

Avi-Tech Holdings Limited

17 May 2022

Non rated (Initiation)

BBG	AVI SP
Market cap	S\$59.9 m
Price (16 May 2022)	S\$0.32
52-week range	S\$0.32 – S\$0.39
Target Price	Non rated
Shares Outstanding	171m
Free Float	34.93%
Major Shareholders	Lim Eng Hong 28.18% Loh Zee Lan Nancy 6.02%
P/BV (06/21)	1.1x
Net Debt to EBITDA (06/21)	Net cash

Source: Company data, Bloomberg, SAC Capital

Recovery tied to Automotive semiconductor market

Avi-Tech provides mainly burn-in services and sells boards used in the burn-in process. Burn-in is one of the stress testing procedures for semiconductor chips. Burn-in is mandatory for mission-critical chips such as those installed in vehicles. Burn-in services account for 23% of total revenue while board sale contributes 61%. The remaining 16% is from provision of engineering services (e.g. system integration) to the electronics manufacturing sector.

Infineon Technologies is one of Avi-Tech's main customers who engages burn in services for its production in Malaysia. Infineon has lifted its FY22 revenue forecast to ~€13b (+18% yoy) and the market leader in automotive semiconductor also expects sales of its automotive products to exceed its full year revenue growth rate.

Electrification of vehicles and autonomous driving are key drivers that will lift demand for automotive semiconductor in the long term. Automotive market makes up >50% of the Group's revenue. Global EV market is expected to grow at a CAGR of 41.8% from 12.7m units in 2021 to 106.6m units in 2027. The growing demand is affirmed by Infineon's move to expand its Kulim factory in Malaysia in 2H22. This will increase production capacity for power semiconductor which bring in an additional revenue of €2b. Separately, current development in self driving technology uses advanced driver assistance system (ADAS) which engages a broad array of semiconductor devices (e.g. sensors and processors). Just ~10% of vehicles on the road globally were installed with ADAS in 2020. A fully automated vehicle would involve more semiconductor applications.

Avi-Tech has been returning to shareholders for the past 5 years through dividend payout. Dividend is sustainable given the management's capability to maintain positive operating cash flow for the past years and likely the years going forward. The Group has also accumulated a net cash balance of S\$19m ending 1H22. M&A opportunities are on the card as management seeks to deploy the free cash to stimulate growth.

Risks: Worsening of chip shortage, Concentration risk

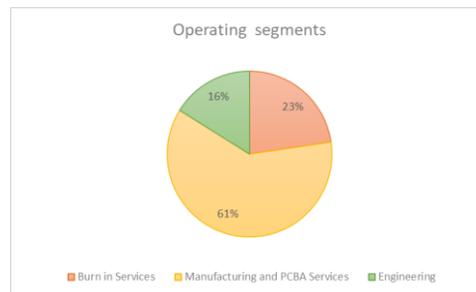
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Key Financials

FY ended 30 June (S\$m)	FY2017A	FY2018A	FY2019A	FY2020A	FY2021A
Revenue	40.0	35.7	33.6	29.4	29.3
EBIT	8.0	5.7	5.7	7.0	4.3
Net profit	7.0	4.9	4.6	6.0	3.5
EPS (S cents)	4.1	2.8	2.7	3.4	2.0
Dividend per share (S cents)	2.8	2.6	2.3	2.5	1.5
Net cash / (debt)	4.3	5.2	6.5	8.6	9.8
Valuation					
EBIT margin (%)	20.1	16.0	17.0	23.7	14.7
ROIC (%)	15.5	11.0	11.4	12.3	6.5
EV/EBITDA (x)	5.5	7.2	6.9	5.5	8.1
P/E (x)	7.8	11.3	11.8	9.2	15.7
Dividend yield (%)	8.8	8.1	7.2	7.8	4.7

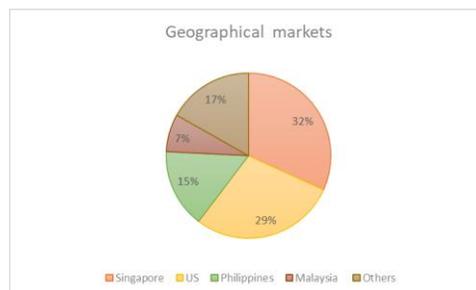
Background

Avi-Tech is a solution provider involved in the burn-in process of semiconductor chips. Burn-in is a process where semiconductor components are stress tested (thermal and/or electrical stresses) to detect any early failures. The Group provides burn-in services as well as manufactures boards that are used in the burn-in process for external sales. The Group also offers engineering services including contract manufacturing and system integration projects for electronics manufacturing. One of the end user market is smartphone. All of its services are carried out in its facility in Singapore.



Source: Company data

Components needed for board and contract manufacturing are sourced from suppliers appointed by its customers. Main costs for burn-in services are electricity costs and manpower costs. Burn-in services have higher margin as compared to the other 2 operating segments. Burn-in also does not require huge CAPEX expenditure as equipment used in the process are largely unchanged throughout the years. CAPEX is allocated for maintenance and software upgrades instead.



Source: Company data

4 major customers account for 66% of its FY21 revenue (74% in FY20), thus, presenting a significant concentration risk. Avi-Tech has recently onboarded a new Chinese MNC client for sales of burn in boards. Ramp up in volume in the coming years would help the Group to diversify its revenue sources.

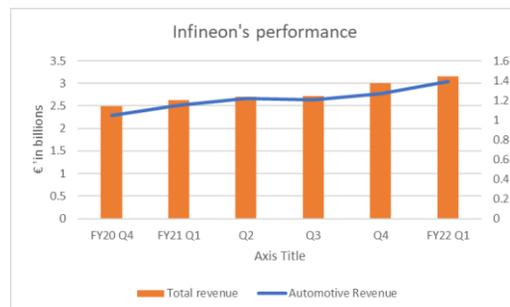
Avi-tech derives >50% of its revenue from the automotive industry. One of its main customers is Infineon Technologies. Avi-tech provides burn-in services for Infineon's automotive chips produced in manufacturing plants in Malaysia. Burn in services are mandatory for automotive chips as they are mission-critical. Customers require the vendors to be located near their chip production facilities as well due to the short delivery cycle time of 4-6 hours.

Long supplier qualification process of 6-9 months serves as a barrier of entry. High switching costs discourage customers from changing their vendors. As such, this helps existing vendors to create a sticky relationship with their customers. However this would also mean that it would be difficult for Avi-Tech to get orders from other automotive chip producers who have their own suppliers.

Investment Highlights

Chip shortages improving

Surge in demand for higher-margin semiconductors used in electronic devices during the pandemic has shifted away production capacity for automotive semiconductors. This has led to lower burn in services provided given the smaller production volume. Infineon, being the market leader in automotive semiconductors, has lifted its FY22 forecasts with topline estimated to reach ~€13b. Automotive market makes up 44% of its FY21 revenue. This translated to a yoy growth rate of 18%. Infineon expects its automotive segment to grow at a higher rate than its overall revenue.



Source: Infineon Technologies AG quarterly updates

Bright long term industry outlook

Electrification of vehicles and autonomous driving are key significant trends that are driving the demand for automotive semiconductors. Global EV market is expected to grow at a CAGR of 41.8% from 12.7m units in 2021 to 106.6m units in 2027. An EV requires approximately double the number of chips (possibly even more) in an internal combustion engine vehicle. For instance, EV requires power semiconductors to convert and control current and voltages to run the motor.

Infineon is adding a 3rd module to its Kulim factory in Malaysia for the production of SiC and GaN power chips which is expected to contribute an additional €2b revenue. This expansion plan affirms the growing demand for power semiconductors. Construction begins in June 2022 and is slated to be completed and furnished with equipment by 3Q 2024.

Self driving technology is also transforming vehicles on the road. Current advancement in the technology allows partial automation by equipping vehicles with advanced driver assistance systems (ADAS) which enable vehicles to steer, accelerate and decelerate on its own. ADAS engages a broad array of sensors (e.g. camera, lidar, ultrasonic etc), processors, electronic control units, microcontroller units to perform its functions. As of 2020, just ~10% of vehicles on the road globally were installed with ADAS.

As vehicles become fully autonomous (i.e. no longer require a driver behind the wheel), the number of chips installed in an AV is expected to grow accordingly as well. The chips are likely to become more complex and more so critical to be failure-free.

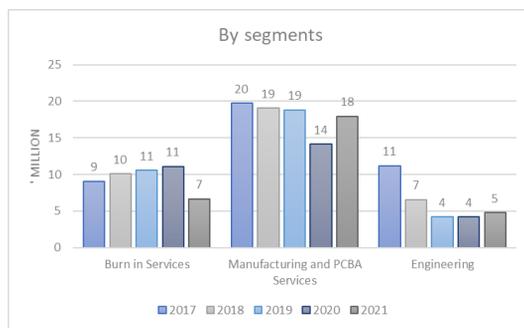
Investment Highlights

Consistent dividend payout

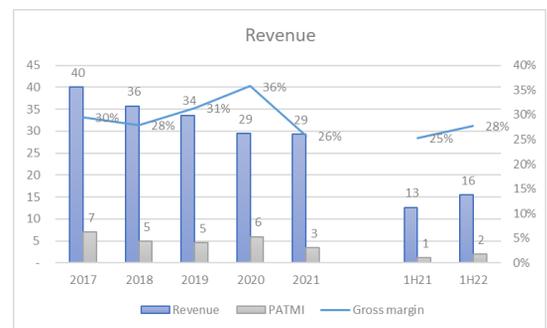
Avi-tech has been paying dividends to its shareholders for the past 5 years. FY21 dividend of 1.5c/share translates to a yield of 4%. Payouts have consistently exceeded its dividend policy of 30% of its consolidated earnings and are well-sustained by its cash generative operations. The Group has accumulated a net cash balance of S\$19m as of 31 Dec 21, representing 33% of market cap. M&A opportunities are on the card given the healthy amount of free cash. Management is actively looking for targets that complements its business.

Financial Performance

1H22 revenue grew 23% yoy, attributed to uptick in burn-in board sales (+12%) and more engineering services provided (+142%) from robust semiconductor demand for electronics. Gross margin rose 3ppt to 28% on lower unit cost on higher board volume production. Revenue generated from burn in services was flattish. We expects 2H topline and margin to be better as automotive chip production steps up and sees more demand for burn-in boards and burn-in services. Burn in service is of higher margin. Avi-Tech currently holds sufficient inventories for manufacturing. Any increase in raw materials cost can generally be passed down to customers as the suppliers are appointed by them.



Source: Company data



Source: Company data

Russia and Ukraine conflict has led to higher global oil and gas prices which in turns drove up local cost of electricity. This has a direct impact on Avi-Tech as one of the main costs of burn in services comes from electricity usage. Current electricity costs form ~2% of its total cost of sales. As such, we do not think it will significantly impact the Group's margin even with more burn in services being engaged. The Group also engages in short term hedging to manage the volatility of electricity prices.

Comparables

Name	YE	Mkt Cap	Revenue	EBITDA	EBIT	Net profit	EBIT margin %	Net margin %	ROE %	ROIC %	EV/EBITDA (x)	EBIT/EV %	PER (x)	PBR (x)
Avi-Tech Holdings Limited	30 June	61.3	29.3	5.6	4.3	3.5	14.7	11.9	6.8	7.5	8.2	9.5	17.6	1.2
KESM Industries	31 July	117.7	79.4	22.3	3.8	2.3	4.8	3.0	2.0	2.8	2.4	7.2	50.1	1.0

Income statement

S\$'m	YE 30 June				
	FY2017A	FY2018A	FY2019A	FY2020A	FY2021A
Revenue	40.0	35.7	33.6	29.4	29.3
Cost of sales	-28.2	-25.8	-23.1	-18.9	-21.8
Gross profit	11.8	9.9	10.5	10.5	7.5
Other income	1.3	0.9	0.9	1.7	1.4
Impairment loss on other financial asset	0.0	0.0	-0.4	-0.1	0.0
Distribution expenses	-0.1	-0.1	-0.1	-0.1	-0.1
Administrative expenses	-5.0	-5.1	-5.3	-5.0	-4.6
EBIT	8.0	5.7	5.7	7.0	4.3
Interest expense	0.0	0.0	0.0	0.0	0.0
Shares of profits from associates	0.0	0.0	0.0	0.0	-0.1
PBT	8.0	5.7	5.7	6.9	4.2
Tax expense	-1.0	-0.8	-1.1	-1.0	-0.7
Profit/(loss) for the year	7.0	4.9	4.6	6.0	3.5

Balance Sheet

S\$'m	YE 30 June				
	FY2017A	FY2018A	FY2019A	FY2020A	FY2021A
Intangible assets	0.0	0.0	0.0	0.3	0.0
Investment in associate	0.0	0.0	0.0	0.5	0.4
PPE	13.5	12.7	12.1	11.5	11.1
ROU assets	0.0	0.0	0.0	1.5	1.2
Total non-current assets	21.5	13.2	12.1	13.7	12.7
Inventories	3.9	3.4	3.0	2.0	3.0
Trade receivables	8.9	5.0	6.6	4.6	7.9
Fixed deposits	18.8	26.0	27.4	29.6	26.0
Other receivables/prepayments	0.3	0.4	0.4	0.6	0.1
Cash and bank balance	4.7	5.2	6.5	8.6	9.8
Others	0.3	1.5	0.6	0.0	0.0
Total current assets	36.9	41.4	44.6	45.5	46.8
Total assets	58.4	54.6	56.6	59.2	59.5
Deferred tax liabilities	1.1	0.9	0.9	0.9	1.1
Finance lease payables	0.1	0.1	0.0	1.3	1.0
Total non-current liabilities	1.2	1.0	1.0	2.2	2.1
Finance lease payables	0.1	0.0	0.0	0.3	0.2
Trade payables	4.9	1.9	2.9	1.7	3.7
Other payables	2.3	2.1	2.0	2.5	1.5
Income tax payable	0.6	1.1	1.1	1.3	0.7
Bank borrowings	0.4	0.0	0.0	0.0	0.0
Total current liabilities	8.3	5.1	6.1	5.8	6.1
Total liabilities	9.5	6.1	7.1	7.9	8.3
Share capital	31.7	31.7	31.7	31.7	31.7
Treasury shares	-1.0	-1.0	-1.0	-1.0	-1.0
Retained earnings	18.2	17.7	18.8	20.5	20.5
NCI	0.0	0.0	0.0	0.0	0.0
Total equity	48.9	48.5	49.5	51.2	51.3
Total liabilities and equity	58.4	54.6	56.6	59.2	59.5

Ratios

	YE 30 June				
	FY2017A	FY2018A	FY2019A	FY2020A	FY2021A
Profitability (%)					
Gross profit/(loss) margin	30%	28%	31%	36%	26%
Profit/(loss) before tax margin	20%	16%	17%	24%	14%
Liquidity (x)					
Current ratio	4.4	8.2	7.3	7.9	7.7
Quick ratio	4.0	7.5	6.8	7.6	7.2
Interest coverage ratio	502.3	814.7	1144.2	183.8	126.9
Net Debt to Equity (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Valuation (x)					
P/E	7.8	11.3	11.8	9.2	15.7
P/B	1.1	1.1	1.1	1.1	1.1
EV/EBITDA	5.5	7.2	6.9	5.5	8.1
Cash Conversion Cycle					
Trade receivable days	81	71	63	70	78
Inventory days	50	51	51	49	41
Trade payable days	64	48	38	44	45
CCC days	68	74	75	74	74

Cash Flow Statement

S\$'m	YE 30 June				
	FY2017A	FY2018A	FY2019A	FY2020A	FY2021A
Cash flows from operating activities					
Profit before income tax	8.0	5.7	5.7	6.9	4.2
Depreciation of PPE & ROU assets	1.1	1.2	1.3	1.4	1.3
Interest expense	0.0	0.0	0.0	0.0	0.0
Interest income	-0.5	-0.5	-0.5	-0.6	-0.2
Others	-0.1	0.4	0.7	0.3	0.3
Operating cash flow before WC changes	8.6	6.8	7.2	8.1	5.6
Changes in working capital					
Inventories	-0.8	0.1	0.1	0.8	-1.2
Trade receivables	-1.7	3.9	-1.6	2.0	-3.3
Other receivables and prepayments	0.1	0.0	-0.1	-0.2	0.4
Trade payables	2.3	-3.0	1.0	-1.3	2.1
Other payables	0.0	-0.3	-0.1	0.5	-1.0
Interest received	0.5	0.5	0.5	0.6	0.2
Interest paid	0.0	0.0	0.0	0.0	0.0
Income taxes paid	-0.7	-0.5	-1.0	-0.8	-1.2
Net cash generated from operating activities	8.2	7.5	6.1	9.7	1.6
Cash flows from investing activities					
Purchase of PPE	-1.7	-0.4	-0.8	-0.6	-0.4
Purchase of intangible asset	0.0	0.0	0.0	-0.3	0.0
Others	-1.4	2.3	-3.0	-3.6	7.6
Net cash used in investing activities	-3.1	1.9	-3.8	-4.4	7.3
Free Cash Flow	5.1	9.4	2.3	5.3	8.9
Cash flows from financing activities					
Proceeds from bank borrowings	0.0	0.0	0.0	0.0	0.0
Dividends paid to SH	-3.4	-5.3	-3.6	-4.3	-3.4
Others	-0.7	-0.4	0.0	-0.3	-0.3
Net cash generated from financing activities	-4.1	-5.7	-3.6	-4.5	-3.7
Net (decrease)/increase in cash/equivalents	1.0	3.7	-1.3	0.8	5.2
Cash/equivalents at beginning of financial year	6.5	7.5	11.2	9.8	10.6
Effects of foreign exchange rate changes	0.0	0.0	0.0	0.0	0.0
Cash/equivalents at end of financial year	7.5	11.2	9.8	10.6	15.8

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