

15 May 2023

Natongate Holdings

Fruitful China Marketing Trips

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NATGATE is riding on a new wave of original design manufacturers (ODMs) seeking production diversification into Malaysia. Its recent marketing trips to China are promising potential new clients and orders by end-2023. Besides, pivoting to consignment-based on-boarding for future clients will yield higher margins and reduce inventory risks. It is expanding its total floor space by c.50% by adding 80k sq ft to Plant 5 (by Jul 2023) and an extra 248k sq ft to Plant 7 (by Dec 2023). We maintain our forecasts, TP of RM1.50 and OUTPERFORM call.

Tailwinds from China plus one policy. After our recent meeting with NATGATE, we left with a strong sense of optimism. The group's reassurance of its bright prospects is supported by the growing number of ODMs looking to diversify their production beyond China and expressing interest in NATGATE's capabilities. This follows the group's multiple visits to China over the past few months, meeting various ODMs that manufacture products catered to industries such as data computing, networking, and automotive power transmission. While the group is still in talks with these prospective clients, we learnt that the discussions have been very positive with a good chance of crystallising into new opportunities by end-2023.

Strategising for margin expansion. Acknowledging the continued shortages of certain key components, the group has decided to on-board future customers on a consignment basis instead of the conventional turnkey basis. We view this development positively as it allows the group to: (i) yield higher margin with only manpower cost, (ii) mitigate raw material price fluctuation, and (iii) reduce the risk of inventory overstocking and expenses related to slow-moving goods. However, we have yet to factor in these potential catalysts pending further details.

Expansion on track. To accommodate new potential clients, the group is currently constructing a new capacity of c.80k sq ft at the third floor adding to its existing c.216k sq ft Plant 5, which is scheduled for completion by July 2023. Furthermore, the expansion of another 248k sq ft alongside its existing 227k sq ft Plant 7 is progressing as planned, with completion expected by December 2023. Overall, this will increase the group's total floor space by c.50%.

Forecasts. Maintained as we believe our forecasts have adequately reflected its near-term growth potential.

We keep our TP of RM1.50 based on 23x FY24F PER, representing 30% premium to peers' forward mean. We believe the higher valuation is justified by the group's favourable exposure to the fast-growing networking product segment and its advanced capabilities which yield better margins as well as enhancing customer stickiness. There is no adjustment to our TP based on ESG given a 3-star rating as appraised by us (see Page 4).

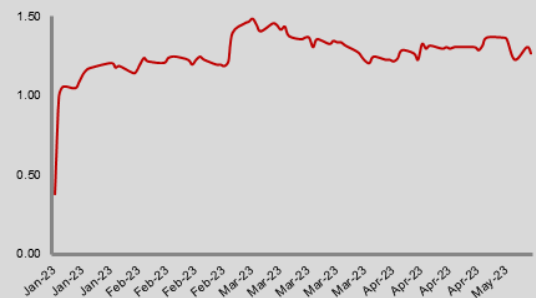
Investment thesis. We like NATGATE for its: (i) exposure to the fast-growing industrial and commercial products used in the networking and telecommunication sectors, (ii) 4IR-ready facilities that is able to take on higher complexity jobs, and (iii) added-value services such as chip-on-board (COB) that enhance customer stickiness and yield better margins. Maintain **OUTPERFORM**.

Risks to our call include: (i) heavy reliance on the networking segment which contributes c.70% of group revenue, (ii) competition from foreign EMS players that have presence in Malaysia, and (iii) adverse impact from component shortage which could delay delivery schedule.

OUTPERFORM ↔

Price : RM1.24
Target Price : RM1.50 ↔

Share Price Performance



KLCI	1,422.9
YTD KLCI chg	-4.9%
YTD stock price chg	226.3%

Stock Information

Shariah Compliant	Yes
Bloomberg Ticker	NATGATE MK Equity
Market Cap (RM m)	2,571.7
Shares Outstanding	2,073.9
52-week range (H)	1.50
52-week range (L)	0.81
3-mth avg daily vol:	9,276,457
Free Float	33.8%
Beta	2.2

Major Shareholders

Ooi Eng Leong	57.9%
Tan Ah Geok	7.2%
Lee Kim San	0.8%

Summary Earnings Table

FYE Dec (RM m)	2022A	2023F	2024F
Turnover	945.7	1,151.8	1,313.6
EBITDA	152.1	185.8	204.9
PBT	85.6	113.2	134.3
Core Net Profit	85.6	113.2	134.3
Consensus	-	118.1	137.7
Earnings Revision	-	-	-
EPS (sen)	4.1	5.5	6.5
EPS growth (%)	43.8	32.2	18.6
NDPS (sen)	0.0	0.0	0.0
BVPS (RM)	0.11	0.17	0.23
Price/BV (x)	11.2	7.5	5.4
PER (x)	30.0	22.7	19.2
Net Gearing (x)	1.4	0.6	0.4
ROA (%)	11.2	11.2	10.1
ROE (%)	37.4	33.1	28.2
Dividend Yield (%)	0.0	0.0	0.0

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Income Statement						Financial Data & Ratios					
FY Dec (RM m)	2020A	2021A	2022F	2023F	2024F	FY Dec	2020A	2021A	2022A	2023F	2024F
Revenue	566.2	760.9	904.1	1,093.4	1,275.3	Growth (%)					
EBITDA	57.3	95.7	125.8	154.6	179.4	Turnover	73.7	34.4	18.8	20.9	16.6
Depre & Amor	-19.7	-25.9	-27.7	-28.5	-30.2	EBITDA	126.5	67.1	31.5	22.8	16.1
Operating Profit	37.5	69.9	98.2	126.0	149.2	Operating Profit	286.8	86.1	40.5	28.4	18.3
Other Income	1.4	1.7	4.5	2.2	2.6	PBT	420.5	90.4	42.0	33.7	21.2
Interest Exp	-4.6	-7.2	-9.2	-7.1	-5.0	Adj Net Profit	482.6	94.2	27.0	28.9	21.2
Associate	0.0	0.0	0.0	0.0	0.0						
PBT	32.9	62.7	89.0	118.9	144.2	Profitability (%)					
Taxation	-2.2	-3.1	-13.3	-21.4	-26.0	EBITDA Margin	10.1	12.6	13.9	14.1	14.1
Minority Interest	0.0	0.0	0.0	0.0	0.0	Operating Margin	6.6	9.2	10.9	11.5	11.7
Net Profit	30.7	59.5	75.6	97.5	118.2	PBT Margin	5.8	8.2	9.8	10.9	11.3
Core Net Profit	30.7	59.5	75.6	97.5	118.2	Core Net Margin	5.4	7.8	8.4	8.9	9.3
						Effective Tax					
						Rate	6.8	5.0	15.0	18.0	18.0
						ROA	6.1	6.1	6.5	9.8	8.4
						ROE	27.4	38.2	26.3	25.3	23.5
						DuPont Analysis					
						Assets Turnover (x)	1.2	1.3	1.2	1.1	1.0
						Leverage Factor (x)	4.2	3.8	3.3	3.0	2.8
						ROE (%)	27.4	38.2	37.4	33.1	28.2
						Leverage					
						Debt/Asset (x)	0.3	0.4	0.4	0.2	0.2
						Debt/Equity (x)	1.4	1.5	1.4	0.6	0.4
						Net (Cash)/Debt	136.1	184.5	264.4	-28.0	-300.4
						Net Debt/Equity (x)	1.2	1.2	1.2	-0.1	-0.6
						Valuations					
						Core EPS (sen)	1.5	2.9	4.1	5.5	6.5
						DPS (sen)	0.0	0.0	0.0	0.0	0.0
						BVPS (RM)	0.1	0.1	0.1	0.2	0.2
						PER (x)	83.8	43.2	30.0	22.7	19.2
						Div. Yield (%)	0.0	0.0	0.0	0.0	0.0
						P/BV (x)	23.0	16.5	11.2	7.5	5.4
						EV/EBITDA (x)	47.3	28.8	18.7	13.7	11.1
Balance Sheet											
FY Dec (RM m)	2020A	2021A	2022F	2023F	2024F						
Fixed Assets	182.5	209.7	216.3	229.3	247.5						
Intangible Assets	0.0	0.0	0.0	0.0	0.0						
Other FA	0.8	0.4	0.4	0.4	0.4						
Inventories	100.1	152.8	178.8	215.7	251.8						
Receivables	147.7	166.6	198.0	239.5	279.3						
Other CA	22.6	31.0	31.0	31.0	31.0						
Cash	18.2	45.6	277.2	449.5	549.9						
Total Assets	472.1	606.2	901.9	1,165.5	1,360.0						
Payables	203.0	216.3	253.1	305.4	356.5						
ST Borrowings	76.4	143.0	143.0	37.5	37.5						
Other ST Liability	1.8	1.1	130.4	350.0	375.2						
LT Borrowings	78.0	87.1	87.1	87.1	87.1						
Other LT Liability	0.5	0.3	0.3	0.3	0.3						
Net Assets	112.4	158.4	288.0	385.3	503.5						
Shr. Equity	112.0	155.9	287.7	385.3	503.5						
Mnrt. Interest	0.3	2.6	0.3	0.0	0.0						
Total Equity	112.4	158.4	288.0	385.3	503.5						
Cashflow Statement											
FY Dec (RM m)	2020A	2021A	2022A	2023F	2024F						
Operating CF	45.8	28.9	73.9	87.4	111.4						
Investing CF	-39.6	-27.2	-34.3	-41.5	-48.4						
Financing CF	6.1	26.1	192.1	126.4	37.5						

Source: Kenanga Research

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Malaysian Technology Peers Comparison

Name	Rating	Last Price (RM)	Target Price (RM)	Upside (%)	Mkt Cap (RM'm)	Shariah Compliant	Current FYE	Core EPS (sen)		Core EPS Growth		PER (x) – Core Earnings		PBV (x)	ROE (%)	Net Div. (sen)	Net Div. Yld (%)
								1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.
D&O GREEN TECHNOLOGIES BHD	UP	3.99	3.51	-12.03%	4,938.8	Y	12/2023	10.3	14.0	31.6%	35.5%	38.6	28.5	5.2	14.0%	1.7	0.4%
GHL SYSTEMS BHD	OP	0.810	1.05	29.63%	918.9	Y	12/2023	3.0	3.4	21.3%	12.9%	27.0	24.0	1.7	6.5%	0.0	0.0%
INARI AMERTRON BHD	MP	2.22	2.60	17.12%	8,287.1	Y	06/2023	10.2	11.5	-3.2%	12.7%	21.8	19.3	3.3	15.0%	9.7	4.4%
JHM CONSOLIDATION BHD	MP	0.800	0.800	0.00%	481.8	Y	12/2023	5.3	5.9	40.0%	10.6%	15.1	13.6	1.4	9.8%	0.5	0.6%
KELINGTON GROUP BHD	OP	1.45	1.92	32.41%	932.4	Y	12/2023	8.7	9.0	1.1%	3.2%	16.6	16.1	3.3	21.3%	2.4	1.7%
KESM INDUSTRIES BHD	MP	7.25	8.24	13.66%	311.9	Y	07/2023	(10.0)	6.7	-2250.0%	-32.6%	N.A.	108.8	0.9	-1.2%	7.5	1.0%
LGMS BHD	OP	1.11	1.50	35.14%	506.2	Y	12/2023	3.5	5.9	26.2%	69.8%	31.9	18.8	5.1	17.4%	0.0	0.0%
MALAYSIAN PACIFIC INDUSTRIES BHD	UP	27.50	20.00	-27.27%	5,469.7	Y	06/2023	81.1	130.6	-51.0%	61.0%	33.9	21.1	2.6	7.9%	35.0	1.3%
NATGATE HOLDINGS BHD	OP	1.24	1.50	20.97%	2,571.7	Y	12/2023	5.5	6.5	32.2%	18.6%	22.7	19.2	7.5	39.6%	0.0	0.0%
OPPSTAR BHD	UP	1.77	1.30	-26.55%	1,126.1	N	12/2023	3.1	4.0	18.1%	29.6%	57.5	44.4	39.1	90.7%	0.8	0.5%
P.I.E. INDUSTRIAL BHD	OP	3.37	4.05	20.18%	1,294.2	Y	12/2023	22.5	25.3	22.0%	12.5%	15.0	13.3	2.1	14.6%	7.0	2.1%
SKP RESOURCES BHD	UP	1.25	1.20	-4.00%	1,953.0	Y	03/2024	9.7	7.9	-11.1%	-17.9%	12.9	15.8	2.2	17.8%	4.8	3.8%
UNISEM (M) BHD	MP	2.82	2.75	-2.48%	4,548.9	Y	12/2023	8.9	13.8	-41.2%	55.7%	18.3	16.4	1.8	5.9%	6.0	2.1%
Simple Average										-13.6%	23.6%	25.4	20.5	5.9	19.9%		1.4%

Source: Kenanga Research

Stock ESG Ratings:

	Criterion	Rating			
GENERAL	Earnings Sustainability & Quality	★	★	★	☆
	Community Investment	★	★	☆	
	Workers Safety & Wellbeing	★	★	★	
	Corporate Governance	★	★	★	
	Anti-Corruption Policy	★	★	★	
	Emissions Management	★	★	★	
SPECIFIC	Technology & Innovation	★	★	★	☆
	Supply Chain Management	★	★	★	
	Energy Efficiency	★	★	★	
	Effluent/Water Management	★	★	★	
	Waste Management	★	★	★	
	Ethical Practices	★	★	★	☆
OVERALL		★	★	★	

☆ denotes half-star
 ★ -10% discount to TP
 ★★ -5% discount to TP
 ★★★ TP unchanged
 ★★★★ +5% premium to TP
 ★★★★★ +10% premium to TP

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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Published by:

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