

Inari Amertron Bhd (BUY, NEW)

 INDUSTRY: NEUTRAL
 INITIATION

2 April 2014

Price Target: RM3.09

Share Price: RM2.65

Not Too Late, Still Has Legs

Highlights

- Share price continued to gain bullishly accompanied by financial results which consistently exceed expectations thanks to effective management executions coupled with favorable semiconductor outlook. We continue to like this firm and believe that there is more room to grow.
- RF business is poised to propel further due to:
 1. Positive semiconductor outlook (~5-10% growth).
 2. Smart communication devices remains as the main application growth driver for the overall industry.
 3. Higher demand for Avago's RF ICs.
 4. Asset-light adoption by global players.
- Although Amertron's products are relatively more mature relative to RF ICs, OIDA believes that this segment's steady growth will be supported on the back of strong demand creating a potential market size of ~USD1.2tr by 2017.
- Acquisition of Amertron is synergistic and complementary, as proven by past two quarters' results where Inari's top and bottom line saw major improvements. Besides, this also allows Inari to have access to expertise in fibre optics which is crucial for its ISK's development.
- By leveraging on Agilent well-established T&M market and its role as electronics and electrical industry lead partner for ETP, CEEDTec is expected to grow rapidly with exposure to international market.
- ISK's contributions is expected to rise thanks to:
 1. Insatiable demand for data as user usage behavior migrates from voice coupled with introduction of more online services.
 2. Copper transition to fibre as the latter offers high bandwidth allowing huge data to be carried more efficiently.

Catalysts

- Wireless communications / mobility / IoT (M2M) / LTE
- Business diversifications into optoelectronics and T&M
- Favorable FOREX
- Continuous effective operational strategy.

Risks

- Single major client risk (Avago) / high dependency
- FOREX risks
- Patent disputes
- Resources / labour shortage.

Rating

BUY, TP: RM3.09

- Positives - Synergy from acquisition, 40% dividend payout at reasonable yield, listing transfer to Bursa Main Board.
- Negatives – innovation stalemate in telecommunication.

Valuation

- We value the stock with a fair value of **RM3.09** based on 15.1x CY15 P/E multiple, average P/E multiple of its Malaysian and US-based peers (see Figure #13).

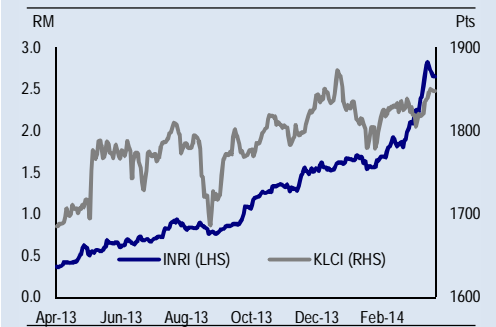
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KLCI	1847.8
Expected share price return	16.6%
Expected dividend return	3.0%
Expected total return	19.6%

Share price



Information

Bloomberg ticker	INRI MK
Bursa code	0166
Issued shares (m)	495
Market cap (RM m)	1,313
3-mth avg. volume ('000)	2,967

Price Performance	1M	3M	12M
Absolute	41.2	62.9	583.0
Relative	40.3	63.3	523.6

Major Shareholders

Insas Bhd	33.5%
Ho Phon Guan	6.4%
Tan Lee Pang	6.4%

Summary Earnings Table

FYE Jun (RMm)	2013A	2014E	2015E	2016E
Revenue	241.1	815.4	909.5	980.0
EBITDA	58.3	122.5	155.7	177.1
PBT	43.3	101.3	131.6	151.0
PATAMI	42.0	95.0	121.7	138.8
Adj PATAMI	46.0	95.0	121.7	138.8
Rep EPS (sen)	8.8	19.9	25.5	29.1
Adj EPS (sen)	9.6	19.9	25.5	29.1
DPS (sen)	4.5	8.0	10.2	11.6
Net DY (%)	1.7	3.0	3.8	4.4
PER (x)	30.1	13.3	10.4	9.1
P/Book (x)	8.0	5.9	4.4	3.4
EV/EBITDA (x)	21.5	10.4	7.9	6.6
Net D/E (%)	(8.6)	5.7	(10.2)	(24.0)
ROA (%)	11.3	21.5	22.9	22.1
ROE (%)	29.2	44.2	42.3	37.4

HLIB

Prologue

Inari Amertron's (Inari) share price continued to gain bullishly accompanied by financial results which consistently exceed expectations thanks to effective management executions coupled with favorable semiconductor outlook. Our previous target price of RM1.90 published in a non-rated report titled "Validating Moore's Law" dated 25th Oct 2013 was nullified without any difficulties. We continue to like this firm and believe that there is more room to grow, thus we officially initiate coverage on Inari.

More room to grow.

Pillar 1: Integrated Semiconductor

This is the original business when Inari went public, specializing in providing full integrated back-end services (see Figure #1) to leading global players in communications technology. Its core services are primarily packaging and testing services with key products including wide range of System-in-Package products (multiple integrated circuits (IC) enclosed in a package) as well as printed circuit board (for mechanical support and electrical connection of electronic components).

IC packaging and testing.

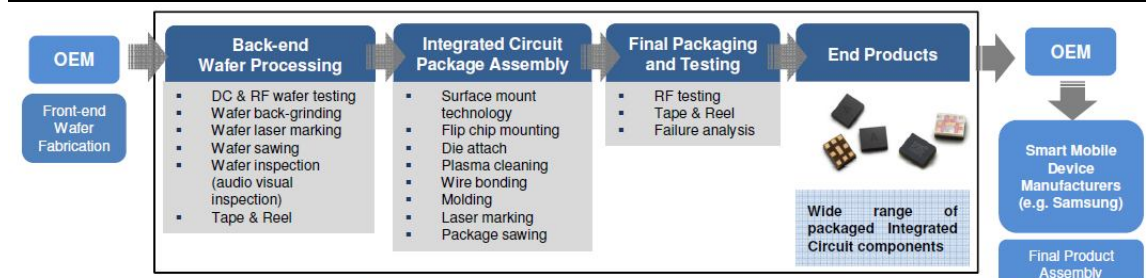
Assembly and processing lines are housed by 4 factories located in Penang's Free Industrial Zone. As of FYE13, Inari had installed capacity of 1.6bn ICs per annum and was running at a high average utilization rate of 88% with 1.4bn ICs produced. Besides that, Inari's fine pitch flip chip which has an installed capacity of 400m ICs per year was also loaded with an average utilization rate of 82%.

High utilization rate in FY13.

At this juncture, this business segment is only serving Avago who outsources radio frequency (RF) IC wafer assembly and processing to Inari. Avago is a global leading designer, developer and global supplier of broad range of analog, mixed signal and optoelectronics components and subsystems serving three primary markets, including wireless communications, wired infrastructure and industrial.

Avago factor.

Figure #1 Integrated Back-end Services



Integrated back-end services.

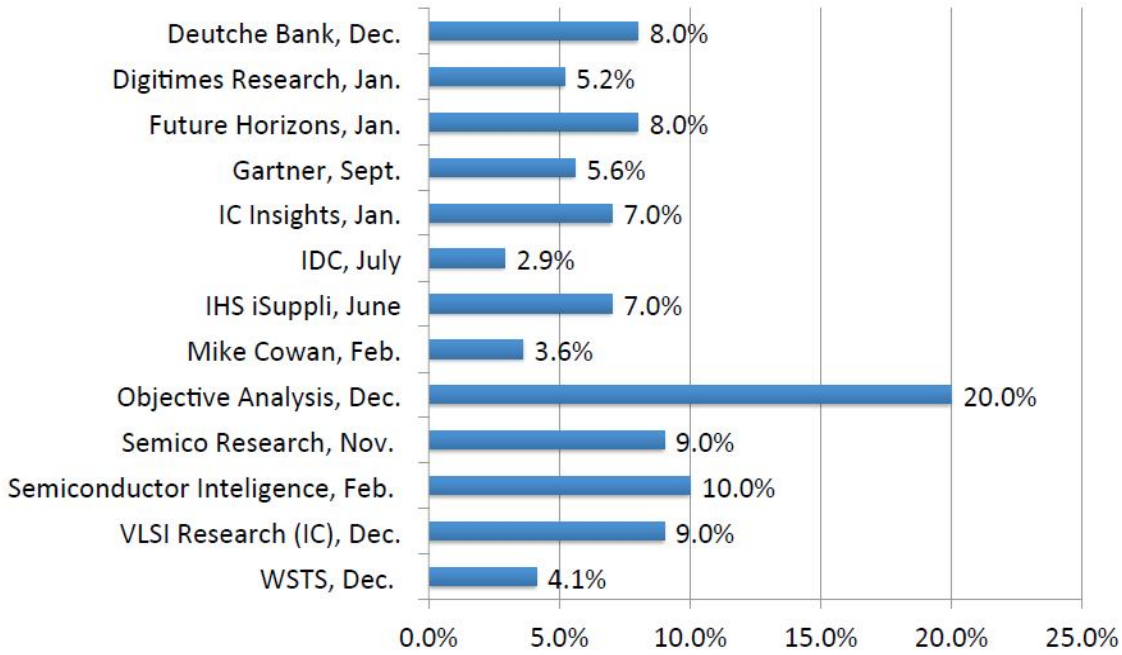
Company Data

This pillar is poised to expand resiliently going forward due to:

1. Positive semiconductor outlook whereby growth is generally expected to be within the range of 5% to 10% (see Figure #2).
2. Smart communication devices remains as the main application growth driver for the overall industry. Gartner is expecting smartphone deliveries to grow at a CAGR of 12% - 17% from 2012 - 2017 generating an estimated semiconductor market value of USD34bn. ABI also concur the view by complementing a quarterly forecast of handset shipments close to 600m units in 4Q15 which will be further boosted by wide adoption of 4G / LTE (see Figure #3).
3. Higher demand for Avago's RF ICs. New mobile phone would usually require to be complied with older standards for interoperability and backward compatibility purposes and this has resulted in more and more frequency bands to be embedded into it, requiring more RF ICs. This situation is further made worse with the introduction of 4G / LTE which is frequency agnostic (see Figure #4).
4. Global players are going asset-light (without factory) due to the high manufacturing costs in fabrication and assembly as economies of scale is becoming an uphill task. In turn, subcontracting is an emerging trend which eventually benefits Inari as it has the full support of Avago.

Poised to expand resiliently.

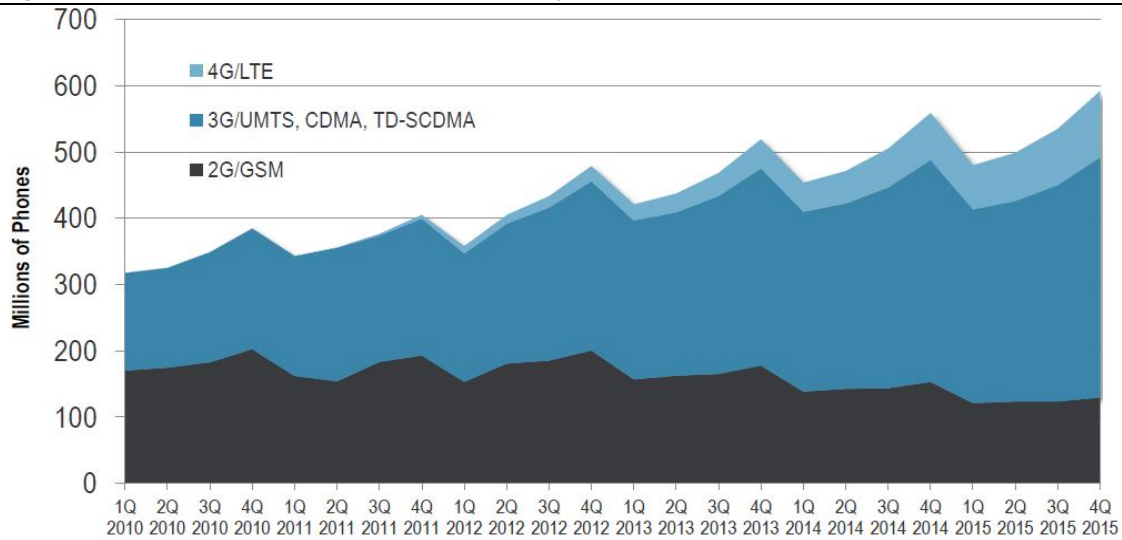
Figure #2 FY14 Semiconductor Market Forecasts



MAEI, various

Generally to be within 5% - 10%.

Figure #3 Handset Growth Trends by Generation



ABI

Boosted by introduction of 4G / LTE.

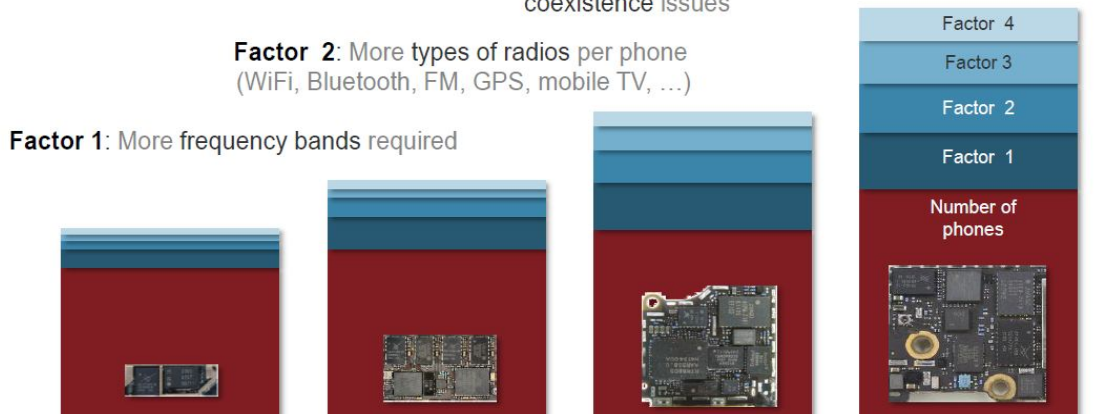
Figure #4 Handset Growth Trends by Generation

Factor 4: Fewer SKUs :
More bands per phone

Factor 3: Increasingly crowded spectrum creates coexistence issues

Factor 2: More types of radios per phone
(WiFi, Bluetooth, FM, GPS, mobile TV, ...)

Factor 1: More frequency bands required



More RF IC required.

Avago

Pillar 2: Optoelectronics

For diversification, Inari gained a foothold in this segment via acquisition of Amertron in Jun 2013. Its core services are manufacturing, testing and assembly of optoelectronics components and IC plastic package assembly (see Figure #5). Key products include LEDs, LED displays, optical sensors, IR sensors, opto-couplers for use in the data center, aerospace, defence, industrial automation and automotive industries. Amertron's operations are located in Philippines with 2 factories (Clark Field and Parañaque) and the other in China (Kunshan, Jiangsu). Avago and Osram are Amertron's significant customers.

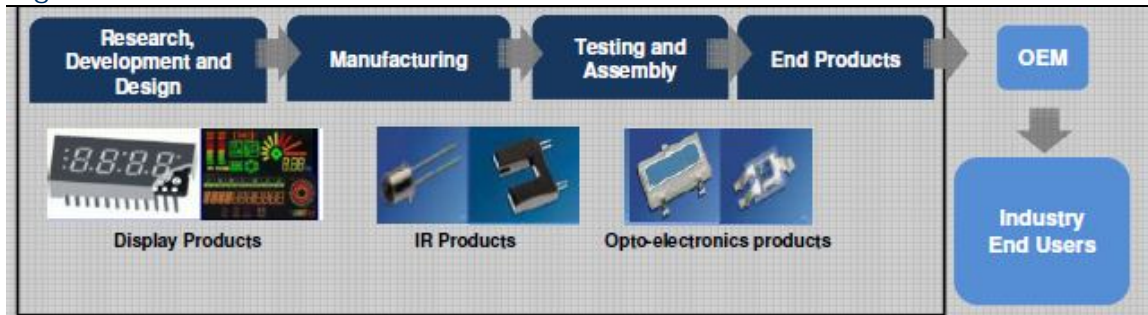
Although Amertron's products are relatively more mature relative to RF ICs, Optoelectronics Industry Development Association (OIDA) believes that this segment's steady growth will be supported on the back of strong demand creating a potential market size of ~USD1.2tr by 2017 (see Figure #6). Echoing that, Gartner is expecting optoelectronics to be the top 3 growth segment in 2014 with 8.4% yoy (see Figure#7), outpacing the whole semiconductor industry and its own 2013 growth rate of 5.4% yoy and 3.6% yoy respectively. This is chiefly due to its energy efficiency endorsing wide applications such as smart devices, TV, image sensors, vision systems as well as its function as photovoltaic (solar) cells, a viable solution for renewable energy (environmental-friendly).

Furthermore, we believe that this merger is synergistic and complementary. As proven by past two quarters' results, Inari's top and bottom line saw significant improvements due to higher efficiencies and cost savings achieved through raw material procurement, customer engagement and production flexibility. Last but not least, this acquisition also allows Inari to have access to expertise in fibre optics which is crucial for its Inari South Keytech's development (refer to below).

A potential market size of ~USD1.2tr by 2017.

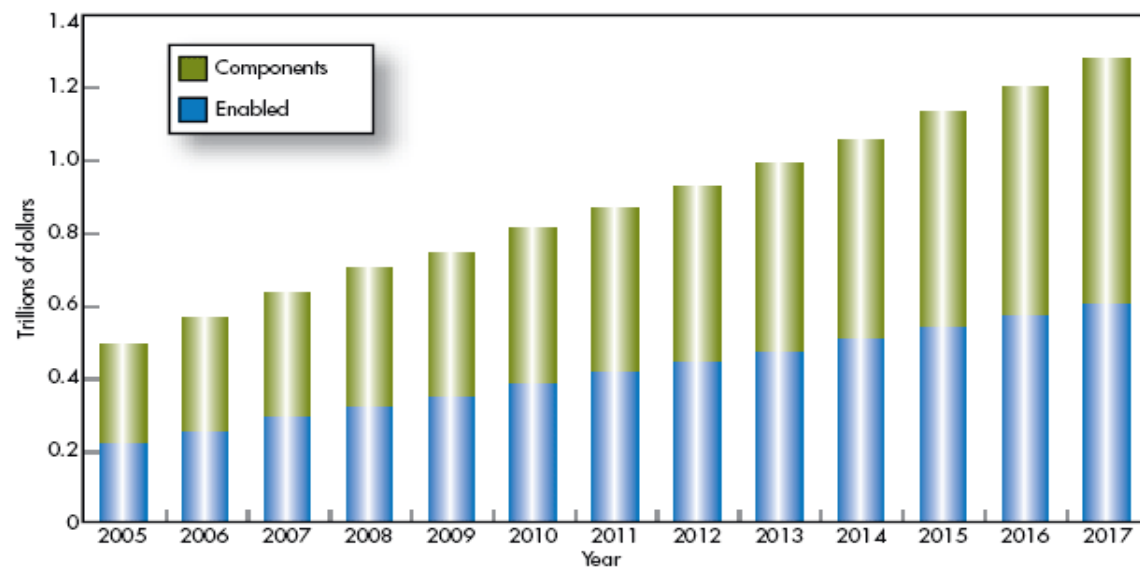
Synergistic and complementary.

Figure #5 Amertron's Core Services



Company Data

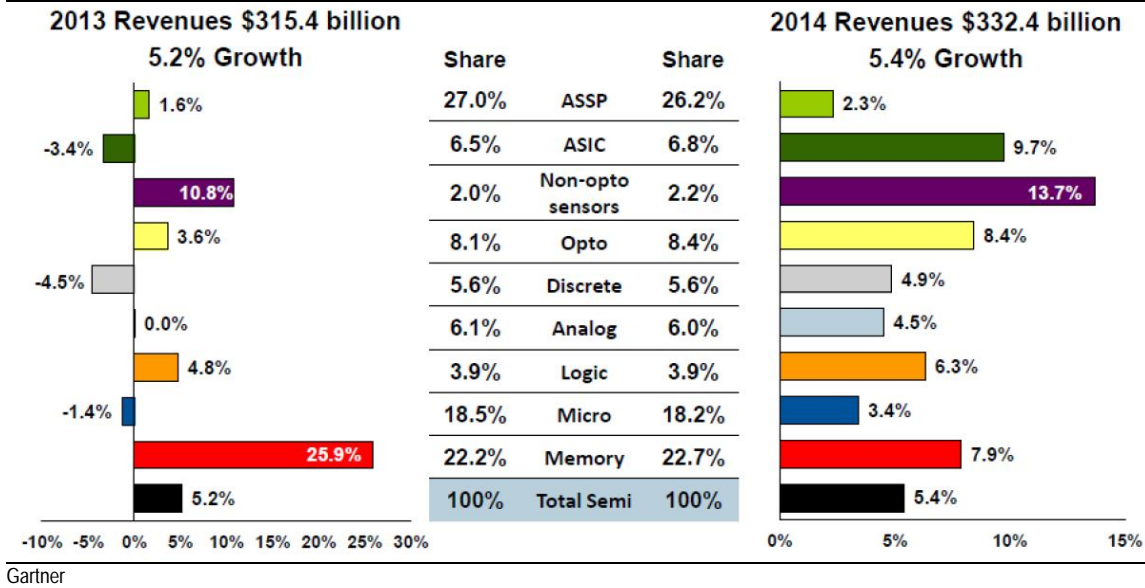
Figure #6 Optoelectronics Market Size



OIDA

Steady growth ahead.

Figure #7 Optoelectronics Growth Forecast



Opto to outgrow industry.

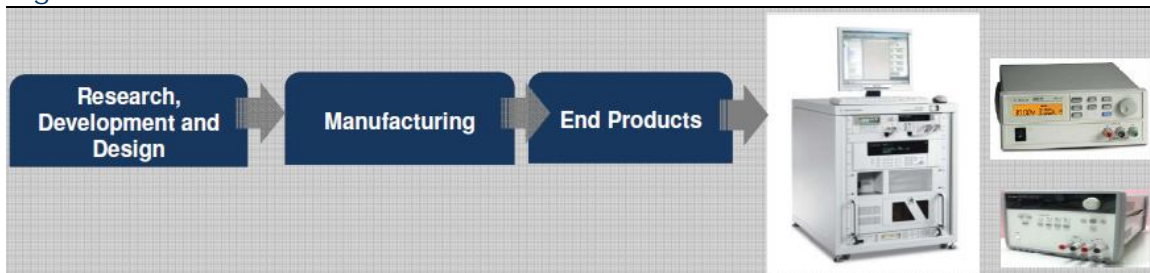
Pillar 3: Electronic Test and Measurement Equipment

Inari's 51%-owned CEEDTec is an original design manufacturer (ODM) and R&D house in the electronics industry with niches in design, development and manufacturing of electronic test and measurement (T&M) products. Its key products include automated test equipment for automotive applications (such as automotive functional test systems for ABS testing, ECU test, etc) as well as precision bench-top power sources for laboratories and manufacturing testing (programmable, manual, multi-channel ranging from 30W to 375W).

Notably, CEEDTec is a key eco-system partner for Agilent. By leveraging on Agilent well-established T&M market and its role as electronics and electrical industry lead partner for ETP, CEEDTec is expected to grow rapidly with exposure to international markets. As of 2QFY14, CEEDTec had over 20 new products at final development stage and plan to introduce to Agilent in stages starting from April 2014.

A key eco-system partner for Agilent.

Figure #8 CEEDTec's Core Services



Company Data

Pillar 4: Fibre Optics

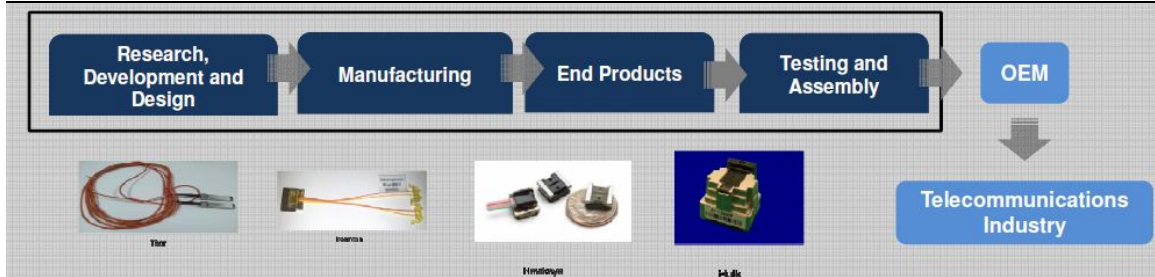
Driven by its 100%-owned subsidiary Inari South Keytech (ISK). This division's operations are located at Iskandar Johor, close proximity to its major customer Avago in Singapore. ISK's core services include design and production of fibre-optic connectors with Class10 cleanrooms as well as providing R&D facility for customer's new product introduction (see Figure #9). Key products are fibre-optics transmitters and receivers for use in telco industry.

While revenue contributions from this business segment is marginal due to its infancy, we foresee that this will be one of the sales generator in future as:

1. Insatiable demand for data as user usage behavior migrates from voice coupled with introduction of more online services, such as gaming, video streaming, e-commerce, etc. In turn, this has resulted in exponential increase in global IP traffic (see Figure #10).
2. The switch from copper transition to fibre as the latter offers high bandwidth allowing huge data to be carried more efficiently. According to Ovum, global annual shipments of telecom and datacom lasers has been increasing astonishingly in recent years reaching ~60m and ~50m for single-mode and multimode respectively in 2013. This trend is expected to continue solidly supported by its continuous technology roadmap.

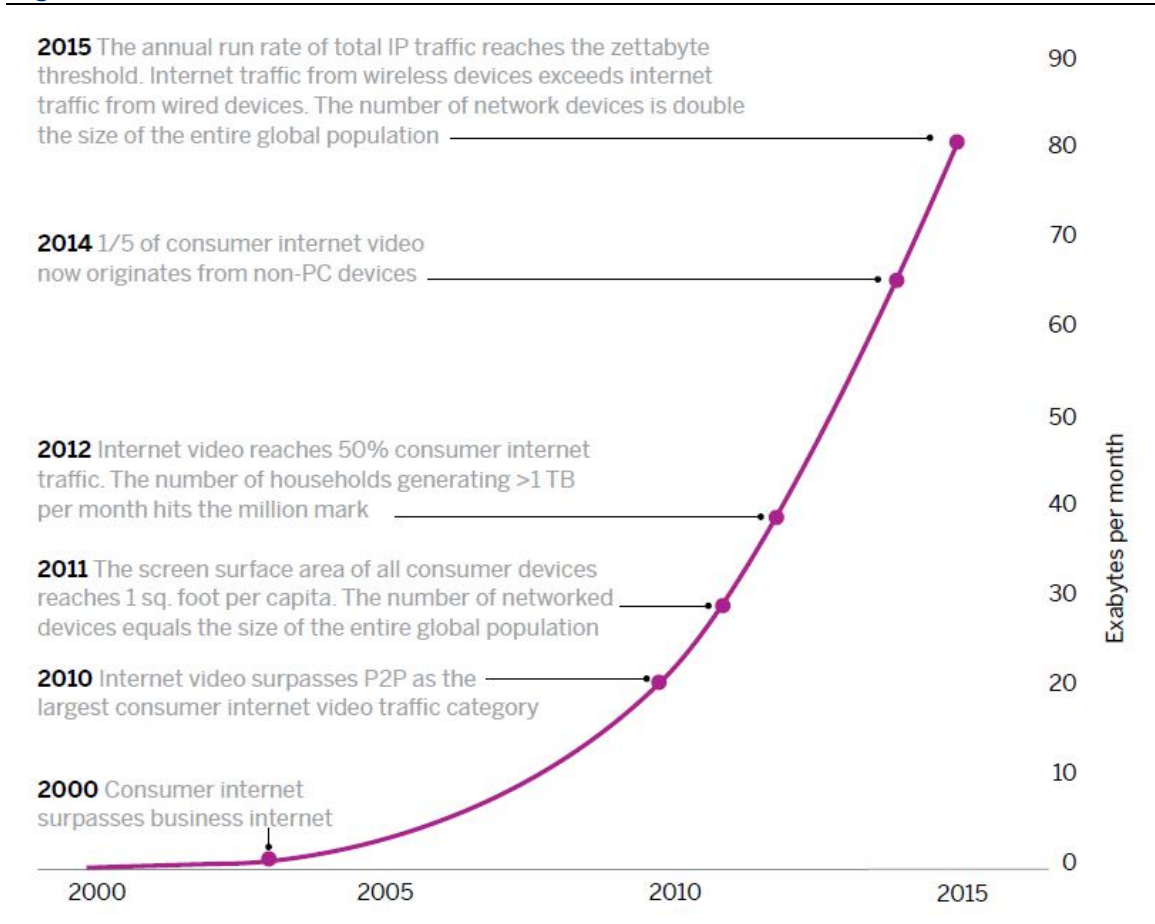
Insatiable demand for data.
Migration to fibre.

Figure #9 ISK's Core Services



Company Data

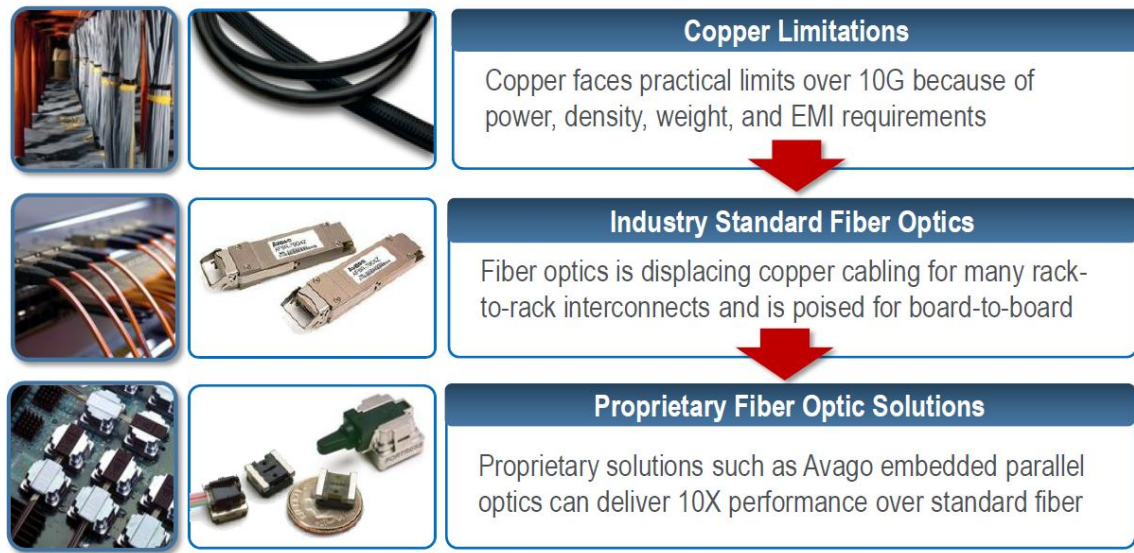
Figure #10 Annual Global IP Traffic



Global IP traffic is expected to reach 80EB per month in 2015.

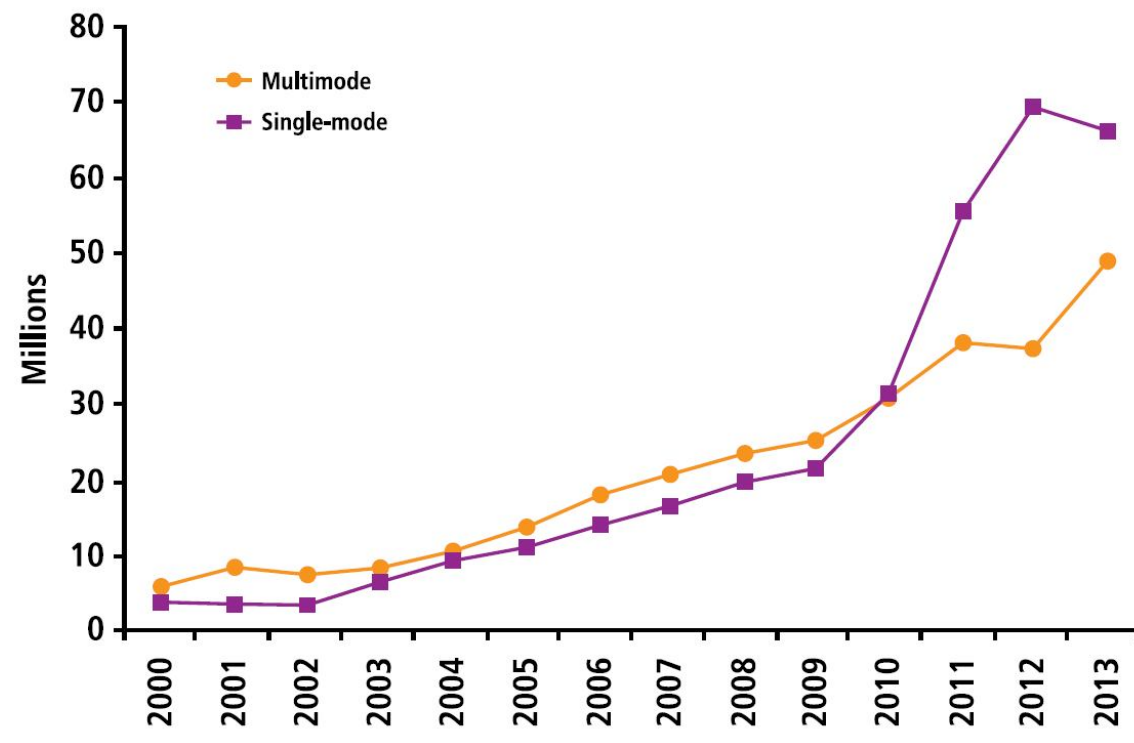
Cisco

Figure #11 Copper Transition to Fibre



Avago

Figure #12 Annual Shipments of Telecom and Datacom Lasers



Ovum

Figure #13 Regional Peers Comparison

Company	FYE	Price	Market Cap (USD m)	P/E (x)		P/B (x)		Gross DY (%)
				2013	2014	2013	2014	2013
Malaysia								
Inari Amertron	Jun	RM2.65	402.5	16.6	12.3	N/A	N/A	2.9
Globetronics Tech	Dec	RM3.71	318.9	16.6	14.0	3.6	3.3	4.9
Unisem	Dec	RM1.06	219.1	24.1	14.3	0.7	0.7	2.4
MPI	Jun	RM4.40	268.3	15.7	12.5	1.2	1.1	2.9
Average (excl INRI)				18.8	13.6	1.8	1.7	3.4
Foreign								
Avago Technologies	Oct	USD65.05	16,251.5	19.0	16.7	5.1	4.5	1.6
Analog Devices	Oct	USD54.08	16,901.5	23.5	20.6	3.4	3.2	2.7
Skyworks Solutions	Sept	USD37.61	7,120.1	14.4	12.9	3.1	2.7	N/A
Texas Instruments	Dec	USD47.53	51,532.7	20.8	18.2	4.8	4.6	2.5
Broadcom	Dec	USD31.52	17,903.4	12.9	11.6	1.9	1.8	1.5
Qualcomm	Sept	USD80.10	135,455.5	15.6	14.0	3.5	3.5	1.8
Infineon Tech	Sept	EUR8.83	13,733.6	22.2	17.4	2.4	2.2	1.5
RF Micro Devices	Mar	USD8.03	2,268.8	18.9	13.7	3.4	2.7	N/A
Average				18.4	15.6	3.4	3.1	1.9
Overall avg (excl INRI)				18.5	15.1	3.0	2.7	2.4

Bloomberg, HLIB

Inari Amertron Berhad (BUY, PT: RM3.09, CP: RM2.65)

Income Statement

FYE 30 June (RMm)	2012A	2013A	2014E	2015E	2016E
Revenue	180.8	241.1	815.4	909.5	980.0
COGS	(146.4)	(182.8)	(692.9)	(753.8)	(802.9)
EBITDA	34.4	58.3	122.5	155.7	177.1
D&A	(13.6)	(14.6)	(21.0)	(23.7)	(26.0)
EBIT	20.8	43.7	101.5	132.0	151.1
Net Interest Income	(0.5)	(0.4)	(0.2)	(0.4)	(0.1)
Associates	0.0	0.0	0.0	0.0	0.0
PBT	20.3	43.3	101.3	131.6	151.0
Tax	(1.0)	(2.0)	(5.1)	(6.6)	(7.6)
Net Profit	19.3	41.2	96.2	125.0	143.5
MI	0.6	0.8	(1.2)	(3.3)	(4.7)
PATAMI	19.9	42.0	95.0	121.7	138.8
Exceptionals	(1.1)	4.0	0.0	0.0	0.0
Adj PATAMI	18.7	46.0	95.0	121.7	138.8
Basic Shares (m)	477.6	477.6	477.6	477.6	477.6
Rep EPS (sen)	4.2	8.8	19.9	25.5	29.1
Adj EPS (sen)	3.9	9.6	19.9	25.5	29.1
Adj FD EPS (sen)	2.9	7.1	15.0	19.1	21.8

Quarterly Financial Summary

FYE 30 June (RMm)	2Q13	3Q13	4Q13	1Q14	2Q14
Revenue	62.1	56.8	67.7	191.3	186.6
COGS	(47.3)	(44.4)	(50.1)	(163.2)	(153.5)
EBITDA	14.8	12.3	17.6	28.2	33.1
D&A	(3.4)	(3.9)	(3.9)	(5.3)	(5.2)
EBIT	11.3	8.4	13.7	22.9	27.9
Net Interest Income	(0.1)	(0.1)	(0.1)	(0.9)	(1.4)
Associates	0.0	0.0	0.0	0.0	0.0
PBT	11.3	8.3	13.5	22.1	26.6
Tax	(2.6)	4.1	(0.8)	(1.2)	(1.5)
Net Profit	8.7	12.4	12.8	20.9	25.1
MI	0.3	(0.0)	0.3	0.2	(0.6)
PATAMI	9.0	12.4	13.1	21.0	24.4
Exceptionals	2.6	4.7	(3.5)	(3.8)	(2.7)
Adj PATAMI	11.6	17.1	9.6	17.2	21.7
Basic Shares (m)	477.6	477.6	477.6	477.6	477.6
Rep EPS (sen)	1.9	2.6	2.7	4.4	5.1
Adj EPS (sen)	2.4	3.6	2.0	3.6	4.6
Adj FD EPS (sen)	1.8	2.7	1.5	2.7	3.4

Balance Sheet

FYE 30 June (RMm)	2012A	2013A	2014E	2015E	2016E
Cash	40.5	44.2	18.4	60.0	119.6
Receivables	24.4	94.9	134.0	149.5	161.1
Inventories	22.2	108.3	142.4	154.9	165.0
Investment	0.0	0.0	0.0	0.0	0.0
PPE	54.8	111.1	130.2	146.7	161.0
Intangibles	4.4	9.2	11.9	14.6	17.2
Other Assets	2.3	4.6	4.6	4.6	4.6
Total Assets	148.6	372.3	441.5	530.4	628.5
Payables	48.3	131.3	142.4	154.9	165.0
ST borrowings	4.5	20.4	20.4	20.4	20.4
LT borrowings	8.4	10.3	10.3	10.3	10.3
Other Liabilities	4.4	53.2	53.2	53.2	53.2
Total liabilities	65.7	215.1	226.2	238.7	248.8
Shareholders' Funds	83.3	157.9	215.0	288.0	371.2
MI	(0.4)	(0.8)	0.4	3.7	8.4
Total S/H Equity	82.9	157.2	215.3	291.7	379.7
Ttl Liab&S/H Funds	148.6	372.3	441.5	530.4	628.5

Valuation Ratios

FYE 30 June (RMm)	2012A	2013A	2014E	2015E	2016E
PER (x)	63.6	30.1	13.3	10.4	9.1
Adj PER (x)	67.5	27.5	13.3	10.4	9.1
FD PER (x)	91.3	37.2	17.7	13.8	12.2
DPS (sen)	2.8	4.5	8.0	10.2	11.6
Net DY (%)	1.1	1.7	3.0	3.8	4.4
Book/share (sen)	17.4	33.1	45.0	60.3	77.7
P/Book (x)	15.2	8.0	5.9	4.4	3.4
FCF/share (sen)	(0.7)	5.7	2.5	18.9	24.1
FCF yield (%)	(0.3)	2.1	1.0	7.1	9.1
Mkt Cap	1,265.6	1,265.6	1,265.6	1,265.6	1,265.6
Net Cash(Debt)	27.5	13.6	(12.3)	29.4	89.0
EV	1,238.1	1,252.1	1,277.9	1,236.2	1,176.7
EV/EBITDA (x)	36.0	21.5	10.4	7.9	6.6
ROE (%)	22.5	29.2	44.2	42.3	37.4
Current Ratio (x)	1.6	1.6	1.8	2.1	2.4
Quick Ratio (x)	1.2	0.9	0.9	1.2	1.5
Interest Cover (x)	21.5	49.7	165.6	215.5	246.6

Cashflow Analysis

FYE 30 June (RMm)	2012A	2013A	2014E	2015E	2016E
EBITDA	34.4	58.3	122.5	155.7	177.1
Tax Paid	(2.0)	(2.7)	(5.1)	(6.6)	(7.6)
WC Changes	(12.9)	13.4	(62.2)	(15.5)	(11.6)
Other	(1.3)	1.6	(0.2)	(0.4)	(0.1)
CFO	18.2	70.6	55.0	133.2	157.9
FCF	(3.4)	27.0	12.1	90.4	115.1
CAPEX	(21.6)	(43.6)	(42.9)	(42.9)	(42.9)
PPE sales / disposal	0.7	0.0	0.0	0.0	0.0
Acquisitions	2.3	(86.1)	0.0	0.0	0.0
Other	30.6	70.4	0.0	0.0	0.0
CFI	12.0	(59.3)	(42.9)	(42.9)	(42.9)
Dividend paid	(9.9)	(17.1)	(38.0)	(48.7)	(55.5)
Debt changes	4.1	7.2	0.0	0.0	0.0
Other	0.6	0.8	0.0	0.0	0.0
CFF	(5.3)	(9.1)	(38.0)	(48.7)	(55.5)
Net Cashflow	24.9	2.2	(25.9)	41.7	59.6

Other Ratios

FYE 30 June (RMm)	2012A	2013A	2014E	2015E	2016E
Sales Growth (%)		33.4	238.1	11.5	7.8
EBITDA Growth (%)		69.7	110.0	27.2	13.7
EBIT Growth (%)		110.1	132.3	30.1	14.4
PBT Growth (%)		113.2	133.9	30.0	14.8
Net Profit Growth (%)		113.8	133.3	30.0	14.8
EBITDA Margin (%)	19.0	24.2	15.0	17.1	18.1
EBIT Margin (%)	11.5	18.1	12.4	14.5	15.4
PBT Margin (%)	11.2	18.0	12.4	14.5	15.4
Net Profit Margin (%)	10.7	17.1	11.8	13.7	14.6
Net Debt/Equity (%)	N Cash	N Cash	5.7	N Cash	N Cash
CAPEX/Sales (%)	12.0	18.1	5.3	4.7	4.4

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BUY	Positive recommendation of stock under coverage. Expected absolute return of more than +10% over 12-months, with low risk of sustained downside.
TRADING BUY	Positive recommendation of stock not under coverage. Expected absolute return of more than +10% over 6-months. Situational or arbitrage trading opportunity.
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