D&O Green Technologies Bhd

Switching into Higher Gear

We are initiating coverage on D&O with a MP call and target price of RM0.73. Key investment merits include: (i) successful transformation into better products portfolio with higher margins, (ii) production capacity expansion, and (iii) higher stake in a profitable subsidiary which will anchor a robust 2-year NP CAGR of 45%. With 26.0x FY18E PER being ascribed (at 3-year average forward PER); a valuation which is on par with its closest peer JHM for its niche position in the auto LED market, we see limited capital upside from here.

World leading packaging company. D&O Green Technologies (D&O), through its principal operating subsidiary- Dominant Opto Technologies (Dominant), offers packaging solutions for LED and other customer specific packages for a diverse range of optoelectronic applications under the "DOMINANT" brand. Dominant's state-of-the-art manufacturing facility produces LEDs that are AEC-Q101-qualified, a world class automotive quality standard. To date, its environmentally friendly LED products are sold around the world through a global network of sales and after sale service offices in the key automotive markets, including China, US, Japan, Europe, Korea and India.

Better products portfolio and strategic positioning in different automotive segments to anchor growth. D&O has been rejigging its portfolio since three years ago with the exit of highly competitive and less profitable LED markets (for general lighting and LED TV) to focus on its core competency in the Automotive segment. The transformation has yielded very positive results; with 3-year EBIT CAGR of 62% being recorded despite 3-year revenue CAGR of only 9%, which saw FY16 EBIT of RM32.0m (from FY12 EBIT losses). Note that its Automotive segment which carries higher margins, are already contributing c.95% to the group's revenue as of 1HFY17. Besides better product mix, D&O has also been expanding its foothold in the Automotive exterior LED lights application besides interior application. Note that this segment is seeing more demand given its increasingly higher adoption alongside low penetration rate which only ranges between 12-45% depending on application. We expect the group's utilisation rate (UR) to stay at 80% in FY17 and FY18, underpinned by its existing interior LEDs products, Smart RGB as well as exterior headlights and tail lights.

Boiling point of expansion. As of 2QFY17, the group's UR is already running at an optimal rate of 80%, contributed mainly by Automotive business. We are particularly positive on this as the earnings from Automotive segment remain very sticky given the stringent qualification stage as well as high barriers of entry. To cater for future growth, the group has in Oct 2016 purchased a land cum factory building to address the short-term capacity constraints and to cope with the anticipated medium-to-long term demand growth in the Automotive Segment. Management plans to develop the new factory in stages over a period of five years from 2018. Upon full development of the new factory, management estimates that it would be able to increase its production capacity by c.3x from current level. For FY18, we only conservatively expect an additional 30% capacity added from its existing capacity.

Looking forward, we estimate 2-year revenue CAGR of 21% on the assumption of UR of 75%/80% in FY17E/FY18E alongside capacity expansion of +30% in FY18E and USD/MYR and RMB/MYR assumptions of RM4.29/USD and RM0.62/RMB. In terms of earnings, we estimate a 2-year CNP CAGR of 45% following the higher earnings contribution from Dominant (additional 27.95% stake acquisition) as well as EBIT margin assumptions of 8.3%-8.8% on better operational efficiency. Dividend-wise, assuming a pay-out ratio of c.25%, the group could see DPS of 0.5 sen/0.7 sen which translates to 0.7%/1.0% yield.

Initiating coverage with an MARKET PERFORM call and TP of RM0.73. Our TP is based on an ascribed 26.0x FY18E PER, which is at the group's average 3-year forward PER. This valuation is also in line with its closest peer JHM, which is trading at 2-year forward PER of 26.0x. That said, even with a higher-than-industry valuation being applied (+47% of the semiconductor industry) for its niche position in the auto LED market, we still see limited capital upside from here.

MARKET PERFORM

Price: RM0.695
Target Price: RM0.730

Expected Capital Gain:	*RM0.035*	*+5.0%*
Expected Divd. Yield:	*RM0.007*	*+1.0%*
Expected Total Return:	*RM0.042*	*+6.0%*

KLCI Index 1,748.99

Stock Information

Bloomberg Ticker	DOGT MK Equity
Bursa Code	7204
Listing Market	Main Market
Shariah Compliant	Yes
Issued shares	1,000.8
Market Cap (RM m)	695.5
Par value per share (RM)	0.10
52-week range (H)	0.74
52-week range (L)	0.29
Free Float	57%
Beta	1.0
3-mth avg daily vol:	3,355,268

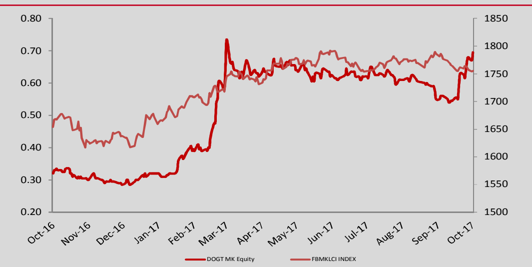
Major Shareholders

PRT Capital Pte Ltd	16.1%
Keen Capital Investment	15.3%
Omega Riang Sdn Bhd	11.3%

Summary Earnings Table

FY Dec (RM m)	2016A	2017E	2018E
Turnover	430.1	483.7	628.8
EBITDA	59.1	71.5	89.9
PBT	29.6	38.0	53.1
Net Profit	11.3	20.9	41.1
Core PATAMI	19.5	20.9	41.1
Consensus (NP)	-	-	-
Earnings Revision	-	-	-
Core EPS (sen)	1.9	2.0	2.8
Core EPS growth (%)	85.7	5.0	37.1
NDPS (sen)	0.0	0.5	0.7
NTA per Share (RM)	0.19	0.21	0.21
Price to NTA (x)	3.6	3.4	3.4
PER (x)	36.2	34.4	25.1
Debt-to-Equity ratio (x)	0.2	0.2	0.2
Return on Asset (%)	4%	4%	7%
Return on Equity (%)	10%	10%	13%
Net Div. Yield (%)	0.0%	0.7%	1.0%

Share Price Performance



	1 mth	3 mths	12 mths
Absolute (%)	26.4%	13.0%	110.6%
Relative (%)	28.3%	13.3%	105.7%

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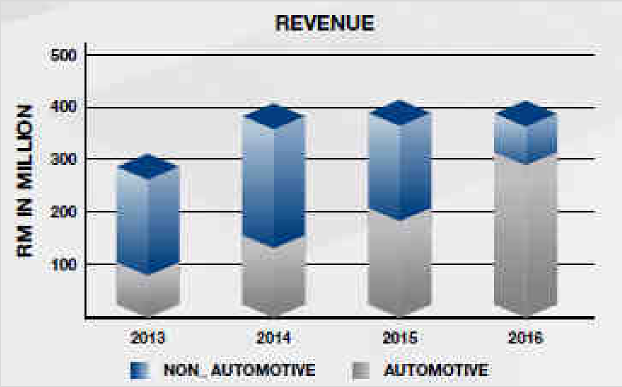
INVESTMENT MERITS

World-leading independent packaging company. D&O Green Technologies (D&O), through its principal operating subsidiary-Dominant Opto Technologies (Dominant), offers packaging solutions for LED and other customer specific packages for a diverse range of optoelectronic applications under the "DOMINANT" brand. Note that Dominant's state-of-the-art manufacturing facility produces LEDs that are AEC-Q101-qualified, a world-class automotive quality standard. By means of embracing its mission statement namely "To provide design innovation and high quality opto-semiconductor products that contribute towards a greener world", the group pride itself as a TQM (Total Quality Management) company that places high emphasis on product and service quality, alongside staying ahead of global competition through continuous investments in research and development capabilities. Business rationalisation to focus on core competency in automotive segment that been implemented since 2014 had resulted in D & O environmentally friendly LED products being sold around the world through its global network of sales and after sale service offices in numerous key automotive markets, including China, the US, Japan, Europe, Korea and India.

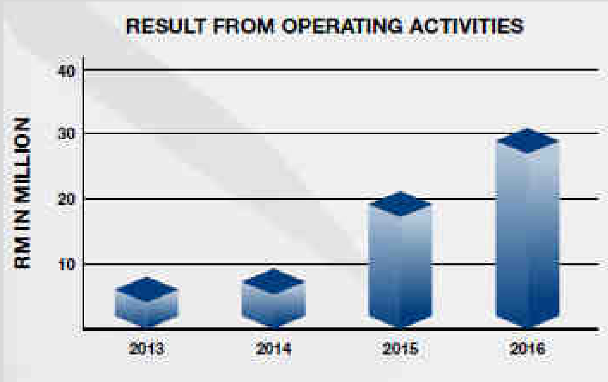
Better products portfolio to anchor growth. The group has previously been operating in the LED markets for automotive, general lighting and LED TV. While the sales volume and growth potential for the latter two markets are tremendous, the risk-to-reward ratio is unappealing, with investment and commercial risks being disproportionately high given the razor-thin margins, high capital requirements and steep price erosion curve. Realising this, the group started to rejig its portfolio three years ago with the exit of highly competitive and less profitable general lighting and LED TV markets to focus on its core competency in the automotive segment.

Revenue mix for Automotive/Non-Automotive



Source: Company

Result from Operating Activities



Source: Company

On a closer look in terms of products portfolio, the low margin non-automotive segment accounted for more than 50%, which was at the peak in 2013 and 2014. However, with continuous effort in phasing out low margin business with more focus on the higher-margin automotive business, contribution from Non-Automotive segment was only 13% in FY16, with 87% of the revenue contributed by the Automotive segment. The transformation was successful with the group's income statement showing a 3-year EBIT CAGR of 62% in FY16, despite 3-year revenue CAGR of only 9%. Meanwhile at the operational level, FY16 EBIT hit a high of RM32.0m (with EBIT margin of 7.4%) from FY12 EBIT losses.

In terms of application in the Automotive LED market, D&O has also strengthened its foothold in the market for Automotive exterior LED lights over the past few years besides interior application. As opposed to interior LED market, this segment is seeing more demand given its increasingly higher adoption alongside low penetration rate which ranges between 12-45% depending on application. We expect the group's utilisation rate (UR) to stay at 80% in FY17 and FY18, underpinned by existing interior LEDs products, Smart RGB as well as exterior headlights and tail lights.

Automotive lighting market forecast

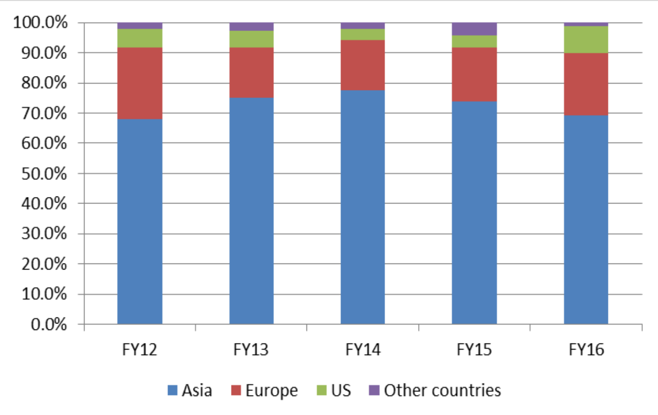
		Unit of measure	2011	2012	2016	2020
Total automotive lighting market		EUR m	14,083	14,873	17,709	18,043
	Front/headlamp	EUR m	9,989	10,486	12,292	12,275
	DRL/fog	EUR m	1,123	1,284	1,803	2,072
	Side	EUR m	287	305	393	446
	Rear	EUR m	1,927	2,026	2,402	2,482
	Interior	EUR m	757	773	820	767
Total automotive light source market		EUR m	3,369	3,605	4,680	5,509
Front lighting – detailed view						
Technology mix						
	Incandescent	%	0	0	0	0
	Halogen	%	86	84	79	67
	HID	%	14	15	16	12
	LED	%	1	1	6	21
Content per vehicle lamp level						
	Incandescent	EUR	0	0	0	0
	Halogen	EUR	4.34	4.30	4.15	4.09
	HID	EUR	21.99	21.16	18.08	15.68
	LED	EUR	108.73	86.99	52.40	28.16
Total new installation market		EUR m	9,451	9,926	11,550	11,484
	Lamp/module level	EUR m	611	680	1,113	1,697
	Driver level	EUR m	495	558	776	904
	Fixture level	EUR m	8,344	8,687	9,661	8,882
Annual lamp replacement market		EUR m	538	560	741	791
	Incandescent	EUR m	0	0	0	0
	Halogen	EUR m	503	518	673	706
	HID	EUR m	36	42	69	85
	LED	EUR m	0	0	0	0

Source: McKinsey's report- Lighting the way: Perspective on the global lighting market

On its interior products application, note that D&O subsidiary- DOMINANT Opto Technologies has in end-2016, unveiled a new digital LED concept for automotive applications- named as SmartRGB LED. The SmartRGB LED is based on an entirely new in-car LED ambient lighting concept that drives down costs, simplifies control, and expands the functionality of LED lighting and display solutions. It was mentioned that this new ambient lighting concept will also be the first product developed under the umbrella of IseLED, an open alliance formed to provide a full ecosystem for the new digital LED right from inception. The founding partners of the IseLED Alliance are DOMINANT Opto Technologies, Inova, NXP, TE Connectivity and the University of Pforzheim. While we understand that the production will be in 2018-2019 as the design selection only materialised recently, we believe this will be one of the key earnings growth from the group's interior products segment.

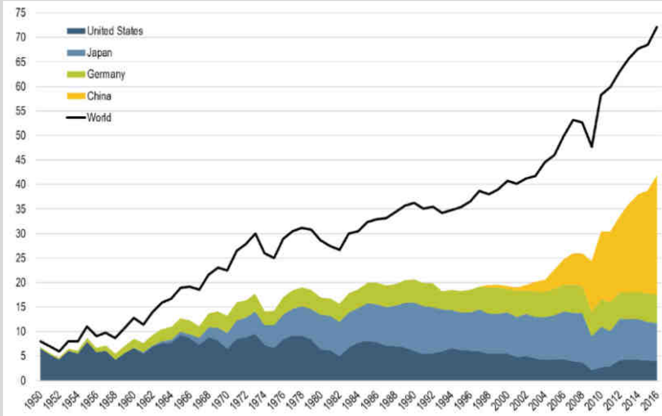
Strategic foothold in key automotive markets. D&O end-products are being sold around the world through a global network of sales and after-sale service offices in the key automotive markets, including China, the US, Japan, Europe, Korea and India. In terms of revenue breakdown to date, Asia is now the lion's share of the revenue which contributed 66%, following by Europe (22%), US (10%) as well as other countries at 2%. Note that these key automotive markets where D&O has footings are gaining traction since the last two decades.

Revenue segmental breakdown in terms of countries



Source: Company

Global automobile production from 1950-2016



Source: International organisation of Motor Vehicle Manufacturers

To capitalise on the earnings uptrend in these major markets, where there are minority stakes the group does not fully owned, D&O has on the 24th August 2017, proposed to increase its respective stake in its 61.84%-owned subsidiary Dominant Opto Technologies Sdn Bhd, with minimum scenario of additional c.12.45% stake acquisition, to 74.29% effectively (or 13.7m Dominant shares) or maximum scenario of additional c.27.95% stake acquisition (or 30.75m Dominant shares) to 89.79% effectively in Dominant. The purchase consideration of RM8.95 per Dominant shares will be satisfied via the issuance of new irredeemable convertible preference shares (ICPS) in D&O. As of our latest time of writing, Bursa Malaysia Securities Berhad had vide D&O's letter dated 10 October 2017, granted D&O an extension of time until 23 December 2017 for the submission of the draft circular in relation to the Proposed Acquisition to Bursa Securities.

(Please refer the section of company outlook for further details on the corporate exercises)

Boiling point of expansion. As of 2QFY17, the group's utilisation rate is already running at an optimal rate of 80%. We see this as a positive sign of the group being the beneficiary of the burgeoning rising LED adoption in the automotive lightings. To cater for future growth, the group had in October 2016 purchased a land cum factory building (measuring 2.41 hectare), next to its existing plant in Melaka for RM11m to address the short-term capacity constraints and cope with the anticipated medium-to-long term demand growth in the Automotive segment. Management plans to develop the new factory in stages over a period of five years from 2018 at an estimated cost of c.RM34m. Upon full development of the new factory, management estimated that it would be able to increase its production capacities by c.3x from current level. From our recent meeting, we understand the group plans to shift its office in 2H2018 if the completion of renovation works progress as planned. For FY18, we only conservatively expect an additional 30% capacity from existing capacity.

COMPANY OUTLOOK

Greater earnings contribution from higher stake in Dominant. D&O has on 24th August 2017, issued offer letters to the remaining shareholders (Offerees) of Dominant Opto Technologies Sdn Bhd (Dominant), to acquire their 30.75m ordinary shares in Dominant, representing 27.95% of its equity interest, for a total purchase consideration of RM275.2m or RM8.95 per share which is to be satisfied via the issuance of ICPS subject to the terms and conditions of the share purchase agreement. As at 22 August 2017, D&O holds a total of 68.0m Dominant shares, representing 61.84% equity interest.

Following the acceptance of the Offer Letters by Thames Electronics Sdn Bhd and Cambrew Asia Limited, being two of the shareholders of Dominant, D&O has on the same day entered into separate conditional share purchase agreements with Thames and Cambrew to acquire a total of 13.7m Dominant Shares, representing 12.45% equity interest in Dominant, for a total purchase consideration of RM122.6m or RM8.95 per share. The Purchase Consideration is to be satisfied via the issuance of 201.0m ICPS at an issue price of RM0.61 per ICPS.

On the 12th September 2017, Bursa Malaysia announced that four shareholders which are holding collectively 4.55%, have accepted the offer letters and entered into separate conditional share purchase agreements with D&O. Note that the purchase consideration of RM44.75m will be satisfied via the issuance of 73.4m ICPS at an issue price of RM0.61 per ICPS.

On 3rd October 2017, Bursa Malaysia announced that an investor has accepted the offer letters and have also entered into a conditional share purchase agreement with D&O in relation to the proposed acquisition of 50k Dominant shares representing 0.05% equity interest in Dominant for a purchase consideration of RM447.5m to be satisfied by the issuance of 733.6k ICPS.

On the 10th October 2017, Bursa Malaysia announced that Golden Horizon Resources Limited (GHRL) has accepted the Offer Letter and has entered into a conditional share purchase agreement with D&O in relation to the proposed acquisition of 12.0m Dominant shares, representing 10.91% equity interest in Dominant for a purchase consideration of RM107.4m to be satisfied by the issuance of 176.1m ICPS.

With the above-mentioned acceptances, all the Offerees have accepted the offer and accordingly, D&O has entered into share purchase agreements to acquire an aggregate of 30.75m Dominant shares, representing 27.95% equity interest. Upon completion of the proposed acquisitions, D&O will hold a total of 98.8m Dominant shares, representing approximately 89.80% equity interest.

The proforma effect on the issued share capital of D&O is as follows:

Proforma effect on the issued share capital of D&O

	Minimum Scenario		Maximum Scenario	
	No. of D&O Shares	RM	No. of D&O Shares	RM
As at the LPD	998,529,993	108,251,973	998,529,993	108,251,973
Upon full conversion of the ICPS	201,008,195	122,615,000	451,168,029	275,212,500
Less: Estimated expenses relating to the Proposals	-	(1,000,000)	-	(1,000,000)
Enlarged issued share capital	**1,199,538,188**	**229,866,973**	**1,449,698,022**	**382,464,473**

Source: Bursa Malaysia

*** Conversion ratio: Each ICPS shall be convertible into 1 D&O Share.*

Post completion of the proposed acquisitions, while the enlarged issued share capital will increase from 998.5m to 1,449.7m which we expect to see the full effect by 1QFY18, we lauded the move as we expect earnings accretion (of +46%) from the 27.95% stake acquisition at Dominant level would be sufficient to offset the dilution (enlarged by +44% of share base) from the issuance of ICPS.

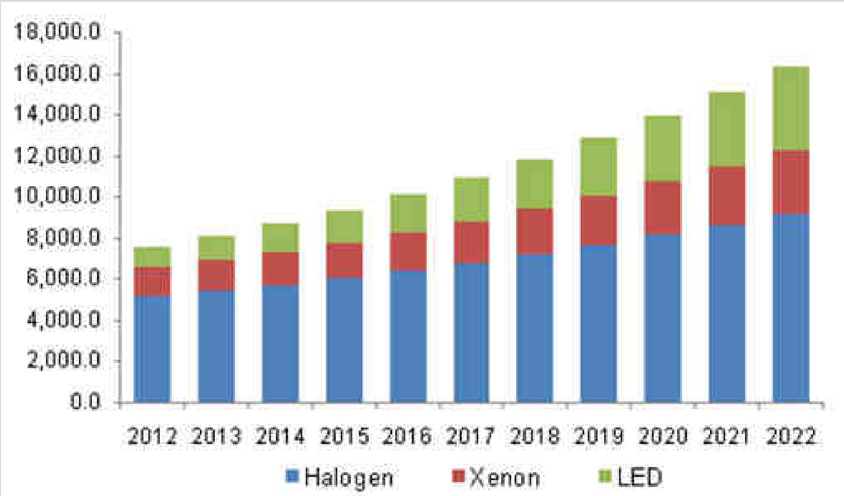
Net beneficiary of strong USD. In terms of forex, the group is primarily exposed to USD and RMB; where c.60%/c.30% of total sales are denominated in USD/RMB with 60% of COGS denominated in USD. Hence, we believe the group will yield a net gain from their transactions, expanded by any further strengthening in USD rates and RMB. Based on our sensitivity analysis with our base case assumption of RM4.29/USD and RM0.62/RMB for FY17E-FY18E earnings, every 10% appreciation in USD and RMB vs MYR would positively impact its bottom-line by c.6%.

SECTOR OUTLOOK

LED market to grow at a 2015-2022 CAGR of 12.0%. According to semiconductor market research firm Grand View Research, the global LED market is forecasted to grow considerably at 2015-2022 CAGR of 12.0%, far outpacing global GDP that is expected to show mere growth of 3.0-3.6% per year over the period. The most significant driving force is the increase in automotive production and advancement of technology, which in turn is leading the rise in demand for automotive LED. At the same time, acceptance of LED for its efficiency, enhanced safety alongside aesthetic appeal is other factors that are driving growth.

Opportunistic trend with enlarged market segment and widening applications. For some time, LED was used in premium vehicles for its exclusivity; however, it is observed that there is change of trend in recent years where LED has also become increasingly popular for mid-range and mass market cars. We are positive with the growing use of automotive LED for interior and exterior applications of greater range of cars' segment, as the increased demand is expected to sustain in the near term, thus allowing automotive LED to gain greater market share in the lighting market. Further trend that may strongly catalyse automotive LED demand is the evolution into autonomous automotive with the use of smart, innovative and semiconductor-based LED.

Asia Pacific automotive lighting market, by technology, 2012 - 2022 (USD Million)



Source: Grand View Research

Technology insights. On the basis of technology, the automotive lighting market is segregated into halogen, xenon, and LED. According to Grand View Research, halogen dominated the industry in 2014 and is expected to grow at a CAGR of over 5% from 2015 to 2022. Low purchasing & replacement cost and easy availability are a few supporting factors for the adoption of halogen technology. They are available in different dimensions, cost-effective and easy to replace. However, excessive heat loss has increased awareness for energy efficiency leading to the reduced usage of halogen. The LED lighting market accounted for over 15% of the overall market in 2014 and is expected to see substantial growth over the forecast period. This is largely attributed to red LED applications such as indicators and brake lights. LEDs are increasingly being used in Daytime Running Lamps (DRLs), which are mandated for new car production in the EU from 2011 to 2012, and OEMs are also used as a competitive edge in their design. LED also aims to penetrate the headlamp sector; however, technology barriers persist in this field as LED is still very expensive for ultra-high brightness applications. Halogen and High-Intensity Discharge (HID) lamps have the advantage of being cheap. Preference of manufacturers towards eco-friendly technologies owing to high power efficiency and reduced CO2 emissions is expected to fuel demand. Presently, a major factor limiting its usage is the high price. However, ongoing technological advancements would result in lowering the costs in future.

Application insights. Application segments analysed in the study of Grand View Research include front, rear, side, and interior. Headlamps segment is estimated to grow at a CAGR of over 7% from 2015 to 2022. These also include DSL/fog lights. Dynamic growth and developments have revolutionized the headlamps segment. The increasing use of LEDs in headlamps as compared to halogen and xenon lights is a prominent trend propelling growth. Adaptive headlights are active safety features designed to enhance the drivers' visibility in low light conditions. Rear lights comprised of brake, tail lights, indicators, and back-up lights mounted on the rear end of each vehicle. Presently, halogen lights are commonly used for rear application purposes. However, LED lights are expected as prominent solutions in vehicles over the forecast period. Illumination products find significant application in vehicle interior systems as they give an aesthetic appearance to the interior. Numerous manufacturers are focusing on developing energy-efficient and compact solutions for interior illumination purpose.

Regional insights. Asia Pacific automotive lighting market accounted for over 40% of the overall share in 2014, according to Grand View Research. Increased automobile production across countries such as China, India, Japan, and Taiwan combined with rising urban population, growing economies, and increasing the purchasing power of individuals is expected to fuel the demand across this region. Europe is anticipated to see steady growth owing to increasing adoption in the brake, reverse, interior lights, and signal indicators. Further, environmental regulations mandated the installation of LEDs across various applications. The North American regions are expected to have substantial demand for LED lights in the automotive sector, mainly supplemented by their increasing application in the interior segment.

Competitive market share insights. Companies dominating the global automotive lighting market share, according to Grand View Research, include Osram GmbH, Hella KGaA Hueck & Co., Valeo SA, Stanley Electric, Magneti Marelli, Koito Manufacturing Co., Ltd., and General Electric (GE). Product launch, joint venture, and expansion are few prominent strategies adopted by key vendors. Ongoing R&D on compact and comparatively cheaper LED lights is expected to result in a shift of preference from halogen and xenon to LED technologies. Thus, the introduction of compact, energy-efficient, and low-cost LED lights is anticipated to emerge as a lucrative strategy for the players.

FINANCIAL ANALYSIS

Historical review – FY16

The group registered marginally lower revenue in FY16 (-1%, to RM430.1m) with growth in higher margin Automotive segment (+35%, contributed 87% of total revenue) negated by the 63% decline in the non-automotive segment (contributed 13% of total revenue). This is in line of the group's strategy in moving away from lower margin business. In terms of market segment, contribution from the automotive segment continued to increase from 64% in 2015 to 87% in 2016 of Group turnover; a trend that is expected to continue to bode well for future earnings. With better sales mix alongside increased manufacturing efficiencies resulting from the rationalization of production capacities and processes as well as weakening of MYR against major export currencies, core NP soared by 88% with margins improving to 4.5% (+2.1%).

Its balance sheet remained healthy with net gearing of less than 2%, albeit a tad higher than 0.6% at the end of 2015. Property, plant and equipment rose 17.8% to RM153.7m on higher capex. Meanwhile, trade receivable turnover rose from 51 days to 79 days due to the generally longer credit terms of 60-90 days offered to automotive customers, compared to 30-60 days for non-automotive customers. Inventory turnover days increased to 129 days compared to 112 days a year ago owing to increased buffer stocks maintained for automotive customers. Positively, book value per share increased from 18.54 cents to 19.49 cents in FY16.

Cash-flow-wise, net cash from operating activities saw a huge turnaround from -RM8.9m in 2015 to RM45.5m in 2016 on better operating profit (before changes in working capital) from RM31.6m to RM68m. Meanwhile, the group spent a total of RM54.6m on capex to expand production capacities, improve machine efficiencies and quality control, and on equipment conversion. We understand that these investments are necessary to cope with the strong demand growth from the automotive clients and sharpen Dominant's competitive edge in order to stay ahead of the market.

Historical review – 6M17

In the latest 6M17, the group achieved a turnover of RM220.1m (+11%) led by robust growth (+30%) in Automotive sales in most key automotive markets. Meanwhile, Non-Automotive segment sales continued to fall to RM10.1m (-72%), following the group's strategy in phasing out of sales to general lighting and LED television. As a result, the sales mix between Automotive/Non-Automotive is now at 95%/5%. Meanwhile at the bottom-line, while effective tax rate was higher at 13.8% (vs 8.6% in 1H16) following the expiry of the group's pioneer status in March 2017, NP still grew by 42%, helped by decent top-line growth as well as better GP margin of 24.6% (+2.0ppts) as a result of favourable product mix and stronger USD and CNY.

Dividend-wise, an interim single-tier tax DPS of 0.5 sen was paid on the 28th July 2017 in the 6-month period for a pay-out ratio of c.60%.

Looking at its 6M17 cash flow, the group generated RM48.0m in positive cash flow from its operations. Meanwhile, RM30.1m has been spent on capex to expand capacity, upgrade machinery and increase automation. All in, overall cash position improved from a net debt of RM5.6m to net cash of RM16.9m as of 30th June 2017.

Forecast assumptions

We estimate FY17E to record full-year sales of RM483.7m (+13%) as we expect an optimal utilisation rate of 75%-80% of its current production capacity alongside robust growth in automotive sales in its key automotive markets. Following this, EBIT is estimated at RM40.3m with better EBIT margin of 8.3% (+0.9ppts) given the better operational efficiency, favourable mix contributed mostly by Automotive sales as well as stronger USD YoY which is estimated to be RM4.29/USD vs RM4.14/USD in FY16. All in, we expect FY17 to close with a core PATAMI of RM20.9m (+7%).

For FY18, with the assumption of: (i) optimal utilisation rate of 75%-80% of its current production capacity, (ii) additional 30% capacity added in FY18, following the phased construction of its new factory to increase its production capacity by c.3x from current level in five years, as well as (iii) MYR/USD and MYR/RMB assumptions of RM4.29/USD and RM0.62/RMB, we expect the group to record revenue of RM628.9m (+30%). While EBIT is expected to grow by 37% following the decent top-line forecast with no major changes in the raw materials costs assumptions in FY17, we forecast the group to record a much higher core PATAMI of RM41.1m (+97%) following the higher earnings contribution from its subsidiary Dominant at the core PATAMI level following the additional 27.95% stake acquisition. This is based on D&O's 89.79% stake in Dominant from the current stake of 61.84% as at of our time of writing. However, at the EPS level, the growth was only at +37% as the growth at PATAMI level has been neutralised with the +44% increase of share base from the issuance of ICPS.

Dividend-wise, we have conservatively assumed dividend pay-out of 0.5 sen for the FY17 (which has been declared on the 1QFY17 results release). This represents a pay-out ratio of 25% which we deemed decent given that the group has not been paying any dividends over the past five years. Meanwhile for FY18, assuming a similar pay-out ratio of 25%, we expect the group to declare DPS of 0.7 sen for FY18. In terms of net dividend yields, this translates into 0.7%/1.0% yield for FY17/FY18.

PEER COMPARISON

Within Malaysia listed companies, we see JHM as its closest peer, given their similarities in business models which are solutions providers for LEDs. Compared to JHM, D&O is trading slightly cheaper (at a slight discount of 3%) with 2-year Forward PER of 25.1x compared to JHM which is trading at 2-year Forward PER of 26.0x. In terms of the ability to generate earnings from its investments, i.e. from the asset as well as equity base perspective, JHM is better than D&O with higher ROE and ROA of 40.5% and 23.1%, vis-à-vis D&O's 9.8% and 4.1%, respectively. On the other hand, D&O has recently started to reward its shareholders in the form of dividend pay-out, with 0.5 sen DPS, representing 47% of pay-out ratio thus far. We expect the group to maintain its pay-out for FY17 for now.

Industry Peers – Valuations Comparison

Company	Price as of 17th Oct (RM)	Market Cap (RM'm)	Fwd PER (x) Actual	1 yr fwd	2 yr fwd	Fwd PBV (x) Actual	1 Yr Fwd	2 Yr Fwd	Est. Div. Yld. %	Est. ROE %	Est. ROA %	1 Yr Fwd NP Growth	2 Yr Fwd NP Growth
INARI	2.76	5579.5	23.6	21.4	18.8	6.3	5.8	5.1	3.0%	26.6	21.3	13.2	16.4
UNISEM	4.02	2950.0	16.7	15.8	14.4	3.3	1.9	1.8	3.2%	12.3	10.4	15.1	10.0
MPI	14.00	2784.5	14.9	14.2	13.6	2.5	2.3	2.1	2.0%	16.5	12.2	11.4	5.5
GTRONIC	6.36	1812.9	65.8	33.8	17.8	7.1	6.5	6.1	2.6%	19.4	17.8	109.7	87.3
JHM	3.12	819.9	21.9	26.0	26.0	10.6	11.1	8.9	NA	40.5	23.1	46.5	9.7
KESM	16.56	712.3	16.2	14.4	12.0	2.2	2.0	2.0	0.8%	13.8	10.4	13.1	20.1
Peer Average (ex D&O)			26.5	20.9	17.1	5.3	4.9	4.3		21.5	15.9	34.8	24.8
D&O	0.695	695.5	36.2	34.4	25.1	3.6	3.4	3.4	0.7%	9.8	4.1	7.3	96.9

Source: Bloomberg, Kenanga Research

Source: Company, Kenanga Research

VALUATION

We initiate coverage with a MARKET PERFORM call and target price (TP) of RM0.73. Our TP is based on an ascribed 26.0x PER on FY18E EPS of 0.028 sen, which is the group's average 3-year forward PER. Note that this valuation is also in line with its closest peer JHM which is trading at 2-year forward PER of 26.0x. We like the company for its: (i) successful transformation of products portfolio, (ii) strategic positioning in different automotive segments as well as (iii) production capacity expansion which will anchor a robust 2-year NP CAGR of 45%. However, with a higher than industry valuation being applied (+47% of the semiconductor industry) given its niche position in the auto LED market, we still see limited capital upside from here.

RISKS

Disruption of dies supply. D&O offers packaging solutions for LED and other customer specific packages for a diverse range of optoelectronic applications. As dies are the most crucial component in D&O's products, any disruption on the supply chain could adversely impact the group's operations. That said, we are not overly perturbed with this business risk as we understand that the group have more than one source of dies supply.

Replacement / absolution of LED technology. As D&O's products are all LED-related, any technology replacement which could overtake LED in terms of costs, energy efficiency, availability as well as reliability will adversely impact the group's competitiveness. That said, with D&O being the expert in the automotive lighting market with strong R&D team as well as wide network, we believe the group could responsively adapt to any rapid shift in technology.

Adverse currency fluctuations. D&O derived c.60% and c.30% of its revenue in USD and RMB with the remaining 10% from Korean Won and Euro. While the group has been a net beneficiary of the weakness of the MYR against its export currencies, any reversal of the trend will have a negative impact on margins. However, we believe that the impact should be minimal with natural hedging from its raw materials purchases (at 60% of its COGS in USD base). Based on our base case assumption of RM4.29/USD and RM0.62/RMB for FY17E-FY18E earnings, every 10% depreciation in USD and RMB vs MYR would impact its bottom-line by -c.6%.

Subpar quality and reliability of the products. In the automotive sector, product quality and reliability are of utmost importance. In mitigating the risk, D&O has adopted a total quality management framework and continuously invested in quality control systems. The Group has also taken up product liability insurance case of any unfortunate events.

Adverse foreign labour policy. As the group still rely heavily on foreign labour for its production, any adverse policy changes or shortage with regards to the foreign labour will have a negative impact to its operations. We understand that the group is investing more into automation to reduce its reliance on labour headcounts.

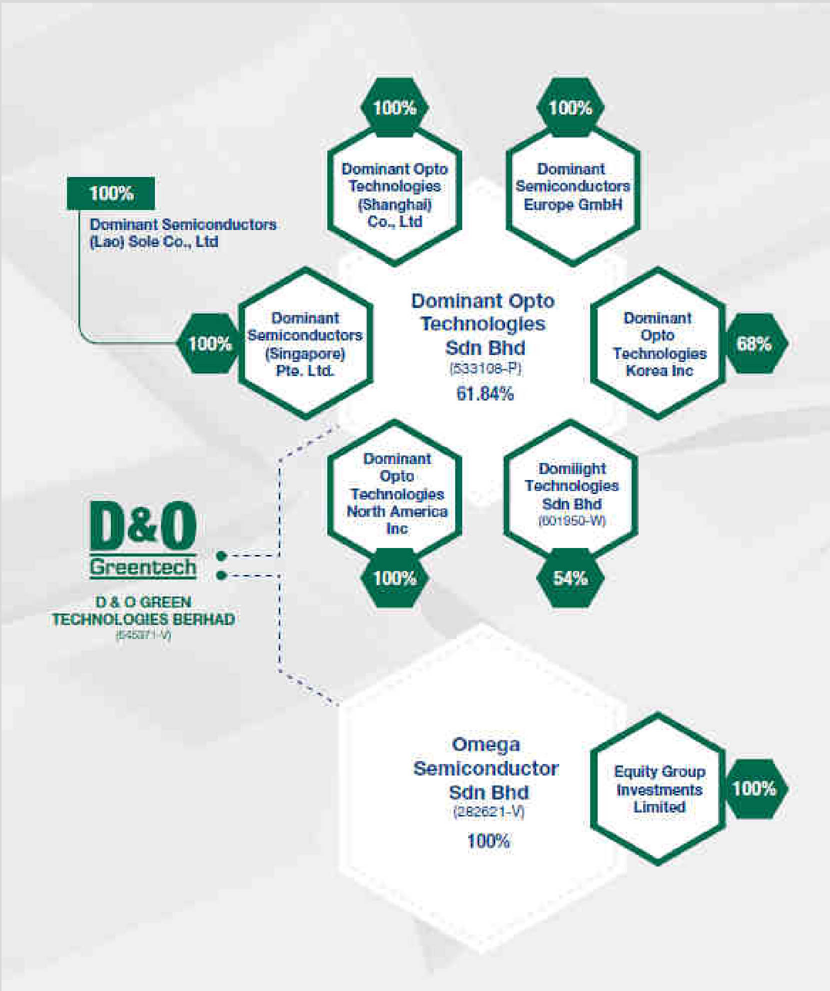
APPENDIX

Company Background

D & O Green Technologies Berhad was listed on Bursa in 2004 as an investment holding and provision of management services company. Through its principal operating subsidiary Dominant Opto Technologies Sdn Bhd ("Dominant"), D & O represents a world leading independent packaging company, offering packaging solutions for LED and other customer specific packages for a diverse range of optoelectronic applications under the "DOMINANT" brand. Dominant is located at the Batu Berendam Free Trade Zone in Melaka, where its state-of-the-art manufacturing facility produces LEDs that are AEC-Q101 qualified, a world class automotive quality standards.

Its mission statement is "To provide design innovation and high quality opto-semiconductor products that contribute towards a greener world". The group pride itself as a TQM (Total Quality Management) company that places high emphasis on product and service quality, alongside staying ahead of global competition through continuous investments in research and development capabilities. Business rationalisation to focus on core competency in automotive segment has been implemented since 2014 which resulted D & O environmentally-friendly LED products being sold around the world through its global network of sales and after sale service offices in numerous key automotive markets, including China, the US, Japan, Europe, Korea and India.

Group Structure as of end of 2016



Source: Company

Board of Directors

Name	Position	Background
Dato' Mohammed Azlan Hashim	Non-Independent and Non-Executive Chairman	• Appointed to the Board on 16 September 2004. • Holds Bachelor of Economics (Monash) and qualified as a Chartered Accountant (Australia). • Has extensive experience in corporate sector, including financial services and investment. • Is currently chairman of SILK Holdings Berhad, Scomi Group Berhad, Labuan IBFC Sdn Bhd and University Malaysia Terrengganu. • Is currently board member of Khazanah Nasional Berhad, Labuan Financial Services Authority and Chairman of Kumpulan Wang Persaraan Investment Panel
Tay Kheng Chiong	Group Managing Director	• Appointed to the Board on 16 September 2004. • Holds Bachelor of Engineering (Honours) degree majoring in Electrical and Electronics. • Appointed as a member of the Employees' Share Option Scheme Committee • Has more than 25 years' working experience in the opto semiconductor industry • Is currently director of Mega First Corporation
Cheam Dau Peng	Executive Director	• Appointed to the Board on 16 September 2004. • Appointed as a member of the Employees' Share Option Scheme Committee • Has more than 20 years' working experience handling production and plant operation.
Goh Nan Yang	Non-Independent and Non-Executive Chairman	• Appointed to the Board on 16 September 2004 • Appointed as chairman of the Remuneration Committee • Appointed as a member of the Employees' Share Option Scheme Committee and Nomination Committee • Currently also sitting in the board of MFCB and holds directorship in several private limited companies in Malaysia.
Yeow See Yuen	Independent and Non-Executive Chairman	• Appointed to the Board on 4 February 2009 • Appointed as a member of the Audit Committee, Remuneration Committee and Nomination Committee • Is currently a member of the Institute of Chartered Accountants of England and Wales • Started career in Auditing at Cooper & Lybrand in Singapore, and in Equity Research at Deutsche Securities Asia Limited (9 years). Thereafter, actively involved in investment banking related work. • Currently also sitting in the board of MFCB and holds directorship in several private limited companies in Malaysia and overseas.
Wong Meng Tak	Independent Non-Executive Director	• Appointed to the Board on 16 September 2004 and subsequently appointed as Senior Independent and Non-Executive Director on 8 April 2013 • Appointed as a Chairman of the Audit Committee and Nomination Committee • Has vast experience in banking industry where career started in 1971 with HSBC (Malaysia) Ltd.
Jesper Bjoern Madsen	Independent Non-Executive Director	• Appointed to the Board on 21 August 2014 • Appointed as a member of the Audit Committee and Remuneration Committee. • Started career with Carlsberg A/S Group (over 20 years) with vast experience in overseas investments and markets
Low Tek Beng	Alternate Director	• Appointed to the Board on 16 September 2004 as alternate Director to Cheam Dau Peng • Holds first class honours Bachelor of Mechatronic degree from University of Leeds, United Kingdom. • Started career as Product Development Engineer with a multinational semiconductor company and subsequently promoted to Product Development Manger before leaving • Is currently Chief Operation Officer in Dominant Opto Technologies Sdn. Bhd.

Source: Company

Business Overview

D&O key products: DomiLED

Source: Company

D&O key products: Power DomiLED

Source: Company

D&O key products: SpiceLED

Source: Company

D&O key products: Primax

Source: Company

Product Portfolio

Standard Power

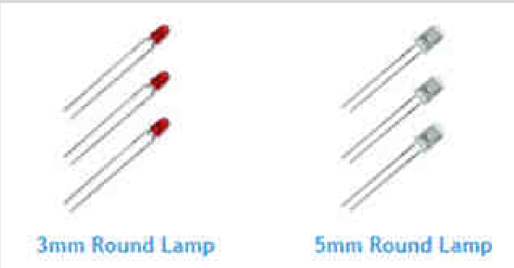
Source: Company

Product Portfolio (Cont'd)

Medium Power

High Power

Through Hole Lamp



Multi Colour

SMT Right Angle

Source: Company

Income Statement

FY Dec (RM m)	2014A	2015A	2016A	2017E	2018E
Revenue	421.3	433.1	430.1	483.7	628.8
EBITDA	31.6	46.7	59.1	71.5	89.9
D&A	-22.1	-23.2	-27.2	-31.2	-34.5
Operating Profit	9.5	23.5	32.0	40.3	55.4
Other Income	5.1	18.4	6.0	0.0	0.0
Interest Exp.	-2.8	-3.1	-2.4	-2.4	-2.4
Associate	-1.3	-1.4	0.0	0.0	0.0
PBT	6.1	19.0	29.6	38.0	53.1
Taxation	-1.6	-1.4	-8.5	-5.2	-7.3
Minority Interest	3.0	7.3	9.8	11.8	4.6
Net Profit	0.7	10.2	11.3	20.9	41.1
Core NP	3.9	10.3	19.5	20.9	41.1

Balance Sheet

FY Dec (RM m)	2014A	2015A	2016A	2017E	2018E
Fixed Assets	117.8	130.4	153.7	172.5	188.0
Intangible Assets	24.2	24.2	24.2	24.2	24.2
Other FA	28.3	31.5	29.0	29.0	29.0
Inventories	96.5	106.9	116.6	128.4	167.9
Receivables	60.0	60.6	93.4	85.7	111.5
Other CA	6.5	32.1	7.1	7.1	7.1
Cash	29.2	60.4	43.3	57.0	47.4
Total Assets	**362.3**	**446.2**	**467.3**	**504.0**	**575.1**
Payables	117.9	114.9	121.5	136.8	178.9
ST Borrowings	61.5	61.7	43.0	43.0	43.0
Other ST Liability	4.9	0.9	1.3	-4.7	19.4
LT Borrowings	0.2	0.2	5.9	5.9	5.9
Other LT Liability	0.9	0.6	7.1	7.1	7.1
Net Assets	**177.0**	**267.8**	**288.4**	**315.9**	**320.8**
Shareholders' Equity	134.1	185.2	197.3	213.0	305.8
Minority Interest	42.9	82.6	91.1	102.9	15.0
Total Equity	**177.0**	**267.8**	**288.4**	**315.9**	**320.8**

Cashflow Statement

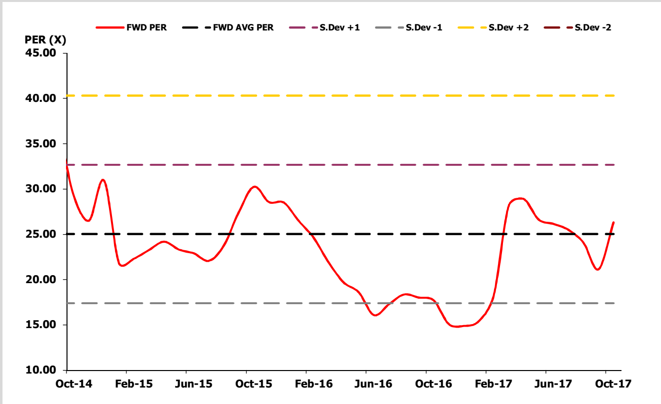
FY Dec (RM m)	2014A	2015A	2016A	2017E	2018E
Operating CF	29.0	-8.9	45.5	75.5	50.5
Investing CF	-24.5	-32.5	-45.5	-50.0	-50.0
Financing CF	-4.4	69.4	-13.4	-5.2	-10.2
Change In Cash	0.1	28.0	-13.5	20.3	-9.7
Free CF	5.7	-42.2	-9.2	25.5	0.5

Financial Data & Ratios

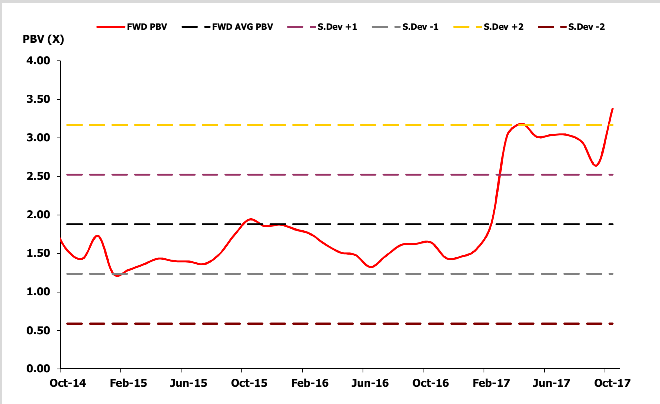
FY Dec (RM m)	2014A	2015A	2016A	2017E	2018E
Growth (%)					
Turnover	28%	3%	-1%	12%	30%
EBITDA	16%	48%	27%	21%	26%
Operating Profit	27%	148%	36%	26%	37%
PBT	20%	256%	56%	28%	40%
Adj. Net Profit	3%	167%	88%	7%	97%
Adj. FD EPS	2%	168%	86%	5%	37%
Profitability (%)					
EBITDA Margin	7%	11%	14%	15%	14%
Operating Margin	2%	5%	7%	8%	9%
PBT Margin	1%	4%	7%	8%	8%
Core Net Margin	1%	2%	5%	4%	7%
Effect. Tax Rate	30%	7%	29%	14%	14%
ROA	1%	2%	4%	4%	7%
ROE	3%	6%	10%	10%	13%
DuPont Analysis					
Net Margin (%)	1%	2%	5%	4%	7%
Assets Turnover (x)	1.2	1.0	0.9	1.0	1.1
Leverage Factor (x)	2.0	1.7	1.6	1.6	1.8
ROE (%)	3%	6%	10%	10%	13%
Leverage					
Debt/Asset (x)	0.2	0.1	0.1	0.1	0.1
Debt/Equity (x)	0.3	0.2	0.2	0.2	0.2
Net Cash/(Debt)	32.5	1.5	5.6	-8.2	1.5
Net Debt/Equity (x)	0.2	0.0	0.0	0.0	0.0
Valuations					
EPS (sen)	0.4	1.0	1.9	2.0	2.8
NDPS (sen)	-	-	-	0.5	0.7
BVPS (RM)	0.13	0.19	0.19	0.21	0.21
PER (x)	179.7	67.1	36.2	34.4	25.1
Net Div. Yield (%)	-	-	-	0.7	1.0
PBV (x)	5.2	3.7	3.6	3.4	3.4
EV/EBITDA (x)	22.5	14.6	11.7	9.6	7.7

Source: Kenanga Research

Fwd Core PER Band



Fwd PBV Band



Source: Bloomberg, Kenanga Research

Stock Ratings are defined as follows:

Stock Recommendations

OUTPERFORM	: A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM	: A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM	: A particular stock's Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT	: A particular sector's Expected Total Return is MORE than 10%
NEUTRAL	: A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT	: A particular sector's Expected Total Return is LESS than -5%

******Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.***

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