

VITROX CORPORATION

(VITRO MK EQUITY, VTRX.KL)

01 Oct 2020



Company report

AmInvestment Bank

www.amequities.com.my

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Rationale for report: Initiation

HOLD

(Initiation)

Price	RM12.20
Fair Value	RM10.56
52-week High/Low	RM13.34/RM6.09

Key Changes

Fair value	Initiation
EPS	Initiation

YE to Dec	FY19	FY20F	FY21F	FY22F
Revenue (RM mil)	339.6	380.7	438.6	500.9
Core net profit (RM mil)	79.7	100.5	120.1	142.1
FD Core EPS (sen)	16.9	21.3	25.5	30.2
FD Core EPS growth (%)	(24.6)	26.2	19.5	18.3
Consensus Net Profit (RM mil)	-	106.8	132.3	154.7
DPS (sen)	4.3	5.3	6.4	7.5
PE (x)	72.1	57.2	47.8	40.4
EV/EBITDA (x)	64.6	53.1	44.5	37.5
Div yield (%)	0.3	0.4	0.5	0.6
ROE (%)	17.8	19.6	20.4	20.7
Net Gearing (%)	nm	nm	nm	nm

Stock and Financial Data

Shares Outstanding (million)	472.0
Market Cap (RM mil)	5,757.9
Book Value (RM/share)	1.02
P/BV (x)	11.9
ROE (%)	17.8
Net Gearing (%)	-

Major Shareholders	Chu Jenn Weng (26.9%) Siaw Kok Tong (19.1%) Yeoh Shin Hoong (10.3%)
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Free Float	29.0
Avg Daily Value (RM mil)	4.0

Price performance	3mth	6mth	12mth
Absolute (%)	33.5	71.1	62.2
Relative (%)	33.1	53.6	70.8



Investment Highlights

- We initiate coverage on ViTrox Corp (ViTrox) with a HOLD recommendation. Our fair value of RM10.56/share is pegged to an FY22F PE of 35x, a premium above its local market-cap weighted average PE due to its technology leadership which will benefit from higher semiconductor back-end demand riding on the adoption of 5G, artificial intelligence (AI) and Industry 4.0 developments.
- We expect the group to register net profits of RM101mil, RM120mil and RM142mil respectively in FY20F–FY22F, representing earnings growth of 26%, 19% and 18% YoY respectively.
- ViTrox is principally involved in the development of 3D and line scan vision inspection system and system-on-chip embedded electronic devices for the semiconductor and electronics packaging industries.
- As at FY2019, the group has 504 customers where 73% of its products and services are exported to more than 40 countries in the world with applications in customer segments such as telecommunication, automotive, mobile devices, computing, consumer, industrial and medical.
- ViTrox's key investment merits are as follows:
 - i) Market diversification targeting high-growth regions i.e. Taiwan and China;
 - ii) Focus on product innovation to strengthen portfolio offerings;
 - iii) Drive improvements in end-to-end lead time.
- After a weaker 1HFY20 impacted by the effects of the virus pandemic, we are optimistic of a gradual earnings recovery in 2HFY20 supported by a robust pipeline for its key business units. Growth will be underpinned by Taiwan and China while other regions see a comeback in orders after being hit by Covid-19 uncertainties.
- We like ViTrox as we believe that its leadership in machine vision system (MVS) and automated board inspection (ABI) business units, and focus on product innovation to strengthen its product offerings will benefit from the adoption of technological megatrends aforementioned. However, we are cautious in the near term due to uncertainties relating to the Covid-19 pandemic as well as the US-China trade war. We believe that the stock is fairly valued at its current price.

COMPANY OVERVIEW

Company background

ViTrox was established in 2000 and later converted into a public limited company under the name ViTrox Corporation Bhd in 2004. As at 2 April 2020, the group has six wholly-owned subsidiaries and one associate company (Exhibit 1). The group also holds a 35% effective interest in Penang Automation Cluster Sdn Bhd (PAC) in a joint venture with Pentamaster Technology Sdn Bhd and Walta Engineering Sdn Bhd, which aims to create the first world-class SME precision metal fabrication hub in Penang for small and medium enterprises (SMEs), multinational corporations (MNCs) and large local companies (LLCs).

EXHIBIT 1: CORPORATE STRUCTURE



Source: Company

Management profile

Designation	Name	Background
Chairman / Independent non-executive director	Datuk Seri Dr Kiew Kwong Sen	<ul style="list-style-type: none"> First appointed to the board in July 2005. Qualifications: (i) Bachelor of Science in Mechanical Engineering from National Taiwan University; (ii) Master of Science in Industrial Engineering from the University of California, Berkeley, USA; and (iii) honorary doctorate by Toyohashi University of Technology, Japan. Working experience: (i) product line manager at Hewlett-Packard (Malaysia) Sdn Bhd (1975–1984); (ii) offshore manufacturing manager, Hewlett Packard Component Group San Jose California (1983–1998); (iii) president of Gibraltar Semiconductor (2000–present); and (iv) president of Mini-Circuits Malaysia, Taiwan and China (2000–present).
Managing director / President / CEO	Chu Jenn Weng	<ul style="list-style-type: none"> First appointed to the board in July 2005. Qualifications: (i) Bachelor's degree in Electrical and Electronics Engineering from Universiti Sains Malaysia (USM); and (ii) Master of Science in Image Processing from USM. Working experience: specialist engineer at Hewlett-Packard (Malaysia) Sdn Bhd (1993–1999).
Executive director / Executive vice-president	Siaw Kok Tong	<ul style="list-style-type: none"> First appointed to the board in July 2005. Qualifications: Bachelor's degree (first class honours) in Computer Science from USM. Working experience: senior engineer at Hewlett-Packard (Malaysia) Sdn Bhd (1995–1999).
Executive director / Executive vice-president	Yeoh Shin Hoong	<ul style="list-style-type: none"> First appointed to the board in July 2005. Qualifications: Bachelor's degree (first class honours) in Computer Science from USM. Working experience: R&D engineer, ViTrox Technologies Sdn Bhd (1997–present).

SALES PROFILE

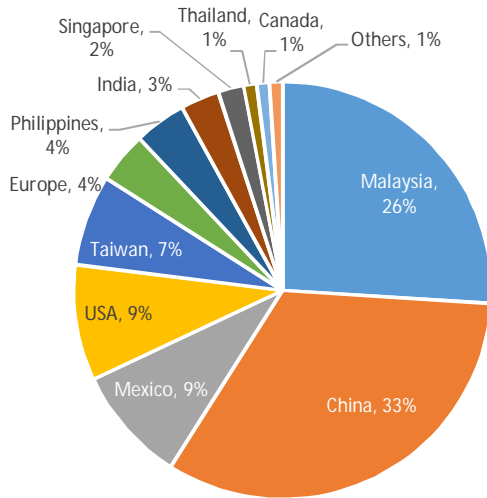
Customer sales distribution

The group’s customers range from outsource assembly and test (OSAT) companies, printed circuit board manufacturers, electronics assembly companies, original equipment manufacturers (OEM), original design manufacturers (ODM), electronics manufacturing services (EMS) providers and contract manufacturers (CM) globally.

In FY19, the group’s worldwide customer base stood at 504 customers and its largest customer contributed 7% of revenue while its top 10 customers contributed 40% of the group revenue. One of the group’s strategies is to diversify its customer base and reduce dependency on a single large customer.

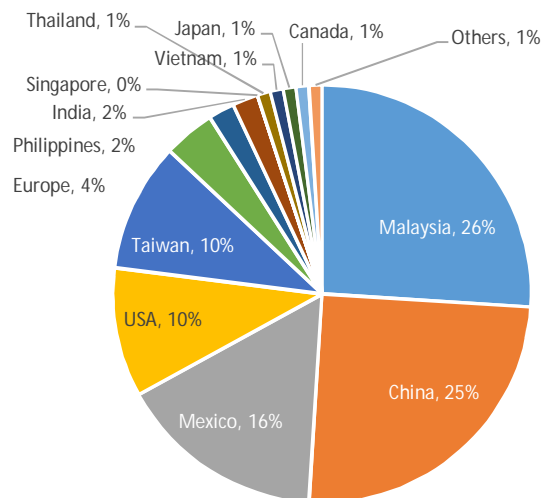
Approximately 26% of the group’s sales are generated locally while the remaining 76% are from exports to more than 40 countries across the world. ViTrox’s sales distribution by country in 2018 and 2019 are shown in Exhibits 2 & 3 respectively. Due to the US-China trade tension, contribution from China shrank while more EMS companies diversifying their bases out of China to mitigate risks has caused an increase in contribution from other regions such as the USA, Mexico and Taiwan.

EXHIBIT 2: SALES DISTRIBUTION BY COUNTRY (2018)



Source: Company, AmlInvestment Bank Bhd

EXHIBIT 3: SALES DISTRIBUTION BY COUNTRY (2019)



Source: Company, AmlInvestment Bank Bhd

Segmental breakdown

ViTrox has four business units namely machine vision system–standard (MVS-S), machine vision system–tray (MVS-T), automated board inspection (ABI) and electronics communication system (ECS).

Business Unit	Description	Examples
Machine vision system–standard (MVS-S)	<ul style="list-style-type: none"> For semiconductor back-end component inspection. Examples: orientation inspection; mark, lead & package inspection; 3D & 5-sided inspection; in-pocket inspection; tape seal inspection; and bottom carrier tape inspection. Process flow for a vision inspection system is shown in Exhibit 4. 	<p>Wi8 i G2 VR20 Li</p>







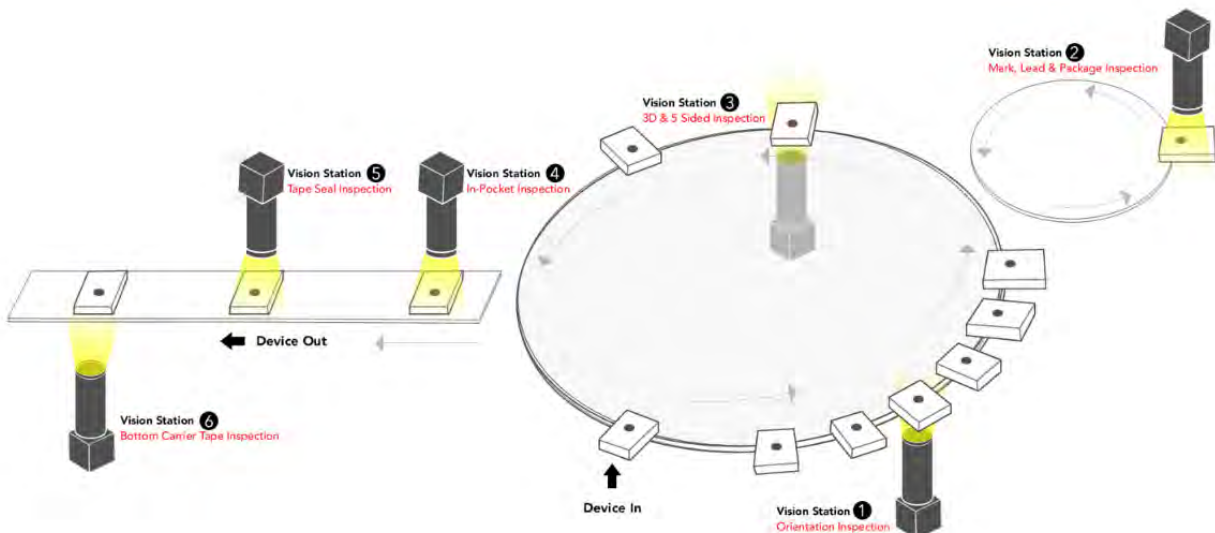
Business Unit	Description	Examples	
Machine vision system–tray (MVS-T)	Tray-based vision handler for semiconductor component inspection, includes tray-to-tray and tray-to-reel handling mechanism.	 <p>TR1100i</p>	 <p>TH2000i</p>
Automated board inspection (ABI)	Optical and x-ray inspection system for electronics board inspection. Examples: advanced 3D paste inspection (API), advanced optical inspection (AOI) and advanced 3D X-ray inspection (AXI).	 <p>V310i</p>	 <p>V810i S2 XLT</p>
Electronics communication system (ECS)	ECS products are for machine automation, and mainly used in data communication and motion control.	 <p>iM4402</p>	 <p>iD1232-14</p>

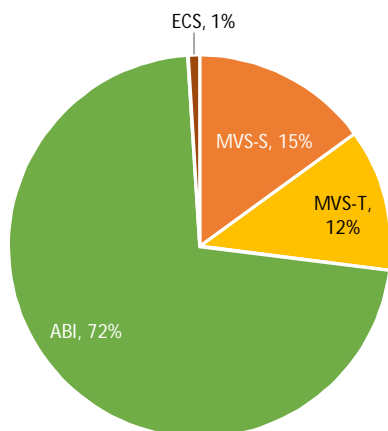
EXHIBIT 4: VISION INSPECTION SYSTEM



Source: Company

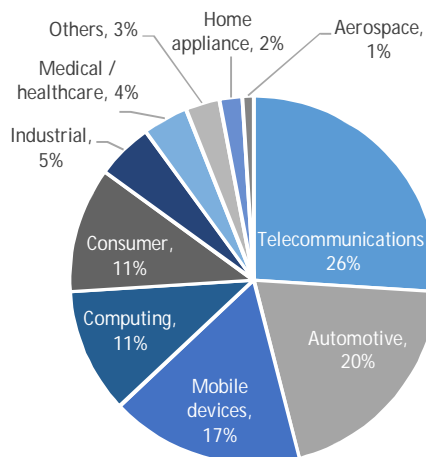
ViTrox's revenue breakdowns by business unit and by customer market segment in FY19 are as follows:

EXHIBIT 5: REVENUE BY BUSINESS UNIT



Source: Company, AmInvestment Bank Bhd

EXHIBIT 6: REVENUE BY CUSTOMER MARKET SEGMENT



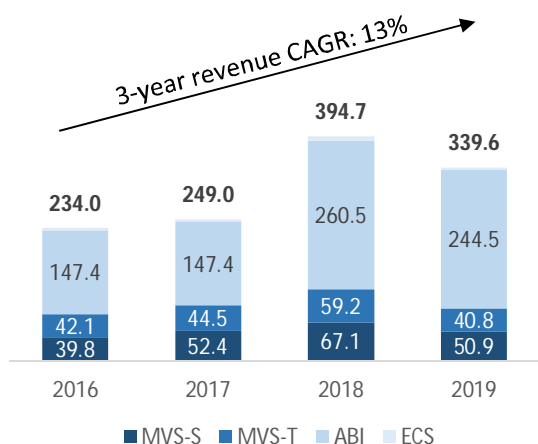
Source: Company, AmInvestment Bank Bhd

FINANCIAL REVIEW

In FY19, group revenue shrank 14% YoY on lower demand from both its ABI and MVS business units as a result of a normalization of end customer demand due to excess inventory build-up and market downturn amid uncertainties arising from the US-China trade war. Consequently, FY19 core profit contracted by 24% YoY due to its less favorable product mix.

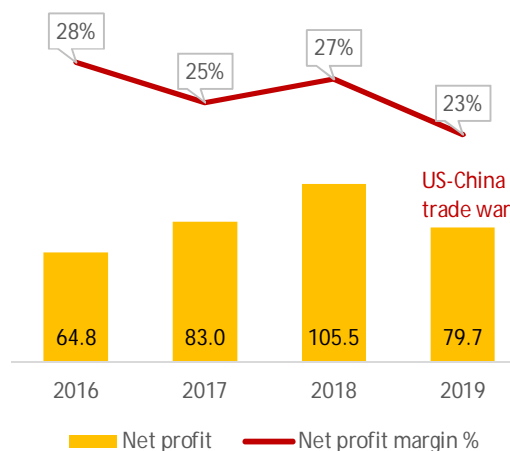
Meanwhile, ViTrox's 1HFY20 core profit declined slightly by 2% YoY due to a change in product mix offsetting cost-saving initiatives taken in 2QFY20. The group saw a 5% YoY increase in revenue as higher MVS-T sales on growth from increased demand of its new product TH-3000i as well as higher demand for its existing products, particularly from customers in Taiwan and China, although partially offset by lower ABI demand impacted by Covid-19-related market uncertainties.

EXHIBIT 7: REVENUE GROWTH



Source: Company, AmInvestment Bank Bhd

EXHIBIT 8: NET PROFIT GROWTH & MARGIN



Source: Company, AmInvestment Bank Bhd

OUTLOOK

ViTrox expects 2H2020 demand outlook for its MVS-S, MVS-T and ABI products to remain positive due to a strong product pipeline for the upcoming months despite uncertainties caused by the Covid-19 pandemic. Earnings recovery is supported by a robust pipeline from Taiwan and China, which contributed 82% of MVS-T 1HFY20 revenue, and a continued strong pipeline for China for the group's ABI segment. The group forecasted 3QFY20 revenue for the three business units to range from RM91mil to RM103mil (vs. 2QFY20 revenue of RM97mil).

Based on its latest 2QFY20 analyst briefing, the group's key strategies for the remainder of 2020 which are also in line with ViTrox's key investment merits, are as follows:

- i) **Diversify and grow customer base** through strategies such as increased promotion and upgrade opportunities, increasing sales leads, conducting more product evaluations and benchmarking, and increasing sales and service coverage in strategic locations.
- ii) **New or enhanced product rollouts** across its three major business units i.e. MVS-S, MVS-T and ABI in 2H2020. The group's approach is to launch at least two new or enhanced products by every business unit.
- iii) **Improving operational efficiencies** via lead-time reduction, better inventory management and improving order forecasts, **and implementing prudent cost controls.**

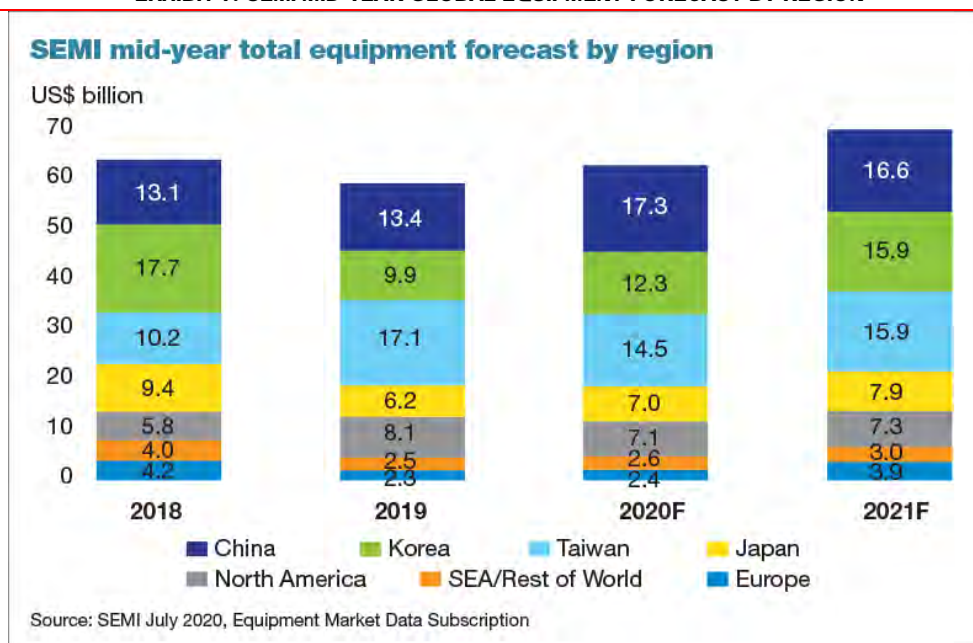
KEY INVESTMENT MERITS

□ Market diversification targeting high-growth regions i.e. Taiwan and China

According to SEMI's *July 2020 Mid-Year Equipment Forecast*, global sales of semiconductor equipment is expected to grow 6% to US\$63bil in 2020 and consequently record double-digit growth in 2021 at US\$70bil sales. Assembly and packaging equipment will expand by 10% and 8% respectively in 2020 and 2021 due to advanced packaging capacity build-up while the semiconductor test equipment market is expected to rise 13% in 2020 and continue growing into 2021, underpinned by 5G demand. China, Taiwan and Korea are expected to lead the growth in spending in 2020.

We believe that this will bode well for ViTrox which continues its market expansion strategy by focusing on high-growth regions and positioning more strategic channel partners (SCPs) to improve effectiveness and strengthening its sales and service coverage for its MVS-T business unit, where 83% of 1HFY20 sales are from Taiwan and China. Besides its MVS-T business unit, the group's ABI business unit also has a strong order pipeline from China for both AXI and AOI.

EXHIBIT 9: SEMI MID-YEAR GLOBAL EQUIPMENT FORECAST BY REGION



Source: The Edge Markets.

□ Focus on product innovation to strengthen portfolio offerings

Instead of individual product offerings, ViTrox will shift its focus on high-growth areas with complete product and service platform solutions. An example of the group's comprehensive product portfolio is in its ABI business unit with its V-ONE Smart Manufacturing Software which is well-positioned to benefit from the adoption of Industry 4.0. It's V9i Conformal Coating and Final Inspection Robotic Vision System, 3D Paste Inspection System, 3D X-ray inspection system with AI options will drive the group towards providing a one-stop-solution, thus differentiating itself from its competitors.

□ Drive improvements in end-to-end lead time

As part of the group's objectives, ViTrox will continuously enhance its operations to ensure its products and services are delivered in a timely manner across the entire operation – from the receipt of raw material up till the delivery of the final product to customers.

VALUATION

We initiate coverage on ViTrox with a **HOLD** recommendation and fair value of **RM10.56/share**, pegged to an **FY22F PE of 35x**, a premium above both its local sector market-cap weighted average PE and +0.5SD above its 5-year historical PE of 30x due to its technology leadership. ViTrox stands to benefit from the higher semiconductor back-end demand via its MVS and ABI business units on riding on the adoption of 5G, artificial intelligence (AI), and Industry 4.0 developments.

EXHIBIT 10: PEER COMPARISON TABLE

Company	Recomm	Price	FV (RM)	Upside (%)	Mkt Cap (RM mil)	P/E (x)		EPS (sen)		EPS Growth (%)		P/B		ROE (%)		DY (%)		EV/EBITDA	
						CY20	CY21	CY20	CY21	CY20	CY21	CY20	CY21	CY20	CY21	CY20	CY21	CY20	CY21
Malaysia																			
MYR																			
Malaysian Pacific Industries Bhd	BUY	17.82	19.53	10	3,544.3	20.5	19.2	87.0	93.0	15.1	6.9	2.4	2.2	11.8	11.8	1.5	1.5	6.0	5.2
Unisem M Bhd		3.47			2,428.5	26.9	21.1	12.4	15.8	1,053.8	27.4	1.8	1.7	6.9	8.1	2.1	2.3	6.9	6.4
ViTrox Corp Bhd	HOLD	12.50	10.56	-16	5,880.5	58.6	49.0	21.3	25.5	32.5	23.7	10.8	9.3	19.6	20.4	0.4	0.5	54.3	45.5
Pentamaster Corp Bhd	UNDERWEIGHT	4.38	3.21	-27	3,070.1	34.1	28.5	13.3	15.4	17.0	15.6	5.3	4.5	17.7	17.4	0.3	0.3	17.4	14.4
Mi Technovation Bhd		4.06			2,935.7	46.2	30.9	8.5	12.7	7.6	49.4	7.1	6.4	15.7	19.3	0.7	1.1	n.a.	n.a.
Globetronics Technology Bhd		2.75			1,713.8	31.2	25.1	8.2	10.2	22.4	24.4	5.6	5.3	18.9	24.1	2.7	3.3	34.4	16.7
Inari Amertron Bhd	BUY	2.17	2.45	13	6,794.3	37.3	25.5	5.8	8.5	1.8	46.1	5.6	5.5	16.3	23.0	3.2	4.5	20.3	15.0
Simple average					36.4	28.5		22.4	25.9	164.3	27.6	5.5	5.0						
Market cap weighted avg					39.0	30.4		22.1	25.7	111.1	29.5	6.1	5.5						
Simple avg (excl. ViTrox)					32.7	25.1		22.5	25.9	186.3	28.3	4.6	4.3						
Mkt cap w.a. (excl. ViTrox)					33.4	25.1		22.3	25.8	133.6	31.2	4.8	4.5						
Taiwan																			
Hon Hai Precision Industry Co	-	77.30	-	-	152,552.1	10.5	8.6	737.6	904.3	(11.3)	22.6	0.8	0.8	7.9	9.3	5.0	5.7	4.4	4.7
Taiwan Semiconductor Manufactu	-	426.00	-	-	1,586,886.0	23.4	22.2	1,840.4	1,945.1	38.2	5.7	6.1	5.5	27.1	25.9	2.5	2.8	17.9	16.8
Foxconn Technology Co Ltd	-	52.70	-	-	10,504.1	10.5	9.6	500.4	543.3	(0.7)	8.6	0.6	0.6	6.2	6.3	4.9	5.0	1.0	1.2
Simple average					14.8	13.5		1,026.1	1,130.9	8.7	12.3	2.5	2.3						
Market cap w.a.					22.2	20.9		1,736.2	1,846.0	33.6	7.2	5.6	5.0						
Korea																			
SK Hynix Inc	-	78,400.00	-	-	202,521.2	14.5	8.0	548,366.6	995,357.6	98.3	81.5	1.1	1.0	7.9	13.1	1.5	1.8	8.6	3.5
China/HK																			
Semiconductor Manufacturing In	-	18.24	-	-	126,152.8	53.9	57.8	4.5	4.2	862.2	(6.7)	1.3	1.3	3.2	2.1	0.0	0.0	30.6	196.3
TongFu Microelectronics Co Ltd	-	23.90	-	-	16,174.4	77.2	49.1	29.8	46.8	1,390.0	57.0	3.9	3.6	6.2	9.4	0.1	0.3	37.9	29.4
Hua Hong Semiconductor Ltd	-	24.95	-	-	17,329.5	40.7	33.8	7.9	9.5	(37.3)	20.3	1.7	1.6	3.6	4.8	0.6	0.6	21.0	17.2
Simple average					57.3	46.9		14.1	20.2	738.3	23.5	2.3	2.2						
Market cap w.a.					54.8	54.3		7.4	9.1	818.1	2.7	1.6	1.6						
Regional average					34.7	27.7		39,403.1	71,356.6	249.2	27.3	3.9	3.5						
Regional mkt cap w.a.					24.1	22.3		53,353.6	95,774.9	99.3	14.2	4.9	4.4						

Source: Bloomberg, AmlInvestment Bank Bhd. Prices as at 7 Sept 2020.

EXHIBIT 11: PB BAND CHART

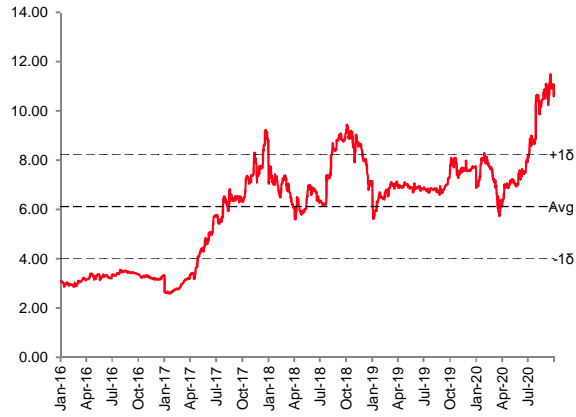


EXHIBIT 12: PE BAND CHART



EXHIBIT 13: FINANCIAL DATA

Income Statement (RMmil, YE 31 Dec)	FY18	FY19	FY20F	FY21F	FY22F
Revenue	394.7	339.6	380.7	438.6	500.9
EBITDA	117.0	87.0	105.2	124.8	146.9
Depreciation/Amortisation	(6.8)	(8.4)	(7.1)	(7.7)	(8.5)
Operating income (EBIT)	110.1	78.6	98.1	117.1	138.4
Other income & associates	-	-	-	-	-
Net interest	3.0	2.9	4.7	5.7	6.8
Exceptional items	-	-	-	-	-
Pretax profit	113.1	81.5	102.8	122.8	145.3
Taxation	(7.6)	(1.8)	(2.3)	(2.7)	(3.2)
Minorities/pref dividends	-	-	-	-	-
Net profit	105.5	79.7	100.5	120.1	142.1
Core net profit	105.5	79.7	100.5	120.1	142.1
Balance Sheet (RMmil, YE 31 Dec)	FY18	FY19	FY20F	FY21F	FY22F
Fixed assets	155.1	99.1	103.4	108.8	115.4
Intangible assets	-	-	-	-	-
Other long-term assets	4.9	79.6	89.5	100.8	113.6
Total non-current assets	160.0	178.6	192.9	209.7	229.0
Cash & equivalent	148.7	191.6	223.3	256.8	301.5
Stock	103.7	111.5	125.0	144.0	164.5
Trade debtors	156.7	126.4	145.7	167.8	191.7
Other current assets	7.0	8.6	3.7	3.7	3.7
Total current assets	416.1	438.0	497.6	572.2	661.4
Trade creditors	83.9	68.3	76.5	88.1	100.7
Short-term borrowings	3.1	7.3	7.3	7.3	7.3
Other current liabilities	17.9	13.1	12.4	12.4	12.4
Total current liabilities	104.9	88.6	96.2	107.9	120.4
Long-term borrowings	53.1	41.4	40.0	40.0	40.0
Other long-term liabilities	4.6	4.2	4.2	4.2	4.2
Total long-term liabilities	57.7	45.6	44.2	44.2	44.2
Shareholders' funds	413.5	482.4	542.8	632.8	739.4
Minority interests	-	-	-	-	-
BV/share (RM)	0.88	1.02	1.15	1.34	1.57
Cash Flow (RMmil, YE 31 Dec)	FY18	FY19	FY20F	FY21F	FY22F
Pretax profit	113.1	81.5	102.8	122.8	145.3
Depreciation/Amortisation	6.8	8.4	7.1	7.7	8.5
Net change in working capital	(65.1)	0.1	(41.0)	(52.8)	(56.9)
Others	(7.5)	(3.6)	(7.0)	(8.5)	(10.1)
Cash flow from operations	47.3	86.3	61.9	69.3	86.8
Capital expenditure	(28.1)	(11.9)	(11.4)	(13.2)	(15.0)
Net investments & sale of fixed assets	0.3	1.3	-	-	-
Others	4.4	3.2	6.3	7.4	8.5
Cash flow from investing	(23.4)	(7.4)	(5.1)	(5.8)	(6.5)
Debt raised/(repaid)	(3.2)	(7.0)	-	-	-
Equity raised/(repaid)	1.0	1.0	-	-	-
Dividends paid	(21.2)	(27.1)	(25.1)	(30.0)	(35.5)
Others	(1.9)	(2.2)	-	-	-
Cash flow from financing	(25.3)	(35.3)	(25.1)	(30.0)	(35.5)
Net cash flow	(1.4)	43.7	31.7	33.5	44.8
Net cash/(debt) b/f	150.6	148.7	191.6	223.3	256.8
Net cash/(debt) c/f	148.7	191.6	223.3	256.8	301.5
Key Ratios (YE 31 Dec)	FY18	FY19	FY20F	FY21F	FY22F
Revenue growth (%)	20.5	(14.0)	12.1	15.2	14.2
EBITDA growth (%)	30.1	(25.6)	20.9	18.7	17.7
Pretax margin (%)	28.7	24.0	27.0	28.0	29.0
Net profit margin (%)	26.7	23.5	26.4	27.4	28.4
Interest cover (x)	nm	nm	nm	nm	nm
Effective tax rate (%)	6.7	2.2	2.2	2.2	2.2
Dividend payout (%)	25.6	25.4	25.0	25.0	25.0
Debtors turnover (days)	130	152	130	130	131
Stock turnover (days)	81	116	113	112	112
Creditors turnover (days)	77	82	69	69	69

Source: Company, AmInvestment Bank Bhd estimates

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