

Valuetronics (VALUE SP)

Decent showing despite headwinds

Core 2QFY19 met expectations; TP -9% on macro headwinds

Despite a 1.3% YoY fall in revenue, 2QFY19 core PATMI (+14% YoY) met our expectation driven by a favourable product mix and FX gain. While management's tone suggests business momentum is intact for FY19E, we conservatively shave FY19-21E core EPS by 4-7% as: i) smart-lighting recovery could fall short of our expectation; and ii) other businesses could slow if the trade war escalates. Accordingly, our ROE-g/COE-g TP is lowered 9% to SGD0.96 based on 2.1x FY19E P/B from 2.3x previously. We like the stock due to attractive FY19-21E dividend yields of 6-8%, and strong balance sheet (zero debt) with cash equal to 48% of market cap. Maintain BUY.

Strong ICE momentum; smart-lighting grew QoQ

The printing and automotive businesses drove 21% YoY revenue growth in the Industrial and Commercial Electronics (ICE) segment for the quarter. Momentum from these two businesses should continue throughout FY19E. Consumer Electronics (CE) revenue fell 22% YoY, due to high-base effects for smart-lighting sales, and lost production from the Danshui flooding incident. That said, smart-lighting is recovering, evidenced by CE's 11% QoQ revenue growth.

Update on trade war and components shortages

Based on the most recent data, 20% of VALUE's revenues are impacted by tariffs. Nevertheless, VALUE has not seen a slowdown from affected customers, nor does it believe they are frontloading sales ahead of the potential tariff hike in Jan-19. VALUE is helping customers explore solutions to mitigate tariffs, including potentially relocating assembly processes outside China. On components supply, VALUE is observing normalised lead times and pricing for passive components.

One-off provisioning for Danshui plant

VALUE booked a one-off provision of HKD13.6m in the quarter relating to the Danshui flooding incident. This is management's best estimate of non-recoverable costs after filing the insurance claim. Management attributes the bulk of this to raw materials inventories destroyed in the flood.

FYE Mar (HKD m)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue	2,275	2,854	2,905	3,153	3,427
EBITDA	204	268	260	281	308
Core net profit	154	205	196	212	234
Core EPS (HKD)	0.37	0.48	0.46	0.49	0.54
Core EPS growth (%)	27.1	30.7	(5.2)	8.0	10.5
Net DPS (HKD)	0.20	0.27	0.23	0.27	0.30
Core P/E (x)	10.1	13.4	8.5	7.8	7.1
P/BV (x)	1.7	2.6	1.4	1.3	1.2
Net dividend yield (%)	5.4	4.2	5.9	7.0	7.8
ROAE (%)	17.2	20.5	16.5	17.7	17.8
ROAA (%)	9.3	10.8	9.8	10.0	10.3
EV/EBITDA (x)	3.7	7.7	3.4	3.1	2.4
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Consensus net profit	-	-	209	228	247
MKE vs. Consensus (%)	-	-	(12.5)	(7.2)	(5.3)

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BUY

Share Price	SGD 0.68
12m Price Target	SGD 0.96 (+41%)
Previous Price Target	SGD 1.05

Company Description

Valuetronics is a HK based electronics manufacturing services provider with two facilities in China.

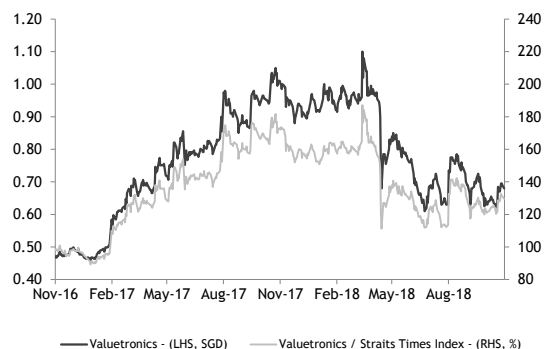
Statistics

52w high/low (SGD)	1.10/0.61
3m avg turnover (USDm)	1.8
Free float (%)	70.1
Issued shares (m)	434
Market capitalisation	SGD295.1M
	USD213M

Major shareholders:

TSE CHONG HING	17.5%
CHOW KOK KIT	7.4%
HSBC Global Asset Management (Hong Kong)	5.0%

Price Performance



	-1M	-3M	-12M
Absolute (%)	5	8	(33)
Relative to index (%)	4	15	(25)

Source: FactSet

Revisions to estimates

Fig 1: MKE forecast revisions for VALUE

	FY19E			FY20E			FY21E		
	New	Old	Chg (%)	New	Old	Chg (%)	New	Old	Chg (%)
Revenue (HKDm)	2,904.8	2,987.9	-2.8	3,153.1	3,309.3	-4.7	3,426.7	3,612.9	-5.2
Gross profit (HKDm)	412.6	426.1	-3.0	446.2	470.9	-5.1	483.2	512.4	-5.6
EBIT (HKDm)	219.4	230.0	-4.4	238.7	255.9	-6.5	263.6	283.9	-7.0
EBITDA (HKDm)	259.9	270.0	-3.7	281.2	297.9	-5.6	308.1	327.9	-6.0
Core PATMI (HKDm)	196.1	203.9	-3.7	211.7	227.0	-6.6	233.9	252.0	-7.0
Core EPS (HKD)	0.46	0.47	-3.7	0.49	0.53	-6.6	0.54	0.59	-7.0
			Chg (ppt)			Chg (ppt)			Chg (ppt)
Gross margin	14.2%	14.3%	0.0	14.2%	14.2%	-0.1	14.1%	14.2%	-0.1
SGA as % of sales	7.1%	7.0%	0.1	6.9%	6.8%	0.1	6.7%	6.6%	0.1

Source: Maybank Kim Eng

While management's tone suggests business momentum is largely intact for the rest of FY19E, we have proactively shaved FY19-21E core EPS by 4-7%. This reflects: i) our more conservative expectations on the extent of a smart-lighting recovery; and ii) the possibility other businesses may slow in the event the trade war escalates.

Our ROE-g/COE-g TP is lowered 9%, now based on 2.1x FY19E P/B (prev: 2.3x), based on FY19-21E average adjusted ROE of 20% and LTG of 2%.

Takeaways from 2QFY19 results:

2QFY19 core PATMI of HKD57.3m (+14% YoY) met our expectation. Core earnings growth was driven by: i) a 0.5ppt YoY increase in gross margin to 14.9% due to favourable product mix; and ii) a swing of HKD4.4m to net FX gain of HKD2.8m from net FX loss of HKD1.6m a year ago.

Results breakdown:

- Revenue:** Sales fell 1.3% YoY as growth in the ICE segment (+21.4% YoY) was offset by declines in the CE segment (-22% YoY). ICE growth was driven by the printing and the automotive businesses, and management expects the momentum from these two to continue driving segmental growth this year. Meanwhile, the CE segment was impacted by: i) high base-effects from the smart lighting business; and ii) production disruptions at VALUE's Danshui factory due to Typhoon Mangkhut. The smart-lighting sales bottomed last quarter, evidenced by the 11% QoQ recovery in CE revenue.
- Updates on trade war and components shortages:** Management has updated that around 20% of revenues are impacted by tariffs. This is a revised figure from the 10% guided previously, as more customers have come forward to update VALUE that they are impacted. Nevertheless, VALUE has not observed a slowdown in momentum thus far. Management also believes customers are not frontloading sales ahead of the potential hike in tariffs to 25% from 10% come Jan-19. VALUE and its customers are proactively exploring solutions to mitigate tariffs, including potentially relocating the assembly process of some products outside China.

On components shortages, VALUE has observed some pricing relief for passive components for MLCCs but points out that supply for certain ICs from Korean and Japanese suppliers remain tight.

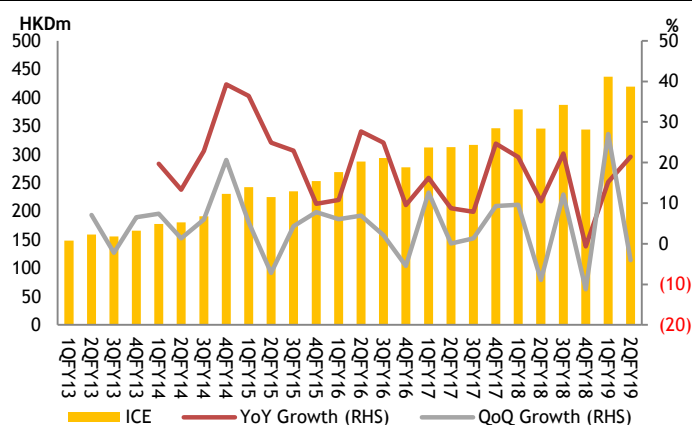
- **One-off provisioning:** VALUE booked a one-off provision of HKD13.6m in the quarter relating to the Danshui flooding incident. Management has filed an insurance claim for the damages suffered in the flash flooding. The provision is management's best estimate for non-recoverable costs from the flooding. Management said the bulk of this relates to non-finished goods inventories destroyed in the flood. Accounting for this provision, 2QFY19 headline PATMI was lower 12.8% YoY.

Fig 2: 2QFY19 P&L summary

FYE Mar	2QFY19 (HKD m)	2QFY18 (HKD m)	1QFY19 (HKD m)	YoY Chg (%)	QoQ Chg (%)	FYE (HKD m)	% of FYE
Revenue	716.2	725.7	704.0	-1.3	1.7	2,987.9	47.5
COGS	(609.2)	(620.9)	(601.2)	-1.9	1.3	(2,561.8)	47.2
Gross profit	107.1	104.8	102.8	2.1	4.2	426.1	49.2
Total SGA	(49.9)	(50.2)	(51.8)	-0.5	-3.5	(209.2)	48.6
Other op. inc	7.2	3.3	5.4	113.6	31.4	13.0	96.9
Other op. exp	0.0	0.0	0.0	nm	nm	0.0	nm
EBIT	64.3	58.0	56.5	10.8	13.8	230.0	52.5
EBITDA	75.1	67.0	67.4	12.2	11.4	270.0	52.8
Int. inc	0.0	0.0	0.0	nm	nm	0.0	nm
Int. exp	(0.1)	(0.1)	(0.2)	37.1	-27.3	(0.8)	39.5
Exceptionals	(13.6)	0.0	0.0	nm	nm	0.0	nm
Pretax profit	50.5	57.9	56.3	-12.7	-10.3	229.2	46.6
Inc. tax	(6.2)	(7.1)	(6.6)	-12.2	-6.6	(25.2)	50.9
Net profit	44.3	50.8	49.7	-12.8	-10.7	203.9	59.2
MI	0.0	0.0	0.0	nm	nm	0.0	nm
PATMI	44.3	50.8	49.7	-12.8	-10.7	203.9	46.1
Core PATMI	57.9	50.8	49.7	14.0	16.7	203.9	52.8
Core EPS (HKD)	0.13	0.12	0.12	12.9	17.2	0.47	52.6
					Change (ppt)		
Gross margin	14.9%	14.4%	14.6%	0.5	0.3	14.3%	
EBIT margin	9.0%	8.0%	8.0%	1.0	0.9	7.7%	
Core net margin	8.1%	7.0%	7.1%	1.1	1.0	6.8%	

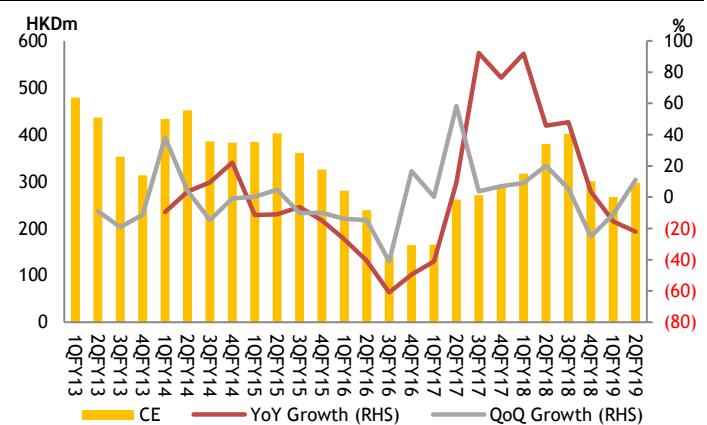
Source: Company, Maybank Kim Eng estimates

Fig 3: ICE has a solid track record of delivering double-digit YoY revenue growth



Source: Company

Fig 4: CE revenue is picking up QoQ now that smart-lighting is recovering



Source: Company

Fig 5: Peer comparisons

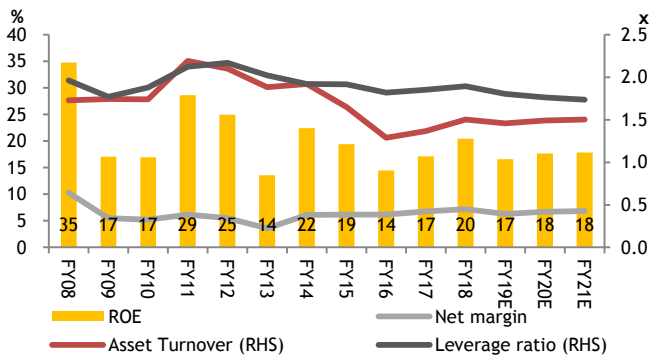
Company	BBG Code	MKE Rec	MKE TP (LC)	Price (LC)	FYE mm/dd	Mcap USDm	P/E (x)			EV /EBITDA (x) FY1	Div yield (%) FY1	ROE (%) FY1	
							Act	FY1	FY2				FY3
Valuetronics	VALUE SP	BUY	0.96	0.68	03/31	217	8.1	8.5	7.9	7.1	3.4	5.9	16.6
Singapore listed EMS and precision engineering peers													
Venture Corp	VMS SP	Buy	22.23	14.70	12/31	3,084	11.1	12.1	11.1	10.8	7.8	4.4	15.7
Sunningdale Tech	SUNN SP	NR	-	1.41	12/31	195	8.6	11.1	10.1	8.9	4.0	3.5	6.4
Memtech Int'l	MTEC SP	NR	-	0.79	12/31	82	6.7	7.8	6.7	5.7	2.5	5.8	9.2
HI-P Int'l	HIP SP	Hold	0.84	0.85	12/31	544	5.6	8.8	11.1	11.6	3.7	2.4	15.1
Average							10.1	11.4	10.8	10.5	6.7	4.2	15.1
High mix low volume EMS peers													
Benchmark Elec	BHE US	NR	-	23.75	12/31	1,038	18.2	17.1	14.3	14.3	-	-	-
Plexus	PLXS US	NR	-	58.19	09/29	1,853	18.0	15.1	13.4	11.5	9.1	-	13.0
Average							18.1	15.8	13.7	12.5	9.1	0.0	13.0
Global EMS peers													
Hon Hai	2317 TT	NR	-	76.10	12/31	34,247	7.8	8.6	8.1	7.2	4.9	4.8	10.5
Flex	FLEX US	NR	-	8.22	03/31	4,329	7.5	7.5	6.7	5.6	4.5	0.0	17.1
Jabil	JBL US	NR	-	25.29	08/31	4,094	9.7	8.5	7.6	7.1	3.4	1.4	24.3
Pegatron	2938 TT	NR	-	52.20	12/31	4,427	9.2	10.0	8.7	7.8	3.2	6.9	9.3
SKP Resources	SKP MK	NR	-	1.23	03/31	368	12.0	11.4	9.5	7.6	6.5	4.3	21.5
V.S. Industry	VSI MK	Buy	1.95	1.57	07/31	666	17.3	13.9	11.5	11.1	7.6	3.6	-
Sanmina	SANM	NR	-	25.43	09/29	1,728	11.5	9.0	8.0	7.3	-	0.0	-
FIH Mobile	2038 HK	NR	-	0.75	12/31	775	-	-	-	-	nm	0.0	-
Celestica	CLS CN	NR	-	13.64	12/31	1,228	9.3	9.6	8.3	7.1	5.5	0.0	10.8
UMC Electronics	6615 JP	NR	-	2,254	03/31	380	23.9	24.0	16.6	13.1	-	1.3	6.1
Fabrinet	FN US	NR	-	51.16	06/29	1,884	17.2	14.1	13.0	11.0	-	nm	-
Average							8.8	9.0	8.3	7.4	4.7	4.6	12.2

Source: FactSet, Bloomberg, Maybank Kim Eng

Value Proposition

- EMS company that manufactures products, such as IOT bulbs and in-car connectivity modules, which are in the early part of their product life cycles.
- For certain high mix, low-volume projects, VALUE receives lump-sum pricing, which tend to have better margins. High-mix products make up half of revenues.
- Strengths are design-for-manufacturing and flexibility in adapting to timing & production needs of customers.
- Consistently delivered double-digit ROEs.

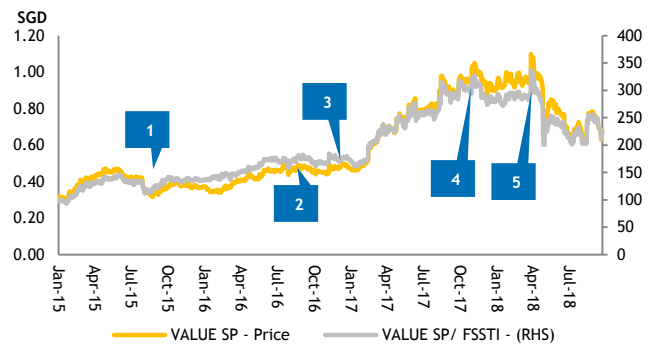
Decade-long double-digit ROEs



Source: Company, Maybank Kim Eng

Price Drivers

Historical share price trend



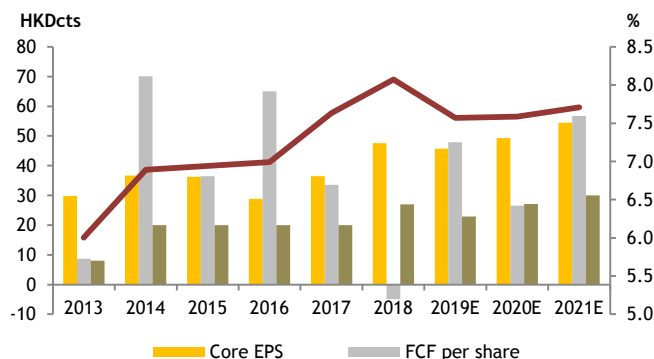
Source: Company, Maybank Kim Eng, FactSet

1. Phased out mass-market LED lighting business. Share price lacklustre during this time.
2. IOT lighting began contributing to revenue.
3. Net profit increased 70% in 3QFY17 due to IOT lighting demand and operating leverage.
4. Automotive contracts powered fourth consecutive quarter of growth in ICE.
5. Surprise quarterly earnings miss by key lighting customer.

Financial Metrics

- FY19-21E EPS CAGR of 9% to be underpinned by continued growth of in-car connectivity modules and IOT bulbs.
- Acquired SMT machines in 1HFY18 to cater to new and existing customers.
- Cash of HKD798.2m as of 2QFY19 with no debt.
- Strong FCF in FY19-21E to support dividends and potential M&A.
- Dividend yields of 6-8% forecast during FY19-21E.

EPS, FCF per share, DPS, EBIT margins



Source: Company, Maybank Kim Eng

Swing Factors

Upside

- Better-than-expected growth of IOT bulbs and in-car connectivity modules.
- New customer acquisitions in ICE.
- Operating leverage from increased production.

Downside

- Weaker-than-expected end-demand for products that are customer or industry specific, as well as driven by adverse economic factors.
- Cost increases for labour and materials.
- Unforeseen pricing erosion for key products.

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FYE 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
Key Metrics					
P/E (reported) (x)	7.4	10.6	9.1	7.8	7.1
Core P/E (x)	10.1	13.4	8.5	7.8	7.1
P/BV (x)	1.7	2.6	1.4	1.3	1.2
P/NTA (x)	1.7	2.6	1.4	1.3	1.2
Net dividend yield (%)	5.4	4.2	5.9	7.0	7.8
FCF yield (%)	9.0	nm	12.4	6.9	14.7
EV/EBITDA (x)	3.7	7.7	3.4	3.1	2.4
EV/EBIT (x)	4.3	9.0	4.0	3.6	2.8

INCOME STATEMENT (HKD m)

Revenue	2,274.9	2,853.7	2,904.8	3,153.1	3,426.7
Gross profit	341.7	414.6	412.6	446.2	483.2
EBITDA	204.2	268.4	259.9	281.2	308.1
Depreciation	(30.2)	(37.5)	(40.0)	(42.0)	(44.0)
Amortisation	(0.5)	(0.5)	(0.5)	(0.5)	(0.5)
EBIT	173.6	230.4	219.4	238.7	263.6
Net interest income / (exp)	(0.6)	(0.7)	(0.8)	(0.8)	(0.8)
Associates & JV	0.0	0.0	0.0	0.0	0.0
Exceptionals	0.0	0.0	(13.6)	0.0	0.0
Other pretax income	0.0	0.0	0.0	0.0	0.0
Pretax profit	173.0	229.7	205.0	237.9	262.8
Income tax	(18.9)	(25.0)	(22.6)	(26.2)	(28.9)
Minorities	0.0	0.0	0.0	0.0	0.0
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	154.1	204.7	182.5	211.7	233.9
Core net profit	154.1	204.7	196.1	211.7	233.9

BALANCE SHEET (HKD m)

Cash & Short Term Investments	807.7	671.1	778.3	785.7	911.5
Accounts receivable	486.3	582.8	547.3	644.9	650.7
Inventory	291.9	385.6	351.8	419.5	419.2
Property, Plant & Equip (net)	157.1	209.6	217.0	230.0	241.0
Intangible assets	17.4	18.7	18.7	18.7	18.7
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	62.6	100.9	104.1	114.1	105.1
Total assets	1,823.0	1,968.8	2,017.1	2,212.8	2,346.2
ST interest bearing debt	0.0	0.0	0.0	0.0	0.0
Accounts payable	484.7	482.9	459.3	549.2	563.6
LT interest bearing debt	0.0	0.0	0.0	0.0	0.0
Other liabilities	400.0	424.0	411.0	411.0	413.0
Total Liabilities	884.4	906.8	870.7	960.6	977.0
Shareholders Equity	938.6	1,062.0	1,146.4	1,252.2	1,369.2
Minority Interest	0.0	0.0	0.0	0.0	0.0
Total shareholder equity	938.6	1,062.0	1,146.4	1,252.2	1,369.2
Total liabilities and equity	1,823.0	1,968.8	2,017.1	2,212.8	2,346.2

CASH FLOW (HKD m)

Pretax profit	173.0	229.7	205.0	237.9	262.8
Depreciation & amortisation	30.6	38.0	40.5	42.5	44.5
Adj net interest (income)/exp	0.0	0.0	0.0	0.0	0.0
Change in working capital	(30.3)	(180.9)	30.1	(85.4)	19.9
Cash taxes paid	(8.9)	(17.5)	(22.6)	(26.2)	(28.9)
Other operating cash flow	0.0	0.0	0.0	0.0	0.0
Cash flow from operations	164.3	69.3	253.1	168.8	298.3
Capex	(23.7)	(90.0)	(47.3)	(55.0)	(55.0)
Free cash flow	140.7	(20.8)	205.7	113.8	243.3
Dividends paid	(75.8)	(116.1)	(98.0)	(105.8)	(117.0)
Equity raised / (purchased)	0.4	4.8	0.0	0.0	0.0
Change in Debt	0.0	0.0	0.0	0.0	0.0
Other invest/financing cash flow	(1.6)	50.2	(0.5)	(0.5)	(0.5)
Effect of exch rate changes	0.0	0.0	0.0	0.0	0.0
Net cash flow	63.7	(81.9)	107.2	7.4	125.8

FYE 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
Key Ratios					
Growth ratios (%)					
Revenue growth	16.5	25.4	1.8	8.5	8.7
EBITDA growth	17.8	31.4	(3.2)	8.2	9.6
EBIT growth	27.2	32.7	(4.8)	8.8	10.5
Pretax growth	27.5	32.8	(10.8)	16.0	10.5
Reported net profit growth	27.9	32.9	(10.9)	16.0	10.5
Core net profit growth	27.9	32.9	(4.2)	8.0	10.5
Profitability ratios (%)					
EBITDA margin	9.0	9.4	8.9	8.9	9.0
EBIT margin	7.6	8.1	7.6	7.6	7.7
Pretax profit margin	7.6	8.1	7.1	7.5	7.7
Payout ratio	54.4	56.1	53.7	55.0	55.0
DuPont analysis					
Net profit margin (%)	6.8	7.2	6.3	6.7	6.8
Revenue/Assets (x)	1.2	1.4	1.4	1.4	1.5
Assets/Equity (x)	1.9	1.9	1.8	1.8	1.7
ROAE (%)	17.2	20.5	16.5	17.7	17.8
ROAA (%)	9.3	10.8	9.8	10.0	10.3
Liquidity & Efficiency					
Cash conversion cycle	39.5	46.0	55.2	52.3	51.3
Days receivable outstanding	65.6	67.4	70.0	68.1	68.1
Days inventory outstanding	45.7	50.0	53.3	51.3	51.3
Days payables outstanding	71.8	71.4	68.1	67.1	68.1
Dividend cover (x)	1.8	1.8	1.9	1.8	1.8
Current ratio (x)	1.8	1.9	2.0	2.0	2.1
Leverage & Expense Analysis					
Asset/Liability (x)	2.1	2.2	2.3	2.3	2.4
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Net gearing (%) (excl. perps)	net cash	net cash	net cash	net cash	net cash
Net interest cover (x)	nm	nm	nm	nm	nm
Debt/EBITDA (x)	0.0	0.0	0.0	0.0	0.0
Capex/revenue (%)	1.0	3.2	1.6	1.7	1.6
Net debt/ (net cash)	(807.7)	(671.1)	(778.3)	(785.7)	(911.5)

Source: Company; Maybank

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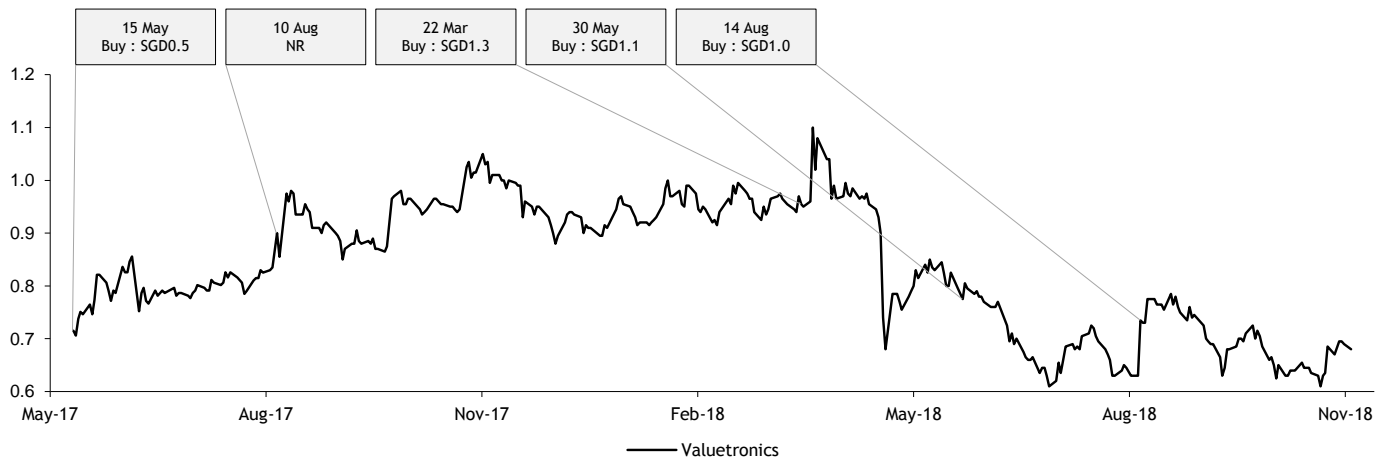
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