

26 January 2017

Technology | Hardware & Equipment

Notion VTEC

Not Rated

Earnings To Rebound

After being struck by a series of unfortunate events over the past five years, we believe Notion is finally ready to stage a strong earnings recovery in FY17F-19F. This leverages on production ramp-up at its plungers manufacturing unit, as well as favourable forex (following full settlement of all its hedging positions as of Sep 2016). We are forecasting for an earnings CAGR of 17% for FY17-19F. The stock, trading at an appealing 2017 P/E of 7.6x and current P/NTA of 0.7x, is NOT RATED.

Light at the end of the tunnel. Notion VTEC (Notion) was hit by a series of unfortunate events over the last five years, ie a major flood at its Thailand facility in 2012, a fire accident in its Klang production plant in 2013, losses from non-core investments in 2014, and losses suffered from its currency-related derivatives exposure in 2015 and 2016. All these are set to come to an end as it has managed to recover due to insurance claims and clean-up of its books by writing off non-core investments, as well as settling all its derivatives exposure.

Ramp-up for automotive component. For its automotive segment, Notion currently manufactures one of the components under the electronic braking system (EBS) known as plungers. In FY16, it delivered approximately 13m units of plungers to two major customers. This is set to scale up further going forward as management is looking to expand its capacity by 30% pa over the next two years. If it materialises, this would increase its automotive exposure to close to 40% of total revenue by FY19F, from 33% in FY16.

Industrial products to gather pace. The group recently set up a new division focusing on the manufacturing of industrial products in a core facility in Johor, Malaysia. Management is currently in talks with one of its existing customers to explore potential job opportunities. We understand that negotiations may be finalised in due course, with target production set to commence by 2H17. We expect revenue of MYR3m per month come FY18.

Going spot on forex. Notion derives all of its revenue in foreign currency terms (USD/EUR/THB at 60%/30%/10% respectively in FY16). Only about 5-10% of its costs are denominated in non-MYR currencies, mainly on raw material procurement. This coupled with its zero hedging policy going forward, makes Notion a prime beneficiary should the current weakness in the MYR persist. We are currently forecasting for an average USD/MYR of 4.43 for 2017 and 4.25 thereafter, and EUR/MYR of 4.60 in the foreseeable future. Based on our calculations, every 10 cent change in USD/EUR against MYR could potentially lift its bottomline by 8-10%/5-6%, assuming all else remains constant.

Valuation and risks. Pegging a 10-12x 2017 P/E, we estimate that Notion could be worth as much as MYR1.00-1.20 per share. Our target P/E is in line with the range of 10x-15x P/Es that we peg to export-oriented technology counters under our coverage. With its NTA per share closing at MYR1.05, we believe Notion is deeply undervalued, at this juncture. Our projected earnings CAGR of 17% of FY17-19F is subject to volatility in forex and are highly reliant on capacity expansion under its plungers production division as well as the commencement of its industrial products by 2H17.

Target Price:	N/A
Price:	MYR0.76
Market Cap:	USD45.9m
Bloomberg Ticker:	NVB MK

Share Data

Avg Daily Turnover (MYR/USD)	0.96m/0.21m
52-wk Price low/high (MYR)	0.36 - 0.76
Free Float (%)	69
Shares outstanding (m)	270
Estimated Return	N/A

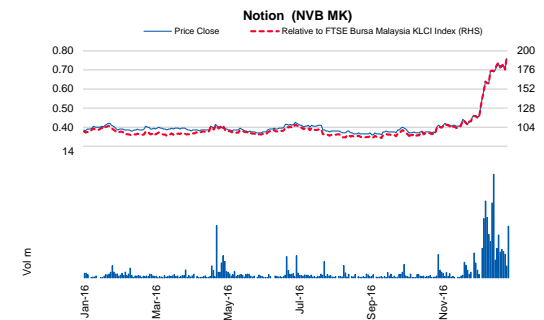
Shareholders (%)

Choo Wing Hong	11.8
Choo Wing Onn	9.9
Nikon Corp	9.4

Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	67.0	76.7	97.4	85.4	92.4
Relative	64.4	72.6	97.0	84.5	88.8

Source: Bloomberg



Source: Bloomberg

Forecasts and Valuations	Sep-15	Sep-16	Sep-17F	Sep-18F	Sep-19F
Total turnover (MYRm)	240	230	267	319	344
Reported net profit (MYRm)	(13.0)	5.3	27.3	33.0	35.5
Recurring net profit (MYRm)	(3.2)	6.2	25.6	31.3	33.8
Recurring net profit growth (%)	(83.8)	0.0	309.9	22.1	8.1
Recurring EPS (MYR)	(0.01)	0.02	0.09	0.12	0.12
DPS (MYR)	na	0.01	0.03	0.03	0.04
Recurring P/E (x)	na	32.9	8.0	6.6	6.1
P/B (x)	0.73	0.72	0.65	0.61	0.57
P/CF (x)	6.81	6.91	2.78	3.37	2.98
Dividend Yield (%)	na	1.4	3.7	4.6	4.9
EV/EBITDA (x)	18.2	4.4	1.9	1.4	1.2
Return on average equity (%)	(4.5)	1.9	9.1	10.1	10.1
Net debt to equity	net cash	net cash	net cash	net cash	net cash
Our vs consensus EPS (adjusted) (%)			23.8	18.9	16.8

Source: Company data, RHB

Analyst

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Financial Exhibits

Financial model updated on: 2017-01-26.

Asia	Financial summary	Sep-15	Sep-16	Sep-17F	Sep-18F	Sep-19F
Malaysia	Recurring EPS (MYR)	(0.01)	0.02	0.09	0.12	0.12
Technology	EPS (MYR)	(0.05)	0.02	0.10	0.12	0.13
Notion	DPS (MYR)	0.00	0.01	0.03	0.03	0.04
Bloomberg	BVPS (MYR)	1.05	1.05	1.16	1.25	1.34
NVB MK	Weighted avg adjusted shares (m)	270	270	270	270	270
Not Rated						
Valuation basis	Valuation metrics	Sep-15	Sep-16	Sep-17F	Sep-18F	Sep-19F
10-12x 2017 P/E	Recurring P/E (x)	na	32.9	8.0	6.6	6.1
	P/E (x)	na	38.4	7.5	6.2	5.8
	P/B (x)	0.73	0.72	0.65	0.61	0.57
	FCF Yield (%)	8.7	8.8	21.4	15.1	14.1
	Dividend Yield (%)	0.0	1.4	3.7	4.6	4.9
	EV/EBITDA (x)	18.2	4.4	1.9	1.4	1.2
	EV/EBIT (x)	na	26.8	3.9	2.8	2.2
Key drivers						
i. Increasing revenue from the Automotive segment in the product mix;						
ii. Introduction of a new business segment;						
iii. Efforts to improve productivity of production.						
Key risks	Income statement (MYRm)	Sep-15	Sep-16	Sep-17F	Sep-18F	Sep-19F
i. Demand for solid state drives (SSD) takes flight;	Total turnover	240	230	267	319	344
ii. Personal computer (PC) market failing to get out of the doldrums;	Gross profit	35	42	48	64	81
iii. Tepid demand for cameras with interchangeable lens.	EBITDA	11	42	72	80	83
	Depreciation and amortisation	(38)	(35)	(36)	(39)	(38)
	Operating profit	(27)	7	35	41	44
	Net interest	(4)	(2)	(1)	(0)	(0)
	Exceptional income - net	(10)	(1)	0	0	0
	Pre-tax profit	(11)	16	35	41	44
	Taxation	(2)	(11)	(7)	(8)	(8)
	Minority interests	0	0	(0)	(0)	(0)
	Recurring net profit	(3)	6	26	31	34
Company Profile	Cash flow (MYRm)	Sep-15	Sep-16	Sep-17F	Sep-18F	Sep-19F
Notion VTEC (Notion) is a leading precision engineering specialist and manufacturer of high precision components for the HDD, digital camera, automotive, consumer electronics, and air-conditioning industries.	Change in working capital	(9.3)	(27.6)	10.2	(10.4)	(4.6)
	Cash flow from operations	30.2	29.7	74.0	61.1	69.1
	Capex	(12.3)	(11.7)	(30.0)	(30.0)	(40.0)
	Cash flow from investing activities	11.1	(9.2)	(24.9)	(30.0)	(40.0)
	Dividends paid	0.0	0.0	0.0	(7.7)	(9.4)
	Cash flow from financing activities	(21.2)	(16.3)	(10.0)	(12.7)	(9.4)
	Cash at beginning of period	23.3	43.1	41.9	79.3	96.0
	Net change in cash	20.1	4.3	39.0	18.4	19.7
	Ending balance cash	43.1	41.9	81.0	97.7	115.6
	Balance sheet (MYRm)	Sep-15	Sep-16	Sep-17F	Sep-18F	Sep-19F
	Total cash and equivalents	43	42	79	96	114
	Tangible fixed assets	232	202	196	187	189
	Total assets	379	342	385	414	443
	Short-term debt	17	11	6	3	3
	Total long-term debt	21	10	5	2	2
	Total liabilities	96	59	71	76	81
	Shareholders' equity	283	284	314	338	362
	Minority interests	0	0	0	0	0
	Total equity	283	284	314	338	362
	Net debt	(6)	(22)	(69)	(91)	(109)
	Total liabilities & equity	379	342	385	414	443
	Key metrics	Sep-15	Sep-16	Sep-17F	Sep-18F	Sep-19F
	Revenue growth (%)	20.2	(3.9)	16.1	19.3	7.7
	Recurrent EPS growth (%)	(83.8)	0.0	309.9	22.1	8.1
	Gross margin (%)	14.6	18.0	18.0	20.0	23.5
	Operating EBITDA margin (%)	4.6	18.1	26.8	25.0	24.0
	Net profit margin (%)	(5.4)	2.3	10.2	10.3	10.3
	Dividend payout ratio (%)	0.0	52.3	28.1	28.5	28.6
	Capex/sales (%)	5.1	5.1	11.2	9.4	11.6
	Interest cover (x)	(7.48)	3.44	46.18	105.50	113.54

Source: Company data, RHB

Earnings To Rebound

Focusing on three core segments

Notion started off in 1995 as a manufacturer of precision engineering parts, with its maiden plant in Jalan Meru, Klang housing four computer numeric control (CNC) machines. Today, the group operates three production facilities in Malaysia (two in Klang and one in Johor) as well as one manufacturing outfit in Ayutthaya, Thailand. With over 1,500 CNC machines on-board, the group accommodates a total headcount of close to 1,800 personnel currently.

Notion's first major breakthrough happened in 1999 when it started producing hard disk drive (HDD) spacers. Subsequently in 2003, the group commenced production of other HDD components such as disk clamps and motor hubs. Then in 2008, it ventured into the automotive segment by manufacturing components for the EBS as well as the camera segment for the provision of camera barrels for single lens reflex (SLR) cameras.

Along the way, management set up its own jigs and fixture department as well as customised tooling division. Today, its HDD division remains the largest revenue contributor, which accounts for over 45%, followed by automotive (33%) and camera (22%) segments respectively.

Figure 1: FY16 revenue breakdown by segment

Segments	FY16 revenue (MYRm)	% of total revenue	Current components in production
HDD	103.7	45%	Antidiscs, disk clamps and spacers
Automotive	76.0	33%	Plungers for EBS, housing for EBS and added value services for motorcycle parts
Camera	50.7	22%	Camera barrels for SLR cameras
Total	230.4	100%	

Source: Company data

Management led by single largest shareholder

Notion's management team is currently led by its executive chairman Mr Thoo Chow Fah, who is one of the group's founders. Together with managing director Mr Choo Wing Hong and executive director Mr Choo Wing Onn, the trio of founding members collectively own approximately 36% of the company. Its second largest shareholder, Nikon Corp (7731 JP, NR), came on-board in early-2010 after taking up placement of new shares worth MYR34m back then.

Based on our compilation, its institutional shareholding currently stands at approximately 8%. The group was first listed on Bursa Malaysia in Jun 2005 with an initial market cap of MYR47m. Currently, it is trading at a market capitalisation of close to MYR200m with an outstanding share base of 270.4m (inclusive of treasury shares of 2.2m).

Figure 2: Major shareholders

Substantial shareholders	Stake (%)
Choo Wing Hong	11.8
Choo Wing Onn	9.9
Nikon Corp	9.4
Lembaga Tabung Haji	7.2
Thoo Chow Fah	5.1

Source: RHB

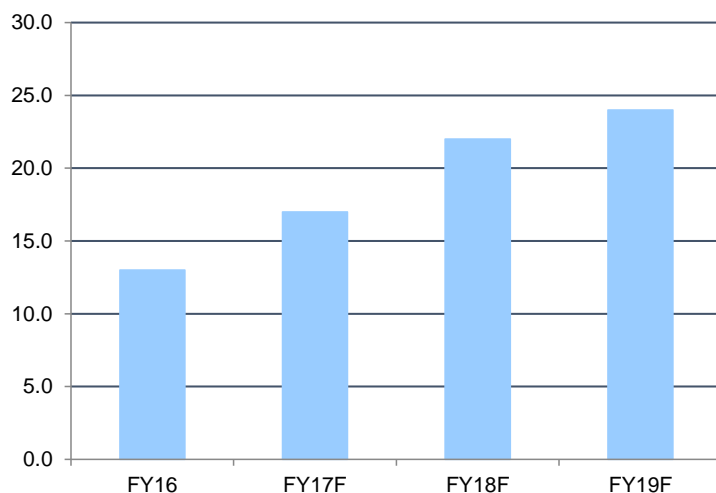
Automotive – volume gain over the next two years

For its automotive segment, Notion currently manufactures one of the components under EBS known as plungers. Essentially, EBS is one of the latest automobile brake technologies that automatically vary the amount of force applied to each of a vehicle's wheels, based on key parameters such as road conditions, speed and loading.

Under EBS, the braking components of a vehicle will be activated electronically to reduce response and build-up times in brake cylinders. This in turn reduces braking distance by several meters, which can be decisive in the event of an emergency. EBS typically comes integrated with an anti-lock braking system function to ensure driving stability and steering ability throughout the braking procedure. Each EBS-equipped vehicle would typically require two units of plungers.

In FY16, the group delivered approximately 13m units of plungers to two major customers, namely ZF Friedrichshafen AG and Continental AG (CON GR, NR). This is set to scale up further in both FY17 and FY18 as management is looking to expand its capacity by 30% pa over the next two years to be in line with its customers' targets. This, if it materialises, would increase its automotive exposure to close to 40% by FY19F from 33% of total revenue in FY16.

Figure 3: Target production of plungers (m units)



Source: RHB

The group allocated capex of MYR25m-30m pa over the next two years to hit production capacity of over 22m units by FY18. This would also include introducing more automation in its existing production line as the group is looking to reduce dependence on labour under the automotive segment. We gather that management is looking to rationalise its work force by about 100 pax pa over the next two years. This could potentially translate into cost savings of over MYR2m pa.

Other than plungers, Notion also produces housing parts for EBS and provides value-added services for motorcycle assembly parts for Continental AG and Diamet Corporation. This sub-segment contributes approximately MYR30-35m to its overall topline in FY16. We expect this to grow at a modest 10% pa going forward.

HDD – To remain stable for now

Under its existing HDD segment, Notion manufactures core components such as anti-discs, disk clamps, and spacers as well as offers value-added works for baseplates. Its key customers under this segment include SFS Group AG (SFSN SW, NR), Minebea Co Ltd (6479 JP, NR) and Seagate Technology (STX US, NR).

While this segment has historically been the largest revenue contributor to the group, we expect management to put in minimal additional resources over the medium term – given the subpar overall demand outlook for the global personal computer (PC) market. According to compilations by industry experts Gartner and International Data Corporation, global PC shipments declined by 5-6% pa in 2016. Annual shipments now stood at 260-270m vis-à-vis 275-290m a year ago.

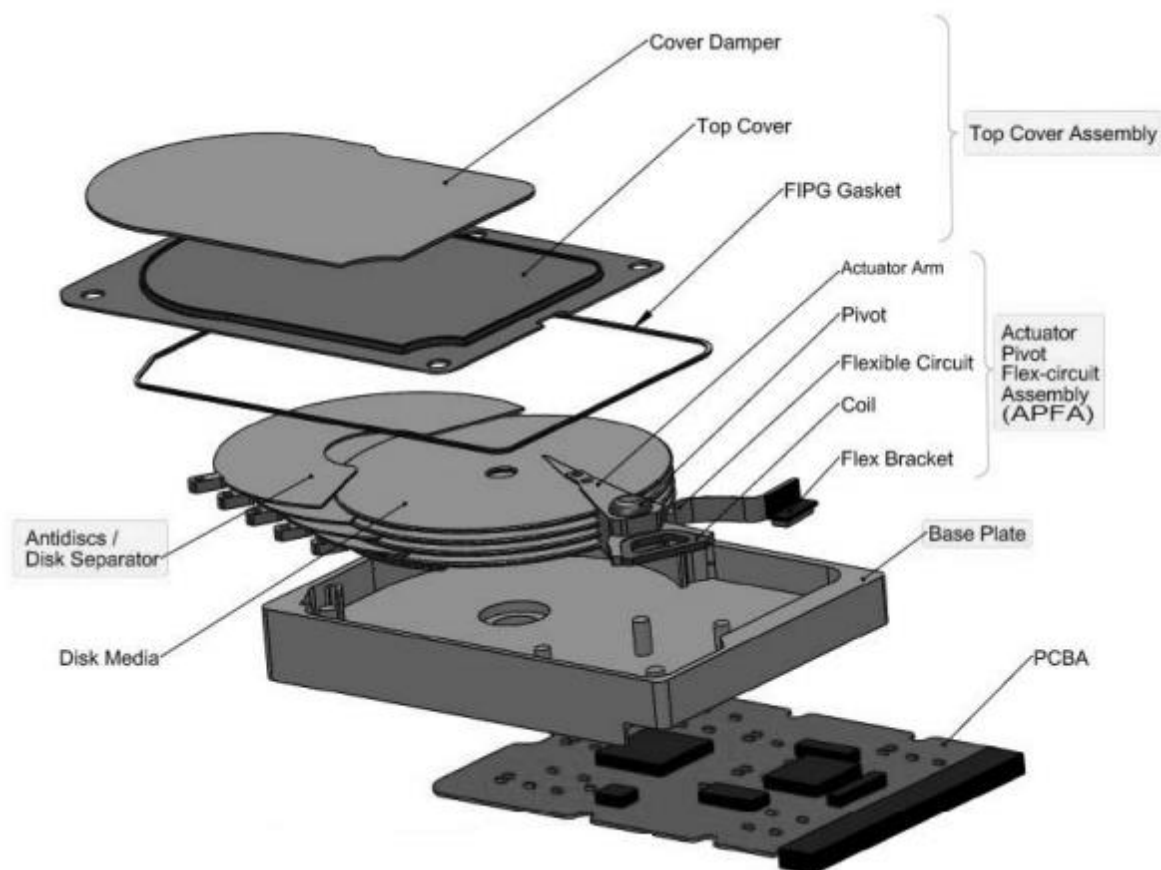
Factors such as the extended replacement cycle, migration towards notebooks or tablets as well as the introduction of more sophisticated smartphone models in our view have contributed to the decline in overall demand. This prompts us to adopt a cautious stance as we expect Notion's HDD segment to remain fairly flattish, with a topline contribution of MYR100-115m pa going forward.

Figure 4: Breakdown of HDD components



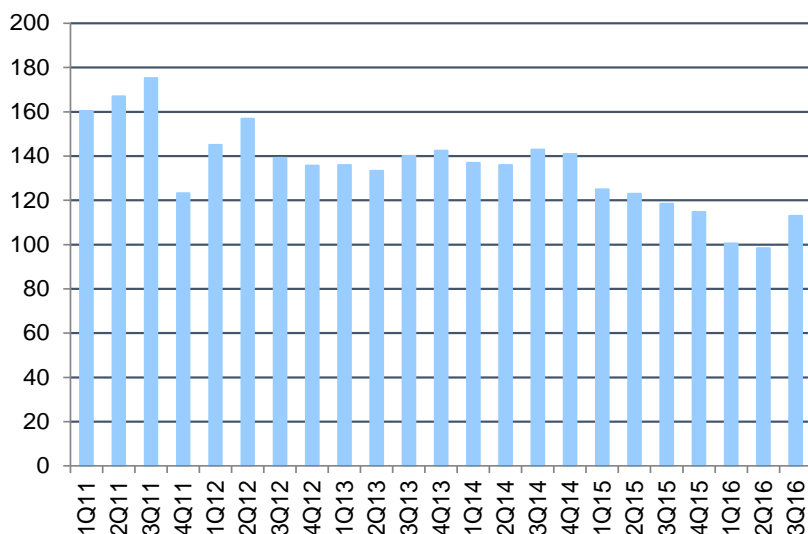
Source: goughlui.com

Figure 5: Overview of HDD components



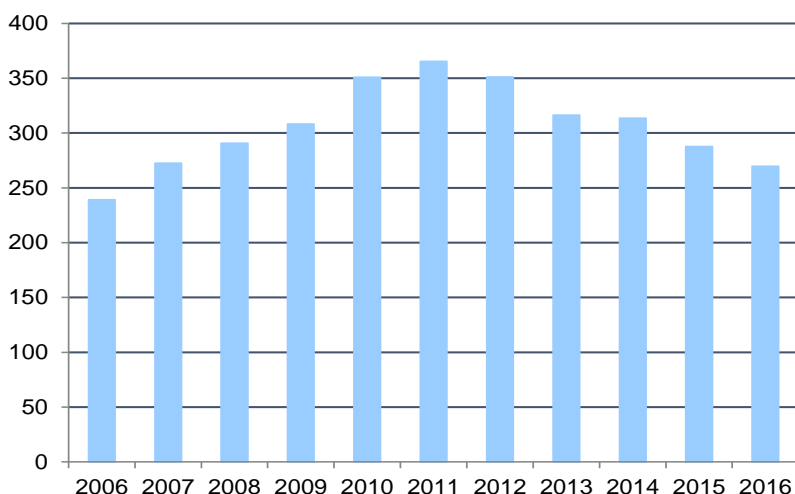
Source: JCY Holdings' prospectus

Figure 6: Quarterly global HDD shipments (m units)



Source: Statista

Figure 7: Annual PC shipments (m units)



Source: Statista

Camera segment highly profitable but volume to remain low

Under its camera segment, Notion manufactures camera barrels for SLR cameras. While monthly revenue has shrunk from a high of close to MYR12m units per month in 2012 to just below MYR5m units per month currently, this niche segment commands the highest profitability margins, at over 30% at the GP level.

Management acknowledged that demand is likely to remain flattish at current levels in the foreseeable future. Hence, new investments into this segment are unlikely for now. Its utilisation rate currently hovers around 70%. Management intends to switch out some of the CNCs under this division to cater to rising demand under its automotive segment.

Figure 8: Sample of camera barrels



Source: Company

Industrial products – up and coming

The group recently set up a new division focusing on the manufacturing of industrial products in one of its core facilities in Johor, Malaysia. Management is currently in talks with an existing customer to explore potential job opportunities. Some of the components that could potentially kick-start this division include bicycle parts, fishing reels as well as components for vacuum cleaners.

Beyond that, the group is in active discussions with some potential customers to facilitate the procurement of tools, jigs, fixtures as well as its assembly line. We understand that negotiations would be finalised in due course, with production targeted to kick off by 2H17. We expect revenue of MYR3m per month come FY18.

Prime forex beneficiary

Notion derives all of its revenue in foreign currency terms (USD, EUR and THB at 60%, 30% and 10% respectively in FY16). Only about 5-10% of its costs are denominated in non-MYR currency, mainly on raw materials procured.

This, coupled with its zero hedging policy going forward, puts Notion as a prime beneficiary should the current weakness in MYR persist. We are currently forecasting for an average USD/MYR of 4.43 for 2017 and 4.25 thereafter and EUR/MYR of 4.60 in the foreseeable future. Based on our calculations, every 10 cent change in the USD and EUR against MYR could potentially lift its bottomline by 8-10% and 5-6% respectively, assuming all else remains constant.

Figure 9: Sensitivity analysis of earnings vs USD/MYR and EUR/MYR

Every ± 10 cent change in USD/MYR	FY17-19F EPS to experience $\pm 8-10\%$
Every ± 10 cent change in EUR/MYR	FY17-19F EPS to experience $\pm 5-6\%$

Source: RHB

Earnings could grow at a CAGR of 17% in FY17-19F

After a series of unfortunate events which marred the group's performance over the last five years, ie a major flood in its Thailand facility in 2012, a fire accident in its Klang production plant in 2013, losses from non-core investments in 2014 and losses suffered from its currency-related derivatives exposure in 2015 and 2016, we believe Notion is finally set for a strong earnings rebound going forward for FY17-19F.

With its books now on a clean slate (non-core investments have been written off and all forex hedging contracts have been settled as of Sep 2016), we do not expect any further significant non-operational items to drag down its operational performance.

Despite being in net cash position of MYR21.7m as of Sep 2016, management assured us that all future investments would be channelled into its core business to achieve economies of scale as well as to enhance production efficiency. We do not foresee any non-core investments over the next 1-2 years as the group's focus would be entirely on growing its automotive as well as industrial products divisions.

As a side note, management would likely go spot on forex going forward, after having incurred more than MYR40m in losses over the past two financial years, for settlement of its forex hedging contracts.

Based on the aforementioned assumptions, we are forecasting for FY17F core earnings of MYR25.6m. If it materialises, this would mark a sharp four-fold improvement over MYR6.2m in FY16 (inclusive of MYR10m in deferred tax expense due to under-provision in previous years).

We expect growth to be driven predominantly by its automotive division as well as the current favourable forex environment. We gather that its 1QFY17 results would be released on 23 Feb. We expect core earnings of MYR6-7m to take the toll stemming from higher orders under its automotive segment as well as the favourable forex, with the USD averaging at 4.32 during the quarter.

Beyond that, we expect Notion to register earnings CAGR of 17% for FY17-19F, as it leverages predominantly on the higher production capacity of plungers under its automotive division as well as the commencement of its industrial products division at a topline contribution of MYR35-50m p.a.

Meanwhile, management is looking to reward its shareholders in the form of dividends upon an earnings recovery. This could be in the form of cash distribution or in the form of shares as the group now holds 2.2m treasury shares. The group paid an interim DPS of 1 sen in early January. We are imputing for DPS of 3-4 sen for FY17-19F, based on a payout ratio of 30%.

Key risks

Key risks to its operations as well as our assumptions include:

- i. Dependence on forex as Notion derives all of its revenue in foreign currency terms (USD, EUR and THB at 60%, 30% and 10% respectively in FY16);
- ii. Projected earnings CAGR of 17% for FY17-19F are highly reliant on capacity expansion under its plungers production division as well as the commencement of its industrial products by 2H17;
- iii. Further weakness in end-demand for HDD and SLR cameras could affect its overall profitability.

Valuation

Based on its FY15 annual report, the group has outstanding warrants of 38.6m as of 29 Jan 2016. The warrants are convertible into ordinary shares at a 1:1 ratio and at an exercise price of MYR1. Given that it is currently out-of-money, we do not expect any conversions to take place upon its expiry on 2 May 2017.

Pegging a 10-12x 2017 P/E and taking into account its current outstanding share base of 270.4m shares, we estimate that Notion could be worth as much as MYR1.00-1.20 per share. Our target multiple is in line with the multiple range of 10x-15x, which we peg to export-oriented technology counters under our coverage.

While Notion's business focus is different from that of semiconductor players, they are all export-oriented and form part of the global technology products' supply chain. This is supported by our earnings CAGR of 17% for FY17-19F, which translates into an appealing PEG of 0.59-0.71x, based on our target multiples. With its NTA per share closing at MYR1.05 as of Sep 2016, we believe Notion is deeply undervalued at this juncture.

While Notion's ROEs may appear to be below its peers' average for now, we see room for improvement over the long run as the group seeks to expand its presence within the more profitable automotive segment.

Over the medium term, the reallocation of the existing idle capacity under its camera division into the automotive segment could help lift its overall asset turnover ratio while management's stance on more proactive capital management going forward could also help to further improve ROEs, in our view.

Figure 10: Notion's valuation against export-oriented technology peers

Local peers	Currency	Rating	TP	Last closing	Mkt cap (USDm)	P/E (x)		EV/EBITDA (x)		P/BV (x)		Div Yield (%)		ROE (%)	
						FY17	FY18	FY17	FY18	FY17	FY18	FY17	FY18	FY17	FY18
Notion	MYR	NR	-	0.70	42.3	7.4	6.0	1.7	1.2	0.6	0.6	4.1	5.0	9.1	10.2
Globetronics	MYR	Neutral	3.67	3.96	251.7	16.1	14.8	8.9	7.8	3.4	3.2	4.6	5.1	21.8	22.5
Inari Amertron	MYR	Neutral	3.20	1.81	792.8	9.3	7.7	6.1	4.7	2.1	1.8	4.4	5.2	25.5	25.6
MPI	MYR	Buy	9.31	7.97	357.3	10.4	10.1	3.4	3.1	1.5	1.4	3.5	3.8	15.6	14.6
Unisem	MYR	Neutral	2.72	2.50	413.6	11.0	10.4	4.6	4.2	1.2	1.2	4.8	5.2	11.4	11.5
Ave (ex-Notion)						11.7	10.7	5.7	5.0	2.1	1.9	4.3	4.8	18.5	18.5

Note: Data as of 24 Jan 2017

Source: Companies data, RHB

Figure 11: Sensitivity analysis of USD/MYR and P/E to our fair value

		USD/MYR for FY17/FY18				
		4.23/4.05	4.33/4.15	4.43/4.25	4.53/4.35	4.63/4.45
2017 P/E	8.0	0.64	0.72	0.80	0.88	0.96
	10.0	0.80	0.90	1.00	1.10	1.20
	12.0	0.96	1.08	1.20	1.32	1.44
	14.0	1.12	1.26	1.40	1.54	1.68
	16.0	1.28	1.44	1.60	1.76	1.92

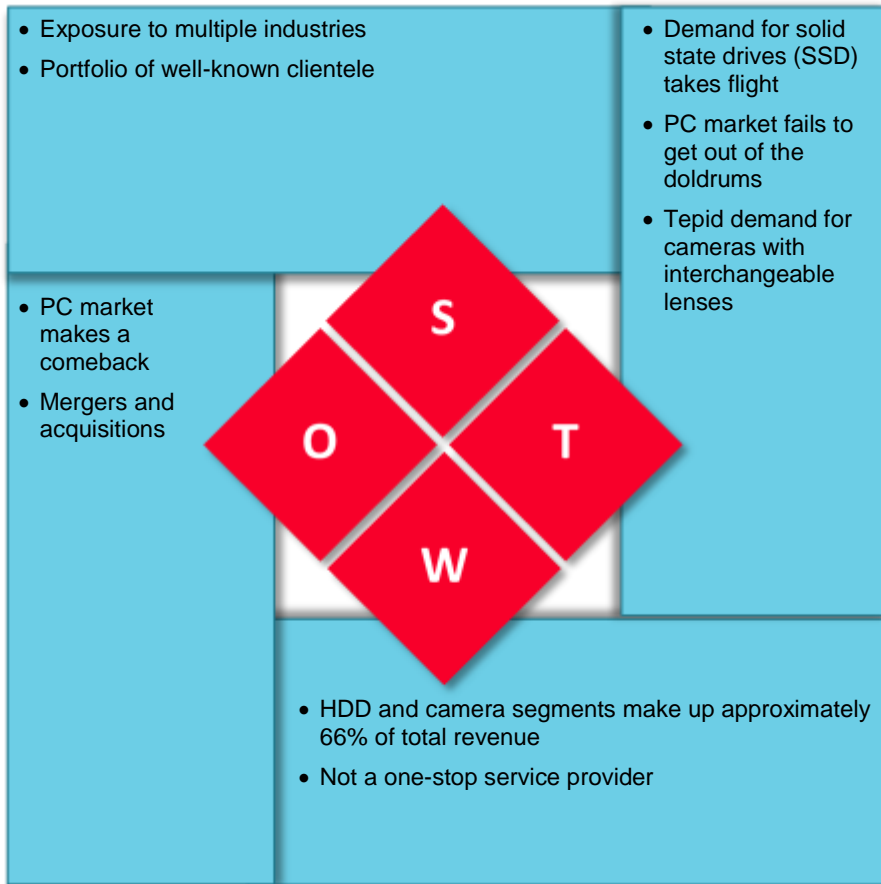
Source: Company data, RHB

Figure 12: Sensitivity analysis of EUR/MYR and P/E to our fair value

		EUR/MYR				
		4.40	4.50	4.60	4.70	4.80
2017 P/E	8.0	0.71	0.76	0.80	0.85	0.89
	10.0	0.89	0.94	1.00	1.06	1.12
	12.0	1.07	1.13	1.20	1.27	1.34
	14.0	1.24	1.32	1.40	1.48	1.56
	16.0	1.42	1.51	1.60	1.69	1.78

Source: Company data, RHB

SWOT Analysis



Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2015-02-24	Not Rated	na	0.44
2015-01-27	Neutral	0.45	0.46
2014-11-26	Neutral	0.45	0.47
2014-10-27	Neutral	0.49	0.51
2014-08-15	Sell	0.49	0.66
2014-05-16	Sell	0.46	0.61
2014-02-20	Sell	0.58	0.64
2013-11-21	Neutral	0.74	0.73
2013-08-16	Neutral	0.74	0.85
2013-05-20	Neutral	0.75	0.76

Source: RHB, Bloomberg

RHB Guide to Investment Ratings

Buy: Share price may exceed 10% over the next 12 months

Trading Buy: Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain

Neutral: Share price may fall within the range of +/- 10% over the next 12 months

Take Profit: Target price has been attained. Look to accumulate at lower levels

Sell: Share price may fall by more than 10% over the next 12 months

Not Rated: Stock is not within regular research coverage

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