M'sian Pacific Industries

Glory Days Within Proximity

OUTPERFORM ↔

Price:	**RM11.12**
Target Price:	**RM14.00** ↑

By Adrian Kok l adrian.kok@kenanga.com.my

We came away from MPI's 1QFY20 Analysts' Briefing with our positive view further reinforced. Management expects subsequent quarter to perform better as strong demand has been observed in this Oct-Nov period. Its Suzhou plant is also benefiting from the long standing trade war, as orders are being diverted to locals. Management is confident of regaining its Shariah-compliant status in this upcoming November review. Raised FY21E CNP by 2% to RM172m. Maintain OP with higher TP of RM14.00, representing 26% upside.

Stronger quarter sequentially. MPI expects to see a stronger QoQ quarter ahead in 2QFY20 (growth on both top and bottom lines), as robust demand was observed in this Oct-Nov period. On top of that, the company has also secured a new US-based customer which specialises in silicon carbide power modules that is gaining rapid adoption in electric vehicles (EV).

Looking at the US-based customers' portfolio, we reckon that the end customer is likely to be Tesla. In Apr 2019, Tesla announced its latest powertrain update on Model S and Model X, promising 12% to 17% longer driving range per full charge. Tesla attributes this to the adoption of silicon carbide power electronics. Such improvement in efficiency could spark more demand of silicon carbide power modules.

Silicon carbide production to jump 30x. The US-based customer has allocated US$1bil to increase its silicon carbide production capacity by 30 times. In anticipation of a massive spike in demand, they are outsourcing the test and assembly task to MPI in order to cope with the task at hand. This allows them to focus more of its resources on design and production.

Massive China expansion. Even with the ban lifted, Huawei is still persistent on reducing its reliance on US vendors. Huawei is aggressively loading local vendors with more orders to mitigate supply chain disruption. This in turn benefits MPI's Suzhou plant that is already running at 104% utilization rate. To accommodate more orders, MPI has allocated US$33mil for "Phase 1" expansion which will be completed by end-2019 and start contribution sequentially.

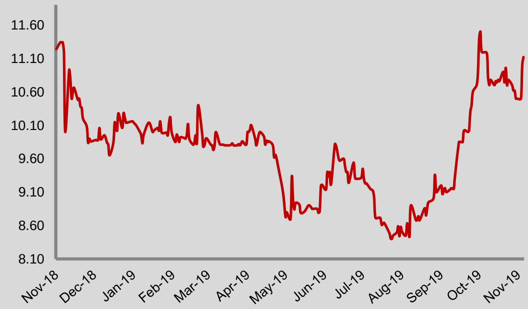
Robust balance sheet. With net cash of RM760m as at end-1QFY20, we are confident that the group will have no issue funding "Phase 2" expansion in Suzhou, which entails doubling the capacity of "Phase 1". In addition, MPI will still have sufficient financial clout to look for potential merger and acquisition opportunities.

Syariah-status almost a done deal. The group has taken the necessary steps and is hopeful of regaining its Shariah-compliant status upon the upcoming review period end-November 2019. This could spark another wave of buying interest from Shariah-compliant funds.

Raised FY21E CNP by 2% to RM172m to account for increasing orders from China and the venture into silicon carbide power modules which are exhibiting promising prospects.

Maintain OUTPERFORM with a higher Target Price of RM14.00 based on higher CY20E PER of 16x (previously 14x), representing +1.5SD from its 5-year mean. Our higher PER is justified by the group's long-term objective to transform its portfolio into an automotive-centric one, a space which offers brighter growth prospects due to rising semiconductor content in automobiles. Moreover, the stock is still a bargain with ex-cash PER of 11x after considering its net cash position of RM760m.

Share Price Performance



KLCI	1,587.18
YTD KLCI chg	-6.1%
YTD stock price chg	+11.8%

Stock Information

Shariah Compliant	No
Bloomberg Ticker	MPI MK EQUITY
Market Cap (RM m)	2,211.7
Shares Outstanding	190.1
52-week range (H)	11.54
52-week range (L)	8.33
3-mth avg daily vol:	201,610
Free Float	34%
Beta	0.9

Major Shareholders

Hong Leong Co Malaysia Bhd	52.6%
Malaysian Pacific Industries Bhd	3.9%
KWAP	2.4%

Summary Earnings Table

FY Jun (RM m)	**2019A**	**2020E**	**2021E**
Turnover	1,542	1,513	1,592
EBIT	390.0	461.8	490.1
PBT	207.0	238.1	254.2
Net Profit (NP)	142.5	161.0	171.9
Core NP	145.9	161.0	171.9
Consensus (CNP)	-	150.7	168.7
Earnings Revision	-	0.0%	2%
EPS (sen)	85.8	84.7	90.4
EPS growth (%)	-11.5	32.0	6.7
NDPS (sen)	29.0	27.0	29.0
BV/Share (RM)	5.70	5.84	6.23
Core PER	10.1	12.3	11.5
Price/BV (x)	1.5	1.8	1.7
Net Gearing (x)	-0.5	-0.7	-0.8
Net Dvd Yield (%)	3.3	2.6	2.8

SILICON CARBIDE PRODUCTION TO RISE 30x

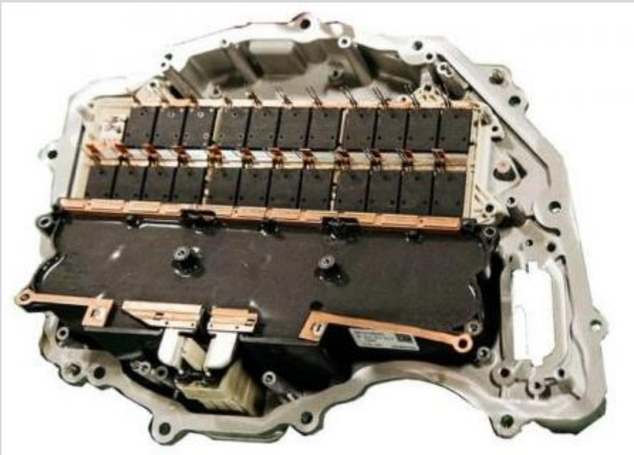
Our conviction on MPI's prospects were further strengthened after learning that the company recently acquired a new US-based customer that focuses on silicon carbide power products, that is seeing rapid adoption in electric vehicles.

The new US-based customer (listed on NASDAQ) has allocated US$1bil (20% of its market capitalisation) to grow its silicon carbide business, marking its largest investment to date. A state-of-the-art silicon carbide fabrication facility and materials mega factory is being constructed to increase its silicon carbide production capacity by a whopping 30 times.

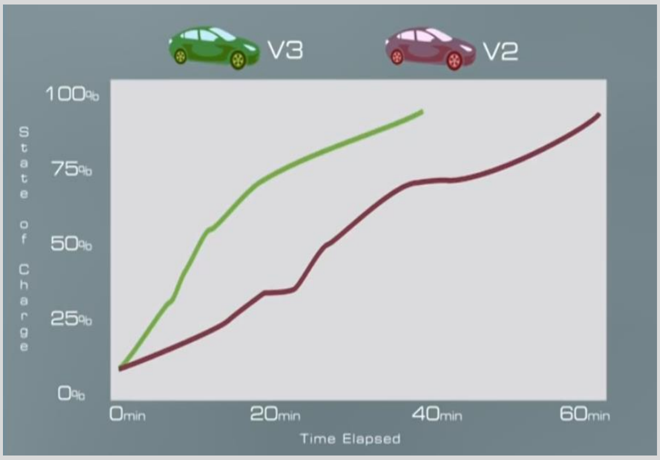
In anticipation of a huge demand spike for silicon carbide application, the US-based customer has opted to outsource the packaging and testing processes to MPI, who specialises in such areas. This frees up resources for the US-customer to focus more on designing and production.

MPI has installed 2 lines for the US-based customer, which is slated to commence operation in the next quarter. The number of lines will be gradually expanded to a total of 6 lines in 2020. Upon full ramp up, it is expected to contribute circa 10% of the group's revenue.

Silicon Carbide Power Modules



Charging Time Reduce by 50%



Source: Munro & Associates, Vehiclesuggest

Extended distance and faster charging for EVs

Power semiconductor made from silicon carbide alleviates two major concern of electric vehicles (EV) — range and charging time. Silicon carbide is able to withstand up to 10x higher voltage than common silicon. This will allow for fewer switches used in a system, translating into simpler and more reliable system layout as well maintaining affordability thanks to less components used.

Also, using silicon carbide for power semiconductors brings about better resilience in terms of operating temperature. Common silicon is generally rated to operate at a maximum temperature of 150°C, whereas silicon carbide is capable to maintain functionality even above 200°C. Meaning, EVs can be charged quicker with a higher powered charger (usually associated with higher temperature) to reduce charging time.

Tesla runs longer on silicon carbide

Based on the US-customer's portfolio, its silicon carbide power products are used in high-end EV manufacturer. We believe that the end-customer for its power product is likely to be Tesla. In April 2019, Tesla attributed the extended range capabilities and shorter charging times of its Model S and Model X to the adoption of silicon carbide power electronics.

For illustration, the same 100kWh battery pack prior to the Apr 2019 facelift is rated for 507km on the Model S and 465km on the model X. Post facelift, the figures were increased to 595km (+17%) and 523km (+12%) respectively. Tesla also claims that the charging time was reduced by 50% with its new Supercharger V3 that runs at a peak rate of 200kW vs. 145kW on the previous Supercharger V2.

THRIVING AMIDST TRADE DISPUTE

While many companies are still blaming the US-China trade war for their deteriorating business prospect. MPI have instead used the long-standing dispute to its advantage by securing more customers for its Suzhou plant.

This comes as the ban on Huawei led to an increase in demand for local Chinese vendors. Realising that its current supply chain is susceptible to sudden and abrupt bans due to high exposure to US vendors, Huawei is aggressively loading local vendors with more orders to mitigate supply chain disruption.

In light of this, Chinese vendors are also forced to incur additional capex in a short time frame to cater for the spike in orders. Such scenario is also echoed by semiconductor equipment maker MI Technovation (UNRATED) during their latest analysts briefing, expecting this to spur more orders for their semiconductor equipment.

Massive expansion in Suzhou plant

In order to take on more orders in its Suzhou plant, MPI is undergoing a massive expansion of its facility that is currently running at 104% utilisation rate. The group has allocated US$33mil for "Phase 1" expansion alone. MPI indicated that the new machines will be arriving by end-2019 and operations for the new customers will commence very soon with revenue contribution expected to be captured in the subsequent quarters.

"Phase 2" expansion (doubling of Phase 1's floor space) will be carried out in 3QFY20. While the company has yet to provide a budget for "Phase 2" expansion, we believe that its cash reserve of RM760mil is more than sufficient to fund the expansion. The company expects contribution from Suzhou plant to climb significantly to 50% from its current level of 30% by 2021.

M&A still in the cards

With its massive cash pile of RM760 mil, MPI has huge financial buffer to hunt for potential M&As. The company hinted that acquiring players involved in the electronic manufacturing services (EMS) and materials space could be synergistic.

This will allow MPI to manufacture full electronic modules, extending its capabilities beyond integrated circuit (IC) packaging. End-to-end service such as this could potentially command higher margins too.

While the search for M&A has been discussed for a quite a while, the company reiterated that it is being very selective on its potential targets in order to reduce the risk of going into a dilutive M&A.

Shariah-compliant status almost a done deal

MPI has done the necessary steps and submitted the documents to meet the prerequisites of getting reinstated into Malaysia's Shariah–compliant list. The company has deposited most its cash pile into an Islamic bank account, reducing its cash in conventional bank account to meet the 33% (cash to total asset) threshold.

With the next review coming up end of November 2019, we believe the reinstatement could spark another wave of buying interest from Shariah-compliant funds. The inclusion comes at a right time as things are turning very positive for MPI with more job wins.

VALUATION

We raised FY21E CNP by 2% to RM172m to account for increasing orders from China and the venture into silicon carbide power modules which are exhibiting promising prospects.

Maintain OUTPERFORM with a higher Target Price of RM14.00 (26% upside) based on higher CY20E PER of 16x (previously 14x), representing +1.5SD from its 5-year mean. Our higher PER is justified by the group's long-term objective to transform its portfolio into an automotive-centric one, a space which offers brighter growth prospects due to rising semiconductor content in automobiles. Moreover, the stock is still a bargain with ex-cash PER of 11x after considering its net cash position of RM760m.

Income Statement

FY Jun (RM m)	2016A	2017A	2018A	2019E	2020E
Revenue	1,463.3	1,544.5	1,542.3	1,480.5	1,513.1
EBITDA	406.9	444.6	390.0	355.3	461.8
EBIT	197.5	251.6	208.1	181.4	226.4
Finance costs	2.2	2.4	3.2	3.2	0.0
PBT	196.4	251.0	207.0	189.8	238.1
Taxation	(0.4)	32.2	34.5	29.8	37.4
Minority Interest	(39.3)	(40.8)	(30.0)	(31.7)	(39.8)
Net Profit	157.5	177.9	142.5	128.3	161.0
Core Net Profit	149.9	183.3	145.9	128.3	161.0

Balance Sheet

FY Jun (RM m)	2016A	2017A	2018A	2019E	2020E
Fixed Assets	720.0	671.2	646.7	664.0	575.0
Intangible Assets	0.0	0.0	0.0	0.0	0.0
Other FA	33.5	37.1	34.6	35.0	35.0
Inventories	87.7	110.8	118.1	105.4	106.6
Receivables	212.4	275.8	248.9	190.5	194.7
Other CA	0.0	0.0	0.0	0.0	0.0
Cash	317.3	535.8	647.6	713.4	952.3
Total Assets	**1,370.8**	**1,630.6**	1,695.9	1,708.4	1,863.8
Payables	160.6	205.5	210.6	194.3	196.5
ST Borrowings	33.3	63.5	75.0	0.0	0.0
Other ST Liability	2.9	2.0	5.1	12.8	16.0
LT Borrowings	0.0	28.6	0.0	0.0	0.0
Other LT Liability	3.9	2.2	0.3	2.1	2.6
Minorities Int.	190.5	209.0	217.4	230.0	269.8
Net Assets	**979.6**	**1,120.0**	**1,187.5**	**1,269.2**	**1,378.9**
Treasury Shares	(163.8)	(163.8)	(163.8)	(163.8)	(163.8)
Share Capital	104.9	352.4	352.4	352.4	352.4
Reserves	1,038.5	931.4	999.0	1,080.7	1,190.3
Total Equity	**979.6**	**1,120.0**	**1,187.5**	**1,269.2**	**1,378.9**

Cashflow Statement

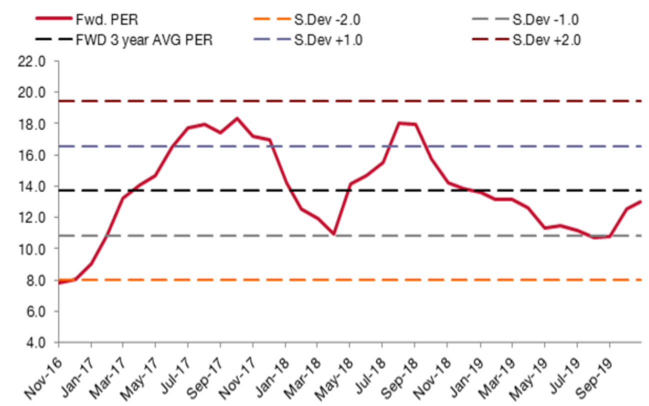
FY Jun (RM m)	2016A	2017A	2018A	2019E	2020E
Operating CF	414.2	357.8	350.2	366.7	436.7
Investing CF	(124.5)	(126.8)	(168.3)	(195.0)	(146.5)
Financing CF	(124.4)	(15.5)	(72.1)	(123.7)	(51.3)
Change In Cash	165.3	215.6	109.8	63.5	239.0
Free CF	289.1	228.8	179.5	172.1	290.3

Financial Data & Ratios

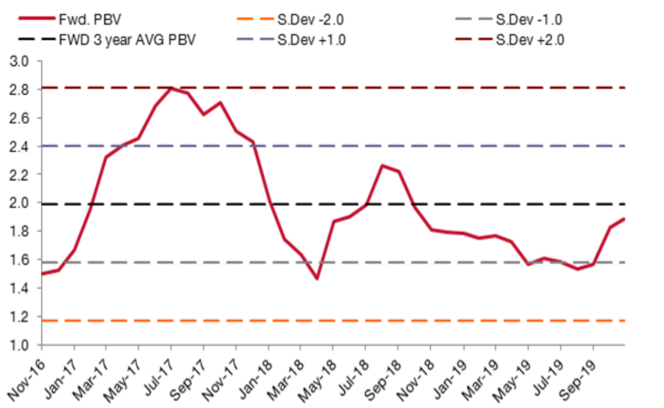
FY Jun (RM m)	2016A	2017A	2018A	2019E	2020E
Growth (%)					
Revenue	5%	6%	0%	-4%	2%
EBITDA	14%	9%	-12%	-9%	30%
EBIT	28%	27%	-17%	-13%	25%
PBT	28%	28%	-18%	-8%	25%
Core Net Profit	38%	22%	-20%	-12%	25%
Profitability (%)					
EBITDA Margin	27.8%	28.8%	25.3%	24.0%	30.5%
EBIT Margin	13.5%	16.3%	13.5%	12.2%	15.0%
PBT Margin	13.4%	16.2%	13.4%	12.8%	15.7%
Core Net Margin	10.2%	11.9%	9.5%	8.7%	10.6%
Effect. Tax Rate	-0.2%	12.8%	16.7%	15.7%	15.7%
ROA	10.9%	11.2%	8.6%	7.5%	8.6%
ROE	15.3%	16.4%	12.3%	10.1%	11.7%
DuPont Analysis					
Net Margin (%)	10.2%	11.9%	9.5%	8.7%	10.6%
Assets Turnover (x)	1.1	0.9	0.9	0.9	0.8
Leverage Factor (x)	1.4	1.5	1.4	1.3	1.4
ROE (%)	15.3%	16.4%	12.3%	10.1%	11.7%
Leverage					
Debt/Asset (x)	0.0	0.1	0.0	0.0	0.0
Debt/Equity (x)	0.0	0.1	0.1	0.0	0.0
Net Cash/(Debt)	284.0	443.8	572.6	713.4	952.3
Net Debt/Equity (x)	-0.3	-0.4	-0.5	-0.6	-0.7
Valuations					
EPS (sen)	78.9	96.5	76.8	71.3	84.7
NDPS (sen)	23.0	27.0	29.0	27.0	27.0
BVPS (RM)	4.16	4.80	5.11	5.77	5.84
PER (x)	11.0	9.0	13.5	14.6	12.3
Net Div. Yield (%)	2.6	3.1	2.8	2.6	2.6
PBV (x)	2.09	1.81	2.04	1.80	1.78
EV/EBITDA (x)	3.8	3.1	4.1	3.8	2.2

Source: Kenanga Research

Fwd Core PER Band



Fwd PBV Band



Source: Bloomberg, Kenanga Research

Peer Comparison

Name	Last Price (RM)	Market Cap (RM'm)	Shariah Compliant	Current FYE	Revenue Growth 1-Yr. Fwd.	Revenue Growth 2-Yr. Fwd.	Core Earnings Growth 1-Yr. Fwd.	Core Earnings Growth 2-Yr. Fwd.	PER (x) - Core Earnings Hist.	PER (x) - Core Earnings 1-Yr. Fwd.	PER (x) - Core Earnings 2-Yr. Fwd.	PBV (x) Hist.	PBV (x) 1-Yr. Fwd.	ROE (%) 1-Yr. Fwd.	Net Div. Yld. (%) 1-Yr. Fwd.	Target Price (RM)	Rating
STOCKS UNDER COVERAGE																	
D&O GREEN TECHNOLOGIES BHD	0.690	768.4	Y	12/2019	3.7%	10.5%	5.8%	30.3%	26.0	26.4	21.6	2.5	2.5	9.3%	1.4%	0.670	MP
KESM INDUSTRIES BHD	8.74	375.9	N	07/2020	13.8%	5.4%	237.6%	17.1%	59.9	18.2	15.2	1.0	1.0	5.8%	1.1%	9.30	OP
MALAYSIAN PACIFIC INDUSTRIES	11.12	2,211.7	N	06/2020	2.2%	5.2%	25.5%	6.7%	15.6	13.1	12.3	1.9	1.9	12.2%	2.4%	14.00	OP
PIE INDUSTRIAL BHD	1.44	553.0	Y	12/2019	5.5%	7.3%	-7.5%	16.2%	13.1	14.1	12.1	1.3	1.3	9.1%	3.5%	1.40	MP
SKP RESOURCES BHD	1.20	1,500.2	Y	03/2020	18.9%	14.1%	16.0%	17.1%	15.5	13.3	11.4	2.5	2.3	18.2%	3.7%	1.35	OP
UNISEM (M) BERHAD	2.17	1,577.8	Y	12/2019	-6.8%	2.7%	-25.5%	31.4%	16.5	22.3	17.0	1.1	1.1	4.9%	2.8%	2.40	MP

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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