# Technology

## 5G and China to drive growth

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**OVERWEIGHT**

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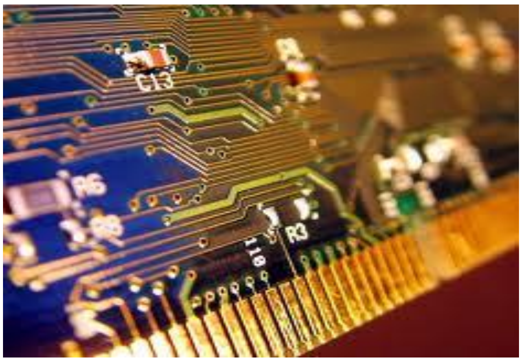
**We recently visited 7 technology companies in Penang – VITROX, RGT, TECHFAST, UCHI, FPGROUP, UWC and GLOBETRONICS. The general tone was more positive with many of the companies indicating better visibility from their customers this time around compared with the same period last year. We are seeing signs of the conceptual play of "5G as a catalyst" beginning to show actual progress towards realisation. This is evident by a surge in orders for VITROX's 3D AOI machine with demanding deadlines from customers in China. Such trend is in line with market demand as 5G-enabled PCB requires 3D AOI to properly measure top and bottom, as well as trapezoidal sections of the PCB. In addition, the global top 10 OSAT players recorded an aggregate revenue growth of 1% YoY, a commendable feat amid a turbulent semiconductor industry this year. This could lead to a turnaround next year as OSAT players' are typically more susceptible to changes in the market. For investors who are looking to gain exposure to the sector at this juncture, we reckon that VITRTOX offers exciting prospects that will grow in tandem with the adoption of 5G given that 36% of its revenue is derived from the telecommunication sector.**



**Better clarity for 1HCY20.** We visited 7 technology companies in Penang – ViTrox Corporation Berhad (VITROX), Rapid Growth Technology Berhad (RGT), Techfast Berhad (TECHFAST), Uchi Technologies Berhad (UCHI), FoundPac Group Berhad (FPGROUP), UWC Berhad (UWC) and Globetronics Technology Berhad (GLOBETRONICS). The general tone was more positive with many of the companies indicating better visibility from their customers this time around compared with the same period last year.

**5G: from conceptual to realisation.** We are seeing signs of the conceptual play of "5G as a catalyst" beginning to show actual progress towards realisation. For instance, equipment maker such as VITROX is currently experiencing a surge in orders with demanding deadlines from customers in China. Most of the orders were placed for 3D Automated Optical Inspection (AOI) machine, as many facilities in China has yet to switch from 2D to 3D inspection. This is in line with market demand as 5G-enabled printed circuit board (PCB) requires 3D AOI to properly measure top and bottom, as well as trapezoidal sections of the PCB.

**OSATs flashed early signs of turnaround**. In the recent 3Q2019 earnings, we noted that the global top 10 outsourced semiconductor assembly and test (OSAT) players recorded an aggregate revenue growth of 1% YoY for 3Q2019, a commendable feat amid a turbulent semiconductor industry this year. This could lead to a turnaround next year as OSAT players' are typically more susceptible to changes in the market (due to their current just-in-time system) compared with equipment makers who generally have longer order book visibility.

**Spotting the niche.** Undiscovered material compound supplier like TECHFAST, whose customers are in the OSAT space, is also seeing an uptick in activities. Tianshui Huatian's new plant in Xi'an (7x bigger than the current Tianshui plant) is currently qualifying TECFAST as its supplier for mould cleaning rubber sheets beginning 1Q2020.

**Benefits from trade diversion begin to materialise.** On the US-China trade war front, we are seeing contract manufacturer like RGT starting to see more enquiries materialising into orders due to the unsettled trade spat between US and China. FPGROUP on the other hand saw a doubling of orders recently from its China customer. Although the last wave of tariff was recently called off, we believe that it does not change the fact that China still intends to be technologically self-sufficient. As such, China will continue to spend on capex to increase its capacity and broaden its range of products to reduce reliance on US vendors.

**Be selective.** Overall, we would recommend devising a strategy which entails taking positions in selective companies who may benefit from the adoption of 5G, such as VITROX and TECHFAST. We foresee OSAT player like GLOBETRONICS missing out the growth momentum even though its end-customer is in the smartphone business. This is due to the fact that its main focus is on smartphone light sensors and TWS gesture sensors, which does not correlate with the growth of 5G.

## ViTrox Corporation Berhad (NOT RATED)

### Full Steam Ahead

**Bustling production floor.** ViTrox Corporation Berhad (VITROX)'s 960k-sq ft Campus 2.0 shifts into high gear as the company prepares for a busy schedule. During our visit to its production facility in Batu Kawan, Penang, we noticed that the entire floor space on level 1 (for Machine Vision System – MVS) and level 2 (for Automated Board Inspection – ABI) were fully occupied, a huge improvement from our previous visit in 3Q19. Recall that 3Q19 was a subdued quarter for the company due to a global slowdown in the technology sector, yet the company hired more engineers (+18% headcount since last year) in anticipation for a busy quarter ahead.

**4Q19 earnings to pick up and continue into 1Q20.** Putting the "rock bottom" 3Q19 behind, the company is positive for 4Q19 as orders are flowing in aggressively. Particularly, a customer from China demanded for 3D automated optical inspection (AOI) beyond the company's production capacity. VITROX could only ship out close to half of the quantity demanded, with the other portion deferred to 1Q20. As such, it is currently loading up its inventory ahead of orders in anticipation for higher demand in subsequent quarters. To cope with customer's demanding deadlines, the company has also embarked on initiatives to improve operational efficiencies. A notable change in its production floor is the implementation of its proprietary V-ONE industrial 4.0 software which enables live monitoring of each machine's completion status.

**Targeting more sales from China.** Riding along China's initiative to be technologically self-sufficient in both hardware and software, VITROX is deploying more personnel to expand its reach in the Chinese market. Currently, China contributes 24% of the group's revenue, namely from areas such as Suzhou, Shanghai and Beijing. The next targeted city is Wuhan, the largest city of the province of Hubei. Housed in this area are national level high-tech industrial zones such as the Donghu New Technology Development Zone and East Lake New Technology Development Zone which are known for producing telecommunication equipment, crucial to the implementation of 5G connectivity. This bodes well for VITROX as it derives 36% of its revenue from the telecommunication segment.

**Order book stood at RM90m** as of 30 Sep 2019, with 67% from ABI division and 33% from MVS division. The company also indicated during our recent visit that more customers were acquired during the month of Oct and Nov. With the usual recognition of 3 months of its order-book, Q419 revenue could potentially record circa 30% QoQ jump.

**Stay for the growth.** According to Bloomberg consensus, the stock is currently trading at a FY20F PER of 30.8x (vs. its 2-year average of 29.6x), which may seem to be fairly valued at this point of time. However, investors who have longer horizon could benefit further from the growth of 5G as the company's FY21F Fwd. PER of 26x still allows for 13.8% upside with an indicative price of RM9.04.

**Company Background**

ViTrox Corporation Berhad (VITROX) specialises in designing and developing automated vision inspection system and equipment testers for the semiconductor and electronic manufacturing services (EMS) industries as well as electronic communications equipment. The company derive 71% of its revenue from the ABI segment (which includes Automated Optical Inspection and Automated X-ray Inspection) and 28% from MVS.

**3D Automated Optical Inspection**


**ViTrox campus 2.0 – 960K sq-ft**

*Source: Company*

## Rapid Growth Technology Berhad (NOT RATED)

### Rapid Growth in the making

**Acquiring new customers.** Since 2018, Customer A (listed on Nasdaq) has granted Rapid Growth Technology Berhad (RGT) the permission to open up their production lines and be a non-exclusive supplier. This allows RGT to engage with Customer A's competitors but not its end-customers. Currently, RGT has started production of multi-phasing air fresheners for a new customer based in the United Kingdom (UK). While volume is still low, the company believes that the flexibility to acquire new customers and venture into new products may in turn offer higher margin businesses.

**Benefiting from trade diversion.** Management said that there are more enquires from prospective customers who seek to shift its production to Malaysia due to the US-China trade war. Besides the new UK customer, RGT will start production of soap dispensers for another US company, well known for its hand sanitiser in the region. Production is slated to commence in 2QFY20 (June FYE) and will contribute positively to the company, albeit at a gradual pace.

**New medical device offers new income stream.** RGT is also venturing into the medical space to manufacture auto injector syringe that is used for insulin delivery. The group will be manufacturing the auto injectors and cartridge refills in a 100K clean room housed in its facility that has been qualified by the customer. This project which is still in the development stage could take 8-12 months before going into mass production. With the Food and Drug Administration (FDA) approval likely to be attained in 2H2020, meaningful contributions may only be seen in 2021.

**Fair treatment.** The group has always practised a policy to pay above minimum wage and provides a well maintained living environment for its factory operators. This has shielded the group from negative surprises such as wage hike regulations by the local government. Also, maintaining a good record throughout its customers' periodical audit has played an important role in allowing to group to better penetrate prospective customers in the US and UK region, which are increasing the emphasis on environmental, social and corporate governance (ESG) when selecting supply chain vendors.

**Target growth of 20-25%.** Overall, management is targeting 20-25% revenue growth for FY20 (June YE), driven by new customers due to trade diversion. Correspondingly, profit could potentially see a larger quantum growth on the back of margin expansion due to more customisation (for air freshener dispenser and refill) and optimising its production line. The group also aims to get more customers and eventually reduce its reliance on customer A to 50% from 85%.

The abovementioned growth translates to Fwd. PER of 12.2x-12.7x vs. 2-year average of 14.0x for EMS players. Based on the average PER, RGT could command a FV of RM0.19-0.20 (vs. RM0.170 currently).

#### Company Background

Rapid Growth Technology (RGT) was established in 1997 in a rented facility with an initial workforce of 30 people. Fast forward, the group has grown rapidly into a family of more than 300 professionals with a fully equipped manufacturing facility in Bukit Minyak, Penang, spanning across 192K sq-ft. RGT provides original design manufacturer (ODM) service for washroom solution (soap dispenser), automotive air care (air freshener) and medical devices (auto injector syringe).

**RGT's production floor**


*Source: The Star*

## Techfast Berhad (NOT RATED)

### Niche but Crucial in the OSAT space

**Exciting quarters ahead.** Techfast Berhad (TECHFAST) is expecting to see exciting quarters ahead in tandem with the Semiconductor Industry Association's (SIA) 5.9% growth projection for 2020 worldwide semiconductor sales. Looking deeper into the Outsourced Semiconductor Test and Assembly (OSAT) space where TECHFAST generates its revenue from, we noticed that the top 10 OSAT players (including the likes of ASE Technology, Amkor Technology and Tianshui Huatian Technology) recorded an aggregate revenue growth of 1% YoY for 3Q2019. This is commendable given such choppy condition for the semiconductor industry this year. TECHFAST 3QFY19 revenue also grew 6.4% YoY.

**Penetrating China market.** Currently, TECHFAST's mould cleaning rubber sheet business (42% of group revenue) has captured close to the entire Malaysian market. To grow further, the group is looking to expand its presence in China and Taiwan, which are seeing rapid growth due to China's goal to be technologically self-sufficient.

**7x bigger plant.** Given the company's cheaper pricing and superior formula which results in more efficient cleaning compared with peers, Tianshui Huatian (TSHT) has agreed select TECHFAST as its supplier for mould cleaning rubber sheet. TSHT is currently qualifying TECHFAST's mould cleaning rubber sheet for its Xi'an plant that is 7x larger than the plant in Tianshui. With the qualification process scheduled to be finalised by end-2019, the group expects contribution to kick in 1QFY20. TSHT is among the top 3 OSAT in China with a global market share of 5.4%.

**Fast, clean and competitive.** TECHFAST has proven to be superior among its peers, thanks to its in-house developed formula that took 7 years to perfect. For instance, its rubber sheet only takes 120-180 seconds of curing time each round compared with peers which take double the time at 360 seconds. Curing duration is a crucial consideration factor given that cleaning time is interpreted as downtime for OSATs. Furthermore, the usage of rubber compound instead of melamine yields better cleaning result, no-foul odour and easier removal process as the rubber sheet does not break off after curing (see pic below). Pricing wise, the company's ASP is circa 15% cheaper than that of its peers who are currently supplying to TSHT's Tianshui plant. As such, it was able to outbid its competitors in the tender to supply for TSHT's Xi'an plant.

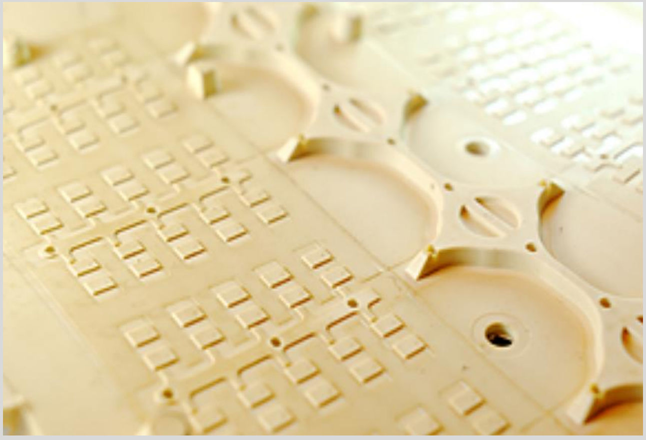
**Scarcity premium given its niche.** Overall, the management is upbeat for the coming quarter given the gradual pickup in the semiconductor space. This translates into a Fwd. PER of 22x vs. its 3-year average of 26.2x. Assuming a reversion to mean, TECHFAST could command a fair value of RM0.52 (18% upside).

#### Company Background

Techfast Berhad (TECHFAST) is principally involved in three main areas, (i) manufacturing and distribution of high precision fasteners, (ii) mould cleaning and conditioning compound and (iii) customised epoxy and colour dye formulation for the encapsulation of photonic devices. The revenue breakdown is 41%, 42% and 17% respectively.

**Mould cleaning rubber sheet**

**Post-cleaning result**



*Source: Company*

## Uchi Technology Berhad (NOT RATED)

### Steady Growth with Good Dividend

**Expanding beyond hardware.** Uchi Technology Berhad (UCHI) is expanding beyond hardware (control modules) design for coffee machines. In tandem with its industry trend of switching to fully-automatic coffee machine, the group now provides software development together with periodical firmware updates that allows for different coffee recipe. Basically, the firmware update tweaks the heat, water, coffee and foam ratio according to customer's demand. Given that software usually commands higher margin compared to hardware, it is understandable why UCHI has been able to sustain its lucrative net margin of 45%-50% for the past years.

**Coffee consumption will continue to rise.** Coffee consumption has been on the rise will continue to see growth, thanks to the increased consumption in Asian countries which serves as a key driving factor. Furthermore, introduction of new products such as flavoured infused coffee beans and organic coffee is expected to contribute positively to the coffee drinking trend.

**Health benefits in coffee.** Increasing awareness of health benefits such as reduced risk of type 2 diabetes, liver cancer and heart failure may also contribute to higher demand for coffee machines, particularly in the household market. *Grand View Research* expects the coffee machine market to grow at a CAGR of 3.7% from 2019-2025, with capsule coffee machine estimated to be the faster growing segment.

**Steady growth.** For FY19F (Dec YE), the company expects to maintain high single digit YoY growth in terms of bottom line. Beyond that, management expect FY20F to record flat to low single digit revenue growth in USD terms, while bottom line will also see low single digit growth. This is based on the 6 months visibility that the company currently has.

**Good dividend.** The stock is currently trading at a Fwd. PER of 16.8x (vs. its 2-year average of 17x). Based on the average PER, UCHI could command a FV of RM2.86 (vs. RM2.82 currently).The company's 70% dividend payout policy translates into an attractive 4.3% dividend yield.

#### Company Background

Uchi Technology Berhad (UCHI) is principally involved in Original Design Manufacturing (ODM), specialising in the design of electronic control systems, display modules and tooling design. Designing and development of electronic control modules are done in-house. UCHI then manufactures and assembles components into semi-finished parts and control modules which its customers will insert into their finished products (eg. coffee machine). Uchi develops the software programming, hardware design and system construction of these ODM products. The branding "UCHI" is printed on most of the microprocessor and PCBs.

**Coffee machine**

**Control module**

*Source: Company*

## FoundPac Group Berhad (NOT RATED)

### Low volume, High margin

**New substantial US customer.** FoundPac Group Berhad (FPGROUP) has for the first time saw Customer A contributed 22% of its total revenue in the recent 1QFY20 (June YE) result. Typically, Customer A contributes less than 10% of group revenue. Incremental orders were placed for printed circuit board (PCB) stiffeners that will be used for research and development (R&D) purpose. While management is unsure of the end product, we believe this is likely related to 5G connectivity as customer A has been attempting to broaden its 5G offerings beyond modem to incorporate front-end radio frequency modules as well. Customer A is a US-based firm with 40% global market share in the smartphone processor space, prominently in the Android operating system (OS) market.

**China customer doubled its orders.** FPGROUP also supplies PCB stiffener to the largest smartphone processor designer in China (Customer B). Although the group's PCB stiffener is selling at a premium compared with prices in China, Customer B still chooses to source from FPGROUP owing to its reliability and attention to details. Recently, Customer B doubled its orders from FPGROUP after cutting off its second supplier in China, due to inferior quality.

**Fresh orders for test sockets.** An Italian semiconductor company recently placed orders for 6 units of test sockets, together with 6 units of handler. We believe that the end usage is non-5G related but more likely to be automotive (probably electric vehicles) related given the customer's background.

**Low volume, staggering margin.** While the order quantity is low, FPGROUP generates staggering margins from these products. In terms of gross profit margin, PCB stiffeners command around 35%-40% while test sockets can go up to 70%. This is attributable to the fact that all test sockets are fully customised according to customer's demand. Each and every stiffeners and test sockets goes through quality control once by machine inspection and then by human inspection. This explains why FPGROUP's products have close to zero rejection rates by customers.

**Targets mid-teens revenue growth.** The company guided a revenue growth of circa 15% for FY20F, on the back of increased R&D activities in preparation for the roll-out of 5G connectivity. This translates in to a Fwd. PER of as high as 20x vs. its 2-year average of 18x. While prospects are good, valuation appeared stretched.

**Company Background**

FoundPac Group Berhad in Bayan Lepas. FPGROUP was incorporated on 16 November 2015 as a private limited company and was converted into public limited company on 11 March 2016. The group is principally involved in the design, development, manufacture, marketing and sale of precision engineering parts namely stiffeners, test sockets, hand lids and related accessories, as well as the manufacture and sale of laser stencils. The groups' customers are primarily large multinational semiconductor manufacturers, outsourced semiconductor assembly and test companies (OSATs) and printed circuit board (PCB) design houses

**Stiffeners**


**Test socket**


*Source: Company*

## UWC Berhad (Not Rated)

### Riding along Moore's law

**10nm process node to drive momentum.** UWC Berhad (UWC) is currently riding along Customer A's roadmap in shrinking the size of its process nodes. In light of this, UWC will see more orders for processor testers as the 10nm processors requires different socket arrangement and thermal design power (TDP) compared with the existing 14nm.

The recently launched 10th generation processors with 10nm process nodes by Customer A on Aug 2019 were only catered for portable devices. This means that processors for non-portable devices will still be manufactured with the existing 14nm process nodes due to bottleneck issues. Nevertheless, we noted that the 10th generation processors for non-portable device still requires new socket arrangement and different TDP even though it is based on the existing 14nm process node. Hence, UWC will still benefit from more orders from Customer A as new testers will be needed. Moreover, Customer A has also assigned UWC to build a test system for its front end wafer processing facility which could potentially fetch an additional RM20mil in revenue.

**5G connectivity will serve as a boon.** Aside from processors testers, UWC is also involved in manufacturing and assembling parts in equipment such as manipulator (to test flash memory), precision power supply and data network test equipment relating to 5G connectivity. Being involved in the semiconductor and 5G ecosystem puts UWC in a better position compared to other contract manufacturers locally. As such, UWC will be able to ride the next wave of growth when 5G adoption takes off, which is likely to be incorporated in more devices next year.

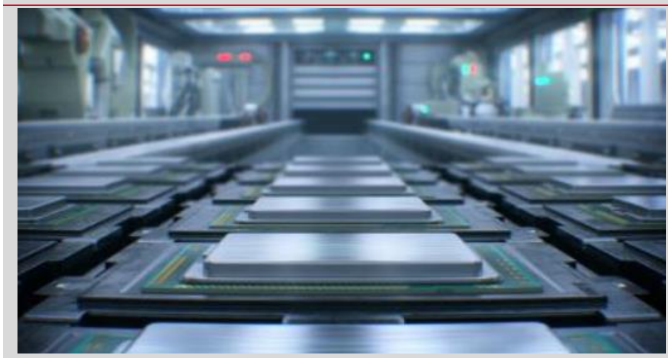
**Orderbook stood at RM55mil** as of end 1QFY20 (July YE), which will provide 3 months earnings visibility. The company reported 1Q20 revenue of RM47mil and PAT margin of 23.9%, and expect the next two quarters to hover around this level for both top line and bottom line.

The companies' guidance for revenue growth in the high teens translates into FY21F (July YE) Fwd PER of 19x, representing a 36% premium when compared to the average 2-year Fwd PER 14x for EMS peers (eg. ATA, VSI and SKP). At the current price, we believe that the growth potential has already been factored in. Hence, we do not see a strong reason to take position at this juncture.

**Company Background**

UWC Berhad (UWC) was incorporated in Malaysia in 1990, under the name of Unique Wire Cut Sdn Bhd and was subsequently converted to a public limited company on 10 Jul 2019. The group is involved in the fabrication of metal parts, turnkey management, assembly, testing and integration, and delivery services. 70% of the group's revenue is derived from the semiconductor industry. In terms of customer concentration, the top 3 customer accounts for 66% of total group revenue with Customer A alone making up 30% of total group revenue.

**Processor tester**



**Radio frequency tester**

*Source: Company*

## Globetronics Technology Berhad (Not Rated)

### Not benefiting from 5G

**Hearables and wearables to drive growth, not 5G.** Globetronics Technology Berhad (GLOBETRONICS) is seeing little likelihood of benefiting from the adoption of 5G connectivity as sensory products (50% of group revenue) in smartphone is approaching a saturation point. This is in line with our observation that the adoption of 5G connectivity will largely benefit players who are involved in the radio frequency (RF) space instead of sensors. However, application of sensors will still see growth in non-smartphone products such as true wireless stereo (TWS) Bluetooth earbuds and smart watches.

**Growing TWS market.** The TWS market has been expanding rapidly and has yet to reach its full potential. For 9M2019, the global TWS sales reached 77.5mil units, a 68% jump from the 46mil units sold in 2018. According to *Counterpoint Research*, this number is expected to reach 129mil by end-2020. Unsurprisingly, the largest player with circa 45%-50% market share is GLOBETRONICS' indirect customer (Customer A). GLOBETRONICS is the sole supplier for gesture controls used in customer A's TWS products. With Customer A's recent launch of the TWS "Pro" edition, this will likely drive its sensory business segment from 50% to 60% of total group revenue in FY20 (Dec YE).

**Ambient and motion won't see big changes.** We do not expect to see significant increase of ambient light sensor in next year's US smartphone launch given that the current model has already housed a full array of sensors in the front panel (see pic below). While it is common that each product cycle will see slight changes in design or placement which may result in an uptick in ASP, the company expects this to be offset by cost down of older products. The same could be said for motion sensors in smart watches.

**Unattractive.** While no earnings guidance was given, according to Bloomberg consensus, the stock is currently trading at a Fwd. PER of 21x (vs. its 3-year average of 20.7x), which is unattractive given that GLOBETRONICS will be excluded from the next wave of growth from 5G adoption even though its end-customer is in the smartphone business. GLOBETRONICS focus on smartphone sensors and TWS gesture sensors are less likely to outshine the growth that RF related players will enjoy when the next US flagship smartphone implements support for 5G connectivity.

**Company Background**

Globetronics Technology Berhad (GLOBETRONICS) assembles integrated circuits, light-emitting diode components, gesture controls, ambient sensors, and quartz crystal and timing devices. Sensors are the leading revenue contributor for the company, accounting for 50%. GLOBETRONICS builds its sensors and gestures controllers mainly for a US smartphone maker listed on the US stock exchange. Sales volume is also dependent on revenue generated from quartz crystal and timing devices. These devices are used in a multitude of electronic products, such as mobile devices, GPS, and PCs.

**Smartphone ambient light sensor**


**Production floor**

*Source: Company, Computerworld*

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



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