Company, DBS Bank

Cash Flow Statement (S$m)

FY Dec	2019A	2020A	2021F	2022F	2023F
Pre-Tax Profit	39.9	70.3	67.3	97.1	113
Dep. & Amort.	14.8	19.0	18.3	30.9	35.7
Tax Paid	(7.1)	(10.2)	(5.8)	(11.7)	(16.9)
Assoc. & JV Inc/(loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	2.67	(26.1)	10.6	(20.0)	(12.0)
Other Operating CF	2.18	6.11	0.0	0.0	0.0
Net Operating CF	52.5	59.0	90.4	96.2	120
Capital Exp.(net)	(47.6)	(80.5)	(80.0)	(80.0)	(80.0)
Other Invts.(net)	0.0	0.0	0.0	0.0	0.0
Invts in Assoc. & JV	2.61	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	(0.3)	0.0	0.0	0.0	0.0
Net Investing CF	(45.3)	(80.5)	(80.0)	(80.0)	(80.0)
Div Paid	(9.5)	(9.6)	(11.1)	(16.0)	(18.7)
Chg in Gross Debt	3.95	35.3	0.0	0.0	0.0
Capital Issues	0.0	206	0.0	0.0	0.0
Other Financing CF	(1.6)	(9.9)	0.0	0.0	0.0
Net Financing CF	(7.2)	222	(11.1)	(16.0)	(18.7)
Currency Adjustments	(0.5)	1.10	0.0	0.0	0.0
Chg in Cash	(0.5)	202	(0.8)	0.19	21.2
Opg CFPS (S cts)	7.57	12.9	12.1	17.7	20.0
Free CFPS (S cts)	0.74	(3.3)	1.57	2.47	6.06

Source: Company, DBS Bank

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	18 Mar 21	4.84	6.22	BUY
2:	17 Aug 21	3.82	4.18	HOLD
3:	14 Oct 21	3.68	4.05	HOLD

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

Source: DBS Bank

Analyst: *Lee Keng LING*

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

**Share price appreciation + dividends*

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Sources for all charts and tables are DBS Bank unless otherwise specified.

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