

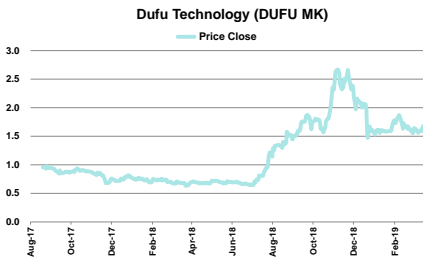


Dufu Technology Corp

Riding The Big Data Era

Target: N/A

Price: MYR1.69



Source: Bloomberg

Stock Profile

Bloomberg Ticker	DUFU MK
Avg Turnover (MYR/USD)	6.23m/1.53m
Net Gearing (%)	Net Cash
Market Cap (MYRm)	412.5m
Beta (x)	1.76
BVPS (MYR)	0.71
52-wk Price low/high (MYR)	0.627 - 2.713
Free float (%)	41.3

Major Shareholders (%)

Perfect Full Yen Sdn	10.99
Perfect Commerce Sdn	10.39
Lee Hui-Ta	9.68

Share Performance (%)

	1m	3m	6m	12m
Absolute	0.6	(18.0)	(3.6)	136.9
Relative	4.0	(15.2)	4.7	148.7

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Investment Merits

- Riding on strong demand for storage solutions for enterprise and data centre infrastructure with the adoption of industry 4.0
- Surge in demand for high quality (high margin) HDD components
- Solid balance sheet with net cash position and healthy dividends
- Trading at only 6.8x 2019F P/E, below historical average and peers

Company Profile

Dufu Technology is engaged in the design, development, and manufacturing of precision machining components, computer disk-drive related components, steel moulds and stamping components, as well as providing marketing and engineering support services.

Highlights

Riding the Industry 4.0 revolution. IDC, in its Data Age 2025 report, predicts that worldwide data creation will grow to an enormous 163 zettabytes (ZB) by 2025, which is 10x the amount of data produced in 2017, while hard drives will be central in managing 70% of the datasphere. Internet of Things (IoT), real-time data, cognitive artificial intelligence (AI) systems, increased security data requirements, and big data analytics are among the key trends. The trend should result in strong demand for high capacity HDDs, especially from data centres and catering to growing demand for big data and cloud services. Dufu, which manufactures HDD-related components, is set to ride on the increasing demand for HDD.

HDD still very much relevant. Enterprise solutions and data centres are largely still on HDD (or hybrid HDD and SSD) given its stability and longevity with lower cost per GB, while SSDs could be 10x more expensive for high capacity drives. Note that the latest helium-filled HDD platform in the market can house up to nine platters, which essentially increases demand for spacers. This is part of the reason why HDD unit shipments are downtrending (along with the popularity of SSD and contraction in PC market), while total storage capacity is still on the rise (combined storage shipment jumped 21% to 912 exabytes in 2018) – this has increased demand for HDD components.

Next generation HDD is ready. The next generation enterprise hard drive Heat-Assisted Magnetic Recording (HAMR) and Microwave-Assisted Magnetic Recording (MAMR) have been successfully developed and mass production is expected in 2019. First models to hit the market this year will be 16-20 TB drives for data centres. Essentially, both new technologies are aiming to increase areal density (up to 5tbpsi) to produce larger capacity hard drives, and both would require higher quality material spacers eg titanium (at higher margin) to ensure reliability – this is Dufu's speciality.

Extra machines to cater to higher order flow. We understand that the group has c.450 machines with a yield of >98%, and 50 more machines (+11%) are expected to be fully commissioned by this year to cater to growing demand from its customers – this is driven by growing demand from data centres and the mass production of new generation HDDs. Capex of MYR10-15m is earmarked for FY19.

Company Report Card

Latest results. In FY18, Dufu recorded core net profit of MYR51.5m, a significant 87% YoY rise on higher revenue of MYR241.5m (+33% YoY). The spike was driven by both higher demand for its HDD components and improved margins given higher ASPs for the higher grade products.

Balance sheet/cash flow. Net cash position of MYR30.7m or MYR0.12 per share as at 31 Dec 2018. FCF yield improved to 18% from 10.9% in FY17 owing to the higher earnings base.

Dividend. 1 share dividend for every 20 shares held was proposed (going ex on 28 May 2019), on top of an interim cash dividend of MYR0.025, giving a decent yield of 6.5% at the current price. We believe higher dividends can be sustained in FY19F, with the improved earnings trajectory and healthy cash flow generation.

Management. Lee Hui-Ta is the executive chairman and major shareholder of the group. He was a co-founder of the group in the early 90s and has more than 26 years of experience in precision tooling and CNC precision machining. Key senior management personnel include Yeoh Beng Hooi, who was appointed as CEO since 2015, after serving as COO since 2004. Group CFO is David Khoo Chong Beng, who joined since 2017. Prior to this, he was the financial controller of NTPM.

Investment Case

Riding the big data industry trend. We believe its HDD segment will continue to grow, banking on higher demand for storage solutions given the huge growth in data consumption as well as technological advancements in increasing the number of components within a HDD platform. Margins are expected to improve as demand rises for higher grade spacers that are required for the new generation HDDs.

Besides, its non-HDD segment is expected to grow as the group diversifies into the automotive industry, having been certified. Trading at a forward P/E of 6-6.8x, we believe the group is greatly undervalued by the market despite good earnings visibility and being a beneficiary of a rising industry trend.

Fair value. Based on a target P/E range of 11-14x on FY19F-20F earnings, we derive a fair value range of MYR2.57-3.72. The target P/E range is still at a discount to the 5-year average P/E for its closest peers in the HDD industry eg Notion Vtec (NVB MK, NR) and JCY International (JCYH MK, NR), that are trading at 18-20x.

Key risks include slower adoption of related components, weaker consumer spending, customer concentration where its biggest customer accounts for c.65% of 2017's revenue, and further weakening of the USD.

Profit & Loss	Dec-16	Dec-17	Dec-18
Total turnover (MYRm)	170	181	241
Reported net profit (MYRm)	27	26	52
Recurring net profit (MYRm)	27	27	51
Recurring net profit growth (%)	147.0	1.7	87.3
Recurring EPS (MYR)	0.10	0.10	0.20
DPS (MYR)	0.05	0.07	0.05
Dividend Yield (%)	2.7	3.8	3.0
Recurring P/E (x)	16.5	16.2	8.6
Return on average equity (%)	20.9	18.4	29.8
P/B (x)	3.4	3.1	2.6
P/CF (x)	0.1	0.2	0.1

Source: Company data, RHB

Balance Sheet (MYRm)	Dec-16	Dec-17	Dec-18
Total current assets	122	123	154
Total assets	176	176	220
Total current liabilities	39	31	39
Total non-current liabilities	7	4	7
Total liabilities	47	35	46
Shareholder's equity	129	142	174
Minority interest	0	0	1
Other equity	0	0	0
Total liabilities & equity	176	176	220
Total debt	13	6	11
Net debt	Net Cash	Net Cash	Net Cash

Source: Company data, RHB

Cash Flow (MYRm)	Dec-16	Dec-17	Dec-18
Cash flow from operations	47	22	39
Cash flow from investing activities	(2)	(7)	(21)
Cash flow from financing activities	(27)	(14)	(10)
Cash at beginning of period	24	39	36
Net change in cash	12	(4)	6
Ending balance cash	42	36	41

Source: Company data, RHB