

4Q FY Sept 2009 Final Results
Notion VTec Berhad

- Very strong 4QFY09 and final results
- Expect 40% net profit growth in FY10
- New customers, products, expansion to drive growth
- FY10 forecasts raised 14%. Low P/Es with high growth

BUY

 Price
RM2.60

 Market capitalization
RM366 million

 Board
Main

 Sector
Technology

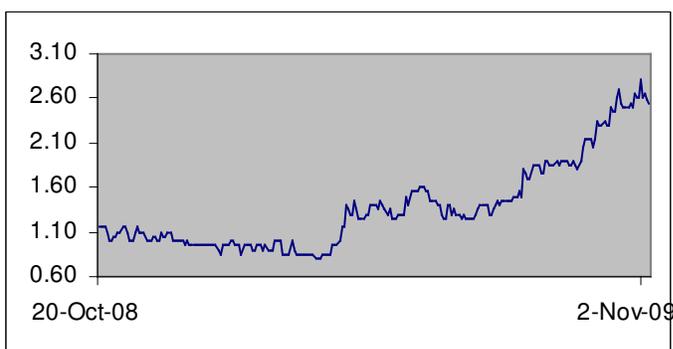
 Stock code
0083

 Analyst
Kevin Khoo

Key stock statistics	FYSept09	FYSept10E
EPS (sen)	25.6	32.5
P/E (x)	10.2	8.0
DPS (sen)	2.5	3.0
NTA/share (RM)	1.16	1.56
Issued capital (mil)	140.7 (50 sen par)	
52-week price range	RM0.80 – 2.70	

Major shareholders (%)

Choo Wing Hong	16.3%
Koperasi Permodalan Felda	15.6%
Choo Wing Onn	11.0%
Thoo Chow Fah	7.6%

Share Price Chart


4Q FY Sept 2009 Final Results Highlights:

Year-end Sept (RM mil)	FY2009	FY2008	% chg
Turnover	172.6	146.1	18.1
Pre-tax profit	43.0	40.9	5.3
Tax	(7.0)	(7.8)	(9.7)
Minority interests	(0.0)	(0.2)	NM
Net profit	36.0	32.9	9.3
EPS (sen)	25.6	23.4	
Pre-tax margin (%)	24.9	28.0	
Net margin (%)	20.8	22.5	

Earnings review

Notion VTec posted a strong set of final results for FY Sept 2009, marked by a robust fourth quarter (July-Sept 2009) that was ahead of expectations. The company is Malaysia's leading listed manufacturer of precision components for hard disk drives (HDD), cameras and other items.

Notion has been chalking up successive profit growth since FY04. FY09 was no exception, with net profit rising 9.4% y-y to RM36 million. This was 8.4% above our forecast of RM33.2 million and ahead of management guidance.

For the full year, pre-tax profit increased 5.3% y-y to RM43 million. Turnover rose 18.1% y-y to RM172.6 million. Full year EPS amounted to 25.6 sen after the recently concluded 5-into-1 share consolidation exercise. Notion now has 140.7 million shares of 50 sen par value outstanding.

The excellent results were achieved despite the severe recession that afflicted export-based industries in the first half of the financial year. This marks Notion's sixth consecutive year of profit growth, which has seen net profit rise nine-folds from just RM3.9 million in FY04 to RM36 million in FY09.

4QFY09 was another stellar quarter, following on from the strong recovery in 3QFY09 as earnings continued to recover from the weak patch in 2QFY09 (Jan-Mar 2009) – the worst period for the HDD industry.

Revenue in 4QFY09 rose 14% y-y to RM54.3 million. Pre-tax profit increased 47.5% y-y to RM16.5 million while net profit rose 46.7% y-y to RM13 million. The latter was much higher than the net profit of RM11.1 million recorded in 3QFY09 and RM4.6 million in 2QFY09.

Growth in the fourth quarter was broad-based. Compared with 3QFY09, sales of camera parts improved by 18% q-q, industrial and automotive parts rose 58% and HDDs increased 14%.

The latest quarter's product mix was 38%: 44%:18% for HDD, camera and industrial components, respectively, as compared with 42%: 46%:12%, respectively in 3QFY09.

As a comparison, the ratio was 60%: 32%: 8%, respectively in 2QFY09, showing that camera and non-HDD sales have bounced back strongly over the last two quarters. This was due to the relative resilience of HDD sales during the recession, unlike more discretionary consumer items.

Net debt declined from RM42.9 million in June 2009 to RM37.8 million in Sept 2009, with gearing at a modest 23.1%.

We expect gearing to fall further, and the company to be in minor net cash position by next year or the year after, despite heavy capex commitments, due to the recently proposed private placement exercise and strong operating cash flows.

A final tax exempt dividend of 2.5 sen per share has been proposed.

Earnings outlook & recommendation

The outlook for Notion is very positive. The recovery in demand for Notion's HDD and non-HDD products is in full swing, as demonstrated by its last two quarterly results, as well as those of its rival Dufu Technology Corp.

While the outlook for export-oriented companies remains tied to that of the US economy, the world's largest economy has already bottomed out. However, the path to recovery may be a slow one as consumer confidence remains weak amid high unemployment.

The key risk to Notion and export-oriented players will be the strength of the recovery as well as USD-RM exchange rates. Notion derives most of its sales in USD, but will soon derive a large Thai Baht denominated income stream when its Thailand operations come onstream (we understand sales will be in Baht, but subject to fluctuation within a given Baht-USD band).

HDD demand has been relatively resilient throughout the recession, even during the worst period in Notion's 2QFY09 when orders for camera parts and other components plunged. Demand is being driven by the need for increased storage for the increasing use of web-based applications.

As the global recovery gathers steam, HDD demand has improved further with world HDD world shipment in the September quarter rising 15% q-q to 152 million units compared to 132 million units shipped for the June quarter. The camera segment also continues to see strong demand recovery, mostly from Asia while sales from Europe and USA were static.

Key growth catalysts

On a more micro level, Notion will see strong growth over the next few years driven by its aggressive expansion program, especially in Thailand, and a widening of its product range, customers and markets.

Earnings are poised to grow rapidly driven by the following catalysts:

- 1) Thailand expansion. Notion will be able cater more for its biggest client, Nikon Thailand and later, to other multinationals as the country also hosts a large concentration of hard disk drive (HDD) and auto companies.
- 2) Increased HDD orders and new products. Notion has secured orders from a new customer, Samsung, and will start production of the 2.5-inch form factor HDD. This opens up Notion to a new customer and market base, as it presently focuses on the 3.5-inch form factor.

The smaller form factor is used for smaller, mobile consumer electronic devices, such as laptops, where demand is growing rapidly.

We understand trial runs are currently being undertaken and production will start in Dec 2009 / Jan 2010 with targeted monthly sales to reach around RM4 million in June 2010.

- 3) Over the longer term, Notion is also going into production of more complete components to offer HDD multinationals a more integrated and value-added service and improve on margins.

For a start, it is targeting to produce entire spindle motors, rather than just parts of it. But this will likely be some time away, as it also involves technology acquisition, which the company is working on.

Thailand expansion

Notion VTec is on an aggressive expansion trail – both locally and regionally. The company had earlier proposed to acquire a piece of land with factory in Ayutthaya, just outside Bangkok, Thailand for RM5.05 million, and will be expanding capacity in Thailand and Malaysia.

The Thailand plant measures about 5 acres and has an existing factory with built-up space of about 23,000 sq ft, which will be eventually expanded to 100,000 sq ft. Notion plans to commence operations in 1Q2010, pending regulatory approvals for the completion of the plant purchase.

The plant will be used primarily to support the camera business for Nikon Thailand given its close proximity (Nikon's factory is in the same area).

Notion will eventually also target other industries nearby, as Thailand is host to the major hard disk drive (HDD) manufacturers, including Western Digital, its main HDD customer, as well as a number of auto makers and other industries.

We understand Notion is eyeing another 4-acre plot directly behind this factory for future expansion. The Thailand operations will enjoy an 8-year tax exemption, which augers well for Notion's overall effective tax rate. Over time, we would not discount the possibility of the camera operations being moved entirely to Thailand, freeing up the Klang plants for HDD orders.

We view the expansion positively as the company is benefiting from strong new orders and the existing capacity at its two plants in Klang is already fully utilized. Notion is widening its client, product and market base, and is gaining market share from other precision component makers.

To fund the Thailand expansion, the company has proposed a 10% private placement exercise, to be placed out to institutional and strategic corporate investors. The share placement proceeds will raise about RM35.5 million and is expected to be completed in December 2009.

In total, Notion will likely spend about RM70 million on capex in the next 2-3 years, in Malaysia and Thailand. This will be easily funded by the private placement exercise and strong operating cashflows.

The company recently ordered over 100 CNC machines, to be delivered from Oct-Dec 2009, for both the 2.5-inch and 3.5-inch HDD form factors. Its two plants in Klang are currently operating at full capacity, and the company is considering acquiring further space nearby to cope with rising demand.

Robust earnings outlook

We expect the expansion exercise to reflect from FY Sept 2010 onwards. Notion's medium-term outlook is positive given the visibility of its new orders and projects, as well as the better macro environment.

We are raising our FY10 net profit forecast by 14% from RM44 million to RM50.3 million, with net profit growth of 40%. Despite the share placement exercise, EPS will increase by a significant 27% to 32.5 sen. For FY11, we expect net profit to rise 20% to RM60.1 million, or 38.8 sen per share.

We maintain our **BUY** recommendation.

Despite the stock's recent rally, valuations remain attractive, especially relative to its strong growth prospects and excellent track record. At RM2.60, its shares are priced at just 8 and 6.7 times for FY2010-2011.

The company continued to provide official guidance for the second consecutive quarter. It targets FY2010 revenue to be in the range of RM220 to RM240 million with net profit between RM49.5 and RM54 million. Our forecasts are conservatively at the lower end of this range.

Profit & Loss Analysis

Year end Sept (RM mil)	2008	2009	2010E	2011E
Turnover	146.1	172.6	224.1	251.4
Operating profit	55.2	63.7	78.2	87.1
Depreciation	(13.3)	(18.2)	(18.5)	(18.5)
Interest income/(exp)	(1.6)	(3.4)	(1.4)	1.3
Associates	0.6	1.0	1.0	1.0
Pre-tax profit	40.9	43.0	59.3	70.9
Tax	(7.8)	(7.0)	(8.9)	(10.6)
Minority interests	(0.2)	(0.0)	(0.1)	(0.1)
Net profit	32.9	36.0	50.3	60.1
Operating margin (%)	37.7	36.9	34.9	34.6
Pre-tax margin (%)	28.0	24.9	26.4	28.2
Net margin (%)	22.5	20.8	22.4	23.9
Effective tax rate (%)	19.1	16.3	15.0	15.0

Per Share Data

Year end Sept	2008	2009	2010E	2011E
EPS (sen)	23.4	25.6	32.5	38.8
P/E (x)	11.1	10.2	8.0	6.7
Dividend (sen)	5.0	2.5	3.0	5.0
Net yield (%)	1.9	1.0	1.2	1.9
Payout ratio (%)	21	10	9	13
NTA (RM)	0.97	1.16	1.56	1.90
Price/ NTA (x)	2.67	2.24	1.67	1.37
Cashflow/share (sen)	33.0	38.6	44.5	50.9
Price/Cashflow (x)	7.9	6.7	5.8	5.1
Gearing (%)	24.2	23.1	Net cash	Net cash
ROE (%)	24.1	22.0	20.8	20.5



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