Still all about its yields

Uchi's stock price has righfully re-rated over the past 2 years on its attractive valuations and above-average dividend yields. While the latter remains attractive at just under 7% over 2016-18E, the lack of near-term earnings catalysts and lacklustre earnings growth, would likely cap further yield compression, in our view. Maintain Hold and TP of RM1.69 based on a 2017E PER of 14x.

Dividend yields remain the main angle, in our view

We expect Uchi's dividend yields to remain solid over the near term. Over the past 5 years, the company has paid out an average of 93% of its earnings and this has translated into healthy dividend yields. Uchi should be able to continue to churn out healthy dividends in the coming years on the back of a stable sales outlook and sustainable margins.

Management has sales visibility till year end

With high order visibitlity for the rest of the year, management has guided that its sales would remain stable in 2016. Given the pace of sales (1H16: US$14m), we believe 2016 sales can match 2015 levels of US$29m.

Margins likely to hold steady

Profit margins are likely to remain stable on several counts. First, the cost of the coffee module is small (accounting for some 5%) in respect of the total cost of the final product. This leaves room for costs (especially from Uchi's perspective) to be controlled. In addition, Uchi is at most times the single external supplier, apart from when the customers produce the modules themselves in-house, and works in a strong partnership with the customer and thus is fairly transparent, particularly when it comes to costs. This, in our view will keep sharp ASP erosion to a minimal.

Maintain Hold and target price of RM1.69

After posting strong 2Q16 results, we recently downgraded Uchi (see *1H16 earnings rise 12% yoy*, 24 August 2016). Given the flat earnings that we see over 2016-18E, we maintain our Hold rating and 12-month TP of RM1.69, based on a 2017E PER of 14x. In our view, dividends remain key to supporting the stock and we believe they can be sustained near term. However, with lacklustre top-line growth and limited near-term earnings catalysts, we see further yield compression as unwarranted. Downside risk: customer concentration; upside risk: better-than-expected demand.

Earnings & Valuation Summary

FYE 31 Dec	2014	2015	2016E	2017E	2018E
Revenue (RMm)	95.5	112.6	116.8	116.1	118.5
EBITDA (RMm)	42.3	58.1	57.8	56.9	58.1
Pretax profit (RMm)	41.3	50.4	54.2	53.5	54.5
Net profit (RMm)	40.1	49.3	53.4	52.7	53.7
EPS (sen)	9.2	11.3	12.2	12.1	12.3
PER (x)	18.3	14.9	13.7	13.9	13.7
Core net profit (RMm)	38.4	54.9	53.4	52.7	53.7
Core EPS (sen)	8.8	12.6	12.2	12.1	12.3
Core EPS growth (%)	(2.1)	43.1	(2.7)	(1.3)	1.8
Core PER (x)	19.1	13.4	13.7	13.9	13.7
Net DPS (sen)	10.0	11.0	11.0	11.0	11.0
Dividend Yield (%)	6.0	6.5	6.5	6.5	6.5
EV/EBITDA (x)	14.2	9.6	9.6	9.6	9.1
Chg in EPS (%)			-	-	-
Affin/Consensus (x)			1.0	1.0	1.0

Source: Company, Affin Hwang forecasts, Bloomberg

Company Update

Uchi Tech

UCHI MK
Sector: Technology

RM1.68 @ 5 October 2016

HOLD (maintain)

Upside 1%

Price Target: RM1.69

Previous Target: RM1.69

Price Performance

	1M	3M	12M
Absolute	+2.4%	+9.1%	+13.4%
Rel to KLCI	+3.4%	+8.3%	+12.3%

Stock Data

Issued shares (m)	436.6
Mkt cap (RMm)/(US$m)	733.5/177.2
Avg daily vol - 6mth (m)	0.5
52-wk range (RM)	1.43-1.69
Est free float	44.4%
BV per share (RM)	0.55
P/BV (x)	3.07
Net cash/ (debt) (RMm) (2Q16)	189.88
ROE (2016E)	22.6%
Derivatives	Nil
Shariah Compliant	Yes

Key Shareholders

Eastbow International Ltd	19.1%
LTH	9.4%
Ironbridge Worldwide	8.1%
Public Islamic	3.7%

Source: Affin Hwang, Bloomberg

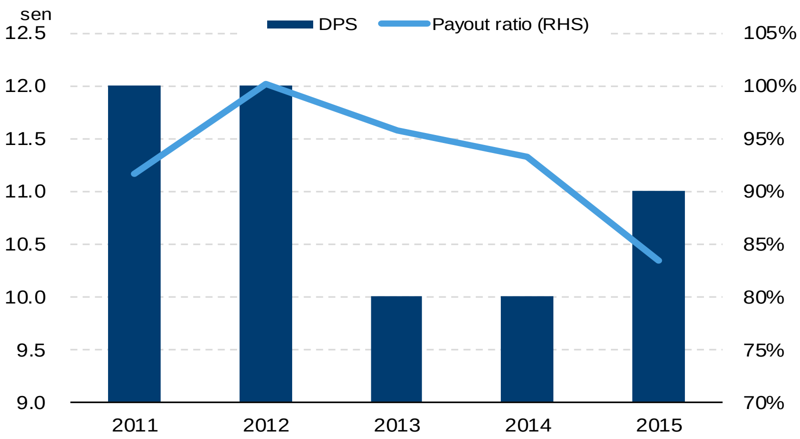
Kevin Low
(603) 2146 7479
kevin.low@affinhwang.com

Strong dividends likely to be sustained

Dividend yields likely to remain solid

We expect Uchi's dividend yields to remain solid over the near term. Over the past 5 years, the company has paid out an average of 93% of its earnings (Fig 1) and this has translated into healthy dividend yields. Uchi should continue be able to churn out healthy dividends in the coming years on the back of a stable sales outlook and sustainable margins.

Fig 1: Dividend payout ratio



Source: Company

Fig 2: Dividend yields

Source: Bloomberg, Company

Sales should remain solid

Low penetration rates likely to support demand

Although management has admittedly said that European macroeconomic conditions have still not recovered (to prior to Lehman crisis levels) and coupled with more recent turn of events concerning Brexit, we are of the view that demand for high-end automatic-coffee machines will sustain, at least over the near term (recall that nearly 90% of Uchi's sales fall within Europe). Upside to sales could possibly also come from the US, although drip coffee still remains the preference in this continent. Nevertheless, we believe that Uchi's top-line growth will be underpinned by the rather low penetration rates in the high-end automated-coffee machine segment (which we believed to be in the 30% level in the EU and single digits in the US).

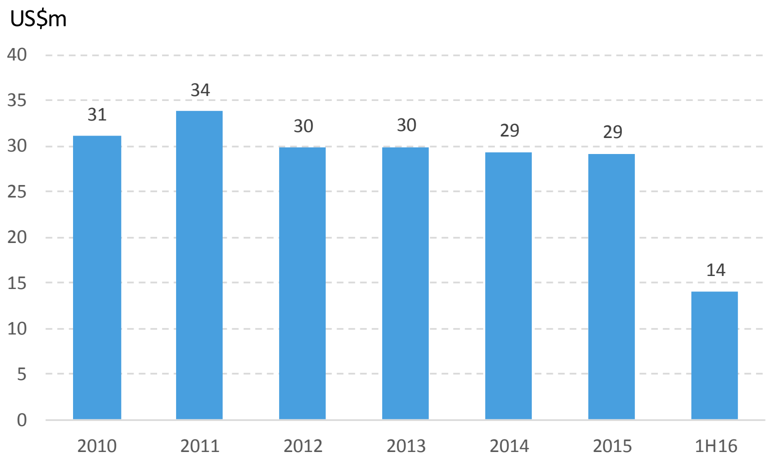
Uchi also plays an important role as key supplier

Over the recent quarters, while Uchi's sales have been relatively volatile on a quarterly basis, sales have, nevertheless, not deviated beyond the range of between US$6-8m/quarter over the past 2 years. Reasons are several fold but importantly, Uchi is a major supplier, and sometimes the sole supplier, of fully-automated coffee-machine modules for major brands including Krups, Jura and Nespresso amongst others. Its key competitive edge lies in the cost savings that Uchi offers to its customers and the continued focus on technology improvement that it provides for its clients. Meanwhile, the stable quarterly sales also reaffirms the low penetration rates for these high-end automated-coffee machines.

Management has sales visibility till year end

With high order visibitlity for the remainder of the year, management has guided that its sales would remain stable in 2016. In view of this, and with 1H16 top line of US$14m, sales for 2016 appear to be tracking towards 2015 levels (US$29m).

Fig 3: Sales in US$



Source: AffinHwang, Company

Margins have remained solid

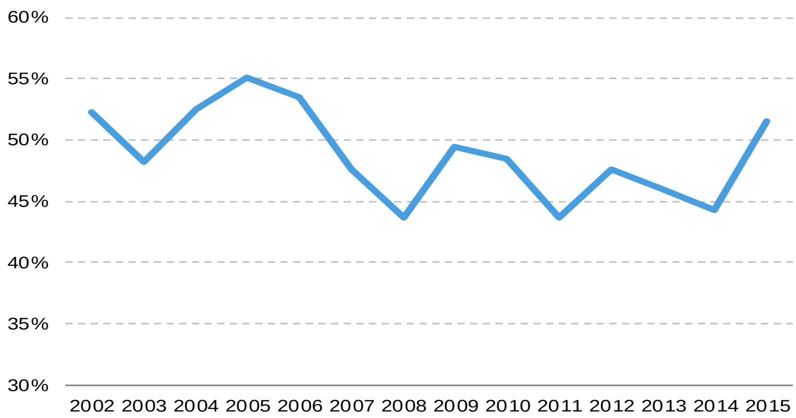
Margins likely to hold steady

From a profitability perspective, profit margins are likely to remain stable on several counts. First, the cost of the coffee module is small (accounting for some 5%) in respect of the total cost of the final product. This leaves room for cost (especially from Uchi's perspective) to be controlled. In addition, Uchi is at most times the single external supplier, apart from when the customers produce the modules themselves in-house, and works in a strong partnership with the customer and, thus, is fairly transparent, particularly when it comes to costs. This, in our view will keep sharp ASP erosion to a minimal.

Increased automation should help mitigate cost pressure

Moreover, to counter the cost of rising minimum wages, the company has enhanced the adoption of automation in its production lines, and, therefore, has been able it to reduce its headcount by over 10% in recent times.

Fig 4: Long-term EBITDA margin trend



Source: Company

Positively impacted by weaker RM

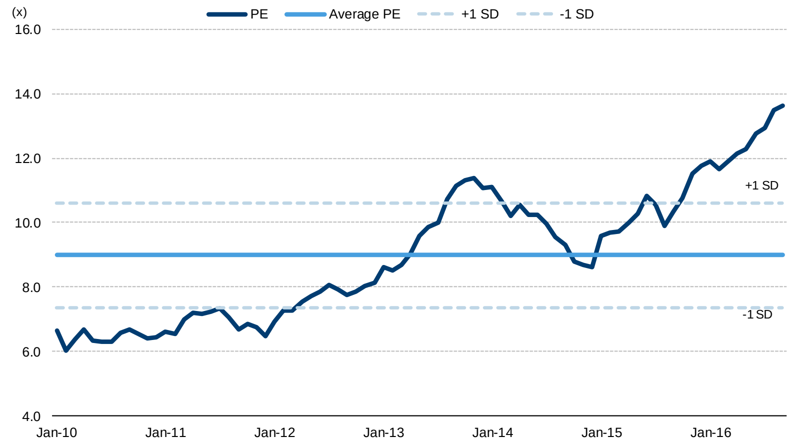
Note that while bulk of Uchi's sales is derived from Europe, its sales are pegged to the US$, instead of the Euro. This is also the reason behind its stronger earnings in 1H16 (core profit up 12% yoy), which was lifted by the depreciation of the RM. Positive operating leverage from the stronger revenue base has also helped Uchi sustain its strong margins

Valuation and recommendation

Strong re-rating since 2015

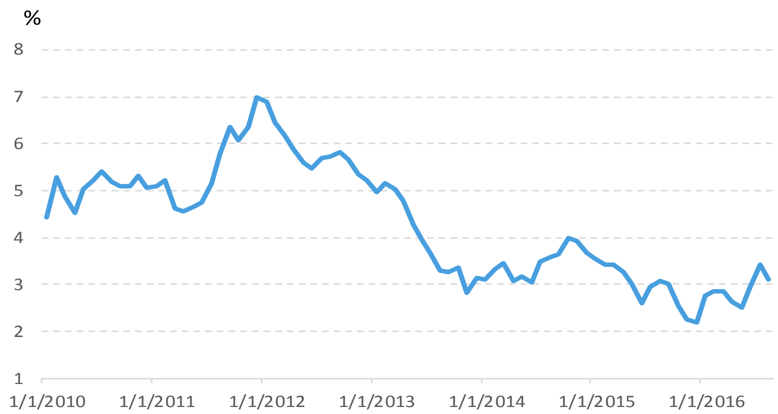
Uchi's stock price has seen a re-rating over the past 2 years, underpinned largely by its attractive valuations and above-average dividend yields. Its PER multiples (Fig 5) are, thus, at their current highs, and stand at >+2SD above the past-5-year mean PER. While dividend yields, at just under 7% for 2016-18E, still remains attractive vis-à-vis the market, we are of the view that further upside may be capped considering Uchi's sluggish earnings-growth prospects over 2016-18E. Meanwhile dividend yields adjusted for 10-year MGS risk free rates at 3.1%, are near their past-6-year lows (Fig 6) and below their past-6-year average of 4.3%. As such, the stock appears to be fairly priced after taking into account the equity-risk premium.

Fig 5: PE at >+2SD historical mean



Source: AffinHwang forecasts, Bloomberg

Fig 6: Dividend yields less 10-year MGS



Source: AffinHwang, Bloomberg

Limited near-term catalysts

While earnings upside may be driven by a rising penetration rate for high-end automated-coffee machines and the expansion into the outsourcing of other electronic components (recall that Uchi's key strength lies in Application Specific Integrated Circuits or ASIC), we believe that this may only be a longer-term earnings-growth driver. Notably, Uchi has tried to diversify its business although the success rate has been slow on this front.

Maintain Hold and target price of RM1.69

We maintain our Hold rating on Uchi and 12-month target price of RM1.69, based on a 2017E PER of 14x. Dividend yields remain key to supporting the stock and we believe that dividends can be sustained at least over the near term. However, with lacklustre earnings growth and limited near-term earnings catalysts, we are of the view that further yield compression may be unwarranted.

Risks

Upside risks to our call would be better-than-expected demand and rapid growth from the introduction of new products. Downside risks would include a high dependency on a few customers, weaker-then-expected demand and a sharp depreciation of the US$ vis-à-vis the RM.

UCHI – FINANCIAL SUMMARY

Profit & Loss Statement

FYE 31 Dec (RMm)	2014	2015	2016E	2017E	2018E
Revenue	95	113	117	116	119
Operating expenses	(53)	(55)	(59)	(59)	(60)
EBITDA	42	58	58	57	58
Depreciation	(6)	(7)	(7)	(8)	(8)
EBIT	36	51	50	49	50
Net int income/(expense)	3	5	4	4	5
Associates' contribution	0	0	0	0	0
Pretax profit	41	50	54	54	54
Tax	(1)	(1)	(1)	(1)	(1)
Minority interest	0	0	0	0	0
Net profit	40	49	53	53	54
Core net profit	40	49	53	53	54

Balance Sheet Statement

FYE 31 Dec (RMm)	2014	2015	2016E	2017E	2018E
Fixed assets	80	72	69	68	65
Other long term assets	8	8	8	8	8
Total non-current assets	**88**	**80**	**77**	**76**	**73**
Cash and equivalents	133	174	178	190	203
Stocks	13	14	16	17	18
Debtors	7	10	10	11	11
Other current assets	1	1	1	1	1
Total current assets	**154**	**200**	**205**	**218**	**233**
Creditors	26	23	13	13	13
Short term borrowings	-	-	-	-	-
Other current liabilities	19	20	20	20	20
Total current liabilities	**45**	**43**	**33**	**33**	**33**
Long term borrowings	-	-	-	-	-
Other long term liabilities	1	1	1	1	1
Total long term liabilities	**1**	**1**	**1**	**1**	**1**
Shareholders' Funds	**193**	**231**	**243**	**254**	**267**

Cash Flow Statement

FYE 31 Dec (RMm)	2014	2015	2016E	2017E	2018E
EBIT	36	51	50	49	50
Depreciation & amortisation	6	7	7	8	8
Working capital changes	5	(7)	(11)	(1)	(1)
Cash tax paid	(1)	(1)	(1)	(1)	(1)
Others	3	(4)	4	4	5
Cashflow from operation	**49**	**46**	**49**	**59**	**60**
Capex	(12)	(0)	(5)	(6)	(6)
Disposal/(purchases)	0	6	-	-	-
Others	4	4	-	-	-
Cash flow from investing	**(9)**	**10**	**(5)**	**(6)**	**(6)**
Debt raised/(repaid)	-	-	-	-	-
Equity raised/(repaid)	2	21	-	-	-
Net interest income/(expense)	3	5	4	4	5
Dividends paid	(22)	(38)	(41)	(41)	(41)
Others	(3)	(5)	(4)	(4)	(5)
Cash flow from financing	**(21)**	**(17)**	**(41)**	**(41)**	**(41)**
Net change in CF	**20**	**40**	**3**	**12**	**13**
Free Cash Flow	**37**	**46**	**44**	**53**	**54**

Source: Company, Affin Hwang forecasts

Key Financial Ratios and Margins

FYE 31 Dec (RMm)	2014	2015	2016E	2017E	2018E
Growth					
Revenue (%)	1.6	18.0	3.7	(0.6)	2.1
EBITDA (%)	(2.2)	37.3	(0.4)	(1.6)	2.1
Core net profit (%)	(2.1)	43.1	(2.7)	(1.3)	1.8
Profitability					
EBITDA margin (%)	44.3	51.5	49.5	49.0	49.0
PBT margin (%)	43.3	44.7	46.4	46.1	46.0
Net profit margin (%)	42.0	43.8	45.7	45.4	45.3
Effective tax rate (%)	(2.9)	(2.2)	(1.5)	(1.5)	(1.5)
ROA (%)	16.6	17.6	18.9	17.9	17.5
Core ROE (%)	20.0	25.9	22.6	21.2	20.6
ROCE (%)	18.8	24.2	21.3	19.8	19.2
Dividend payout ratio (%)	108.9	97.4	89.9	91.1	89.5
Liquidity					
Current ratio (x)	3.4	4.7	6.2	6.6	7.0
Op. cash flow (RMm)	49.3	46.4	49.4	59.3	60.4
Free cashflow (RMm)	36.8	46.1	44.4	53.3	54.4
FCF/share (sen)	8.4	10.6	10.2	12.2	12.5
Asset management					
Debtors turnover (days)	28.6	32.0	32.0	33.0	34.0
Stock turnover (days)	64.0	64.0	64.0	64.0	64.0
Creditors turnover (days)	175.3	80.0	80.0	81.0	80.0
Capital structure					
Net gearing (%)	(68.9)	(75.6)	(73.1)	(74.6)	(76.1)
Interest cover (x)	-	-	-	-	-

Quarterly Profit & Loss

FYE 31 Dec (RMm)	2Q15	3Q15	4Q15	1Q16	2Q16
Revenue	27	29	30	31	27
Operating expenses	(14)	(13)	(15)	(16)	(14)
EBITDA	13	16	15	15	14
Depreciation	(2)	(2)	(2)	(2)	(1)
EBIT	11	14	14	14	12
Net int income/(expense)	2	1	1	1	1
Associates' contribution	0	0	0	0	0
Exceptional Items	(0)	(4)	1	(1)	(1)
Pretax profit	13	11	16	14	12
Tax	(0)	(0)	(0)	(0)	(0)
Minority interest					
Net profit	12	11	16	13	12
Core net profit	12	15	15	15	13
Margins (%)					
EBITDA	46.8	55.1	50.4	49.1	49.9
PBT	46.1	38.6	52.5	44.9	45.2
Net profit	45.2	37.2	52.1	43.8	43.8

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

This report is printed and published by:
Affin Hwang Investment Bank Berhad (14389-U)

A Participating Organisation of Bursa Malaysia Securities Bhd
Chulan Tower Branch,
3rd Floor, Chulan Tower,
No 3, Jalan Conlay,
50450 Kuala Lumpur.
www.affinhwang.com
Email : research@affinhwang.com
Tel : + 603 2143 8668
Fax : + 603 2145 3005