

INNOTEK LIMITED

BUY (MAINTAINED)

Share Price:	S\$0.53
Target Price:	S\$0.945
Upside:	78.3%

COMPANY DESCRIPTION

Singapore Exchange Mainboard-listed InnoTek Limited ("Innotek" or "the Group") is a precision metal components manufacturer serving the consumer electronics, office automation (OA) and automotive industries.

With five manufacturing facilities in the PRC, the Group's wholly owned subsidiary, Mansfield Manufacturing Company Limited ("MSF"), provides precision metal stamping, commercial tool and die fabrications and sub-assembly works to a strong and diversified base of Japanese and European end-customers.

Name	INNOTEK LIMITED
Bloomberg Code	INNOT SP Equity
3M Avg Daily Trading Vol (k)	329.2
3M Avg Daily Trading Val (\$'000)	151.4
Major Shareholder / Holdings	Advantec Holdings / 36.64%
Shares Outstanding (m)	228.8
Market Capitalisation (\$m)	134.4
52 week Share Price High/Low	S\$0.61 / S\$0.33

STOCK PRICE PERFORMANCE

Absolute Return (%)	1M 2.8	3M 19.8	12M 39.7
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PRICE CHART



Source : Bloomberg

INVESTMENT MERITS

➤ **Recommending a BUY on Innotek target price of S\$0.945.** As seen below, Innotek's valuations are the most attractive with both P/E and EV/EBITDA ranking as the cheapest within its sector peers. Financial metrics such as ROE and profit margins for Innotek are the best among its industry group as depicted in Exhibit 1. We believe this gap reflects the lack of market confidence in the sustainability of Innotek's turnaround efforts. As management continues to execute on its growth strategies going forward, such as new customer acquisitions, geographical expansion, new product introductions and further production improvements, we believe the market will start to take notice and re-rate the stock closer to its peer group valuations.

After having restructured and turned around Innotek from 2016-2018, management is now targeting to grow the company in 2019. Going forward, we are expecting Innotek's net earnings to grow by 4.0% yoy to S\$21m in FY19 and expand by another 4.8% yoy to S\$22m in FY20. This growth will be underpinned by Mr Lou's plan to further reduce its production headcount to under 2,000 and the engagement of factory automation to improve profitability. We understand that its adoption of a new incentive scheme to reward production workers by production volume has helped to improve profitability and would continue to do so going forward.

With more than 50% of its market cap backed by cash, proactive capital management can help unlock value via special dividends, share buybacks or accretive acquisitions. Presently trading at 6.4x FY19 P/E, our target price for Innotek is S\$0.945 based on peer average of 11.1x P/E.

Automotive and Office Automation to drive growth. We understand that Innotek had recently secured three new customers for its Automotive segment and that new automobile projects secured by the Group had started mass production in 2019. Notwithstanding the current uncertainty in China's automotive industry, the Group's newly acquired major customers have expressed confidence in the quality and functionality of its products. Therefore the Group expects stability of its automotive business which will contribute steadily to the revenue in the future.

Meanwhile, the transfer of production from China to Southeast Asia by the Group's Japanese office automation ("OA") customers is still ongoing. Several of them have imposed more stringent requirements on existing Chinese suppliers, including adopting a centralized and careful selection of suppliers. The Group's OA business is still growing steadily this year, underscoring the Group's capability to respond to customers' strict requirements on product quality and delivery time.

The Group intends to increase its market share by shifting from single-component supply to assembly works. Mansfield (Thailand) was officially opened in June 2018 and scheduled to start mass production in first half 2019. This new plant in Thailand is expected to be an integral part of the supply chain and will continue to supply products to the Group's customers in Thailand with the support of Mansfield Dongguan.

KEY FINANCIALS

December YE	FY16	FY17	FY18	FY19(F)	FY20(F)
Revenue (S\$m)	214.7	212.9	218.3	235.8	252.3
EBITDA (S\$m)	19.2	20.3	27.3	30.2	32.8
EBITDA margin (%)	9.0	9.5	12.5	12.8	13.0
Net Profit (S\$m)	11.6	9.9	20.2	21.0	22.0
EPS (S cts)	5.11	4.36	8.90	9.26	9.70
EPS Growth (%)	NA	-14.7	104.1	4.0	4.8
P/E (x)	11.6	13.6	6.7	6.4	6.1
P/B (x)	0.6	0.7	0.8	0.8	0.8
ROE (%)	9.3	7.4	13.5	13.8	14.2
DPS (S¢)	0.5	1.0	1.5	2.0	2.5
Dividend Yield (%)	0.9	1.8	2.8	3.7	4.6

Source : Lim & Tan Research, Bloomberg

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Improving productivity and efficiency. As Innotek had mentioned, behind the financial performance is one notable statistic, where their production workforce has declined from 4,000 in FY15 to 2,120 in FY18. Over this comparative, revenue has held relatively stable, ranging from S\$212.9mln to S\$233.1mln. This means that revenue per employee over the last three years has increased to S\$103k from S\$58k. Going forward, we are expecting the number of employees to drop to below 2,000 and productivity to improve with more automation which would in turn drive up profitability further.

Robust balance sheet and expecting higher dividends. Innotek currently has cash and cash equivalents amounting to S\$72.4mln and debts of S\$1.8mln, which in turn translates to a net cash position of S\$70.6mln that equates to around 51% of current market cap. Given this strong balance sheet and with earnings growth expected for the next two years, we thus are forecasting Innotek to dish out dividends per share of S\$0.02 for FY19F and S\$0.025 for FY20F. We understand that management is currently working to remit its cash hoard out of China in the hopes of rewarding shareholders via higher dividends, share buybacks and potential M&As.

Turnaround of Innotek to continue under CEO Mr Lou Yiliang. Mr Lou Yiliang was appointed as Executive Director and CEO of Mansfield Manufacturing Company Limited (InnoTek's main operating subsidiary) in Nov 2015. He had successfully restructured Mansfield during his tenure there, and he was eventually appointed as Group CEO in Mar 2017. Under his leadership, Innotek managed to turnaround in FY16 after incurring heavy losses of more than S\$44mln in total for FY14 and FY15 combined.

This profitability trend continued for both FY17 and FY18, and Innotek eventually experienced a collective net profit of more than S\$41mln for the three-year period from FY16 to FY18. Going forward, we are expecting Mr Lou to continue to lead Innotek into higher profitability.

Signalling his confidence in the company's prospects, Mr Lou had purchased 978k of Innotek's shares at around S\$0.145 apiece during Apr 2016 to July 2016. Mr Lou then further acquired another 14.08mln shares at S\$0.38 apiece on Jul 2018, increasing his total exposure in Innotek to his current 11.5% stake, the second largest after Advantec's 36.64%.

Exhibit 12: Share purchases By Mr Lou Yiliang



Source: Bloomberg

Going against the grain. As mentioned above, according to the World Semiconductor Trade Statistics (WSTS), global semiconductor revenue grew 13.7% yoy to hit US\$468.8 billion in 2018. However, the outlook for the semiconductor seems dismal for the current year, with WSTS forecasting a 3% drop to US\$454.5 billion in 2019.

Given this negative backdrop, we believe that investors and fund managers whom are looking to invest within the local tech scene would choose to sniff out those companies that can outperform its peers. With earnings growth expected for Innotek in FY19, we opine that fund flows may look to reallocate out of the underperforming stocks and seek exposure into those that can move against a rising tide.

Exhibit 13: Global Semicon Sales Forecast By WSTS

Autumn 2018 - Q4 Update	Amounts in US\$M			Year on Year Growth in %		
	2017	2018	2019	2017	2018	2019
Americas	88,494	102,997	97,021	35.0	16.4	-5.8
Europe	38,311	42,957	42,824	17.1	12.1	-0.3
Japan	36,595	39,961	40,351	13.3	9.2	1.0
Asia Pacific	248,821	282,863	274,350	19.4	13.7	-3.0
Total World - \$M	412,221	468,778	454,547	21.6	13.7	-3.0
Discrete Semiconductors	21,651	24,102	24,776	11.5	11.3	2.8
Optoelectronics	34,813	38,032	38,611	8.8	9.2	1.5
Sensors	12,571	13,356	13,899	16.2	6.2	4.1
Integrated Circuits	343,186	393,288	377,261	24.0	14.6	-4.1
Analog	53,070	58,785	61,083	10.9	10.8	3.9
Micro	63,934	67,233	68,513	5.5	5.2	1.9
Logic	102,209	109,303	112,109	11.7	6.9	2.6
Memory	123,974	157,967	135,557	61.5	27.4	-14.2
Total Products - \$M	412,221	468,778	454,547	21.6	13.7	-3.0

Source: World Semiconductor Trade Statistics

KEY RISKS

▶ **Margin pressures expected in the short-term.** While Innotek had recently released a set of commendable 1Q19 results which saw net profit surge to S\$3.9mln from net earnings of S\$117k in 1Q18, management had warned of margin pressures. Innotek had verbally guided that its high profit margins in 1Q19 is not sustainable.

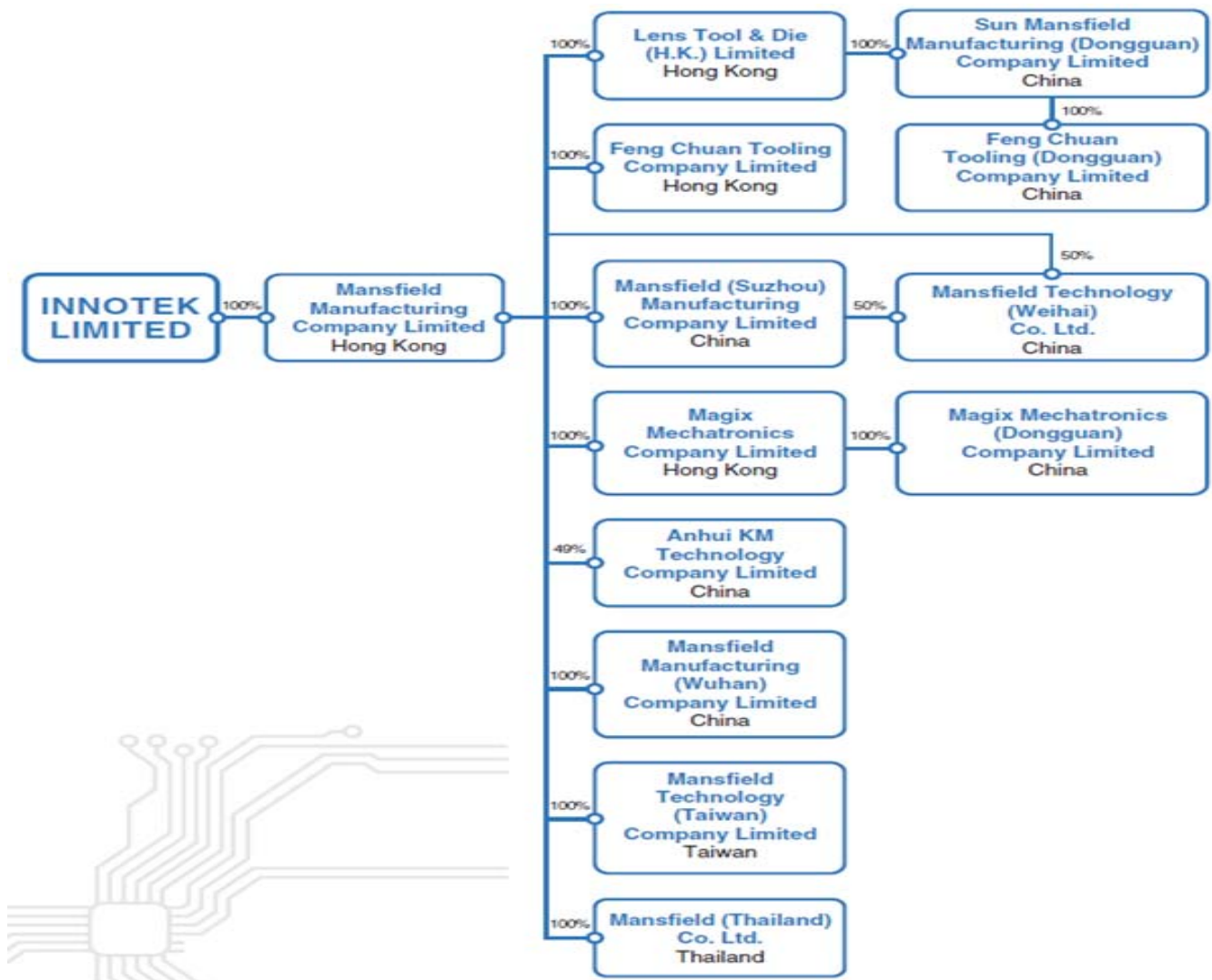
Economic slowdown in China. As Innotek had mentioned, China's economic slowdown amidst ongoing concerns of a Sino-US trade war is expected to keep overall business and consumer sentiment on edge in the foreseeable future. This will continue to impact a number of industries in China in 2019, including automotive, which is an important source of revenue for the Group. Although the Chinese government is taking active measures to expand domestic demand, it remains to be seen if it can help to reverse the overall economic downturn in the short term.

COMPANY PROFILE

Singapore Exchange MainBoard-listed Innotek Limited's wholly-owned Mansfield Manufacturing Company Limited ("MSF") is a precision metal components manufacturer serving the consumer electronics, office automation and mobility device industries. MSF's three business units - Precision metal stamping, Tools and Die design and fabrications, Integrated Processes and Assembly - have a strong and diversified base of Japanese and European end-customers.

MSF has more than 700 stamping presses with capacity ranging from 25 tons to 1100 tons, a significant number of Computer Numerical Control ("CNC") machines, Electrical Discharge Machines ("EDM"), plastic injection moulding and grinding equipment. MSF has six manufacturing plants in China, with total manufacturing space to over two million square feet.

Exhibit 14: Corporate Structure Of Innotek

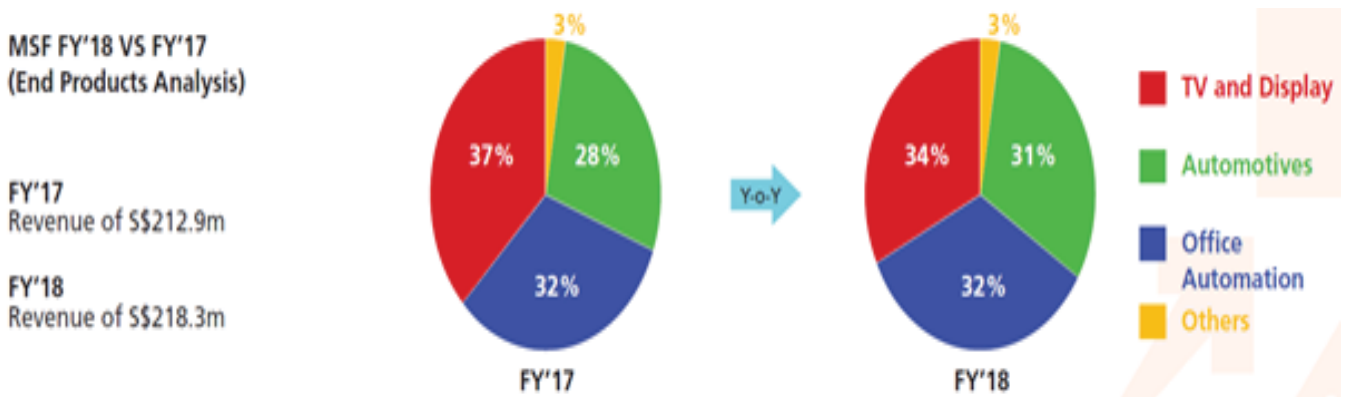


Source: Company

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Innotek serves four business segments, namely TV and Display, Automotives, Office Automation and Others. As highlighted above, we believe that the TV and Display and Automotives segments are slated to drive Group earnings for FY19. We are also expecting the Automotives segment to account for a larger portion of Group revenue in FY19, as with the trend that was seen in FY18 as compared to FY17.

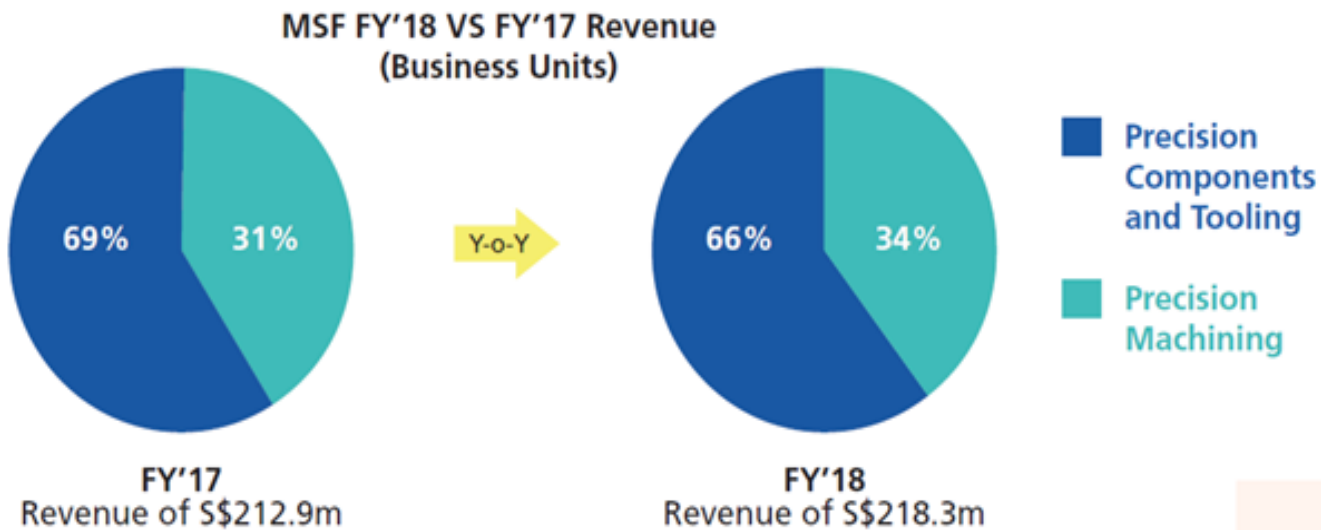
Exhibit 15: FY18 Revenue Segmental Breakdown (End Product)



Source: Company

Meanwhile, Innotek has two business units, namely Precision Component and Tooling and Precision Machining. On Innotek's top five customers, with the exception of Wistron Corp, we note that the other four customers are all Japanese players. We believe that this is attributed to CEO Mr Lou Yiliang's experience in dealing with the Japanese market. Collectively, the top five customers of Innotek account for 54% of Group revenue.

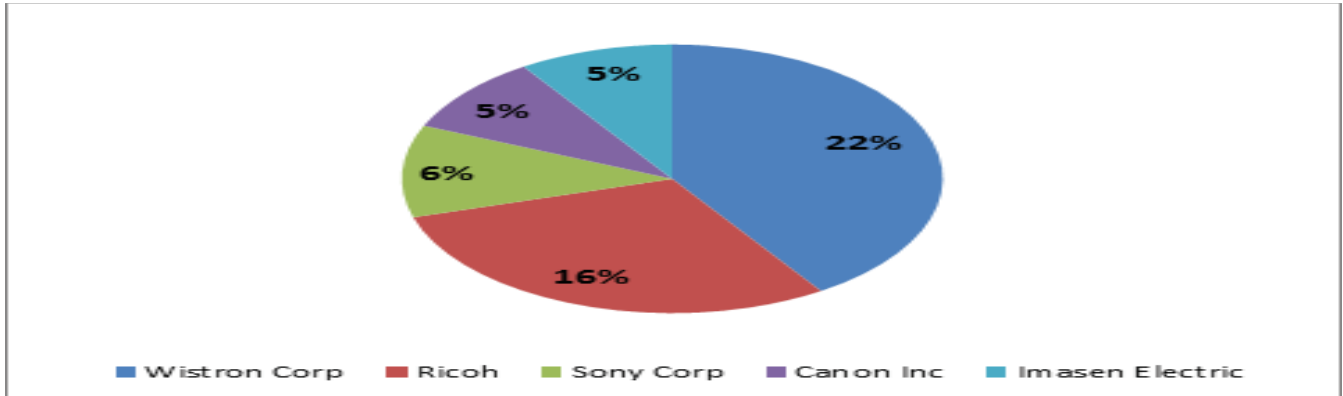
Exhibit 16: FY18 Revenue Segmental Breakdown (Business Units)



Source: Company

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Exhibit 17: FY18 Revenue Contribution - Top 5 Customers



Source: Company, Lim & Tan Research

Exhibit 18: Customers By Product Industry

A> Office automation	
B> Automotive	
C> TV/Display(incl TV back panel)	

Source: Company

Innotek's earnings for 2018 rose to S\$20.2mln from S\$9.9mln in 2017 despite a broad slowdown in China. Earnings per share for FY'18 came to 8.98 Singapore cents, up from 4.41 Singapore cents for the previous year.

Net profit before exceptional gain for FY18 increased to S\$17.8mln from S\$8.6mln in FY17. The FY18 exceptional gains of S\$2.4mln include write-back of impairment loss on property, plant and equipment and a write-back of tax provision made in 2017 for obtaining a new three-year tax concession, offset by Mansfield Weihai exit expense.

Revenue rose to a three-year high of S\$218.3mln in FY18 from S\$212.9mln in FY17. Higher sales of heatsinks, car display panels, auto and OA tooling, as well as a one-time order for a commercial display product, offset lower sales of TV back panels and bezels, office automation and automotive products.

Overall gross profit margin edged up as the Group achieved higher sales for its precision machining business and automating production at its stamping business besides reducing outsourcing.

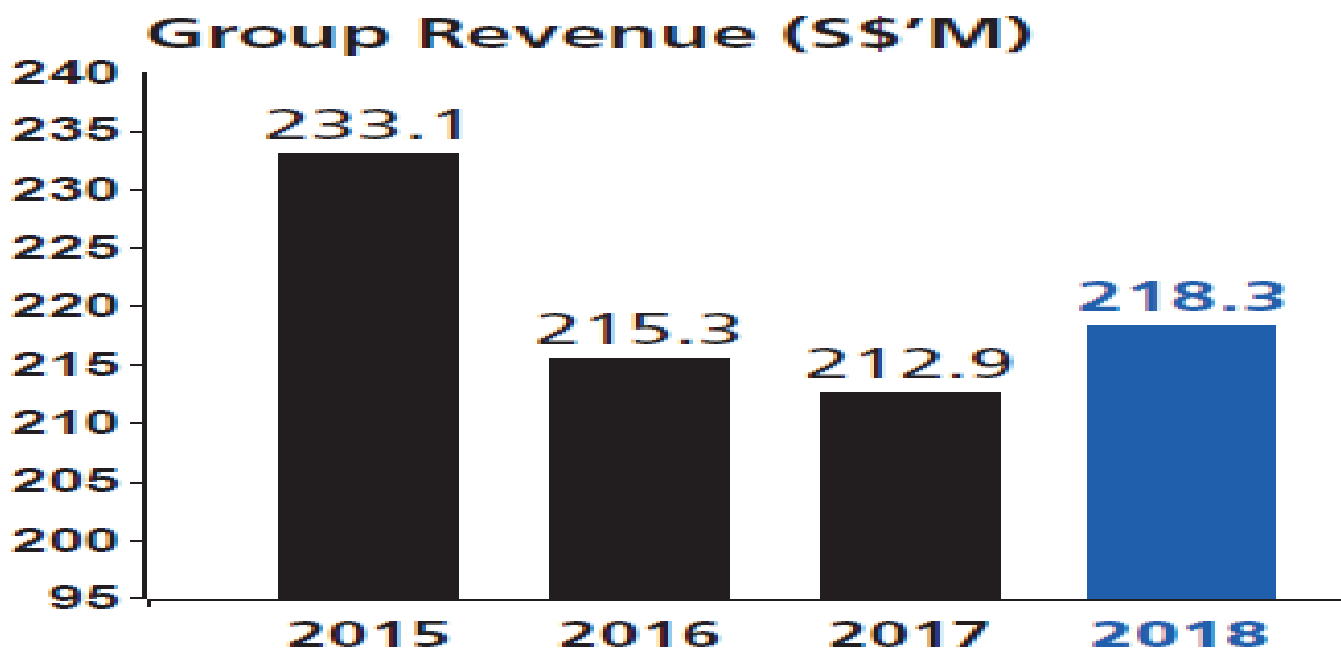
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Exhibit 19: Financial Highlights

FOR THE YEAR (S\$'000)	2015	2016	2017	2018
Revenue	233,137	215,325	212,946	218,299
Operating (loss)/profit	(16,299)	10,903	9,929	15,128
(Loss)/profit before tax	(15,260)	13,861	15,835	23,345
(Loss)/profit for the year attributable to owners of the Company	(16,293)	11,631	9,873	20,239
AT YEAR END (S\$'000)				
Shareholder equity	116,226	124,882	134,035	149,596
Property, plant and equipment, investment properties and prepaid land lease payment	64,133	56,769	56,647	61,393
Total debts	5,288	73	50	60

Source: Company

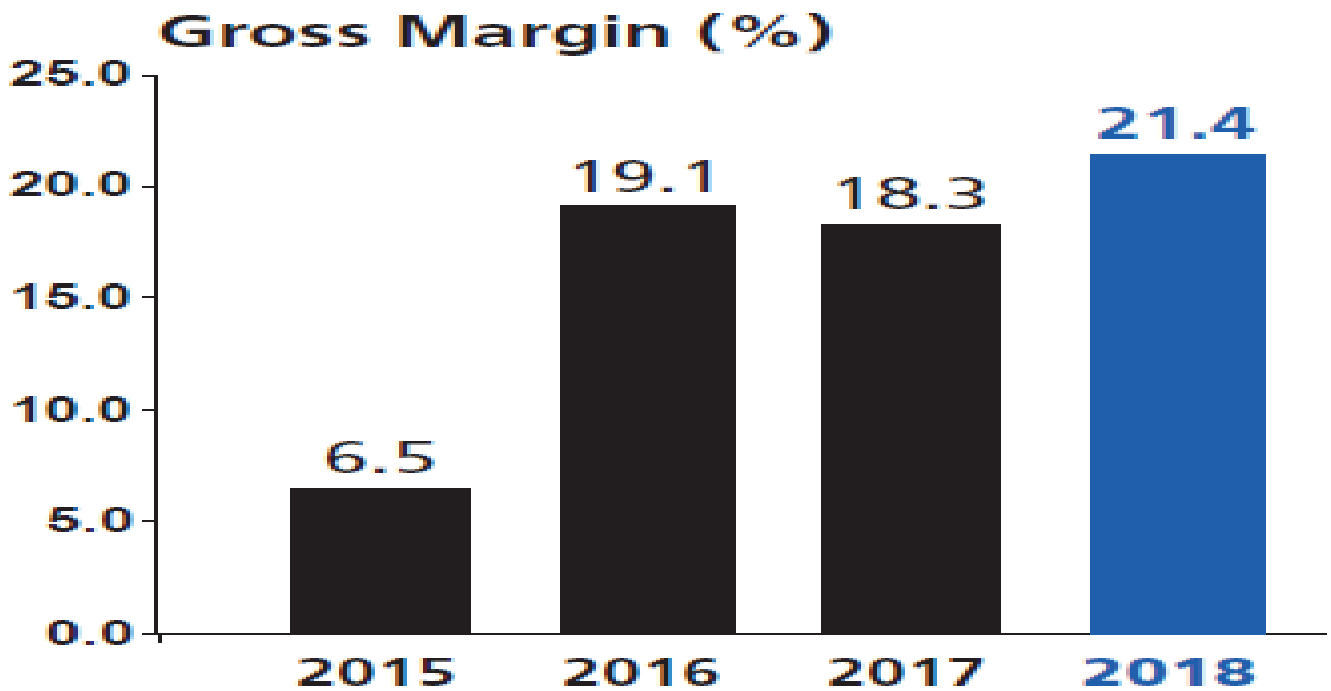
Exhibit 20: Revenue Trend Since 2015



Source: Company

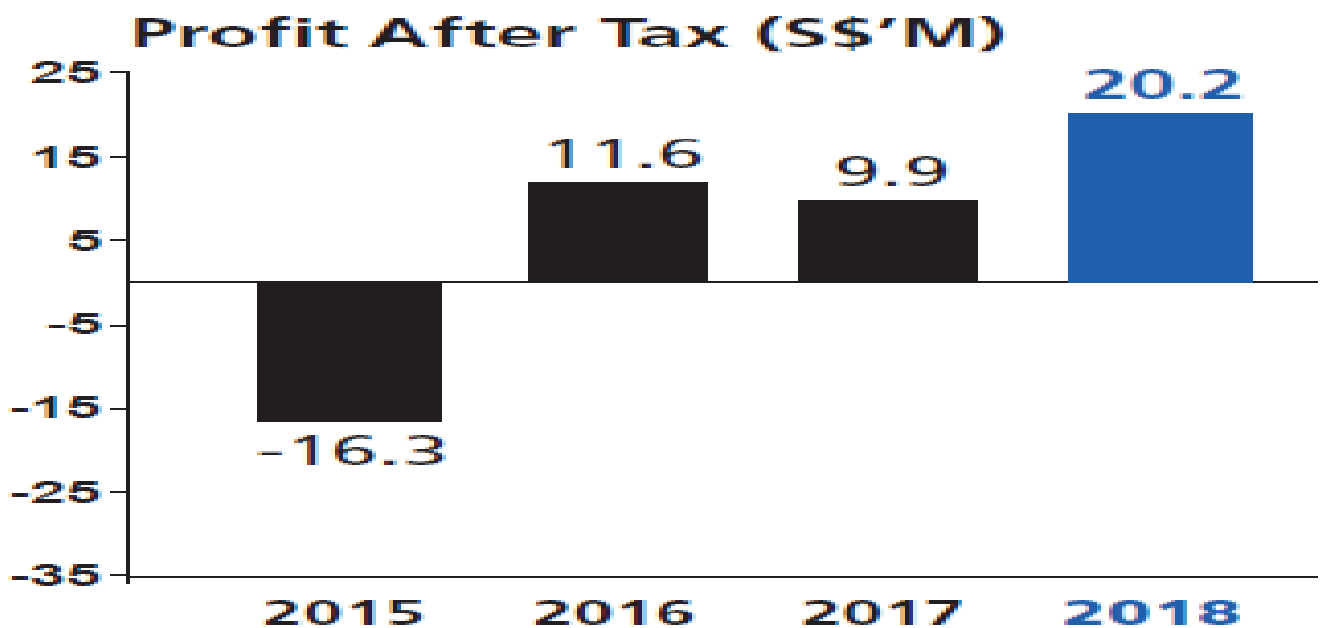
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Exhibit 21: Gross Margin Trend Since 2015



Source: Company

Exhibit 22: Net Profit Trend Since 2015



Source: Company

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Exhibit 23: Mr Neal Manilal Chandaria, Chairman, Non-Executive and Non-Independent Director



Source: Company

KEY PERSONNEL

Mr Neal Manilal Chandaria joined InnoTek as a Non-Executive and Non-Independent Director on 2 November 2015 and is a member of the Nominating Committee. Mr Chandaria was appointed Chairman of the Board and member of the Audit & Risk Management Committee on 27 April 2017. He is a senior executive at Comcraft Group, which is globally active in various sectors including steel, aluminum, plastics, packaging and information technology.

Based in Singapore, he has been helping Comcraft develop its businesses in Asia for more than 20 years. He was previously involved in Comcraft's businesses in Africa and Europe. Mr. Chandaria graduated from Stanford University with a degree in economics. He is the Honorary Consul of the Republic of Kenya in Singapore.

Exhibit 24: Mr Lou Yiliang, Executive and Non-Independent Director



Source: Company

Mr Lou Yiliang was appointed Executive Director of InnoTek and Chief Executive Officer of Mansfield Group on 2 November 2015. In 2017, Mr. Lou was appointed Chief Executive Officer of InnoTek Limited. Besides Chinese, Mr. Lou is also proficient in Japanese.

Born in Shanghai, Mr. Lou has vast experience in the consumer electronics and home appliances businesses in Asia. He started his career as an entrepreneur in the 1980s by helping to procure Toshiba consumer electronic products from Japan to China. The business helped pave the way for the transfer of technology from Toshiba in Japan to major Chinese manufacturers of TV sets and other consumer electronics. These included Chang Hong, Haier, Hisense and Konka.

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