

Outthink. Outperform.

A caffeine shot

Uchi experience a significant re-rating post the announcement of its 2Q17 results and improved earnings outlook. In our view, its new PE multiple range at $>+1SD$ its historical mean is likely sustainable given earnings upside risk from existing key customer Jura and also new business prospects. Potential capital management initiatives should also keep investors interested in the stock. Maintain BUY with a higher target price of RM3.33.

Improved outlook has helped PE multiple re-rating

Uchi's stock price has re-rated after the recent 2Q17 results announcement, driven by management's guidance of an improved outlook over the near term. This is a marked contrast to its outlook and guidance over the past few years, which have been sombre – mostly expecting sales to be flat.

Earnings upside risk is real

We think that positive earnings risks are likely considering Jura's confidence in growing its business in new geographical markets while gaining momentum in the office and professional segment (which could help in margin expansion). Meanwhile, we also believe that there is scope for Uchi to secure new products/customers, as management has continually been participating in trade shows and showcasing its abilities and offering cost-competitive solutions.

Potential capital management initiatives

In our view, there are potential capital management initiatives. Uchi's cash and equivalents have been growing (RM212m as at end 2Q17) while it has minimal near-term capex requirements, and it could also exhaust its share premium that could easily translate to a 1 for 2 bonus issue.

Maintain BUY with higher 12M target price of RM3.33

With the improved earnings growth prospects and potential capital management initiatives, we believe Uchi's PE multiple could continue to re-rate over the near term. Moreover, the company is well managed and prudently run, as reflected in its expanding cash position. We therefore raise our target PE multiple to 20x from 16x and lift our target price to RM3.33 (20x 2018E EPS) from RM2.67 previously. Maintain BUY. Risks: a slowdown in global demand for automated high-end coffee machines, new competition and a loss of its customer base.

Earnings & Valuation Summary

FYE 31 Dec	2015	2016	2017E	2018E	2019E
Revenue (RMm)	112.6	120.9	131.5	147.8	154.6
EBITDA (RMm)	58.1	59.9	67.1	75.4	78.9
Pretax profit (RMm)	50.4	57.1	65.8	74.2	77.6
Net profit (RMm)	49.3	55.5	64.5	72.7	76.1
EPS (sen)	11.3	12.7	14.8	16.7	17.4
PER (x)	23.2	20.6	17.7	15.7	15.0
Core net profit (RMm)	54.9	58.2	64.5	72.7	76.1
Core EPS (sen)	12.6	13.3	14.8	16.7	17.4
Core EPS growth (%)	43.1	6.1	10.8	12.7	4.6
Core PER (x)	20.8	19.6	17.7	15.7	15.0
Net DPS (sen)	11.0	13.0	14.0	16.0	17.0
Dividend Yield (%)	4.2	5.0	5.3	6.1	6.5
EV/EBITDA (x)	16.7	15.8	14.0	12.3	11.6
Chg in EPS (%)	-	-	-	-	-
Affin/Consensus (x)	-	-	1.0	1.2	1.1

Source: Company, Affin Hwang forecasts, Bloomberg

Company Update

Uchi Tech

UCHI MK
Sector: Technology

RM2.62 @ 25 September 2017

BUY (maintain)

Upside: 27%

Price Target: RM3.33

Previous Target: RM2.67



Price Performance

	1M	3M	12M
Absolute	+19.1%	+37.9%	+57.8%
Rel to KLCI	+19.1%	+38.7%	+49.1%

Stock Data

Issued shares (m)	438.0
Mkt cap (RMm)/(US\$m)	1147.6/273.3
Avg daily vol - 6mth (m)	0.9
52-wk range (RM)	1.65-2.76
Est free float	50.7%
BV per share (RM)	0.57
P/BV (x)	4.60
Net cash/ (debt) (RMm) (2Q17)	211.8
ROE (2017E)	25%
Derivatives	Nil
Shariah Compliant	Yes

Key Shareholders

Eastbow International Ltd	19.0%
Ironbridge Worldwide	8.1%
LTH	5.8%

Source: Affin Hwang, Bloomberg

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A niche play

79% of revenue derived from coffee machines

Uchi's core competency lies in software programming, in particular for Application Specification Integrated Circuits (ASIC) and predominantly for the design of electronic control systems. Apart from programming, Uchi is also involved in the hardware design, manufacture and assembly of these ODM control modules, which its end customers will incorporate into their finished products. In 2016, 79% of revenue was derived from the Art-of-Living segment, which largely comprises coffee modules and laboratory equipment for the biotech segment.

Fig 1: Revenue breakdown for 2016



Source: Company

Art-of-Living

Recent change in business model

In the past, Uchi used to be dependent on several coffee manufacturers, which includes the likes of Nespresso, Krups, Saeco, Bosch and Jura, for business revenue. This business model changed when Uchi signed an exclusive agreement with Swiss-based coffee machine manufacturer, Jura. This agreement eventually led to Uchi being the sole source for Jura's coffee machine modules, which aided the latter with technological improvement and upgrades and thus provided Jura with an edge over competitors. While Uchi still manufactures some coffee modules for the other brands, but once these are removed from the shelves (i.e. at end of life), they will not be replaced and therefore will not be used in future models.

Fig 2: Jura coffee machine with TFT module display



Source: Jura

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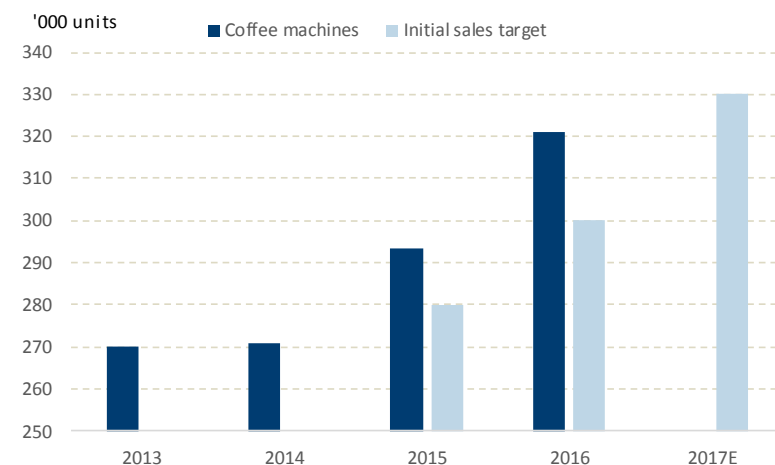
Positive implications from strategic partnership

The strategic implication of this business model is 2-fold. First, it takes Uchi to a partnership level with its customer Jura. Knowing that they are dependent on each other, both are careful in terms of ensuring product success. Secondly, from a financial aspect, we believe that Jura will have a little bit more leeway should there be cost increases. Nevertheless, we think that since the cost of the coffee module is only 7% of the retail price of Jura’s machines, we think that minimal cost increases will be manageable.

Really a play on Jura

Now that it is more dependent on Jura, Uchi’s prospects should be highly correlated with the latter’s market share growth. We understand that Jura is a premium coffee machine manufacturer and a highly regarded brand globally. Jura’s coffee machine sales have improved over the past few years, with sales exceeding its initial targets over 2015-2016, and by a high margin (Fig 3). This leads us to believe that its 2017 sales forecast of 330k units (+3% yoy) is conservative and that it’s more likely to deliver the high single-digit volume sales that it achieved in 2015-2016. Given likely higher ASPs, as Jura gains traction in the office and professional segments, it could see double-digit revenue growth in 2017 (Jura’s 2016 revenue growth of 11.7% yoy)

Fig 3: Jura’s coffee machine sales



Source: Jura

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Biotech division

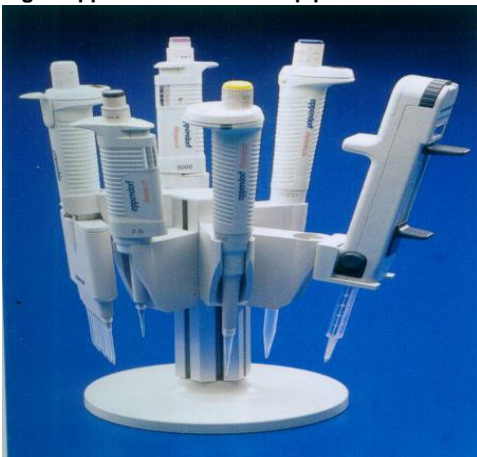
Growing the biotech segment

The biotech segment accounts for the remaining 21% of Uchi's revenue. Uchi serves 2 major customers here, namely Sartorius and Eppendorf, which are both international pharmaceutical and laboratory equipment suppliers, manufacturing electronic modules for use in precision weighing scales, electronic pipettes and deep freezers.

Optimistic on future growth

While the ambition had been to grow this division, which would be positive as it carries higher margins, the revenue split has been pretty stable over the years. We are nevertheless optimistic that revenue will eventually grow as trust and relationships are built leading to a higher number of new products outsourced (the deep freezer for Eppendorf was one of the more recent products). Moreover, the higher manufacturing cost in Europe vis-à-vis Malaysia could be another reason for product transfer, as we believe that Uchi offers better cost-efficient solutions.

Fig 4: Eppendorf's electronic pipettes



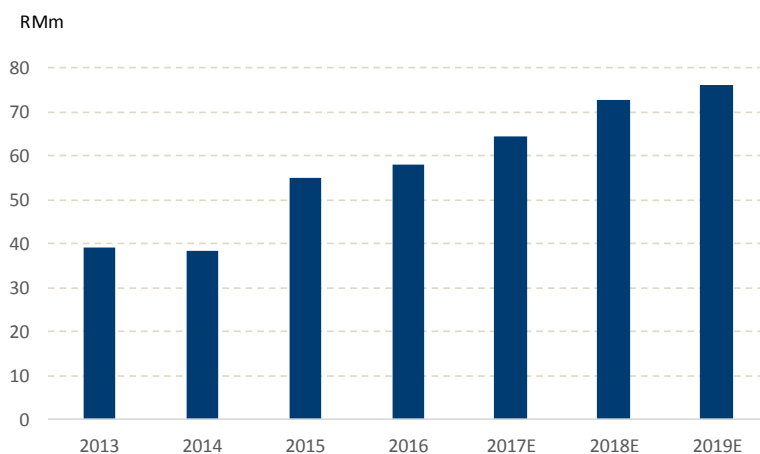
Source: Company

Earnings outlook

11-13% EPS growth for 2017-18E

We are projecting an EPS growth of 11% in 2017E followed by a further 13% growth in 2018E. While earnings for 2015-2016 were notably driven by the appreciation of the US\$, we believe that 2017-2018E earnings growth would be predominantly premised on the volume growth of its coffee modules. We project that the EBITDA margin will remain stable at the 51% level. Our forecasts do not take into account new customers/products introduced or any shift in product mix towards the biotech segment, which carries better margins.

Fig 5: Net profit growth



Source: Company, Affin Hwang forecasts

Valuations and recommendation

Improved outlook has helped PE multiple re-rating

Uchi's stock price has re-rated after the recent 2Q17 results announcement, driven by management's guidance of an improved outlook over the near term - management now expects US\$ revenue growth to be in the mid to high single digit for full-year 2017. This is a marked contrast to its outlook and guidance over the past few years, which have been sombre with expectations that sales would remain flat. This was the case even as recently as the 1Q17 results.

Fig 6: Excerpt from Uchi's 2Q17 results

16. COMMENTARY ON CURRENT YEAR PROSPECT

Barring any unforeseen circumstances, based on customers incoming orders which has been positive and encouraging, the Group expects revenue growth in USD in the mid to high single digit for the financial year ending December 31, 2017.

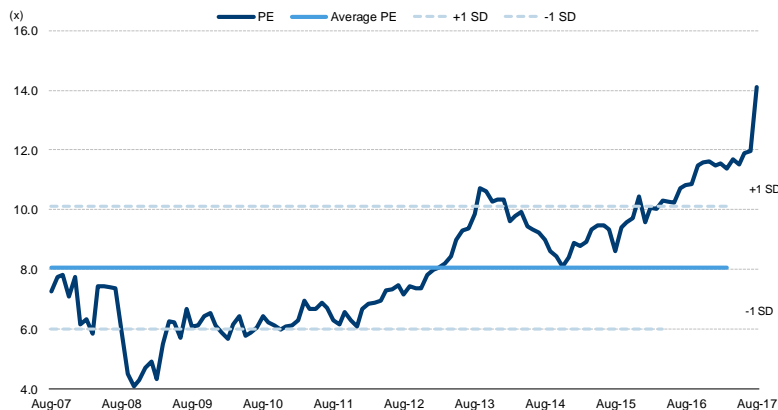
Source: Uchi 2Q17 notes to accounts

PE multiples at 10-year high

The share price performance has resulted in a PE multiple of 14x which is >+1SD and at a >10-year high. We believe that the PE multiple can be sustained at the current high level backed by: 1) the potential for further earnings re-ratings and 2) capital management initiatives.

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Fig 7: Uchi's rolling forward PE multiple



Source: Company, Affin Hwang forecasts

Earnings upside risk is real

We think that earnings forecast re-ratings are likely considering Jura's confidence in growing its business in new geographical markets while gaining momentum in the office and professional segment. Our forecast also does not take into account further margin expansion which could possibly materialise as: 1) the coffee module product mix shifts in favour of the higher margin office and professional segment; and 2) the revenue proportion from higher-margin Jura sales increases vis-à-vis the other coffee manufacturer brands.

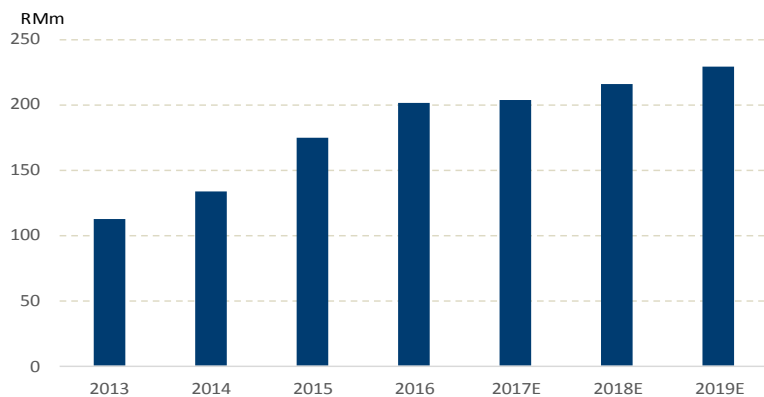
New products and customers would be a catalyst

We also believe that there is scope for Uchi to secure new products/customers as management has continually been participating in trade shows and showcasing its abilities and thus developing new products.

Capital management initiatives on the cards

In our view, there are 2 scenarios in which the company can reward shareholders. First, the company sits on RM212m of cash and equivalents (as at end-2Q17) and could potentially return this to shareholders. Based on our estimates, distributing 25-50% of this could easily translate to a payout of 12-24 sen/share or an additional yield of 4.6-9.2%, on top of the current 2017E yield of 5.3%.

Fig 8: Uchi's cash balance



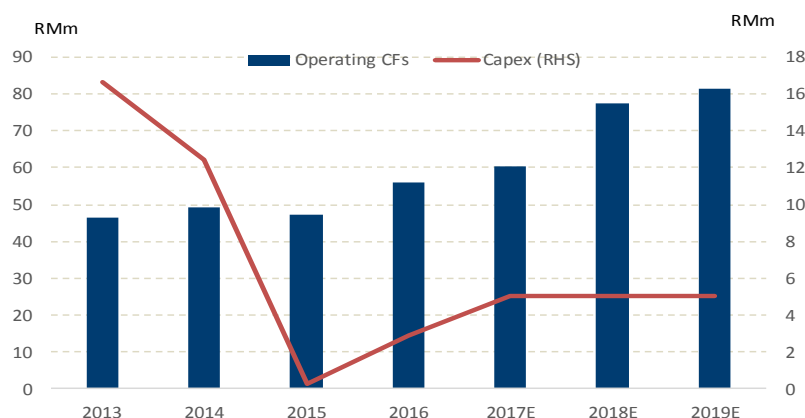
Source: Company, Affin Hwang forecasts

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No major capex plans over the near term

Management guided that there are no near-term plans for any acquisitions or additional capex for expansion considering that the operating capacity is not stretched (utilisation level at c.80%). Moreover, any sudden surge in demand can easily be addressed by outsourcing to local vendors. The company also owns a factory (its previous site) just next door, which would provide ready floor space capacity should the need arises.

Fig 9: Uchi Operating cash flows vs Capex



Source: Company, Affin Hwang forecasts

Potential 1 for 2 bonus issue

Secondly, there is approximately RM50m of share premium, which we estimate can easily translate to a 1 for 2 bonus issue (based on a share par value of RM0.20 and paid-up capital of 445m shares). If management decides to reward shareholders, this would need to take place by end-2018, prior to the consolidation of the share premium and capital account by January 2019, according to the Company's Act 2016.

Maintain BUY with higher target price of RM3.33

With the improved earnings growth prospects and potential capital management initiatives, we believe that Uchi's PE multiple could continue to re-rate over the near term. Moreover, company is well managed and prudently run, as reflected by its expanding cash position. Therefore, we raise our target PE multiple to 20x from 16x and lift our target price to RM3.33 (20x 2018E EPS) from RM2.67 previously. Note that peer valuation comparisons are limited as there is no single company that has a similar business model as Uchi. Our PE reference is thus based on companies that are involved in programming as well as those involved in the manufacture of high-end coffee machines. Given its strong customer relationship and improved earnings outlook, we think the higher PE multiple is justified.

Fig 10: Peer valuation comparison

Company	Stock Ticker	Rating	Price		Mkt Cap (USDm)	Year end	Core PE (x)		EPS growth (%)		EV/EBITDA (x)	P/B (x)	ROE (%)		Div. Yield (%)	
			LC	LC			CY17E	CY18E	CY17E	CY18E			CY17E	CY18E	CY17E	CY18E
Thyssenkrupp Ag	TKA GR	N/R	25.19	N/R	16,985	Sep	20.7	13.7	87.7	50.9	6.2	6.6	21.5	38.5	0.9	1.2
De'Longhi Spa	DLG IM	N/R	26.00	N/R	4,631	Dec	22.0	19.9	5.7	10.2	11.6	3.6	17.0	17.1	2.1	2.3
Austria Technologie & System	ATS AV	N/R	11.99	N/R	555	Mar	nm	22.6	nm	>100	6.2	0.9	-2.3	3.4	nm	0.8
Data Modul Ag	DAM GR	N/R	86.80	N/R	365	Dec	23.9	20.0	25.2	19.3	13.9	3.7	16.8	17.0	0.1	0.1
Average							22.2	19.1	39.5	26.8	9.5	3.7	13.2	19.0	1.0	1.1
Uchi Technologies Bhd	UCHI MK	BUY	2.62	3.33	278	Dec	17.7	15.7	10.8	12.7	15.0	4.3	24.5	26.3	5.3	6.1

*Bloomberg estimates

Note: Pricing as of 25 September 2017



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Risks

Key downside risks

Over the near term, the key risks would include the non-renewal of pioneer status for its products which would result in corporate tax rate of 24% vs its current effective tax rate of 2.4%. We are optimistic, however, that a further 5-year tax incentive would be granted, as in the past, given the continual introduction of new products. Any loss of a major customer, sharp appreciation of the RM or increase in the labour cost would be a major concern.

UCHI - FINANCIAL SUMMARY

Profit & Loss Statement

FYE 31 Dec (RMm)	2015	2016	2017E	2018E	2019E
Revenue	113	121	131	148	155
Operating expenses	(55)	(61)	(64)	(72)	(76)
EBITDA	58	60	67	75	79
Depreciation	(7)	(6)	(6)	(6)	(6)
EBIT	51	54	61	69	72
Net int income/(expense)	5	6	5	5	5
Associates' contribution	0	0	0	0	0
Pretax profit	50	57	66	74	78
Tax	(1)	(2)	(1)	(1)	(2)
Minority interest	0	0	0	0	0
Net profit	49	56	65	73	76
Core net profit	49	56	65	73	76

Balance Sheet Statement

FYE 31 Dec (RMm)	2015	2016	2017E	2018E	2019E
Fixed assets	72	68	67	66	65
Other long term assets	8	8	8	8	8
Total non-current assets	80	76	75	74	73
Cash and equivalents	174	201	204	216	229
Stocks	14	14	17	18	19
Debtors	10	11	12	14	15
Other current assets	1	2	1	1	1
Total current assets	200	227	233	249	264
Creditors	23	22	15	17	18
Short term borrowings	-	-	-	-	-
Other current liabilities	20	24	24	24	24
Total current liabilities	43	46	39	41	42
Long term borrowings	-	-	-	-	-
Other long term liabilities	1	1	1	1	1
Total long term liabilities	1	1	1	1	1
Shareholders' Funds	231	252	264	276	289

Cash Flow Statement

FYE 31 Dec (RMm)	2015	2016	2017E	2018E	2019E
EBIT	51	54	61	69	72
Depreciation & amortisation	7	6	6	6	6
Working capital changes	(7)	(0)	(10)	(1)	(1)
Cash tax paid	(1)	(2)	(1)	(1)	(2)
Others	(3)	(2)	5	5	5
Cashflow from operation	47	56	60	78	81
Capex	(0)	(3)	(5)	(5)	(5)
Disposal/(purchases)	6	0	-	-	-
Others	4	6	-	-	-
Cash flow from investing	10	3	(5)	(5)	(5)
Debt raised/(repaid)	-	-	-	-	-
Equity raised/(repaid)	21	13	-	-	-
Net interest income/(expense)	5	6	5	5	5
Dividends paid	(38)	(45)	(53)	(60)	(64)
Others	(5)	(6)	(5)	(5)	(5)
Cash flow from financing	(17)	(32)	(53)	(60)	(64)
Net change in CF	40	26	3	13	13
Free Cash Flow	47	53	55	73	76

Source: company, Affin Hwang estimates

Key Financial Ratios and Margins

FYE 31 Dec (RMm)	2015	2016	2017E	2018E	2019E
Growth					
Revenue (%)	18.0	7.4	8.8	12.4	4.6
EBITDA (%)	37.3	3.1	12.0	12.4	4.6
Core net profit (%)	43.1	6.1	10.8	12.7	4.6
Profitability					
EBITDA margin (%)	51.5	49.5	51.0	51.0	51.0
PBT margin (%)	44.7	47.2	50.0	50.2	50.2
Net profit margin (%)	43.8	45.9	49.1	49.2	49.2
Effective tax rate (%)	(2.2)	(2.8)	(1.9)	(2.0)	(2.0)
ROA (%)	17.6	18.3	20.9	22.5	22.6
Core ROE (%)	25.9	24.2	25.0	26.9	26.9
ROCE (%)	24.2	22.3	23.7	25.6	25.6
Dividend payout ratio (%)	97.4	102.3	94.7	96.0	97.6
Liquidity					
Current ratio (x)	4.7	5.0	6.0	6.1	6.3
Op. cash flow (RMm)	47.1	55.8	60.3	77.6	81.4
Free cashflow (RMm)	46.9	52.9	55.3	72.6	76.4
FCF/share (sen)	10.7	12.1	12.7	16.6	17.5
Asset management					
Debtors turnover (days)	32.0	32.0	33.0	34.0	35.0
Stock turnover (days)	64.0	64.0	64.0	64.0	64.0
Creditors turnover (days)	80.0	80.0	81.0	80.0	81.0
Capital structure					
Net gearing (%)	(75.6)	(79.8)	(77.2)	(78.2)	(79.2)
Interest cover (x)	-	-	-	-	-

Quarterly Profit & Loss

FYE 31 Dec (RMm)	2Q16	3Q16	4Q16	1Q17	2Q17
Revenue	27	31	32	32	31
Operating expenses	(14)	(15)	(17)	(17)	(14)
EBITDA	14	17	15	15	18
Depreciation	(1)	(1)	(2)	(2)	(2)
EBIT	12	15	13	14	16
Net int income/(expense)	1	1	2	2	2
Associates' contribution	0	0	0	0	0
Exceptional Items	(1)	1	(2)	(0)	(1)
Pretax profit	12	18	13	15	17
Tax	(0)	(0)	(0)	(0)	(0)
Minority interest					
Net profit	12	18	12	14	16
Core net profit	13	17	14	15	17
Margins (%)					
EBITDA	49.9	53.7	46.1	46.7	55.7
PBT	45.2	58.0	40.5	45.1	53.1
Net profit	43.8	56.7	39.0	43.9	51.9

Equity Rating Structure and Definitions

BUY	Total return is expected to exceed +10% over a 12-month period
HOLD	Total return is expected to be between -5% and +10% over a 12-month period
SELL	Total return is expected to be below -5% over a 12-month period
NOT RATED	Affin Hwang Investment Bank Berhad does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation

The total expected return is defined as the percentage upside/downside to our target price plus the net dividend yield over the next 12 months.

OVERWEIGHT	Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months
NEUTRAL	Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months
UNDERWEIGHT	Industry, as defined by the analyst's coverage universe is expected to under-perform the KLCI benchmark over the next 12 months

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