

**HLIB Research**

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**BUY** (Initiate)**Target Price:** RM3.83**Previously:** N.A.**Current Price:** RM3.26

Capital upside	17.4%
Dividend yield	5.2%
Expected total return	22.6%

**Sector coverage:** EMS

**Company description:** Uchi is a renowned original design manufacturer (ODM) of electronic control modules based in Penang, Malaysia.

**Share price**

	1M	3M	12M
Absolute	6.9	19.9	40.5
Relative	6.4	24.2	17.0

**Stock information**

Bloomberg ticker	UCHI MK
Bursa code	7100
Issued shares (m)	452
Market capitalisation (RM m)	1,473
3-mth average volume ('000)	2,413
SC Shariah compliant	Yes
F4GBM Index member	No
ESG rating	★★

**Major shareholders**

Eastbow International Ltd	18.4%
Ironbridge Worldwide Ltd	7.8%
Public Mutual	5.6%

**Earnings summary**

FYE (Dec)	FY20	FY21f	FY22f
PATMI – core (RM m)	84.9	87.0	91.4
EPS – core (sen)	18.7	19.2	20.1
P/E (x)	17.4	17.0	16.2

# Uchi Technologies

## On firm footing

Uchi is a renowned original design manufacturer (ODM) of electronic control modules. We like Uchi for its (i) stable earnings drivers being the sole supplier and R&D partner for its customers, (ii) involvement in indispensable market of coffee and biotech division that could serve as future catalyst in this pandemic era, (iii) commanding higher margin vs peers and (iv) decent dividend yield of ~5%. We initiate coverage on Uchi with a BUY rating with TP of RM3.83, pegged to 19x PE on FY22 EPS.

**One-stop solution.** Uchi is the one-stop solution provider that offers a wide spectrum of services that range from R&D, tools design and set up, and engineering support to the production of finished electronic control systems for household appliances (e.g. fully and semi-automated coffee machines) and appliances for office services sector (industrial scale, professional iron station, etc). Most of Uchi customers are MNCs, each positioning themselves as market leaders in their respective industries. The qualifying process and criteria selection are very stringent with high barriers to entry, hence enabling Uchi to monopolize as the sole supplier for its clients.

**Key in R&D.** Uchi galvanized its position as the sole supplier by contributing in the early stage of product development. The group works together with customers in designing and R&D stage while at the same time, signing a non-disclosure agreement to protect information from being publicized. Uchi earns a fee by conducting research on new products on behalf of clients and recognizes the revenue once the designs are approved by clients. In this regard, it could be viewed as the outsourced R&D partner for the MNCs appliance brand owners.

**Robust coffee machine demand.** Based on Grand View Research, global coffee machine market size (a key client end product contributor to Uchi's revenue; 85% in FY20) is anticipated to reach USD7.6bn by 2025 (CAGR: 3.7%).

**Biotech could serve as future catalyst in this pandemic era.** One of the products in Uchi's pioneer status list is the ultra-low temperature and mass sensing control system. This device is designed for the storage of biological materials (such as virus, bacteria, eukaryotic cells, stem cell and blood) mainly used in blood banks, hospitals, epidemic prevention services, research institutes and biomedical facilities.

**High margin business.** Due to Uchi's unique business model coupled with the pioneer status, it enjoys a consistent core profit margin of above 45% since FY15. Management shared that even in a weak economic environment, the group is aiming to sustain at an operating profit margin of 40%, provided that the forex remains favourable of at least RM3.90/USD.

**Generous dividend payout.** Uchi has a dividend payout policy of minimum 70%. However, the group has been consistently paying out on average close to 92% (average yield of 5%) as dividends. Still, we are taking a conservative stance and assume only an 88% payout, translating to DPS of 17.0-18.7 sen for FY21-23. As of 4Q20, Uchi sits on a net cash position of RM156.7m (NCPS: RM0.35) with no borrowings on its book.

**Initiate coverage** on Uchi with a **BUY** recommendation and **TP of RM3.83**, pegged to 19x of FY22 EPS. This valuation multiple is roughly +1.5SD above the 5-year historical mean P/E of 15x. We like Uchi for its (i) stable earnings drivers being the sole supplier and R&D partner for its customers, (ii) involvement in indispensable market of coffee and biotech division that could serve as future catalyst in this pandemic era, (iii) commanding higher margin vs peers, and (iv) decent dividend yield of ~5% with tendency to tilt on the high side leading to support of any downside risk.

## Financial Forecast

All items in (RM m) unless otherwise stated

### Income statement

FYE Dec	FY19	FY20	FY21f	FY22f	FY23f
Revenue	156.7	155.3	165.6	173.6	180.0
COGS	(74.3)	(75.5)	(74.3)	(78.3)	(82.6)
<b>EBITDA</b>	<b>82.3</b>	<b>86.4</b>	<b>91.2</b>	<b>95.3</b>	<b>97.4</b>
D&A	(6.9)	(6.4)	(6.2)	(6.0)	(5.9)
EBIT	75.4	80.0	85.0	89.2	91.5
Net Interest Income	3.0	2.7	2.8	3.0	3.2
Associates	0.7	2.0	-	-	-
<b>PBT</b>	<b>79.0</b>	<b>84.6</b>	<b>87.8</b>	<b>92.3</b>	<b>94.7</b>
Tax	(3.1)	(0.8)	(0.9)	(0.9)	(0.9)
<b>Reported PAT</b>	<b>75.9</b>	<b>83.8</b>	<b>87.0</b>	<b>91.4</b>	<b>93.8</b>
Exceptionals	(0.3)	1.1	-	-	-
<b>Core PAT</b>	<b>75.7</b>	<b>84.9</b>	<b>87.0</b>	<b>91.4</b>	<b>93.8</b>
HLIB/Consensus			100%	102%	100%

### Balance sheet

FYE Dec	FY19	FY20	FY21f	FY22f	FY23f
Cash	136.9	156.7	168.8	180.0	190.7
Receivables	13.9	18.8	18.1	19.0	19.7
Inventories	16.5	15.3	15.3	16.1	17.0
PPE	45.5	40.8	38.6	37.6	36.7
Other	17.3	20.0	20.0	20.0	20.0
<b>Assets</b>	<b>230.1</b>	<b>251.6</b>	<b>260.8</b>	<b>272.7</b>	<b>284.1</b>
Payables	31.1	35.9	34.6	36.5	38.5
Provision for warranty	1.6	1.4	1.4	1.4	1.4
Other	35.2	35.0	35.0	35.0	35.0
<b>Liabilities</b>	<b>67.9</b>	<b>72.2</b>	<b>71.0</b>	<b>72.8</b>	<b>74.8</b>
Share capital	70.8	75.6	75.6	75.6	75.6
Retained earnings	86.3	97.2	107.6	117.6	127.0
Others	5.0	6.6	6.6	6.6	6.6
<b>Equity</b>	<b>162.2</b>	<b>179.4</b>	<b>189.8</b>	<b>199.9</b>	<b>209.2</b>

### Cash Flow Analysis

FYE Dec	FY19	FY20	FY21f	FY22f	FY23f
PBT	75.9	84.6	87.8	92.3	94.7
D&A	6.9	6.4	6.2	6.0	5.9
Working capital	2.9	2.1	(0.6)	0.1	0.4
Taxation	(3.7)	(2.1)	(0.9)	(0.9)	(0.9)
Others	2.0	(5.3)	-	-	-
<b>CFO</b>	<b>84.1</b>	<b>85.7</b>	<b>93.6</b>	<b>97.6</b>	<b>100.1</b>
Capex	(0.7)	(0.7)	(5.0)	(5.0)	(5.0)
Others	3.0	3.1	-	-	-
<b>CFI</b>	<b>2.3</b>	<b>2.5</b>	<b>(5.0)</b>	<b>(5.0)</b>	<b>(5.0)</b>
Dividends	(62.8)	(71.9)	(76.5)	(81.3)	(84.4)
Others	0.8	3.8	-	-	-
<b>CFF</b>	<b>(62.1)</b>	<b>(68.1)</b>	<b>(76.5)</b>	<b>(81.3)</b>	<b>(84.4)</b>
<b>Net CF</b>	<b>24.3</b>	<b>20.1</b>	<b>12.1</b>	<b>11.2</b>	<b>10.7</b>
Beginning cash	113.7	136.9	156.7	168.8	180.0
Forex	(1.1)	(0.3)	-	-	-
<b>Ending cash</b>	<b>136.9</b>	<b>156.7</b>	<b>168.8</b>	<b>180.0</b>	<b>190.7</b>

### Quarterly financial summary

FYE Dec	4Q19	1Q20	2Q20	3Q20	4Q20
Revenue	39.4	35.6	25.7	40.4	53.6
COGS	(18.8)	(18.3)	(12.6)	(17.3)	(20.7)
<b>EBITDA</b>	<b>20.7</b>	<b>17.3</b>	<b>13.2</b>	<b>23.1</b>	<b>32.8</b>
D&A	(1.6)	(1.6)	(1.6)	(1.6)	(1.6)
EBIT	19.0	15.6	11.6	21.5	31.3
Net Interest Income	(0.1)	3.2	0.3	0.4	(1.2)
Associates	1.5	(2.3)	0.2	1.9	2.3
<b>PBT</b>	<b>20.5</b>	<b>16.5</b>	<b>12.0</b>	<b>23.8</b>	<b>32.4</b>
Tax	(0.8)	(0.5)	(0.2)	(0.1)	(0.0)
<b>Reported PAT</b>	<b>19.7</b>	<b>16.0</b>	<b>11.8</b>	<b>23.7</b>	<b>32.3</b>
Exceptionals	1.0	(2.3)	0.8	0.6	2.0
<b>Core PAT</b>	<b>20.8</b>	<b>13.8</b>	<b>12.5</b>	<b>24.3</b>	<b>34.4</b>

### Valuation Ratios

FYE Dec	FY19	FY20	FY21f	FY22f	FY23f
Core EPS (sen)	16.7	18.7	19.2	20.1	20.7
P/E (x)	19.5	17.4	17.0	16.2	15.8
EV/EBITDA (x)	16.3	15.3	14.4	13.6	13.2
DPS (sen)	16.0	17.0	17.0	18.0	18.7
Dividend yield (%)	4.9	5.2	5.2	5.5	5.7
BVPS (RM)	0.4	0.4	0.4	0.4	0.5
P/B (x)	9.1	8.2	7.7	7.4	7.0
EBITDA margin	52.5	55.6	55.1	54.9	54.1
EBIT margin	48.1	51.5	51.4	51.4	50.8
PBT margin	50.5	54.5	53.1	53.2	52.6
Net margin	48.3	54.7	52.5	52.7	52.1
ROE (%)	46.7	47.3	45.8	45.7	44.8
ROA (%)	32.9	33.7	33.4	33.5	33.0
Net gearing	Cash	Cash	Cash	Cash	Cash

### Assumptions

FYE Dec	FY19	FY20	FY21f	FY22f	FY23f
RM:USD	4.2	4.2	4.0	4.0	4.0

## Company Background

**Formally established in 1989.** Uchi is one of the renowned Original Design Manufacturing (ODM) providers in the region. Started in 1981 in Taiwan, the founder Kao De Tsan's interest in electronic design prompted him to establish Uchi Electronic Co. Ltd. Joined by his brother, Kao Te Pei in 1982 and together with other partners, the two Kao brothers started off the company by designing a control module for electronic bathroom scales for their first customer Krups, a German industrial conglomerate.

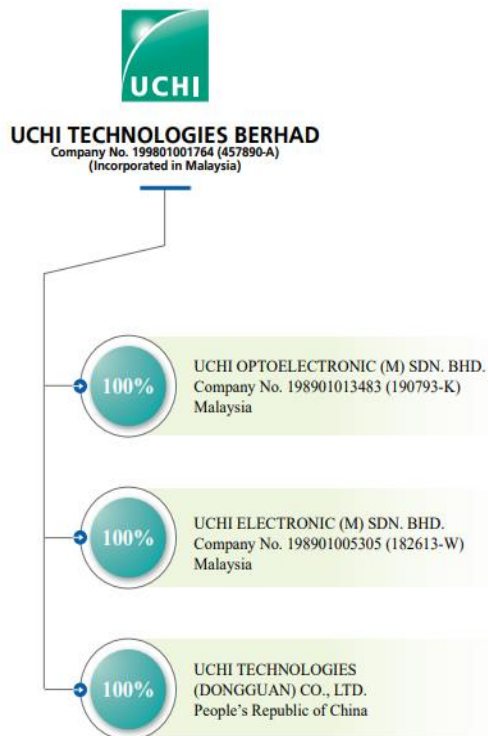
Subsequently, the company moved on to develop control modules for electronic slicers and mixers. Eventually, the company designed and developed control modules for coffee makers. At that time, the company was also developing switching power supply, a voltage converter for bar coding system for Symbol Technologies Inc.

With their vision to "Look South", the Kao brothers decided to set up a manufacturing base in Penang in 1989. The Group commenced operations in December 1989 at its Georgetown factory with a built-up area close to 13k sqft. Subsequently, the Group shifted to Prai Industrial Estate, Penang in 1996 when business expanded. At that time, the Group had already established a good customer base with long-standing relationships.

In 1998, Uchi Technologies Berhad (Uchi) was incorporated in Malaysia under the Companies Act, 1965 under the name Uchi Technologies Sdn. Bhd. Few years down the road, it was then converted to a public limited company, listed on the Second Board of the Bursa Malaysia and further transferred to the Main Board in May 9, 2002. After the listing in 2002, it has evolved into the renowned ODM provider in Malaysia today (see Figure #1).

Uchi is the one-stop solution provider that offer a wide spectrum of services that range from research and development, tools design and set up, as well as engineering support to the production of finished electronic control systems. The group's manufacturing facilities are strategically located in Prai Industrial Estate, Penang and Dongguan, China, with a combined built-up space of more than 300k sqft supported by circa 320 workers.

**Figure #1 Company structure**



Uchi

Uchi has two operating sites (see Figure #2):

- i. Uchi Optoelectronic (M) Sdn Bhd (UOM) situated in Malaysia is the main operating plant.
- ii. Uchi Dongguan situated in Dongguan City, GuangDong Province of China, is the assembly arm of UOM.

**Figure #2 Company operating sites**

Location	Subsidiaries	Descriptions
Malaysia Land area 139.9k sqft Built-up area 148.1k sqft Headcount: 260 people Capacity utilisation: >85%	Uchi Optoelectronic  Uchi Electronic	<ul style="list-style-type: none"> <li>▪ Main subsidiary incorporated on 13 Dec 1989.</li> <li>▪ Principally involved in the design, research, development and manufacture of electronic control modules.</li> <li>▪ ISO9001, ISO14001, OHSAS 18001 certified company.</li> <li>▪ Incorporated on 31 May 1989.</li> <li>▪ Principal activities involving the assembly of electrical components onto printed circuit board (PCB) and trading of complete electronic module and saturated paper for PCB lamination.</li> </ul>
China Land area: 208.7k sqft. Built-up area: 161.1k sqft. Headcount: 60 people Capacity utilisation: <75%	Uchi Dongguan	<ul style="list-style-type: none"> <li>▪ Design, research, development, manufacture and trading of electronic modules.</li> <li>▪ The establishment of this factory serves to mitigate risks of any disruption of activities in Malaysia as required by Uchi's clients.</li> <li>▪ ISO9001, ISO14001, OHSAS 18001 certified company.</li> </ul>

*Uchi, HLIB Research*

## Investment Thesis

### Stable earnings driver

**Evolved to manufacturing control systems.** With more than 30 years of experience and track record, it has the capabilities in producing wide array of products. In the earlier stage of business, the group mainly manufactured products related to basic consumer electronics such as electronic bathroom scale, remote controller for car stereo, steam iron, microwave oven and yoghurt mixture. The company evolved over the years and currently produces control systems for household appliances (e.g. fully and semi auto coffee machines) as well as appliances for office services sector (industrial scale, professional iron station, etc.). These high end products also provide better margins as compared to products in its earlier days.

**Export-reliant.** As an ODM, Uchi owns the capabilities to provide seamless end-to-end solutions. The group strives to develop a good relationship with its customer to ensure that they constantly exceed the expectations by providing viable and innovative solutions. Uchi designs and develops electronic control systems in-house, which are then manufactured and delivered to customers for further assembly into finished products. With a range of customer base that includes prominent multinationals, majority (>90%) of their products are exported to the European market. Its products can be divided into 2 categories (see Figure #3-#5).

**Figure #3 Group products**

Categories	Descriptions
Art-of-living	<ul style="list-style-type: none"> <li>▪ Encompassing household and professional appliances.</li> <li>▪ Principally involved in the design, research, development and manufacture of electronic control modules.</li> <li>▪ Restriction of hazardous substances RoHS-compliant: products for household and office equipment adhere to European eco-design requirements and EU energy regulations.</li> <li>▪ Eco-savvy features that include standby and off-mode electrical power consumption of less than 0.5watt and complete shutdown within 15 minutes of ceasing operations.</li> <li>▪ ISO9001, ISO14001, OHSAS 18001 certified company.</li> </ul>
Biotech	<ul style="list-style-type: none"> <li>▪ Design, research, development and manufacture of ultra-low temperature and mass sensing control system for bio-chemical equipment, touch screen advance display, high precision light measurement (optoelectronic) equipment and mixed signal control system for centrifuge and laboratory equipment.</li> </ul>

*Uchi, HLIB Research*

**Figure #4 Art-of-living products (touch screen control module for coffee machine)**

*Uchi, HLIB Research*

**Figure #5 Biotech products (electronic pipette, weighing scale)**

*Uchi, HLIB Research*

**The sole supplier for customers.** Over the years, the group managed to prove their capabilities with the proactive effort to improve quality of their products while not shy in investing further to provide competitive edge of technologies for their customers. Most of Uchi customers are multinational corporations (MNCs), each positioning themselves as market leaders in their respective industries. The qualifying process and criteria selection are very stringent with high barriers to entry, hence enabling Uchi to become their sole supplier.

**Key in research and development (R&D).** The group galvanized its position as the sole supplier by contributing in the earlier stage of product development. Uchi works together with customers in designing and R&D stage of production while at the same time signing a non-disclosure agreement to protect information from being publicized. The group has been committed in setting aside 7% of their revenue to invest in R&D. By setting up a specific budget for R&D, the group strives in catching up with the latest technology and provide their customers with the best available improvements in the market. Uchi develops technical partnerships with their clients by sharing expertise, technology and consumer preferences knowledge. It earns a fee by conducting research on new products on behalf of clients and recognizes the revenue once the designs are approved by clients. In this regard, it is viewed as the outsourced R&D partner for the MNCs appliance brand owners.

Currently, the team is involved in synergistic collaborations with its customers from diverse industries, ranging from consumer to industrial products. The division can be categorized into 4 groups in each specializing in (i) software programming, (ii) hardware design, (iii) system construction and (iv) basic research. To ensure only the best quality is put forth in their electronic control systems for both the art-of-living and biotechnology products, the group adopts a stringent R&D cycle (see Figure #6).



**Figure #6 Research and development cycles**



*Uchi, HLIB Research*

**Adherence to quality.** In 2019, the group recorded a customer reject rate of 0.11%, making this the 7<sup>th</sup> consecutive year they managed to sustain this at below 0.20% and will continue to maintain this target for 2021 and beyond. Additionally, the group strives to improve their quality standard as what could be portrayed in their technical achievements (see Figure #7).

**Figure #7 Technical achievements**

Year	Event
1996	▪ Uchi Opto attained ISO9002
1997	▪ Uchi Opto attained ISO9001
2001	▪ Uchi Opto attained ISO14001
2002	▪ Uchi Opto attained OHSAS18001 ▪ Uchi Dongguan attained ISO9001
2005	▪ Lead-free products
2010	▪ Complied with 2010 European Ecodesign directive i.e. standby and off-mode to be less than 1.0W ▪ Uchi Dongguan attained ISO14001
2013	▪ Complied with 2013 European Ecodesign directive i.e. standby and off-mode to be less than 0.5W
2015	▪ Complied with European new directive i.e. shut off within 15 minutes after last operation ▪ Uchi Dongguan attained OHSAS 18001

*Uchi, HLIB Research*

**High margin business.** With its policy in being the sole supplier and key R&D partner for its customers, Uchi is able to produce products with better margins without competing on volume as compared to most of the other EMS players. This is evident from their consistent core PAT margin of above 45% since FY15. During our discussion, management shared that they are confident to maintain an operating profit margin of at least 40% provided that forex remains favourable of at least above RM3.90/USD.

**Benefiting from pioneer status.** The heavy emphasis on R&D also enables Uchi to be granted a pioneer status. Uchi Optoelectronic currently enjoys tax exemption under the pioneer status, awarded by the Ministry of International Trade & Industry (MITI). The pioneer status is valid for 5 years from the production date (expires end of 2022) and the renewal will be fixed by the authorities later. One of the terms and conditions of the granted status is that the unit’s expenses for annual R&D activities shall be at least 1% of its total annual gross sales by the third year of production. With these in place, Uchi’s effective tax rate is likely to remain at low-single digits (FY20: 1.0%)

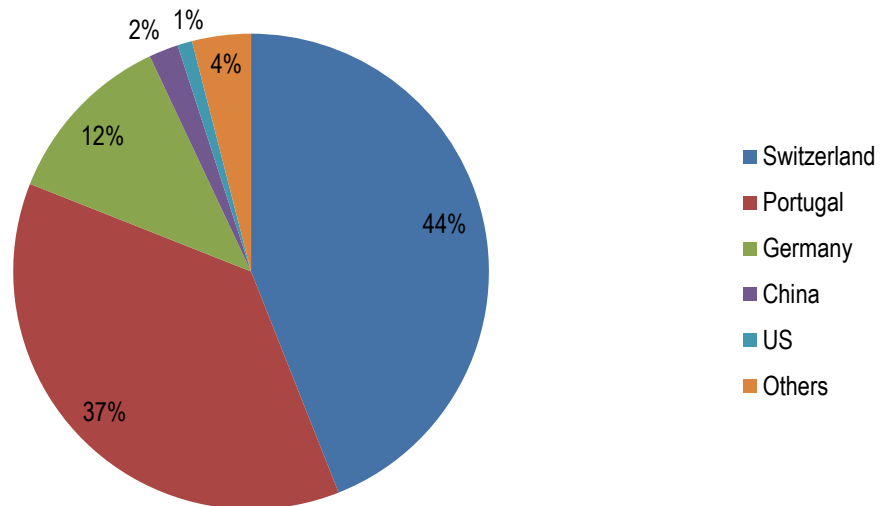
This pioneer status is granted on the back of their design, development and manufacture of:

- i. Real-time centralized energy measurement and control system;
- ii. High precision hot fluid temperature control system; and
- iii. Ultra-low temperature and mass sensing control system for bio-chemical equipment.

**One-stop complete ODM partner.** We had the opportunity to visit Uchi’s plant in Penang and from our observation, the company has a unique business models. As an ODM, they are fully engaged in the manufacturing division as the main business activities. Uchi provides one-stop complete ODM solution to world-renowned customers mainly from Europe, such as Switzerland, Portugal, Germany, China and US (see Figure #8). The company’s in-house R&D team works very closely

alongside the clients' through designing and developing electronic control modules which the group also manufacture and assemble as components into semi-finished parts and control modules.

**Figure #8 Turnover by geographical area for FY19**



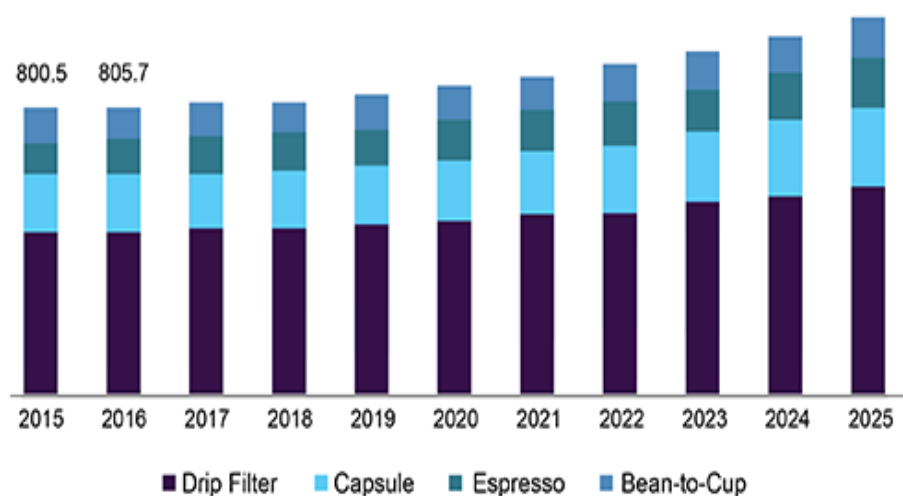
Uchi, HLIB Research

**No direct impact from the trade war.** As Uchi is the sole supplier for its customers, the set-up of Dongguan operation is to serve as a support for their Malaysia operation for risk management purposes as requested by its customers. The sales order loading in both factories in Malaysia and China is meticulously maintained to avoid risks stemming from the trade war and Covid-19.

### An encouraging brew

**Robust coffee machine demand.** Based on Grand View Research, global coffee machine market size is anticipated to reach USD7.6bn by 2025 registering a 6-year CAGR of 3.7% (see Figure #9). This stems on the back of rise in consumption of coffee in Asian countries. Additionally, the introduction of new products such as green and organic coffee is expected to contribute positively to this trend. The rise in coffee consumption is supported by the lifestyle of millennials that incorporate it in their daily habit. This trend is also evident with the booming in the cafe opening.

**Figure #9 Steady increase of global coffee machine market size**



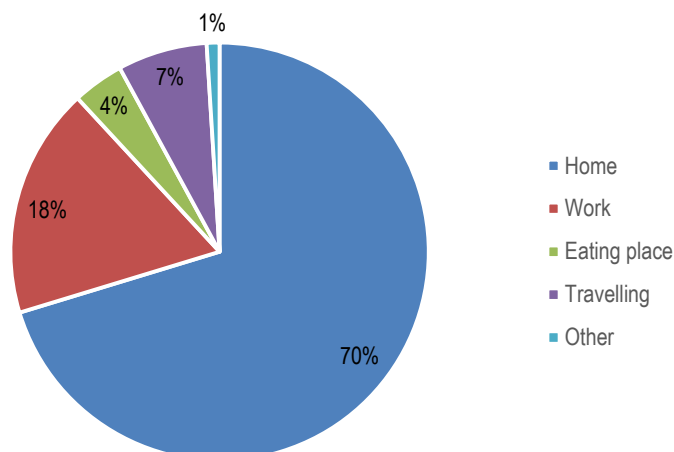
Source: www.grandviewresearch.com

Grandviewresearch.com

However, with the pandemic induced “new normal”, majority now opt to prepare good coffee in the comfort of their home in less time. Based on Mordorintelligence.com, survey conducted by the National Coffee Association in the United States, more than 70% of consumer prefers at-home

coffee preparation (see Figure #10). With the increase in cost of espresso and coffee at restaurants and cafes, consumers are increasingly switching to home-brewed alternatives.

**Figure #10 Coffee consumption by place**



*National Coffee Association*

During the launching event of Customer J's (Uchi's largest client; c.80% of revenue in FY20) fully automatic coffee machine, the CEO shared that its fully automatic coffee machine production is expected to keep increasing in the future. This could be observed from customers' preference in using fully automatic machines, switching from the single served machines. We understand that Uchi also develops software program, hardware design and system construction for these full-automatic products. The group provides software development with firmware updates that allows for different coffee recipe. With customer-centric algorithm introduced with the coffee machines, customers now have a choice to personalize their preferences and enjoy a live customer support through the mobile application created. This essentially bodes well with the growing interest by end customer in adopting technologically advanced kitchen appliance products. This unique value proposition has yielded laudable net margin of 45-50% over the past years for Uchi.

Currently, Europe still dominates being the largest region for the global automatic espresso machines market. Developed countries in Western Europe are predominantly the major target markets for automatic espresso machines. Due to the high purchasing power of those high-end customers from developed countries of Western Europe, the demand is now largely more optimistic as opposed to initial weak projection when the pandemic first broke out.

**Health benefit of coffee.** In 2016, Harvard School of Public Health research rebuked the myth of carcinogens by the World Health Organization in 1991, saying coffee was included in a list of possible carcinogens. A large body of evidence suggests that consumption of caffeinated coffee does not increase the risk of cardiovascular diseases and cancers. In fact, consumption of 3 to 5 standard cups of coffee daily has been consistently associated with a reduced risk of several chronic diseases. Additional research suggests that when consumed in moderation, coffee can be considered a healthy beverage. These findings augurs well for both the coffee and coffee machine market (the latter in which Uchi largely supplies to).

### Potential indirect vaccine exposure

**Biotech could serve as future catalyst in this pandemic era.** In the biotech division, Uchi supplies control systems such as high precision weighing scales, centrifuges and deep freezers. One of the products in Uchi's pioneer status list includes the ultra-low temperature and mass sensing control system. This device is designed for the storage of biological materials (such as virus, bacteria, eukaryotic cells, stem cell and blood) mainly used in blood banks, hospitals, epidemic prevention services, research institutes and biomedical engineering facilities. Contribution from the biotech division to Uchi's revenue is now at 15-21% for FY16-FY20 but this area provides an avenue for future growth.

With the still on-going Covid-19 pandemic, the development of the healthcare market is expected to garner positive impact on the growth of Europe's ultra-low temperature freezer market in the coming years. Based on GlobalNewsWire, ultra-low temperature freezer market is anticipated to reach USD186m in 2027 from USD138m in 2019 which translates into a CAGR of 3.9%. This



stemmed on the back of the rising government support for research activities and clinical trials.

The UK government has committed to providing GBP84m funding to researchers working on the Covid-19 vaccine program. Additionally, the US government has agreed to fund USD483m for Moderna Inc. to develop and test its Covid-19 vaccine. The European Commission has been funding projects to develop vaccines, treatments, and diagnostics via grants from Horizon 2020 and the Innovative Medicines Initiative (IMI), which announced up to USD50m in public grants. The biotech industry in Europe is playing a vital part in the fight against Covid-19, in terms of developing vaccines, therapeutic drugs, diagnostics, and research. With the vaccine development against Covid-19 picking up at urgent pace, we view the production of ultra-low temperature and mass sensing control systems could garner an opportunity to expand further in the future.

## Risks

**USD depreciation.** Uchi's products are priced in USD hence in times of USD weakening against the RM, the group will be in disadvantage from currency loss. We acknowledge that ringgit (vs USD) initially saw some recovery, appreciating since early-Nov and momentarily breaking below 4.00 in the first week of 2021 but subsequently saw weakness resurface thereafter. Externally, rollout of vaccine programmes, reopening of economy and continued low interest rate environment are expected to bring risk-on attitude among investors, leading to appreciation pressure on EM economies, including Malaysia.

Domestically however, uncertainty among investors regarding Malaysia's domestic policies and fiscal position (e.g. status in WGBI and sovereign credit rating decisions) and high number of domestic Covid-19 infections may cap appreciation pressure on the ringgit. All in all, we anticipate the forex to average at RM4.00/USD in 2021 (2020 average: RM 4.20/USD). Management are confident to maintain an operating profit margin of at least 40% provided that forex remains favourable of at least above RM3.90/USD.

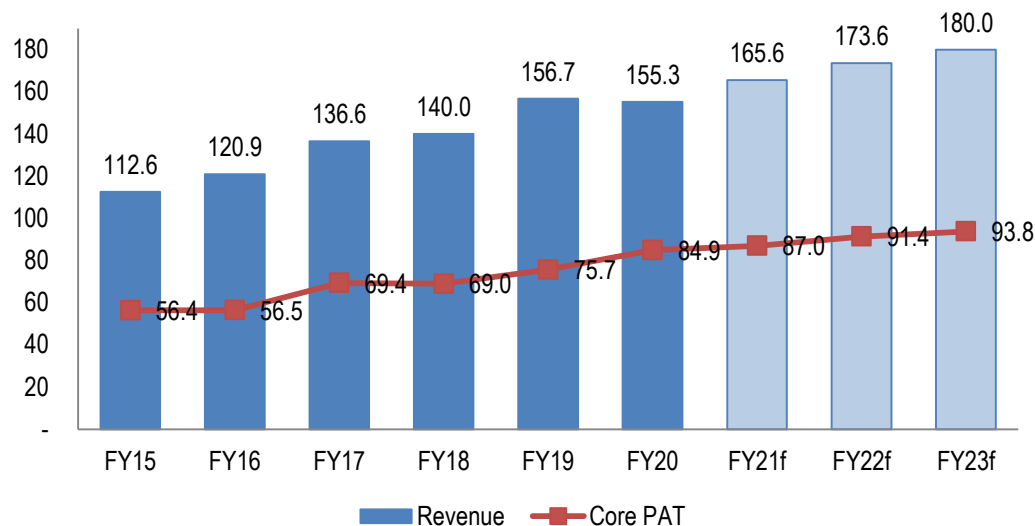
**Covid-19.** Uchi announced on 29 Jan 2021 that 15 of its employees have tested positive for Covid-19. As precautionary and preventive measure to contain the possible spread, Uchi has imposed a halt in production activities since 25 Jan to 4 Feb. Subsequently, we have imputed the effect of the short term plant closure in our FY21 forecast.

## Financials

**Earnings track-record.** Since FY15, revenue has grown at 5-year CAGR of 7% from RM113m in FY15 to RM155m in FY20 (see Figure #11). This sales growth was supported by increasing orders from their key customers in art-of living segment. Historically, the main contributor for revenue growth has been backed by its art-of living segment that made up average 82% of total revenue (with the balance from biotech division). Moving forward, we see this trend to persist mainly backed by the increase of demand from homebound consumers.

Core net profit on the other hand, increased at a higher rate of 5-year CAGR of 9% from RM56.3m in FY15 to RM84.9m in FY20. We forecast Uchi to achieve 3-year core net profit CAGR of 3% over FY20-FY23F, backed by: (i) growth in orders, (ii) high potential of securing new customers benefitting from the US-China trade decoupling, (iii) further increase in end demand from biotech division and (iv) improvement in efficiency in running existing production lines.

Additionally, even with the uncertain economic environment at this juncture, we understand that no revision of cost has been received from its customers. Hence, we expect the earnings to only be affected with the variables in revenue with minimal cost pressure affecting the business operations.

**Figure #11 Uchi's financial performance and forecast (RM m)**

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**Strong balance sheet.** Uchi enjoys a strong net cash position of RM156.7m as of 4Q20 (NCPS: RM0.35) with no borrowings on its book. This will allow the group to continue its growth and grab any new incoming business opportunities as they come into its favour. Historically, it has been able to generate remarkable net operating cash flow with an average of RM67.4m from FY15-FY20.

In the recent years, the group has spent prudent capex of RM9m in FY18, on the back of its effort to support R&D activities as well as the upgrading and enhancement of production facilities. With minimal maintenance capex of RM5m for FY21, we expect the group balance sheet will remain sturdy and capable of weathering the storm of Covid-19.

**Good dividend payout.** Uchi has a dividend payout policy of minimum 70% of its net profit. However the group has been generous enough to consistently pay more, with an average of 92% of its net profit as dividends (ex-special dividend in FY17) over the past six years with an average yield of 5%. After bearing high capex in FY18 as mentioned above, we expect the capex ahead to normalize to an average of RM5m per year for FY21-FY23. Taking this into account, we estimate a healthy FCF generation which should potentially give way a higher dividend payout. Still, we are taking a conservative stance and assume only an 88% payout, translating into a DPS of 17-18.7 sen for FY21-23 (yield: 5.2-5.7%).

**FY20 results snapshot.** In its recent quarterly performance, Uchi's FY20 core PAT of RM84.9m exceeded expectation making up 120% of consensus full year forecast. 4Q20 revenue jumped by 32.5% QoQ/35.9% YoY to RM53.6m on the back of robust demand from both its art-of living and biotech divisions. 4Q20 core PAT surged by +41.4% QoQ/+65.5% YoY to RM34.4m attributable to higher operating leverage that improved the EBITDA margin by 4.2 ppt QoQ. Despite the flat top line of RM155.3m (-0.9% YTD), bottom line increased by 11.5% to RM 84.9m due to the lower opex. Overall, we gather that management are expecting FY21 revenue to continue charting an improvement on the back of recovery demand in art-of living segment and stronger contribution from biotech division as ultra-low temperature control module picking up at faster pace with mass rollout of Covid-19 vaccines.

## Valuation & Recommendation

We initiate coverage on **Uchi** with a **BUY** recommendation and TP of **RM3.83**, pegged to 19x of FY22 EPS. This valuation multiple is roughly +1.5SD above the 5-year historical mean P/E of 15x (see Figure #12). We like Uchi for its (i) stable earnings drivers being the sole supplier and R&D partner for its customers; (ii) involvement in indispensable market of coffee and biotech division that could serve as future catalyst in this pandemic era; (iii) commanding higher margin vs peers; and (iv) high dividend yield of ~5% with tendency to tilt on the high side leading to a strong support of any downside risk. We opine that the higher PE multiple we ascribe is justified by its above-industry average margin and ROE.

Figure #12 Uchi's P/E band



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**Figure #13 Peers comparison**

Company	FYE	Price (Local)	Market Cap (m)		P/E (x)		P/B (x)		ROE (%)		DY (%)
			(Local)	(USD)	2021	2022	2021	2022	2021	2022	
<b>Malaysia</b>											
VS Industry	Jul	2.75	5,175.8	1,256.7	22.0	16.6	2.8	2.6	13.2	15.8	2.0
ATA IMS	Mar	2.73	3,283.8	797.3	24.4	17.8	4.3	3.7	18.3	22.1	1.3
Formosa Prosonic Industries	Dec	2.72	672.8	163.4	NA	NA	NA	NA	NA	NA	NA
Salutica	Jun	0.58	221.4	53.7	NA	NA	NA	NA	NA	NA	NA
SKP Resources	Mar	2.20	2,749.8	667.7	22.0	16.3	4.2	3.7	20.1	23.3	2.5
Uchi Technologies	Dec	3.26	1,473.1	357.7	16.9	17.2	7.6	7.2	46.8	43.4	5.3
<b>Average</b>					<b>21.3</b>	<b>17.0</b>	<b>4.7</b>	<b>4.3</b>	<b>24.6</b>	<b>26.1</b>	<b>2.8</b>
<b>Foreign</b>											
Benchmark Electronics Inc (US)	Dec	31.63	1149.0	1149.0	26.7	23.0	NA	NA	NA	6.4	NA
CTS Corp (US)	Dec	33.29	1076.9	1076.9	22.8	20.2	NA	NA	NA	14.7	NA
Fabrinet (US)	Jun	92.93	3426.4	3426.4	20.7	18.7	3.1	2.7	16.1	15.6	NA
Gentherm Inc (US)	Dec	79.49	2618.7	2618.7	23.9	21.1	3.7	NA	16.9	17.0	NA
Plexus Corp (US)	Sept	90.98	2621.9	2621.9	18.6	16.9	2.5	2.2	14.1	13.2	NA
Hon Hai Precision Ltd (Taiwan)	Dec	120.00	1663558.9	59016.6	15.5	12.5	1.2	1.2	8.1	9.7	3.3
Pegatron Corp (Taiwan)	Dec	71.40	190129.2	6745.0	8.5	10.2	1.1	1.0	12.6	9.9	6.9
Wistron Corp (Taiwan)	Dec	32.40	94077.0	3337.5	10.2	9.8	1.2	1.1	11.3	11.4	6.8
Venture Corp Ltd (Singapore)	Dec	19.16	5559.8	4134.0	15.7	14.6	2.0	1.9	13.3	13.5	4.1
DBG Technology Co Ltd (China)	Dec	11.78	9125.0	1402.0	24.0	19.0	3.4	3.1	14.2	16.2	1.6
Xiamen Intertech (China)	Dec	56.84	26130.9	4014.9	24.2	18.8	5.3	4.5	21.7	23.5	1.4
Inventec Corp (Taiwan)	Dec	25.90	92915.6	3296.3	12.2	15.2	1.6	1.6	13.6	10.7	6.0
Quanta Computer (Taiwan)	Dec	88.50	341842.5	12127.2	14.1	13.5	2.4	2.3	17.0	17.3	5.7
<b>Average</b>					<b>18.2</b>	<b>16.4</b>	<b>2.5</b>	<b>2.2</b>	<b>14.4</b>	<b>14.4</b>	<b>4.3</b>
<b>Overall average</b>					<b>17.0</b>	<b>14.8</b>	<b>2.7</b>	<b>2.4</b>	<b>17.1</b>	<b>15.8</b>	<b>3.8</b>
<b>Overall average (ex Uchi)</b>					<b>19.1</b>	<b>16.5</b>	<b>2.8</b>	<b>2.4</b>	<b>15.0</b>	<b>14.1</b>	<b>3.7</b>

Bloomberg

## Environmental Social and Government (ESG)

Uchi not only excels in their business performance, it has also proven their commitment in enhancing shareholders' value by proactively create a socially and environmentally conscious business (see Figure #7).

**Figure #14 ESG Socially and environmentally conscious business**

Sustainability Themes	Titles	Descriptions
OHSAS Standard	Complying with OHSAS standards and benchmarking against international environmental and quality policies	<ul style="list-style-type: none"> <li>Continue to invest time and resources in designing, introducing and implementing social, educational or health related programmes and systems which are constructive in minimizing damage to local communities and the environment in which they operate.</li> <li>Continue to build trust among employees, suppliers, customers and community members and addressing the concerns of all stakeholders involved equally.</li> </ul>
Corporate Governance	Uphold the principles of the Malaysian Code on Corporate Governance (MCCG 2017)	<ul style="list-style-type: none"> <li>Recognizing that ethical behaviour, accountability, transparency and sustainability are important to the governance of the company</li> <li>Having a clear operating model that guides the group on how to make the right decisions for the right reasons and the right ways.</li> </ul>
Community outreach	Commitment to change extends to community	<ul style="list-style-type: none"> <li>Sponsored charity events throughout the year.</li> <li>Continued the River Rehabilitation Campaign which was initiated in 2015 in collaboration with Majlis Perbandaran Seberang Perai (MPSP).</li> <li>Monitoring of the river annually to improved and continues to maintain the water quality.</li> <li>Planting activities on UCHITEC premises with a mission to foster a greener environment.</li> </ul>
Innovation	Building culture of continuous innovation	<ul style="list-style-type: none"> <li>Highlighted in their energy-saving modules for household and office equipment which comply with European eco-design requirements.</li> <li>Integrated the feature which enables a standby and off-mode with an electrical power consumption of less than 0.5 watts.</li> <li>Focused on creating solutions which empower their customers and their end-users to reduce their environmental impact with several exciting projects in various research and development phases.</li> </ul>
Environmental	Commitment to preserve the environment by generating renewable energy	<ul style="list-style-type: none"> <li>Positive outcomes from the Grid-Connected Photovoltaic Power System (PV System) which was installed in December 2016.</li> <li>Commitment to preserve the environment by generating renewable energy using the PV system has resulted in a commendable reduction in our estimated CO2 emissions by an estimated 515 tons in 2019.</li> <li>This has helped mitigate their electricity usage cost by providing an income of RM481k from electricity generated using solar energy.</li> </ul>
People	Long-term success of the company depends on its capacity to attract, retain and develop the best talent.	<ul style="list-style-type: none"> <li>The Company aims to build and sustain an environment where its people have a sense of personal commitment to their work and give their best to promote the success of the Company.</li> <li>In turn, the Company encourages and enables a healthy work-life balance for its employees.</li> <li>Emphasize respect and trust when dealing with their people at all levels without exception.</li> <li>In 2019, the Group allocated 622,500 options to our employees under the Uchi Technologies Berhad Employee Share Option Scheme (ESOS) 2016.</li> </ul>



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