

24 February 2023

Industrial | Industrial Products

Cape EMS (CEB MK)

Available Capacity For More Orders

- **MYR1.14 FV, based on 18x FY23F P/E.** Cape EMS intends to raise MYR155.7m from its IPO, to primarily fund its capacity expansion and working capital expenses. It is well-positioned to benefit from the US-China trade diversion and growth in demand for electronic manufacturing services (EMS). CEB's 3-year earnings CAGR of 43.7% (FY21-24) should be driven by its strong orderbook (cover ratio: 1x), high order enquiries from existing and new customers, capacity expansion, and strong ties with customers.
- **Exposure to different sectors through two channels.** CEB serves customers in industrial and consumer electronics – these two markets constitute an overall larger addressable market that enables it to sustain and grow despite the unfavourable business conditions in one industry. CEB has also adopted direct and indirect distribution channel strategies to optimise its market access and coverage.
- **Available capacity for business expansion.** CEB is able to provide its customers customised EMS and dedicated manufacturing areas, including dedicated space (floor space for its EMS operations total 332.8k sq ft), tools and equipment (34 EMS operations lines and 13 die casting lines). Its ability to provide capacity – 9MFY22 utilisation rate stands at ~58.6% – could attract new customers. After its expansion plans are funded by IPO proceeds, CEB will: i) Add 10 new aluminium die cast production lines, ii) increase its EMS operation floor space by ~40%, ii) expand EMS production lines for e-cigarettes by 133%, as well as ii) add one more cleanroom to its facility. The availability of capacity helps Cape EMS better meet customer demand in production volume – especially for higher-volume output – within a short period of time.
- **Strong unbilled purchase order.** As at 4 Jan, CEB has a total unbilled purchase order of MYR358.7m, of which 93.5% represents industrial electronic products. The group has also received a letter of award from two new EMS customers, after undergoing a qualifying process with them. For this first new customer, CEB expects to complete the first sample finished products (thermal energy devices) by March, and anticipates mass production to commence by 2Q. For the second customer, it is now carrying out the pilot production run. CEB is also adding another four lines for its high-margin consumer products – e-cigarettes for the refill pods, as requested by Customer A.
- **Earnings forecast and valuation.** We project a 3-year earnings CAGR of 43.7%, and ascribe a P/E of 18x to its FY23F earnings to derive our FV of MYR1.14. The valuation is in line with its closest peers – Aurelius Technologies (ATECH) and PIE Industrial (PIE), which are trading at 2-year consensus forward P/Es of 17-22x. They deserve higher valuations, due to the nature of their industrial-oriented businesses, which are regarded as more recession-proof vs consumer-oriented EMS. Key downside risks: Global supply chain disruptions, over-dependence on major customers, softening demand in customers' end-user markets and intensifying competition.

Forecasts and Key Data	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Total turnover (MYRm)	168	344	428	627	811
Recurring net profit (MYRm)	20	26	32	58	78
Recurring net profit growth (%)	429.9	29.8	23.5	80.3	32.5
Recurring EPS (MYR)	0.02	0.03	0.04	0.06	0.08
Recurring P/E (x)	41.1	31.6	25.6	14.2	10.7
P/BV (x)	10.2	4.9	2.4	2.2	1.9
P/CF (x)	-424.4	25.1	18.3	25.4	12.9
Dividend yield (%)	0.0%	0.0%	1.2%	2.1%	2.8%
EV/EBITDA (x)	31.1	24.3	14.0	9.4	7.2
ROE (%)	39.5	20.9	9.3	13.0	19.0
Net debt to equity (%)	Net Cash	0.1	Net Cash	Net Cash	Net Cash

Source: Company data, RHB

Fair Value (Return):	MYR1.14 (+27%)
IPO Price:	MYR0.90
Closing Application Date:	24 Feb 2023
Indicative Listing Date	10 Mar 2023

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Company Description

Cape EMS is principally involved in electronics manufacturing services for consumer and industrial electronics products. It is also involved in aluminium die casting and the supply of electronic products.

IPO Details

Public Issue of new shares (m)	173.0
Offer for sale (m)	86.7
Shares outstanding (m)	923.0
Implied market cap	MYR830.7m

Major Shareholders (%)

Tee Kim Chin	40.6
Tee Kim Yok	13.8
Fortress Capital	16.6

Utilisation of IPO Proceeds

	MYRm
Setting-up of new cleanroom facility	62.8
Construction of New Senai 226 Warehouse	53.1
Working capital	20.5
Estimated listing expenses	11.0
Purchase of new machinery and equipment for die cast manufacturing	4.6
Installation of energy saving cooling system	3.7
TOTAL	155.7

Additional Data

Listing Market	MAIN
Bursa Code	5311

Note:

Small cap stocks are defined as companies with a market capitalisation of less than USD0.5bn.

Financial Overview And Valuation

9MFY22 results review. 9M22 revenue rose 31.3% YoY, mainly attributed to the increase in revenue from the provision of EMS for industrial (+28% YoY) and consumer electronic products (+618.2% YoY). The incremental revenue from industrial electronic products is largely attributable to:

- i. Higher sales of point-of-sale (POS) terminals to Tastar Electronics;
- ii. The commencement of EMS for light-emitting diode (LED) lighting products;
- iii. The fulfilment of higher orders for digital vending machines.

Meanwhile, surge in its consumer electronic products revenue was mainly due to the commencement of mass production of electronic cigarettes.

Following the revenue growth, gross profit increased by 48.7% YoY while GPM increased from 11.5% in 9M21 to 13% in 9M22. The higher GPM was mainly due to contributions from high-margin consumer electronic products, ie electronic cigarettes.

In tandem with the higher revenue and gross profit, its core earnings grew 20.6% from MYR19.9m in 9M21 to MYR24.6m in 9M22. However, the core earnings margin dropped from 8.2% to 7.7%, largely on higher finance costs and a steeper tax rate.

Forecasts. With its strong unbilled purchase orders of MYR358.7m to be recognised in FY23, as well as new capacity for existing and new customers, we forecast a 3-year earnings CAGR of 43.7%, as the group continues to receive inquiries from customers and carry out new product development with customers.

Valuation. As we peg the stock to a target P/E of 18x based on its FY23F earnings, we arrive at a FV of MYR1.14. We also applied a 30% premium to its valuation from the 2-year consensus forward P/E of its local peers – 13.5x – due to its exponential earnings growth and industrial-focused business. This valuation is also in line with the 2-year forward P/Es of its closest peers, PIE and ATECH, which have 17-22x 2-year forward P/Es. These two counters have higher valuations than other EMS players as they provide EMS mostly for industrial electronic products, which are more recession-proof, on top of having diverse customer bases.

Dividends and balance sheet. The group has a dividend payout policy of 30% of its PAT which translates to dividend yields of 1.9% and 2.5% in FY23F and FY24F. CEB has a healthy balance sheet, with net cash per share of 18 sen post IPO.

Figure 1: Peer comparison

Company	Country	FYE	Mkt Cap (USDm)	Price		P/E (x)		Div. Yld (%)	ROE (%)	EV/ EBITDA	NP Growth (%)		PEG
				23-Feb-23		1 Yr Fwd	2 Yr Fwd	1 Yr Fwd	1 Yr Fwd	1 Yr Fwd	1 Yr Fwd	2 Yr Fwd	
				(Local Currency)	Actual	1 Yr Fwd	2 Yr Fwd	1 Yr Fwd	1 Yr Fwd	1 Yr Fwd	1 Yr Fwd	2 Yr Fwd	
Local Peers													
VS Industry	MY	07/2023	776.6	0.90	19.8	13.5	11.1	3.2	10.6	8.6	47.1	20.8	0.5
SKP Resources	MY	03/2023	514.5	1.46	12.4	12.8	10.8	4.0	21.8	8.2	-3.1	18.0	0.6
PIE Industrial	MY	12/2022	271.1	3.13	18.6	20.0	17.0	2.2	11.9	12.2	-6.9	17.4	1.0
Aurelius Technologies	MY	01/2023	287.0	3.23	54.2	33.1	21.9	0.7	18.6	26.0	63.4	51.5	0.4
JHM Consolidation	MY	12/2022	107.3	0.79	12.9	24.9	11.4	0.4	7.6	9.7	-48.1	118.8	0.1
Mkt. Cap Weighted Avg.			529.1		22.3	17.7	13.5	2.8	14.8	11.6	23.6	29.5	0.6
Simple Avg.			391.3		23.6	20.9	14.5	2.1	14.1	12.9	10.5	45.3	0.5
International Peers													
Jabil	US	08/2023	11019.2	82.68	11.1	9.7	9.3	0.3	46.3	4.9	13.9	4.4	2.1
Plexus	US	09/2023	2697.9	97.39	19.5	17.1	14.6		14.4	10.0	13.8	17.1	0.9
Flex	US	03/2023	10451.5	23.17	11.2	9.9	9.5	0.0	25.1	6.5	13.0	3.6	2.7
Sanmina	US	09/2023	3572.1	61.21	13.9	9.4	8.1	0.0	20.5	5.0	49.1	15.7	0.5
Venture Corp	SG	12/2022	3978.0	18.30	17.1	14.4	13.9	4.3	13.5	9.6	19.2	3.7	3.8
Benchmark Electronics	US	12/2023	853.0	24.25	12.5	11.4	9.8		7.3	0.0	10.0	15.5	0.6
Celestica	CA	12/2023	1577.6	12.95	10.8	6.4	5.9	0.0	14.7	3.9	69.5	7.9	0.7
Mkt. Cap Weighted Avg.			3344.4		15.7	12.8	11.2	0.9	16.3	6.7	26.7	13.6	1.2
Simple Avg.			4878.5		13.7	11.2	10.2	0.9	20.3	5.7	26.9	9.7	1.6

Source: Bloomberg, RHB

Company Overview

Cape EMS is an EMS provider offering a range of contract manufacturing services for end-to-end manufacturing services. These entail parts and components sourcing and procurement, production, assembly, testing, packaging up to direct shipment fulfilment. Its manufacturing contracts are typically turnkey ones, to provide complete box build products. The typical lead time from receipt of purchase order to completing the box build assembly process is 3-6 months.

The group's divisions comprise the following.

Provision of EMS (88.3% of FY21 revenue)

CEB provides EMS for complete box build products for the following industrial and consumer electronic products:

Industrial electronic products

- Wireless communication equipment including point-to-point/point-to-multiple-point antenna devices, interface and gateway devices, and microwave antenna devices;
- Smart utility data collection equipment including gateway devices, repeaters, remote readers and transceivers, as well as temperature monitoring device;
- POS terminals;
- Others including LED lighting products, digital vending machines and portable printer power desks.

Figure 2: CEB's industrial electronic products



Source: Company

Consumer electronic products

- i. Household appliances, mainly cordless vacuum cleaners;
- ii. Electronic cigarettes including pod-based electronic cigarettes which contain devices and refill pods, as well as disposable cigarette sticks.

Figure 3: Consumer electronic products

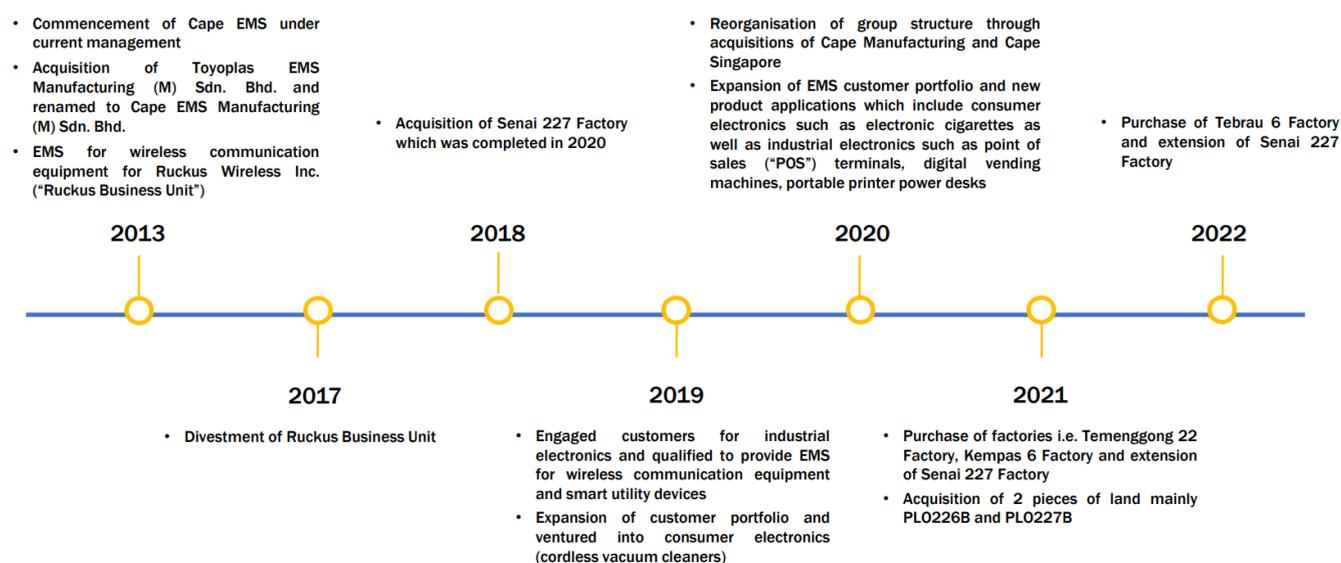


Source: Company

Supporting services (11.7% of FY21 revenue)

The group carries out supporting services for its EMS operations where it has in-house aluminium die cast manufacturing, as well as sourcing and procurement of parts and components for its box build consumer and industrial electronic products.

Figure 4: Key milestones



Source: Company data

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CEB principally operates in Malaysia, to serve customers in Malaysia and foreign countries. Its US customers account for a major part of revenue. Export sales to the US were mainly derived from the provision of EMS for industrial electronic products comprising wireless communication equipment, smart utility data collection equipment and consumer electronic products namely electronic cigarettes. This is followed by increasing contributions from export sales to Singapore, which was mainly contributed by its provision of EMS for POS terminals and household appliances to customers in Singapore, namely Tastar Electronics and K & Q on behalf of the brand owners from Hong Kong and China, namely BBPOS and Midea America Corp.

Figure 5: Top customers (FY21)

	Products	% of FY21 total revenue	Length of relationship (years)
Airspan group of companies	Wireless communication equipment	22.7	4
K & Q	Household appliances	14.3	4
Customer A	Electronic cigarettes	12.3	3
Testar Electronics	POS terminals	18.3	3
SOQ and NextCentury	Smart utility data collection equipment	18.3	3

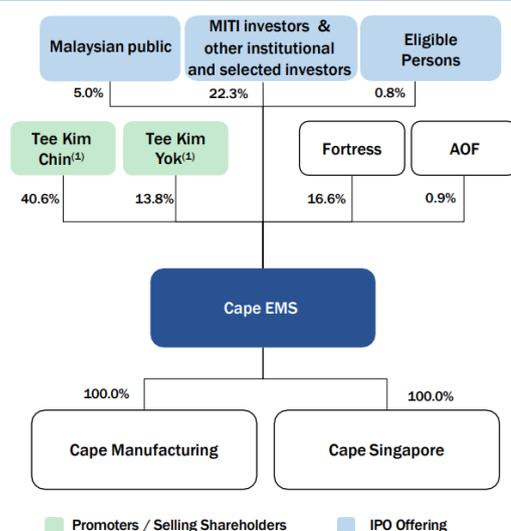
Source: Company data, RHB

Figure 6: Top suppliers (FY21)

	Main product categories	Total purchases (MYRm)	% of purchases	Length of relationship (years)
BM Nagano	PCBA	54.2	21.2	7
Tastar Electronics	Components for POS terminals	53.6	21.0	2
SOQ	Components for smart utility data collection equipment	31.3	12.3	2
Changhuat Plastic	Plastic parts	27.0	10.6	4
Jiangsu Midea	Components for household appliances	24.5	9.6	2

Source: Company data, RHB

CEB is led by an experienced management team. Managing Director/Group CEO Tee Kim Chin is responsible for the overall strategy and corporate direction of the group. Tan Zong Yuan, the group's CFO, heads the accounting and finance department and is responsible for duties like financial planning and review, cash flow management and financial reporting. They are supported by the rest of the senior management team, who are experienced in their respective fields.

Figure 7: Group structure post IPO

Source: Company data, RHB

Future Plans And Strategies

Setting up Tebrau 6 Factory for aluminium die cast manufacturing. In Feb 2022, the group entered into a conditional sale and purchase agreement to acquire a new production facility for a consideration of MYR16.8m – the Tebrau 6 Factory, in order to incorporate its new aluminium die cast facilities. On 29 Sep 2022, its subsidiary Cape Manufacturing presented the relevant documents to Johor Bahru Land Office to register itself as a lessee, and to register a charge in favour of Ambank Islamic. On 30 Sep 2022, Cape Manufacturing paid the balance purchase consideration of MYR15.1m to Venice Tulip.

CEB plans to purchase and install 10 new production lines comprising furnaces and die casting machines which are expected to be installed progressively. Installation is set to begin in 1Q23 and be completed the next quarter. It also aims to purchase related machinery and equipment such as nine units of robotic pick and spray equipment, two computer numerical control (CNC) lathe machines and three rotary screw air compressors, and complete the installation of such by 2Q23. The total cost for setting up Tebrau 6 Factory (including its acquisition, renovation, purchase and installation of aluminium die cast production lines and related machinery and equipment) is estimated at MYR39.7m and will be funded through internally generated funds and/or bank borrowings as well as IPO proceeds. Upon completion of the installation of the 10 production lines by 2Q23, the group will commence the aluminium die cast manufacturing operations at this facility.

Figure 8: Aluminium die casting equipment



Source: Company, RHB

Construction of New Senai 226 Warehouse and installation of automated storage facilities. CEB also plans to construct this warehouse on its existing vacant land, PLO 226B adjacent to its Senai 227 Factory in Johor which was acquired in 2021. The warehouse will have a total built-up area of approximately 167k sq ft, which is to mainly house the finished goods for its EMS operations. Currently, its Senai 227 factory stores both its finished goods for its EMS operations and input materials. The group plans to enhance its operational facilities by installing automated storage facilities, to enable it to automate the management, storage and retrieval of goods in its warehouse.

The total cost for the construction of the New Senai 226 Warehouse and setting-up of the automated storage facilities is estimated at c.MYR53.1m and will be fully funded by IPO proceeds. The warehouse, including installation of the first phase of automated storage facilities, is expected to be completed and commence operations by 3Q26, while the installation of the second phase is expected to be completed and commence operations by 1Q27.

New production facilities for EMS operations. The group intends to further expand its production facilities and invest in four new automated production lines for refill pods at the Senai 227 Factory to accommodate the expected expansion of its EMS for electronic cigarettes. With the new production lines, its expected capacity will increase by approximately 133% to 7.7m pieces per month by end-2024, compared to 3.3m pieces per month presently. The group has two cleanrooms as set out below:

- i. An ISO Class 8 cleanroom that houses eight automated production lines and two automated blister packaging lines for the refill pods;
- ii. An ISO Class 8 cleanroom that houses one production line for disposable cigarette sticks.

The group plans to set up a new cleanroom at Senai 227 Factory. This will be a new ISO Class 8 cleanroom designed to be an enclosed zone where airborne particles and pollutants are maintained at specific parameters that are the maximum allowable concentration of particles inside the room. The total cost for the new automated production facilities builds in four new automated production lines and the setting-up of the new cleanroom facility, and the purchase and installation of the related equipment for Senai 227 Factory – at an estimated MYR66.5m. This sum will be fully funded by CEB's IPO proceeds. The new automated production facilities are expected to be completed by 4Q24.

Figure 9: Senai 227 Factory interior and location



Source: Company, RHB

Additional factory floor space for EMS operations. Part of its plans is to expand its factory floor space via the New PLO 227B Factory to accommodate business expansion for its existing as well as potential customers. Its factory floor space for EMS operations will increase to 463k sq ft by 2H23. On 19 Sep 2022, Cape Manufacturing obtained a conditional letter of approval from the Ministry of International Trade and Industry (MITI) to undertake EMS operations in Kempas 6 Factory. Thereafter, Cape Manufacturing submitted the relevant documents to Malaysian Investment Development Authority (MIDA) for MITI to proceed with the issuance of the manufacturing license. Cape Manufacturing has received a written response from MIDA that it can commence manufacturing operations when the license application is approved – which it kicked off on 22 Sep 2022.

CEB expects to commence the leasing of the New PLO 227B Factory and begin EMS operations at said factory in 2H23. There is no capital expenditure for the construction of the New PLO 227B Factory, as this arrangement is under the proposed sale, build and leaseback agreement.

IPO Details

Figure 10: Indicative IPO timeline

Opening of the institutional offering	16 Feb 2023
Issuance of the prospectus/opening of the retail offering	10:00 am, 16 Feb 2023
Closing of the retail offering	5:00 pm, 24 Feb 2023
Closing of the institutional offering	27 Feb 2023
Price determination date	27 Feb 2023
Balloting of applications for the issued shares under the retail offering	1 Mar 2023
Allotment/transfer of the IPO shares to successful applicants	8 Mar 2023
Listing	10 Mar 2023

Source: Company data, RHB

Figure 11: Utilisation of IPO proceeds

	Estimated timeframe	MYRm	% of proceeds
Construction of New Senai 226 Warehouse and installation of automated storage facilities	Within 48 months	53.1	34.1
Setting-up of new cleanroom facility and purchase of new automated production lines for EMS operations	Within 24 months	62.8	40.3
Installation of energy saving cooling system	Within 24 months	3.7	2.4
Purchase of new machinery and equipment for die cast manufacturing related services	Within 12 months	4.6	3.0
Working capital	Within 12 months	20.5	13.2
Estimated listing expenses	Within 3 months	11.0	7.0
Total		155.7	100.0

Source: Company data, RHB

Figure 12: Structure of CEB's IPO

	No. of IPO shares	% of enlarged share base ⁽¹⁾
Public Issue		
Retail Offering:		
- Malaysian Public	46,200,000	5.0
- Eligible Persons	8,000,000	0.8
Institutional Offering:		
- Bumiputera investors approved by MITI	28,800,000	3.1
- Other Malaysian institutional and selected investors	90,000,000	9.8
Sub-total	173,000,000	18.7
Offer for Sale		
Institutional Offering:		
- Bumiputera investors approved by the MITI	86,700,000	9.4
Total	259,700,000	28.1

Note (1): Based on enlarged issued shares of 923,000,000 post IPO
Source: Company data, RHB

Key Risks

Global supply chain disruptions. These would refer to the input materials needed for the group's operations – and E&E parts and components such as printed circuit board assemblies, mechanical parts, packaging and related materials, as well as aluminium ingots for die casting manufacturing. CEB sources for input materials from Malaysia as well as abroad, but is reliant on some imported materials – as there are no local alternatives, eg batteries.

Over-dependent on major customers. In the event there is: i) A termination or non-renewal of master supply agreements, ii) a reduction of or no purchase orders, iii) the loss of any of these major customers and CEB being unable to obtain substitute orders of comparable sizes from other existing or new customers in a timely manner, its financial condition and operational performance will be adversely affected.

Loss of key directors, management team, skilled engineers or technicians. CEB's executive directors and key senior management team play a pivotal role in its day-to-day operations. These individuals also chart, formulate and implement strategies to drive growth. CEB is also reliant on the technical expertise of skilled engineers and technicians involved in: i) The initial design and conceptualisation, assembly and configuration, integration and commissioning stages of solutions, and ii) provision of aftersales technical support and services to customers.

Softening demand in customers' end-user markets. CEB's business is dependent on its customers' end-user markets. Any negative performance in their end-user markets could result in less purchase orders for products and services. Some of the factors that may affect these markets include: i) Political, economic, social and regulatory factors, ii) changes in technology, iii) changes in market trends and consumer preferences, and iv) new or enhanced products and services replacing existing products and services.

Intensifying competition. The group generally competes on a variety of factors including – among others – price competitiveness, financial strengths in terms of working capital, availability or willingness to invest in machinery and equipment, adequate production capacity, availability of skilled resources, quality of products and services, customer service, reliability and competency of third-party suppliers, promptness in delivery, track record and market reputation. Failure to remain competitive will have an adverse effect on its future business and financial performance.

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