17 September 2021

Industrials | Industrial Products

Success Transformer (STC MK)

Not Rated

Lighting Up a Brighter Future

Fair Value (Return):	MYR1.18 (+39%)
Price:	MYR0.85
Market Cap:	USD46.7m
Avg Daily Turnover (MYR/USD)	0.51m/0.12m

- **MYR1.18 FV on 12x FY22F (Jun) fully diluted P/E**. Success Transformer – one of South-East Asia's largest industrial lighting manufacturers – should book a 12% FY21-23F earnings CAGR, supported by: i) Growing global demand for energy-saving and cost-cutting products, and ii) opportunities from local government projects to replace street lamps with light-emitting diode (LED) ones. The development of smart city projects could offer another growth avenue. That said, the stock is trading below the regional peer average P/E of 14x, indicating a potential investment opportunity.
- **Growing need for energy-saving and cost-cutting lighting.** Replacing old street lamp bulbs with LED lights should cut 30-40% of electricity bills, lower energy wastage, and bring about a longer estimated lifespan for the lights (c.100,000 hours vs c.24,000 hours for non-LED). According to data from Grandview Research, the CAGR for the global LED lighting market is estimated at 12.5% for 2021-2028F. As STC's products have MyHIJAU and "*Buatan Malaysia*" (Made in Malaysia) accreditation, this should give it an edge over competitors that are not accredited or rely on imported goods. Aside from the energy-saving and cost-saving benefits, the regulatory policies across the US, EU, China, and Canada are expected help boost the usage of LED products.
- **Local government project to replace street lamps with LED lighting.** Prior to 2019, c.80% of street lights in Malaysia were not LED-based. Assuming only 10% of street lamps will be replaced with LED lighting in the near term, we calculated that about 1.59m LED lamps will be required for both lanes of the road. If STC can secure 40% of this 1.59m total, this could keep the group busy for the next 12 months – without taking into account its overseas sales. We believe the public sector's initiative to replace street lamps with LED lighting may have a domino effect on the private sector – which would further boost the use of LED lighting eventually.
- **Getting involved in smart city initiatives would bring about the next phase of growth.** We gather that smart lighting projects have been fleshed out in some municipalities in Malaysia and other South-East Asian countries, as well as in Europe and the United Arab Emirates (UAE). As STC owns a smart lighting products business and an associated cloud system, it has immediate resources to provide faster after-sales support – which should give it an edge over peers that rely on overseas support. As such, we estimate Intelligent Lighting Control System (iLCS) product sales to grow progressively to account for 10% and 15% of FY22F-23F revenue, assuming that smart city initiatives progress steadily.
- **Risks:** Longer-than-expected delay in government spending, stock obsolescence, and heightened competition.

Forecasts and Valuation	Jun-19	Jun-20	Jun-21F	Jun-22F	Jun-23F
Total turnover (MYRm)	259	223	238	257	273
Recurring net profit (MYRm)	18	4	20	23	25
Recurring net profit growth (%)	(21.6)	(77.0)	386.7	16.0	8.5
Recurring P/E (x)	11.36	48.93	9.87	8.51	7.84
P/B (x)	0.6	0.6	0.6	0.6	0.5
P/CF (x)	8.50	6.03	4.62	8.31	6.95
Dividend Yield (%)	1.2	6.8	2.4	2.9	3.5
EV/EBITDA (x)	4.31	3.75	2.04	1.57	1.19
Return on average equity (%)	5.6	3.2	6.2	6.9	7.1
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash

Source: Company data, RHB

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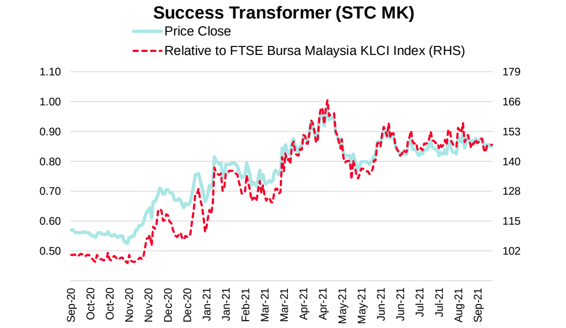
Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	12.6	2.4	(5.0)	12.6	49.1
Relative	17.0	(0.9)	(3.3)	16.7	47.5
52-wk Price low/high (MYR)					0.53 – 0.99



Source: Bloomberg

Note:
Small cap stocks are defined as companies with a market capitalisation of less than USD1bn.

Financial Exhibits

Asia
Malaysia
Industrials
Success Transformer
STC MK
Not Rated

Valuation basis

12x FY22F fully diluted P/E

Key drivers

i. Growing need for energy-saving and cost-cutting lighting;
ii. Local government projects to replace street lamps with LED lighting;
iii. Potential to be involved in smart city initiatives.

Key risks

Downside risks are:
i. Longer-than-expected delays in government spending;
ii. Obsolescence of stock;
iii. Intensifying competition

The reverse of such circumstances would present upside risks.

Company Profile

Success Transformer is principally engaged in the design, manufacturing and distribution of electrical apparatus and industrial lighting. It has a range of brands under original design manufacturing and own brand model, which include industrial lighting products (NIKKON, LIKO) and electrical apparatus (QPS, SES, and SUPER-LITE).

Financial summary (MYR)	Jun-19	Jun-20	Jun-21F	Jun-22F	Jun-23F
Recurring EPS	0.07	0.02	0.09	0.10	0.11
DPS	0.01	0.06	0.02	0.02	0.03
BVPS	1.36	1.35	1.41	1.48	1.56
Return on average equity (%)	5.6	3.2	6.2	6.9	7.1

Valuation metrics	Jun-19	Jun-20	Jun-21F	Jun-22F	Jun-23F
Recurring P/E (x)	11.36	48.93	9.87	8.51	7.84
P/B (x)	0.6	0.6	0.6	0.6	0.5
FCF Yield (%)	7.9	14.0	18.5	9.0	10.8
Dividend Yield (%)	1.2	6.8	2.4	2.9	3.5
EV/EBITDA (x)	4.31	3.75	2.04	1.57	1.19
EV/EBIT (x)	6.00	5.81	2.65	1.99	1.50

Income statement (MYRm)	Jun-19	Jun-20	Jun-21F	Jun-22F	Jun-23F
Total turnover	259	223	238	257	273
Gross profit	83	62	68	79	86
EBITDA	39	29	37	42	46
Depreciation and amortisation	(11)	(10)	(9)	(9)	(9)
Operating profit	28	19	29	33	36
Net interest	0	1	1	1	1
Pre-tax profit	28	18	30	35	38
Taxation	(7)	(5)	(7)	(8)	(9)
Reported net profit	18	10	20	23	25
Recurring net profit	18	4	20	23	25

Cash flow (MYRm)	Jun-19	Jun-20	Jun-21F	Jun-22F	Jun-23F
Change in working capital	(1.4)	23.8	16.6	(10.5)	(8.4)
Cash flow from operations	23.5	32.9	42.1	23.4	28.0
Capex	(7.7)	(5.2)	(6.0)	(6.0)	(7.0)
Cash flow from investing activities	(7.5)	21.8	(6.6)	(6.0)	(7.0)
Dividends paid	(2.4)	(13.4)	(4.6)	(5.7)	(6.9)
Cash flow from financing activities	(8.8)	(24.7)	(3.4)	(5.8)	(5.9)
Cash at beginning of period	47.3	54.4	84.7	116.7	128.3
Net change in cash	7.2	30.0	32.1	11.6	15.1
Ending balance cash	54.4	84.7	116.8	128.3	143.4

Balance sheet (MYRm)	Jun-19	Jun-20	Jun-21F	Jun-22F	Jun-23F
Total cash and equivalents	54	85	117	128	143
Tangible fixed assets	112	67	64	61	59
Total investments	46	30	29	29	29
Total assets	448	374	381	401	423
Short-term debt	27	2	1	0	0
Total long-term debt	15	2	1	1	0
Total liabilities	99	37	33	33	34
Total equity	349	336	347	368	390
Total liabilities & equity	448	374	381	401	423

Key metrics	Jun-19	Jun-20	Jun-21F	Jun-22F	Jun-23F
Revenue growth (%)	(20.6)	(13.9)	6.6	8.2	6.1
Recurrent EPS growth (%)	(21.5)	(76.8)	395.9	16.0	8.5
Gross margin (%)	32.0	28.0	28.7	30.8	31.5
Operating EBITDA margin (%)	15.1	13.0	15.7	16.5	16.7
Net profit margin (%)	6.8	4.6	8.3	8.9	9.1
Dividend payout ratio (%)	13.4	131.1	23.2	25.0	27.7
Capex/sales (%)	3.0	2.3	2.5	2.3	2.6
Interest cover (x)	46.1	38.4	336.0	648.2	1,819.4

Source: Company data, RHB

Lighting Up a Brighter Future

One of the largest industrial lighting manufacturers in South-East Asia

STC is principally engaged in the design, manufacturing and distribution of electrical apparatus and industrial lighting. Besides supplying to the local market, it also exports to over 40 countries – including those in Europe, the UAE, South Africa, Korea, and in South-East Asia. Overall, overseas sales accounted for about 51% of FY20 revenue.

Post completion of disposal of its entire 65% equity interest in a loss-making process equipment subsidiary in FY20, we believe STC is now able to fully focus on and unlock value from its existing transformer and industrial lighting business.

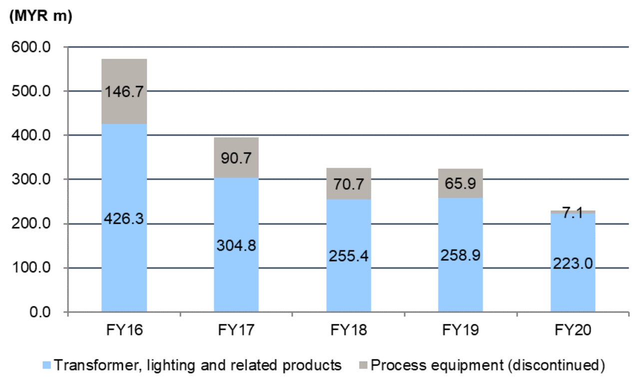
It has been established for over 30 years, and offers a range of brands under its own design manufacturing (ODM) and own brand model (OBM), which include industrial lighting products (NIKKON, LIKO) and electrical apparatus (QPS, SES, and SUPER-LITE). Based on a rough estimate, NIKKON products contribute about 60-70% of total revenue, followed by QPS (c.30%). The remainder comes from sales of its iLCS products.

The group remains active in R&D, to come out with innovative products to remain competitive. Based on historical trends, we expect R&D expenses to still be equivalent of c.3% of total revenue.

Figure 1: Some of the products under the NIKKON, QPS and iLCS brands

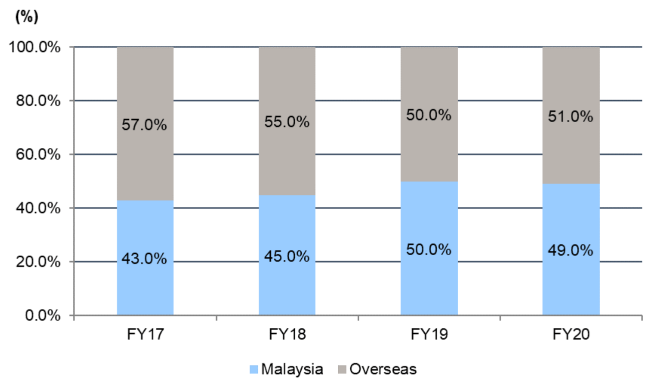
Source: Company data

Figure 2: Revenue by business segment (including discontinued businesses)



Source: Company data

Figure 3: Transformer and lighting segment revenue by geographical location



Source: Company data

Growing need for energy-saving and cost-cutting lighting

NIKKON is the flagship brand of its lighting division. Its LED range of industrial lighting products includes floodlights, streetlights, and high bay lights. Under NIKKON, the intelligent lighting solution allows remote control and monitoring of the outdoor lighting system. The illumination pattern can be adjusted over time, which helps to reduce energy consumption – thereby helping to save on the municipal budget while also being more environmentally friendly.

While the upfront replacement cost of the street lamp bulbs, from high pressure sodium-vapour (HPSV) lamps into LED, appears to be high (we estimate the LED price to be at least double that of HPSV lamps, based on market prices currently available), the benefit of LED streetlights still outweighs the cost – as it is able to provide a reduction of c.30-40% in electricity bills, pare down energy wastage (c.5% of electricity is lost as heat, vs c.80% for HPSV lamps), and offers longer estimated lifespans (c.100,000 hours as compared to c.24,000 hours for HPSV lamps). We gather that there are still HPSV lights available in the market, and these require more maintenance than LED lights.

Meanwhile, reducing electricity consumption will help cut down on carbon emissions, which is in line with the national direction. In Dec 2020, The Edge Weekly reported that the Nationally Determined Contributions (NDC) target for Malaysia is to achieve a 45% improvement in greenhouse gas emission intensity per unit of GDP by 2030.

Operationally, STC has adhered to various local accreditation requirements – Standard and Industrial Research Institute of Malaysia (SIRIM) and MyHIJAU. The MyHIJAU Mark is a consolidation of regional and international green certifications that indicates compliance with global environmental standards. As its products are produced locally and accredited as “Buatan Malaysia”, this gives it a competitive edge over other companies that may rely on imports in supplying to government projects.

According to a Grandview Research report, the CAGR for the global LED lighting market is expected to be 12.5% from 2021 to 2028. Aside from energy-saving and cost-saving benefits, the regulatory policies across the US, EU, China and Canada are expected to boost the adoption of LED products globally.

Prior to the imposition of travel restrictions, STC held various events and participated in exhibitions to promote its products. Having said that, the group has adapted to pandemic conditions by marketing through digital platforms – its own company website and via a social media platform (Facebook) to promote brand awareness, as well as attract, maintain and expand its customer base. Given the extensive customer network worldwide, we believe demand for STC products should continue to grow, as global economic activities adapt to the new norm, and speed up replacement activity.

Local government project to replace street lamps with LED lighting

In 2019, c.80% of the street lights in Malaysia were not LED-based. In 2019, The Star reported that the Government is looking at the option of lighting all roads across the country with LED lamps. In separate article, The Star also reported that all street lighting in Penang will use LED by 2022. Among the 105,813 street lights in Penang, 31,596 lights are maintained by local councils, and the balance is managed by Tenaga Nasional (TNB MK, BUY, TP: MYR12.49). As it is expected to cost c.MYR75m to replace the lights maintained by local councils, the LED lights per unit is estimated at an average MYR2,374 per unit.

While we do not have access to official data on the total number of street lamps nationwide, we arrived at our assumptions based on the length of paved roads in Malaysia. We have excluded earth and gravel roads from our estimation. According to data.gov.my, the total length of paved roads in 2019 under federal and state governments are 19,952km and 170,406km. Based on channel checks, the length of the light pole could vary between 4.5m to 12m, while spacing between two light poles is estimated at 2.5x to 3x the height of the pole.

For ease of calculation, we assume a light pole is required for every 24m on the paved road, based on the assumption of a standard height of 8m for narrow streets in residential and commercial areas, with spacing between light poles set at 3x of the pole height. Assuming only 10% of street lamps will be replaced with LED lighting in the near term, we worked this out to c.1.59m LED required for both lanes of the road. Based on an illustrative ASP of MYR2,000 per unit, this could bring in MYR3.17bn of revenue to the market.

Currently, STC has the capacity to produce up to 50,000 lighting units per month. Assuming the group manages to secure 40% of the illustrated c.1.59m LED above, this alone could keep the group busy for the next 12 months, without taking into account any sales to overseas markets.

In our opinion, given the importance of cost management and the greater emphasis on environmental aspects, we believe the public sector's headstart in replacing street lamps with LED lighting may have a domino effect on the private sector – which will eventually further boost the adoption of LED lighting nationwide. While LED lighting makes up c.70% of lighting segment revenue for now (remaining 30% is from High Intensity Discharge (HID) lighting), we expect demand for LED lighting to continue to grow, given the growing emphasis on environmentally friendly products. As the pandemic has dragged construction activities in FY21, we are looking at a progressive installation of LED for street lighting subsequently. Overall, we are looking at FY21F-23F revenue and PAT CAGRs of 7% and 12%.

Potential for smart city project as the next phase of growth

The iLCS is a smart lighting security system by NIKKON, that allows municipalities, city planners and operators to control and monitor lights either individually or in groups, from a computer or smartphone. Based on data collected via the system, this is expected to help address public safety and assist local municipalities in handling issues such as broken streetlights and traffic congestion.

We gather that a iLCS product – TRIMAX – has plug-and-play global positioning system (GPS) mapping features, and is able to incorporate other applications into it, such as public WiFi, telecommunication network coverage, audio announcements, fire and rescue siren alarms, environmental data and occupancy detection.

According to Malaysian Communications and Multimedia Commission, the smart community initiative was launched in Kemaman, Terengganu (in 2015), Kota Belud, Sabah (in 2016), Lundu, Sarawak (in 2016), Putrajaya (in 2016) and Langkawi (in 2017). The smart communities are expected to help the migration towards the development of smart cities – since the upgrading of communication infrastructure is expected to promote ICT usage within the community.

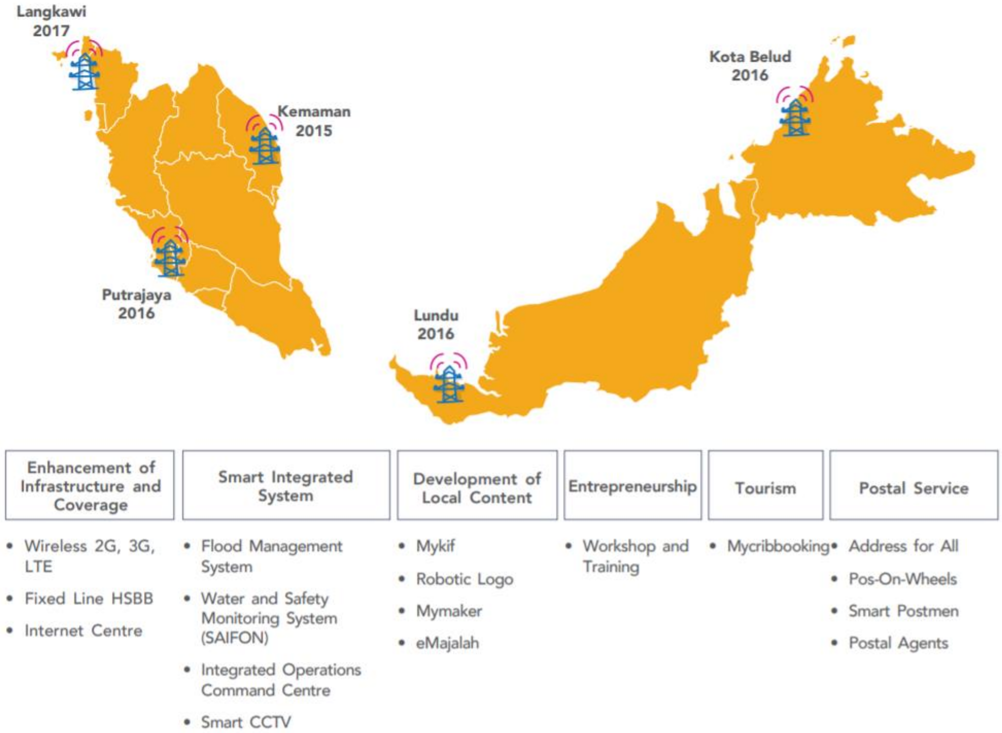
To the best of our knowledge, STC is the first local company to enter smart lighting projects with its in-house brand and products in Malaysia. Smart lighting has been implemented by municipal councils in Malaysia – Smart Johor Bahru, Smart Ipoh and Smart Cyberjaya. Its products have also reached other countries in South-East Asia, the EU and UAE – as a part of street lighting systems, traffic control systems, and car parking management systems.

While iLCS contributes <10% of total revenue for now, we believe the adoption of iLCS could grow as the adoption of Internet of Things (IoT) and conversion of smart cities increases. Given that STC owns both of the smart lighting products and cloud system, it has a readily available local team and resources to provide after-sales support. We believe this will give it a competitive advantage over peers that rely on overseas support.

As such, we estimate iLCS's revenue contributions to grow progressively to account for 10% and 15% of FY22F-23F group turnover – assuming that smart city initiatives resume progressively. This is achievable, given that there are many smart city projects that are yet to be tapped into.

Additionally, demand for data centres tend to increase in line with the higher adoption of IoT. This, in turn will lead to higher demand for transformers, which is important in stepping down electrical distribution from a higher input voltage to lower output voltage. As more data centres and Industrial 4.0 projects are being implemented, we believe this could be fulfilled by QPS, which has an established brand name and offers a comprehensive range of low-voltage transformers in the market. Depending on the scale and speed in building smart cities, the revenue growth in both transformers and iLCS could be significant for the group.

Figure 4: Smart Community Initiative flagship programmes



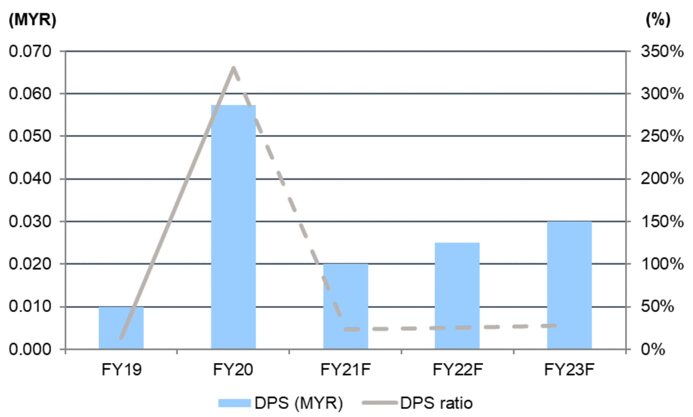
Source: MCMC Annual Report 2018

Solid financials enable STC to weather through challenges

FY20 core PAT of MYR4.05m was derived after stripping off a gain from the disposal of its process equipment subsidiary, as well as insurance compensation. The significant decline in PAT was mainly attributable to lower revenue from the transformer and lighting segment – dragged down by slower market demand (domestically and overseas) and the imposition of the MCO. While 1HFY21 PAT improved significantly due to higher transformer and lighting sales, the group's sales and profitability were affected by the imposition of MCO 2.0 in 3QFY21. As the FMCO was imposed in 4QFY21, affecting factory operations, we gather that there are still some backlog orders that can be fulfilled in 2QFY22.

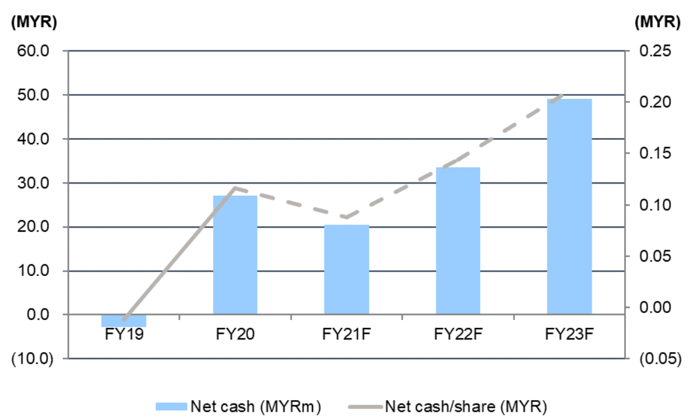
Financially, STC's cash pile has grown since FY20, mainly due to the disposal of its process equipment business. The group remains committed to giving dividends to reward shareholders – but there is no payout policy in place. Given that it has net cash of c.MYR117m, which is equivalent to c.60% of its market cap, we assume FY21F-23F DPS at MYR0.02-MYR0.03, implying yields of 2-4%.

Figure 5: Historical and forecasted dividends



Source: Company data, RHB

Figure 6: Historical and forecasted net cash position



Source: Company data, RHB

Valuation

Our fair value of MYR1.18 is based on 12x FY22F fully diluted P/E, at +0.5x from its 2-year historical mean. This is premised on:

i. Increasing focus on the demand for energy-saving and cost-cutting lighting products globally;

ii. Potential opportunities from street lamps being replaced by LED lighting (from local governments);

iii. The adoption of IoT and set-up of smart cities could buoy demand for iLCS products, as smart city initiatives resume progressively. Given that there are many smart city projects yet to be tapped into, we think this segment could drive the next phase of growth;

iv. STC's loss-making process equipment business, which previously contributed c.20%-25% of total revenue, was only hived off in early FY20. As such, our valuation takes into account its business operation post disposal. We expect better focus and value creation from its core transformer and lighting business moving forward.

The stock is trading at a FY22F P/E of 9x, lower than Bursa Malaysia Industrial Production Index's 14x and the regional peer average forward P/E of 14x. While its closest listed peer, IQ Group (IQGH MK, NR) is trading at 57x P/E, the business is more skewed towards motion sensors, sensor lighting, and wireless door entry, instead of industrial lighting. We gather that its local peers are non-listed entities, among which Signify Malaysia (who manages the Philips brand in the country) is the closest peer, for its industrial lighting business.

Given the potential FY21F-23F earnings CAGR of 12% and backed by sturdy financials, we think our valuation is justifiable.

Figure 7: Peer comparison

Company	FYE	Price 15 Sep 2021 (MYR)	Mkt cap (MYRm)	P/E (x)		Div. Yld (%)	ROE (%)	P/BV (x)	NP growth (%)	
				1-yr fwd	2-yr fwd	1-yr fwd	1-yr fwd	1-yr fwd	1-yr fwd	2-yr fwd
Regional										
Acuity Brands	Aug	USD169.15	USD6,040	17.2	16.6	0.3	16.5	3.0	41.4	3.4
Signify Nv	Dec	EUR44.44	USD6,745	11.6	10.9	3.6	22.6	2.5	57.0	6.1
Seoul Semiconductor Co	Dec	KRW16100	USD804	15.6	14.0	2.1	8.4	1.3	241.4	11.8
Weighted average				**14.3**	**13.6**	**2.0**	**19.1**	**2.6**		
Success Transformer Corp	Jun	0.85	195	9.9	8.5	2.4	6.2	0.6	386.7	16.0

Source: Bloomberg, RHB

Recommendation Chart

Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2021-09-15			

Source: RHB, Bloomberg

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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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