

Hi-P International (HIP SP)

An About-Face

Negative swing on guidance; D/G to HOLD, TP -40%.

We downgrade Hi-P to HOLD with TP lowered to SGD1.45 after slashing EPS by 35-45% for FY18-20E. Hi-P has negatively revised guidance, and now expects to end FY18 with similar revenue and lower profit compared to FY17 amid customer cautiousness. Our EPS cuts reflect lower revenue and margin assumptions to factor in volume and pricing pressure. Our ROE-g/COE-g TP is based on 2x P/B (prev: 3.2x), based on FY18-20E avg. ROE of 16% and COE of 9%.

1Q18 growth on stronger volumes

1Q18 earnings grew 20% YoY on the back of a 15.1% YoY increase in revenue. This was driven by healthy volumes from Amazon Echo and the ultra-flagship phones of Hi-P's key wireless customer. Hi-P suffered a net FX loss of SGD13m (1Q17: -SGD5.2m) amid the weakening of the USD relative to the CNY and SGD.

Multiple headwinds emerging

Hi-P now expects to finish FY18 with similar revenue and lower profit compared to FY17. This is a negative revision from Feb-18, when it guided for revenue and profit growth in FY18 compared to FY17. A few of Hi-P's customers have turned cautious amid the threat of a trade war. As customers reduce their volume forecasts, price competition has intensified as well. Hi-P has hedged 70-80% of its FX exposure, and it might not enjoy margin improvement in the event of a USD recovery, unless these hedges are unwound. At the key wireless customer, the 9% QoQ drop in ASP of its smartphones, as well as its record inventory levels may be signalling a demand slowdown - which may negatively affect Hi-P.

Paradigm-shift needed to reverse fortunes

A catalyst for us to potentially turn positive on Hi-P would be a strong recovery in sentiment and volume forecasts by customers. In our view, such an event could tilt the demand-supply dynamics back in Hi-P's favour.

FYE Dec (SGD m)	FY16A	FY17A	FY18E	FY19E	FY20E
Revenue	1,305	1,427	1,438	1,557	1,625
EBITDA	158	220	199	215	224
Core net profit	55	121	93	100	104
Core FDEPS (cts)	6.7	14.9	11.5	12.4	12.8
Core FDEPS growth(%)	nm	123.3	(23.2)	7.6	3.3
Net DPS (cts)	0.8	25.0	4.0	4.0	4.0
Core FD P/E (x)	23.5	10.5	13.7	12.7	12.3
P/BV (x)	2.2	2.4	2.2	1.9	1.7
Net dividend yield (%)	0.5	15.9	2.5	2.5	2.5
ROAE (%)	9.6	22.0	16.7	16.1	14.8
ROAA (%)	4.6	10.5	7.5	7.7	7.3
EV/EBITDA (x)	2.5	6.5	5.9	5.0	4.5
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Consensus net profit	-	-	128	144	189
MKE vs. Consensus (%)	-	-	(26.9)	(30.1)	(44.9)

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HOLD

[Prior:BUY]

Share Price SGD 1.57
12m Price Target SGD 1.45 (-8%)
Previous Price Target SGD 2.43

Company Description

Hi-P is an EMS provider with 13 manufacturing sites across 4 countries

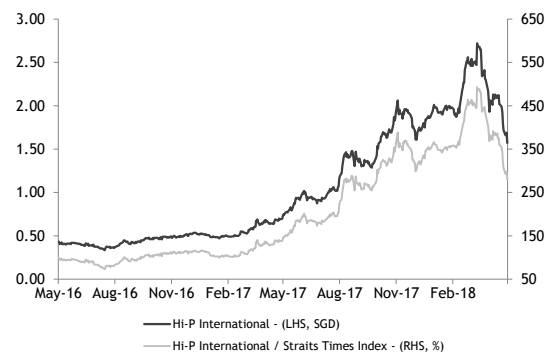
Statistics

52w high/low (SGD)	2.72/0.74
3m avg turnover (USDm)	4.4
Free float (%)	13.7
Issued shares (m)	887
Market capitalisation	SGD1.4B
	USD1.0B

Major shareholders:

Yao Hsiao Tung	83.0%
FMR LLC	2.3%
Edentree Investment Management	2.3%

Price Performance



	-1M	-3M	-12M
Absolute (%)	(24)	(21)	121
Relative to index (%)	(28)	(23)	98

Source: FactSet

Investment thesis

Fig 1: MKE forecast changes for Hi-P

	FY18E			FY19E			FY20E		
	New	Old	Chg (%)	New	Old	Chg (%)	New	Old	Chg (%)
Revenue (SGDm)	1,438.3	1,667.0	-13.7	1,557.5	1,952.9	-20.2	1,624.6	2,145.4	-24.3
Gross profit (SGDm)	205.6	263.0	-21.8	221.5	309.6	-28.4	228.0	343.5	-33.6
EBIT (SGDm)	117.2	176.3	-33.5	127.8	206.1	-38.0	132.0	234.1	-43.6
EBITDA (SGDm)	199.2	258.4	-22.9	214.6	292.9	-26.7	224.1	326.1	-31.3
Core net profit (SGDm)	93.3	142.4	-34.5	100.4	165.5	-39.3	103.8	188.5	-44.9
EPS (cts)	11.5	17.5	-34.5	12.4	20.4	-39.3	12.8	23.2	-44.9
			Chg (ppt)			Chg (ppt)			Chg (ppt)
Gross margin	14.3%	15.8%	-1.5	14.2%	15.9%	-1.6	14.0%	16.0%	-2.0
SGA as % of sales	5.8%	5.2%	0.6	5.7%	5.3%	0.4	5.6%	5.1%	0.5

Source: Maybank Kim Eng

We slashed FY18-20E EPS by 35-45% after the negative guidance by management. These cuts factor in a 13-24% reduction in revenue estimates amid customer cautiousness, and lower margins due to pricing pressure and possible FX headwinds.

Hi-P now expects FY18 revenue to be flattish and net profit to be lower compared to FY17. In Feb, Hi-P had guided for revenue and net profit to be higher than FY17.

Four takeaways from 1Q18 results

1Q18 net profit of SGD10.1m (+20% YoY) made up 7% of our full year estimate. This was driven by growth from the key wireless customer's ultra-flagship phone, and Amazon Echo products. Hi-P also suffered a net FX loss of SGD13m in 1Q18 (1Q17: -SGD5.2m). 1Q is typically a seasonally weak quarter, and may not be representative of the full year performance. For context, 1Q17 also made up 7% of FY17 earnings.

Four takeaways from earnings and implications for the outlook:

- **Cautious outlook:** Hi-P cites that amid the threat of a trade war between the US and China, its customers have been more cautious in their forecasts. Price competition has also increased as various players fight for volumes in a shrinking market. Barring a further deterioration of economic conditions, Hi-P believes its pipeline of new product launches could propel a return of revenue growth in FY19E. We forecast revenue to grow by 8% in FY19E.
- **FX may still be a dampener:** We understood that management has hedged 70-80% of the company's FX exposure following the 3% fall in the USD/CNY in Jan-18. This is a double-edged sword, in our view. The hedge might mitigate further FX losses if the USD continues to weaken against the CNY and SGD. On the flipside, if Hi-P maintains this hedge as the USD strengthens, it is unlikely to be able to enjoy a recovery in margins.
- **Key wireless customer read-across:** Hi-P's key wireless customer saw its smartphone ASP fall 9% QoQ in 1Q18. Inventory levels at this customer are also at a record high. Taken together, this may be an indication of a demand slowdown for the ultra-flagship smartphone that Hi-P makes small metal components for. If this negative pricing and volume trend persist into newer

models, we are concerned this would offset the allocation gains in the form of a longer list of components Hi-P is involved in.

- Signs to watch out for: A persistence of the “wait-and-see” attitude by Hi-P’s customers would be negative for the supply chain. We would need to see a strong recovery in sentiment and volumes on the supply chains that Hi-P participates in before potentially turning positive on the stock.

Fig 2: 1Q18 P&L summary

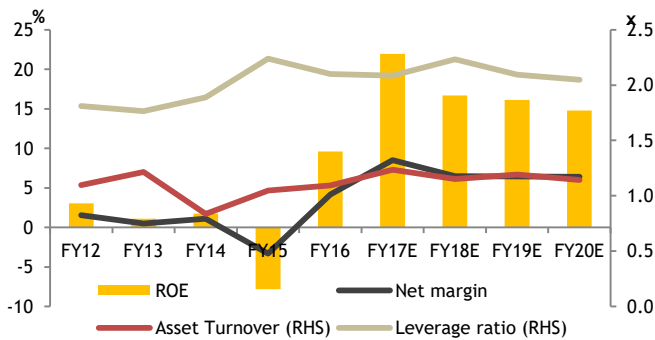
FYE Dec	1Q18 (SGD m)	1Q17 (SGD m)	4Q17 (SGD m)	YoY Chg (%)	QoQ Chg (%)	FYE	% of FYE
Revenue	281.1	244.2	491.8	15.1	-42.8	1,667.0	16.9
COGS	(243.3)	(210.7)	(394.6)	15.4	-38.3	(1,404.0)	17.3
Gross profit	37.8	33.4	97.2	13.0	-61.1	263.0	14.4
Total SGA	(16.3)	(19.1)	(23.0)	-15.1	-29.3	(86.7)	18.8
Other Op. Income	1.6	1.3	3.3	27.3	-51.7	10.0	16.1
Other Op. Expenses	(11.3)	(3.6)	(7.3)	212.0	55.9	(10.0)	113.2
EBIT	11.8	11.9	70.3	-1.0	-83.2	176.3	6.7
EBITDA	29.0	31.1	87.5	-6.8	-66.8	258.4	11.2
Net Int. Income (Exp)	1.7	(0.1)	(0.2)	nm	nm	(5.0)	-33.0
Associates Income	(0.1)	0.1	0.0	nm	nm	0.3	-20.3
Exceptional Items	0.0	0.0	0.0	nm	nm	0.0	nm
Pretax Profit	12.1	11.9	70.1	1.9	-82.7	171.6	7.1
Taxation	(2.0)	(3.5)	(10.5)	-41.6	-80.7	(29.2)	7.0
Net profit	10.1	8.4	59.6	19.9	-83.1	142.4	7.1
Minority Interest	0.0	0.0	0.0	450.0	266.7	0.0	122.2
PATMI	10.1	8.4	59.6	20.0	-83.1	142.4	7.1
Core PATMI	10.1	8.4	59.6	20.0	-83.1	142.4	7.1
EPS (cts)	1.24	1.04	7.34	19.2	-83.1	13.01	9.5
				Change (ppt)			
Gross margin	13.4%	13.7%	19.8%	-0.3			
EBIT margin	4.2%	4.9%	14.3%	-0.7			
Core net margin	3.6%	3.4%	12.1%	0.1			

Source: Company, Maybank Kim Eng

Value Proposition

- Strong execution with key customers like Apple has helped Hi-P win increased allocation in recent years.
- ODM capabilities created some form of customer stickiness in the consumer electronics segment.
- Demonstrated ability to move away from razor-thin assembly projects to prioritise better profitability ones.
- Operates in a highly competitive industry. As such, Hi-P must continually invest in value-added capabilities.

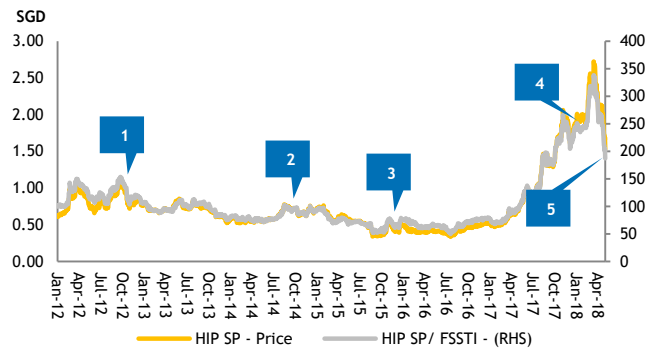
DuPont ROE



Source: Company, Maybank Kim Eng

Price Drivers

Historical share price trend



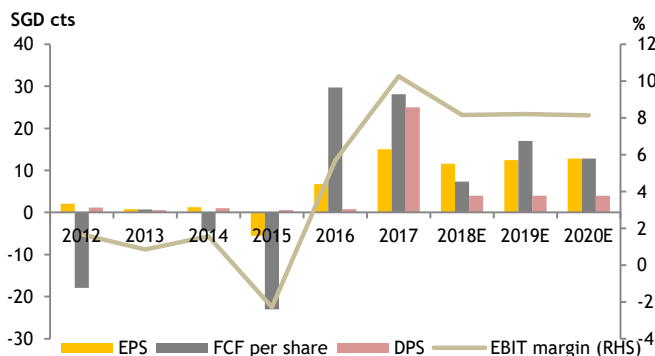
Source: Company, Maybank Kim Eng

1. Between FY11-14, lacklustre share price performance was due to customers Nokia and Blackberry losing market share.
2. YotaPhone 2 official launch. Russia was expected to be a key market. However, Russian economic crisis and sanctions destroyed local and European demand.
3. Hi-P commenced arbitration proceedings against Yota, claiming USD126m.
4. Upgraded 3Q17 earnings guidance. Subsequently, Hi-P announced record quarterly profit of SGD34m, with sanguine 4Q17 outlook.
5. Downgraded FY18 revenue and net profit guidance.

Financial Metrics

- Earnings delivery has largest effect on Hi-P's share price.
- We see FY17-20E EPS CAGR of -5% following a negative revision in management guidance, citing cautious outlook by customers
- Clean balance sheet, improved cash flow, and treasury shares provide ammo for inorganic growth.

EPS, FCF per share, DPS and EBIT margin



Source: Company, Maybank Kim Eng

Swing Factors

Upside

- Better-than-expected orders and execution from existing projects.
- New customer wins and new projects.
- Improved communication regarding strategy, as well as cost control efforts.

Downside

- Micro- and macro-driven risks that negatively affect end-demand of products Hi-P participates in.
- Market share losses and/or payment defaults from customers.
- Sudden and steep declines in the USD (revenue exposure), against the CNY (operating exposure) and SGD (reported currency).

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FYE 31 Dec	FY16A	FY17A	FY18E	FY19E	FY20E
Key Metrics					
P/E (reported) (x)	6.5	7.2	13.6	12.6	12.2
Core P/E (x)	23.5	10.4	13.6	12.6	12.2
Core FD P/E (x)	23.5	10.5	13.7	12.7	12.3
P/BV (x)	2.2	2.4	2.2	1.9	1.7
P/NTA (x)	2.2	2.4	2.2	1.9	1.7
Net dividend yield (%)	0.5	15.9	2.5	2.5	2.5
FCF yield (%)	17.8	17.9	4.7	10.8	8.3
EV/EBITDA (x)	2.5	6.5	5.9	5.0	4.5
EV/EBIT (x)	5.4	9.8	10.0	8.4	7.6
INCOME STATEMENT (SGD m)					
Revenue	1,305.1	1,426.9	1,438.3	1,557.5	1,624.6
Gross profit	155.8	232.9	205.6	221.5	228.0
EBITDA	158.2	219.7	199.2	214.6	224.1
Depreciation	(84.1)	(73.4)	(82.0)	(86.8)	(92.0)
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	74.1	146.4	117.2	127.8	132.0
Net interest income / (exp)	(3.2)	(0.1)	(5.0)	(6.8)	(7.1)
Associates & JV	0.3	0.0	0.3	0.3	0.3
Exceptionals	0.0	0.0	0.0	0.0	0.0
Other pretax income	0.0	0.0	0.0	0.0	0.0
Pretax profit	71.2	146.3	112.5	121.3	125.3
Income tax	(16.7)	(24.8)	(19.1)	(20.6)	(21.3)
Minorities	0.0	(0.0)	0.0	(0.2)	(0.2)
Perpetual securities	0.0	0.0	0.0	0.0	0.0
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	54.5	121.5	93.3	100.4	103.8
Core net profit	54.5	121.5	93.3	100.4	103.8
Preferred Dividends	0.0	0.0	0.0	0.0	1.0
BALANCE SHEET (SGD m)					
Cash & Short Term Investments	110.9	277.9	354.0	458.8	530.2
Accounts receivable	361.8	452.8	335.3	373.1	383.6
Inventory	142.9	178.5	145.7	183.7	198.9
Property, Plant & Equip (net)	359.6	315.1	323.1	316.3	274.2
Intangible assets	11.8	11.4	11.4	11.4	11.4
Investment in Associates & JVs	2.5	7.0	7.3	7.6	7.9
Other assets	40.4	37.1	42.0	42.0	42.0
Total assets	1,030.1	1,279.9	1,218.7	1,392.8	1,448.2
ST interest bearing debt	95.5	205.2	260.0	260.0	260.0
Accounts payable	247.7	421.4	247.3	353.0	335.8
LT interest bearing debt	0.1	0.0	0.0	0.0	0.0
Other liabilities	108.0	124.0	121.0	121.0	122.0
Total Liabilities	450.8	750.4	628.1	733.9	717.6
Shareholders Equity	578.2	528.5	589.6	657.7	729.2
Minority Interest	1.0	1.0	1.0	1.2	1.4
Total shareholder equity	579.2	529.5	590.5	658.9	730.6
Perpetual securities	0.0	0.0	0.0	0.0	0.0
Total liabilities and equity	1,030.1	1,279.9	1,218.7	1,392.8	1,448.2
CASH FLOW (SGD m)					
Pretax profit	71.2	146.3	112.5	121.3	125.3
Depreciation & amortisation	84.1	73.4	82.0	86.8	92.0
Adj net interest (income)/exp	0.0	0.0	0.0	0.0	1.0
Change in working capital	92.0	54.9	(25.9)	29.9	(42.0)
Cash taxes paid	(12.6)	(18.6)	(19.1)	(20.6)	(21.3)
Other operating cash flow	0.0	0.0	0.0	0.0	1.0
Cash flow from operations	234.4	256.0	149.2	217.1	155.7
Capex	(6.9)	(28.9)	(90.0)	(80.0)	(50.0)
Free cash flow	227.5	227.1	59.2	137.1	105.7
Dividends paid	(5.7)	(172.7)	(32.3)	(32.3)	(32.3)
Equity raised / (purchased)	0.0	0.0	0.0	0.0	0.0
Perpetual securities	0.0	0.0	0.0	0.0	1.0
Change in Debt	(220.7)	109.7	54.8	0.0	0.0
Perpetual securities distribution	0.0	0.0	0.0	0.0	0.0
Other invest/financing cash flow	(31.1)	(2.2)	(5.6)	0.2	0.4
Effect of exch rate changes	(0.1)	5.2	0.0	(0.2)	(0.4)
Net cash flow	(30.1)	167.0	76.0	104.8	74.4

FYE 31 Dec	FY16A	FY17A	FY18E	FY19E	FY20E
Key Ratios					
Growth ratios (%)					
Revenue growth	(4.2)	9.3	0.8	8.3	4.3
EBITDA growth	124.7	38.9	(9.3)	7.7	4.4
EBIT growth	nm	97.4	(19.9)	9.0	3.3
Pretax growth	nm	105.5	(23.1)	7.8	3.3
Reported net profit growth	nm	122.8	(23.2)	7.6	3.3
Core net profit growth	nm	122.8	(23.2)	7.6	3.3
Profitability ratios (%)					
EBITDA margin	12.1	15.4	13.9	13.8	13.8
EBIT margin	5.7	10.3	8.1	8.2	8.1
Pretax profit margin	5.5	10.3	7.8	7.8	7.7
Payout ratio	12.0	166.2	34.6	32.2	31.1
DuPont analysis					
Net profit margin (%)	4.2	8.5	6.5	6.4	6.4
Revenue/Assets (x)	1.3	1.1	1.2	1.1	1.1
Assets/Equity (x)	1.8	2.4	2.1	2.1	2.0
ROAE (%)	9.6	22.0	16.7	16.1	14.8
ROAA (%)	4.6	10.5	7.5	7.7	7.3
Liquidity & Efficiency					
Cash conversion cycle	78.6	50.4	48.3	45.4	44.4
Days receivable outstanding	116.1	102.8	98.6	81.9	83.8
Days inventory outstanding	60.4	48.5	47.3	44.4	49.3
Days payables outstanding	97.9	100.9	97.6	80.9	88.8
Dividend cover (x)	8.4	0.6	2.9	3.1	3.2
Current ratio (x)	1.4	1.2	1.4	1.4	1.6
Leverage & Expense Analysis					
Asset/Liability (x)	2.3	1.7	1.9	1.9	2.0
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Net gearing (%) (excl. perps)	net cash	net cash	net cash	net cash	net cash
Net interest cover (x)	22.9	nm	23.2	18.8	18.7
Debt/EBITDA (x)	0.6	0.9	1.3	1.2	1.2
Capex/revenue (%)	0.5	2.0	6.3	5.1	3.1
Net debt/ (net cash)	(15.3)	(72.7)	(93.9)	(198.7)	(270.2)

Source: Company; Maybank

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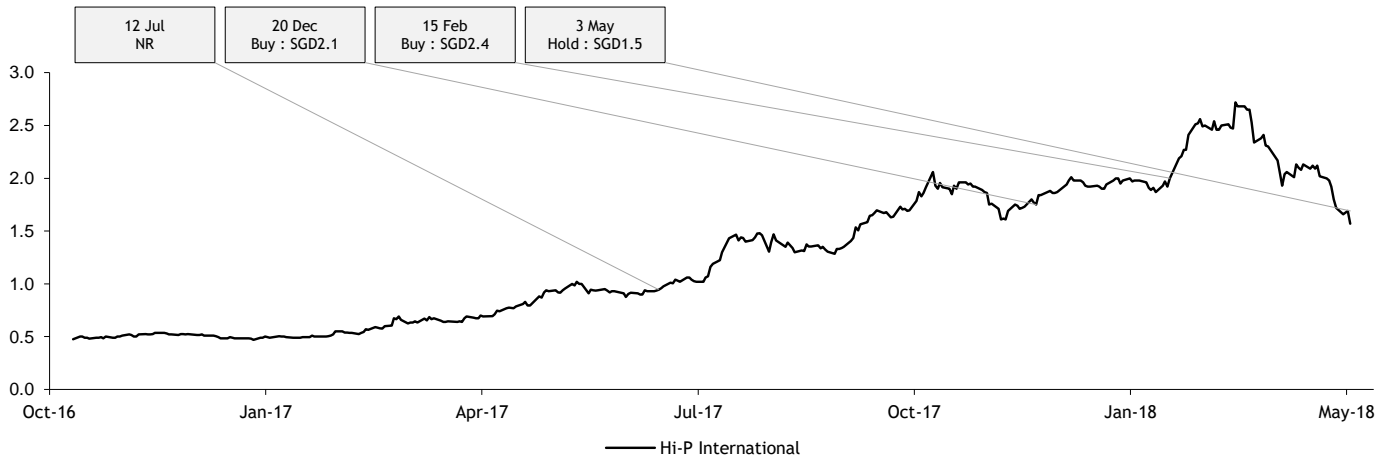
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