

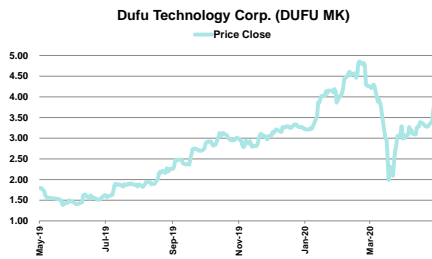


# Dufu Technology Corp

## A Proxy To The Big Data Era

Target: N/A

Price: MYR3.82



Source: Bloomberg

### Stock Profile

Bloomberg Ticker	DUFU MK
Avg Turnover (MYR/USD)	8.41m/1.97m
Net Gearing (%)	Net Cash
Market Cap (MYRm)	979m
Beta (x)	2.09
BVPS (MYR)	0.71
52-wk Price low/high (MYR)	1.33 – 4.86
Free float (%)	46.0

### Major Shareholders (%)

Perfect Full Yen	10.99
Perfect Commerce	10.16
Lee Hui-Ta	9.68

### Share Performance (%)

	1m	3m	6m	12m
Absolute	16.1	(1.0)	26.9	108.9
Relative	11.9	7.0	38.8	123.2

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## Investment Merits

- Benefits from increasing demand for storage for enterprise solutions amid the surge in data centre infrastructure and cloud storage;
- Margins improvement due to demand surge in titanium components;
- Trading at only 14x 2021F P/E, with visible growth trajectory in a rising industry trend.

## Company Profile

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

## Highlights

**High capacity storage solutions in demand.** IDC, in its *Data Age 2025* report, predicts that worldwide data creation will grow to an enormous 163 zettabytes (ZB) by 2025. In this digitalisation age, we see tremendous multi-year growth in cloud data centres, enterprise-hardened infrastructure, personal computers, smartphones, and Internet of Things devices. With data creation becoming ever more important, IDC forecasts that over 22ZB of storage capacity needs to be shipped in the next 5-6 years, with more than half of this capacity powered by hard disc drives (HDDs). With the increasing trend of data consumption, the demand for high-capacity HDDs, especially for data centres and cloud storage services, is expected to see tremendous growth – this should benefit component suppliers like Dufu.

**Higher quality materials improve ASP.** Enterprise solutions and data centres are largely still utilising HDDs – or hybrid HDDs and solid state drives – given their stability and longevity with lower costs per GB. Note that the latest helium-filled HDD platform in the market can house up to nine platters (higher storage), which essentially increases demand for spacers despite lower HDD unit shipments. Besides, with newer technologies aiming to increase areal density (up to 5tbpsi) to produce larger-capacity hard drives, higher-quality titanium spacers are preferred due to their reliability. We understand the ASPs for such materials are 3-4x higher than the usual stainless steel or aluminium spacers

**New plant and machines in place.** We understand Dufu has increased its computer numerical control (CNC) machine capacity by 20% over the past one year to cater for growing demand from data centres and mass production of new generation 14-16TB hard drives. There has been a significant rise in shipments in 2H19, driven by increasing demand from the enterprise segment, and management expects the trend to continue in the next few years. Additionally, the new Bukit Minyak Industrial Park factory is now able to offer one-stop solutions – specialising in sheet metal and structure fabrication for

equipment manufacturers. The new plant commenced operations in 2H19 and is well positioned to tap into more business opportunities in the automotive, medical, and semiconductor segments.

## Company Report Card

**Latest results.** In FY19, Dufu booked a core net profit of MYR45.2m, a 12% YoY contraction – mainly on higher employee stock option scheme costs and depreciation charges due to capacity and plant expansions – while revenue growth was flattish at +3%. 1H19 results were impacted by the uncertainties caused by the protracted US-China trade war, but Dufu booked a stronger 2H19 with a record 4Q revenue on demand recovery.

**Balance sheet/cash flow.** As at 31 Dec 2019, it is in a MYR26m net cash position, or 10 sen per share. ROE stood at 23%, down from 33%, on a higher equity base from its capex spend and plant expansions.

**Dividend.** An 8 sen total dividend was declared/proposed at a payout of 47%, yielding 2.1% at current prices. We believe a similar payout can be sustained in FY20F, with the improved earnings trajectory and healthy cash flow generation.

**Management.** Executive Chairman Lee Hui-Ta is Dufu's major shareholder. He co-founded 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 CEO Yeoh Beng Hooi, a post he has held since 2015. Yeoh was previously Dufu's COO between 2004 and 2015. Since he joined in 2017, David Khoo Chong Beng has been its Group CFO.

## Investment Case

**A proxy to the data centre play...** We believe demand for storage solutions, especially enterprise solutions, will continue to prosper. This is given the exponential rise in data volumes, cloud storage, and big data analytics. Additionally, technology advancement has increased the number of components within a HDD platform. Margins are expected to improve as demand rises for higher-grade spacers, which are required for the new generation of HDDs. Trading at a forward 14x P/E, we believe Dufu is a value buy with a visible growth trajectory in a rising data solutions industry trend.

**...and growing metal sheet segment.** Having diversified into both the medical and automotive industries, we believe the metal sheet division will continue its strong growth trajectory. Having commenced operations at the new Bukit Minyak factory in Penang, this unit is well positioned to tap into the semiconductor segment, which is set for growth given the proliferation of 5G.

**Fair value.** Based on a target P/E range of 17-20x on consensus' FY21F earnings, we derive a fair value range of MYR4.67-5.49. The target P/E range is on par with the target P/E of the technology sector, as well as the 5-year average P/E for Dufu's closest peers in the HDD industry – ie Notion VTec (NVB MK, NR) and JCY International (JCYH MK, NR).

**Key risks** include slower capex spending, weaker consumer spending, customer concentration risks, and a weakening of the USD.

Profit & Loss	Dec-17	Dec-18	Dec-19
Total turnover (MYRm)	181	241	249
Reported net profit (MYRm)	26	52	45
Recurring net profit (MYRm)	27	52	45
Recurring net profit growth (%)	1.7	87.4	(12.2)
Recurring EPS (MYR)	0.10	0.20	0.17
DPS (MYR)	0.07	0.05	0.08
Dividend Yield (%)	1.7	1.3	2.1
Recurring P/E (x)	36.6	19.5	22.2
Return on average equity (%)	18.4	29.9	20.8
P/B (x)	7.1	5.8	4.7
P/CF (x)	0.5	0.3	0.3

Source: Company data, RHB

Balance Sheet (MYRm)	Dec-17	Dec-18	Dec-19
Total current assets	123	154	187
Total assets	176	220	269
Total current liabilities	31	39	42
Total non-current liabilities	4	7	12
Total liabilities	35	46	54
Shareholder's equity	142	174	214
Minority interest	0	1	0
Other equity	0	0	0
Total liabilities & equity	176	220	269
Total debt	6	11	18
Net debt	Net Cash	Net Cash	Net Cash

Source: Company data, RHB

Cash Flow (MYRm)	Dec-17	Dec-18	Dec-19
Cash flow from operations	22	39	29
Cash flow from investing activities	(7)	(22)	(24)
Cash flow from financing activities	(14)	(10)	(1)
Cash at beginning of period	39	36	41
Net change in cash	(4)	6	2
Ending balance cash	36	41	43

Source: Company data, RHB