

Inari Amertron (INRI MK)

RF segment likely to thrive in 2H22

Remains our top sector pick; maintain BUY

A selling price freeze on Apple's recent entry-level flagship smartphone launches and the key RF segment customer's positive 4Q guidance augurs well for INRI moving into 2H22 (historically the stronger half). We maintain our earnings estimates, BUY call and TP of MYR4.14 (pegged to 29x FY24E PER, at +0.5SD to the LT mean). INRI remains our top M'sian OSAT pick.

Positive RF segment customer developments

On the back of a 14% YoY growth in 3QFY22 for its wireless division, Inari's key US-based RF segment customer has guided for an equally robust 4QFY22 (+10%/20% YoY/QoQ). Coupled with Apple's flagship smartphone launches earlier today that were priced on par with its 2021 entry level models (positive surprise in light of inflationary/ supply chain headwinds), we expect Apple's smartphone sales to remain resilient in 2H22 with a flat YoY growth, at worst. Prior to the launch, the street expected Apple to produce 90m units of iPhone 14 in 2022 (roughly equalling 2021's iPhone 13), priced c.15% higher than its predecessor - thus, freezing ASPs is likely to boost sales further and inadvertently bodes well for Inari's 1Q/2QFY23.

End-customer's resilience despite broader slowdown

On 31 Aug, the IDC revised its 2022 global smartphone shipment estimates to -6.5% YoY (from -3.5% on 31 May) amidst slowing demand from China, (accounted for c.50% of the overall reduction). Although the market is expected to rebound strongly in 2023 (+5.2%), we opine that Apple will be relatively insulated from the 2022 slowdown owing to: (i) demand/income inelasticity from an affluent/loyal customer base, (ii) its ability to exercise control over its supply chain via long-term agreements with key CMs, (iii) the strength of its software ecosystem and seamless UI/UX, and (iv) the lack of competition from Chinese manufacturers in the premium segment.

ESG: No changes to our in-house proprietary score

We note that Sustainlytics had recently increased INRI's unmanaged ESG risk score to 28.1/Medium Risk (from 11.2/Low Risk previously), in-line with its local OSAT peers (UNI MK and MPI MK, both at 29.1) and underpinned by concerns over the broader industry's labour issues and a lack of clear ESG targets/adherence to leading ESG reporting standards. As outlined in our ESG tear sheet (Pg. 3), we acknowledge the lack of targets/standardisation (to be addressed by mgmt in the upcoming AR) but opine that its labour standards are satisfactory, as they're subjected annually to its key customers' stringent audits. As such, we believe these risks are adequately managed and we maintain our in-house score of 70.

FYE Jun (MYR m)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue	1,429	1,548	2,147	2,291	2,452
EBITDA	449	524	608	673	748
Core net profit	345	405	468	529	600
Core EPS (sen)	10.0	10.6	12.2	13.8	15.6
Core EPS growth (%)	109.0	6.1	15.5	13.0	13.5
Net DPS (sen)	11.0	10.0	12.2	13.8	15.6
Core P/E (x)	31.8	25.0	22.1	19.6	17.3
P/BV (x)	8.0	4.0	4.1	4.1	4.0
Net dividend yield (%)	3.5	3.8	4.5	5.1	5.8
ROAE (%)	25.7	20.2	18.6	20.8	23.4
ROAA (%)	21.0	17.2	16.0	17.6	19.7
EV/EBITDA (x)	22.5	15.6	14.1	12.7	11.4
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Consensus net profit	-	-	427	488	525
MKE vs. Consensus (%)	-	-	9.4	8.3	14.2

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BUY

Share Price	MYR 2.70
12m Price Target	MYR 4.14 (+58%)
Previous Price Target	MYR 4.14

Company Description

Inari Amertron is the biggest semiconductor player in M'sia and one of Broadcom's top OSAT providers in the thriving wireless division.

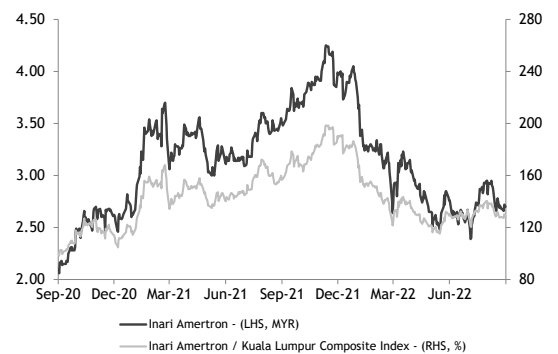
Statistics

52w high/low (MYR)	4.25/2.39
3m avg turnover (USDm)	5.4
Free float (%)	72.0
Issued shares (m)	3,705
Market capitalisation	MYR10.0B USD2.2B

Major shareholders:

Insas Bhd.	14.5%
Kumpulan Wang Persaraan	9.4%
Employees Provident Fund	9.0%

Price Performance



	-1M	-3M	-12M
Absolute (%)	(8)	(2)	(23)
Relative to index (%)	(8)	(0)	(18)

Source: FactSet

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Tear Sheet Insert

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Risk Rating & Score ¹	28.1 (Medium)
Score Momentum ²	N/A
Last Updated	13 Jul 2022
Controversy Score ³ (Updated: 27 May 2022)	0 - No controversies

Business Model & Industry Issues

- Inari is the largest listed technology company on Bursa by market capitalisation - a testament to its niche expertise in back-end wafer processing, assembly, and testing of RF & optoelectronic products for a global clientele that includes Broadcom.
- In our view, the company has been largely successful in complying with environmental and occupational health & safety standards. However, female and independent representation on its board has been comparatively low. Meanwhile, Inari continues to uphold human and labour rights, and fair treatment in managing foreign labours.
- Overall, Inari is still largely well-placed to leverage on its competent management team and strong track record to maintain its market-leading position and capitalise on the mass deployment of 5G smartphones in the years to come.
- Inari also scores well above average in our proprietary scoring methodology (see Pg. 3) with an overall score of 70/100.

Material E issues

- Energy consumption was approximately 400 kGJ across the group in FY21 (8% increase from FY20). Energy intensity however was lower by 29% to 20.5 GJ/m FOU, with a notable YoY reduction in Malaysia and the Philippines.
- Company has been certified ISO 14001 since 2007 and strives to minimise its environmental impact via pollution-prevention mechanisms. In FY21, it generated 74.9 ktCO₂e of greenhouse gas (GHG) emissions (up 7.5% vis-a-vis FY20 due to higher production volumes). Emissions intensity however decreased by 29.3% across the group as a whole. Of the total, direct (Scope 1) GHG emissions amounted to <1% of total emissions with the remaining 99.7% being indirect emissions from electricity usage.
- Achieved its FY21 waste reduction target in Malaysia by either successfully recovering, recycling or reusing 91.5% of its 607 tonnes of generated waste.
- Management is currently installing solar PV panels in its premises to reduce GHG emissions by a further 6% in FY22.

Material S issues

- Gender inclusivity is at the forefront of management's strategic priorities with 64% of the 5,800-strong workforce being female. The female new hire rate has also increased from 13.6% in FY20 to 17.9% in FY21.
- Employee benefits (including insurance and medical coverage) are generous by industry standards and employees are on average, provided 13 hours of training per year in both vocational and non-technical fields.
- In terms of occupational safety & health (OSH), the group reported no workplace injuries in FY21 across its Malaysian operations. OSH training is also mandatory for all staff.
- Inari strives to uphold human and labour rights and fair treatment in managing foreign labours (i.e. legal work permits, at least minimum wage, prohibition of child labour and forced labour). Approx. 22% of Inari's FY21 workforce was foreign labour (vs. 30% in FY20).

Key G metrics and issues

- Independent directors, including the chairman, currently make up 36% of the board or 4 of the 11 members. Although the composition is compliant with Bursa's Main Market Listing requirements, it is not in line with the Malaysian Code on Corporate Governance (MCCG) practise of having at least half the board comprising of independents. The company acknowledges this shortcoming and has set itself a two-year timeline to make the necessary amends.
- Only 9% or 1 of the 11 of the board members is female. Although she is the chairman of the board, it doesn't negate the dearth of diverse perspectives that could arise from a lack of female representation. The company has set itself a 2-year timeline to increase female representation to at least 30% to be more in line with MCCG best practises.
- Average tenure of the independent board members is 10.2 years (longest serving at 12.5 years and shortest at 4.2 years). Leadership churn risk is low with no independent director resigning since June 2012. The board has however not adopted a policy to limit the tenure of its independent directors to nine years with 3 of the 4 existing independent directors having served more than nine years each.
- All 4 board committees are chaired by independent directors and have an independent majority.
- Director's remuneration stands at 0.8% of FY21 net profit. The company's remuneration is based on performance and adherence to corporate governance as well as sustainability targets. It is benchmarked periodically against peers to ensure fair and motivating compensation.
- No material related-party transactions to date.
- Grant Thornton has been the external auditor for more than 10 years since the company listed in 2011.
- Inari has undertaken 2 major acquisitions since listing - notably Amertron (Global) in 2013 for USD32m and 9.7% of PCL Technologies at a reasonable 8.4% premium in 2016. Both acquisitions have been value-accretive and successful in increasing shareholder returns.

¹**Risk Rating & Score** - derived by Sustainalytics and assesses the company's exposure to unmanaged ESG risks. Scores range between 0 - 50 in order of increasing severity with low/high scores & ratings representing negligible/significant risk to the company's enterprise value, respectively, from ESG-driven financial impacts. ²**Score Momentum** - indicates changes to the company's score since the last update - a **negative** integer indicates a company's improving risk score; a **positive** integer indicates a deterioration. ³**Controversy Score** - reported periodically by Sustainalytics in the event of material ESG-related incident(s), with the impact severity scores of these events ranging from Category 0-5 (0 - no reports; 1 - negligible risks; ...; 5 - poses serious risks & indicative of potential structural deficiencies at the company).

Quantitative parameters (Score: 47)						
	Particulars	Unit	FY6/19	FY6/20	FY6/21	*UNI MK (FY12/21)
E	Scope 1 GHG emissions	k tCO2e	0.2	0.4	0.6	1.3
	Scope 2 GHG emissions	k tCO2e	70.7	69.4	74.3	135.6
	Total	k tCO2e	70.9	69.7	74.9	136.9
	Scope 3 GHG emissions	k tCO2e	N/A	N/A	N/A	N/A
	Total	k tCO2e	70.9	69.7	74.9	136.9
	GHG intensity (Scope 1 and 2)	tCO2e/m units	6.5	5.5	3.9	14.0
	Energy intensity	GJ/m units	34.2	28.9	20.5	76.0
	Water intensity	m3/m units	65.0	57.0	40.0	120.0
	Wastewater discharge (COD)	mg/L	386.4	269.4	67.7	N/A
	Waste 3R rate (Malaysia only)	%	91.6%	90.0%	91.5%	41%*
Share of renewable energy use	%	N/A	N/A	>1%	N/A	
Cases of environmental non-compliance	number	0	0	0	0	
S	Proportion of women in the workforce	%	73.0%	69.0%	64.0%	59.0%
	Proportion of women as new hires	%	15.9%	13.6%	17.9%	27.3%*
	Proportion of locals as new hires	% (avg)	81.5%	81.5%	86.5%	N/A
	Lost time injury frequency (LTIF) rate	number (avg)	0.98	0.45	0.97	1.44
	Training hours per employee	number	12	10	13	30
G	MD/CEO salary as % of reported net profit	%	0.3%	0.3%	0.4%	2.2%
	Board salary as % of reported net profit	%	0.8%	0.8%	0.8%	4.0%
	Independent directors on the Board	%	40%	40%	36%	30%
	Female directors on the Board	%	10%	10%	9%	20%

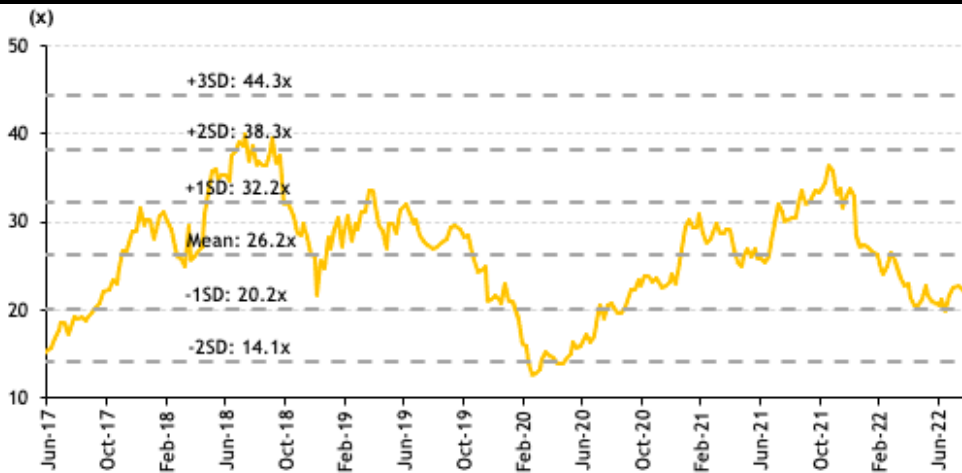
Qualitative Parameters (Score: 86)	
a) Is there an ESG policy in place and whether there is a standalone ESG committee or is it part of a risk committee?	<i>Yes - it has an established sustainability framework/handbook and a sustainability & integrity working group (SIWG) that is led by the Group CEO and assisted by the CFO. The SIWG reports directly to the Sustainability & Risk Management Board Committee.</i>
b) Is the senior management salary linked to fulfilling ESG targets?	<i>Yes</i>
c) Does the company follow the task force of climate related disclosures (TCFD) framework for ESG reporting?	<i>Yes</i>
d) Does the company have a mechanism to capture Scope 3 emissions - which parameters are captured?	<i>No</i>
e) What are the 2-3 key carbon mitigation/water/waste management strategies adopted by the company?	<i>Energy efficiency: Completed - conversion of compressor from screw to centrifugal at P3/13 (saves 322 kWh per mth), conversion of lighting from T8 to LED at P1/3/5 (saves 133 kWh per mth); Ongoing - solar panel installation at P13/21/55 (to save 155,918 kWh per mth). Water mgmt: converting machines from single to dual spindle, rainwater harvesting, recycling of RO reject water, upgrading piping system. Waste mgmt: has 90% 3R target in place and plans to invest in an Industrial Effluent Treatment System.</i>
f) Does carbon offset form part of the net zero/carbon neutrality target of the company?	<i>Yes</i>
g) Has the company faced any lawsuits/controversies pertaining to anti-competitive practises or IP infringement?	<i>No</i>

Target (Score: 100)			
Particulars		Target	Achieved
Waste management 3R rate		90.0%	91.5%
GHG emission reduction via solar panels		6%	N/A
GHG emission reduction via LED lighting		1%	>1%
Female representation on Board		30%	9%
Independent representation on Board		N/A	36%
Impact			
NA			
* Peer Comparison			
We have benchmarked INRI's ESG metrics against that of its closest listed peer with comparable metrics that is publicly available - Unisem (M) Berhad (UNI MK, Not Rated). The peer's ESG standing is not assessed and solely exists as a point of reference.			

ESG score	Weights	Scores	Final Score
Quantitative	50%	47	24
Qualitative	25%	86	21
Target	25%	100	25
Total			70

Per our ESG assessment, INRI has an established ESG framework/ internal policies and scores well in terms of its "E" and "S" metrics but needs to make headway in improving its board diversity and establishing clearer ESG targets moving forward. INRI's overall score of **70** makes its ESG rating **above average** in our view, and in-line with its sector's low-to-medium ESG risk profile (average ESG rating = 50; refer to Appendix I for our ESG Assessment Scoring).

Fig. 1: Inari’s 12M forward PER band (currently trading at 20.8x)



Source: Bloomberg, Maybank IBG Research

Fig. 2: Inari’s 12M forward PBV band (currently trading at 4.1x)



Source: Bloomberg, Maybank IBG Research

Risk statement

There are several risk factors for our earnings estimates, target price and rating for Inari. A sharp downturn in the global markets for electronics, especially smartphones, will affect the demand for components that Inari produces for its key clients (i.e. Broadcom and OSRAM). Design-in and design-out of components related to Inari’s current production will also affect revenue and earnings. Additionally, forex volatility, especially USD/MYR, will affect Inari’s earnings, as over two-thirds of its revenue and COGS are denominated in USD.

Appendix I

Methodology of our proprietary ESG scoring methodology.

We evaluate the ESG ratings based on quantitative, qualitative and ESG targets. We assign a score for each of these three parameters. The overall rating is based on the weighted average of the scores: quantitative (50%), qualitative (25%) and ESG target (25%).

For the quantitative, qualitative and ESG target, the sub-parameters are assigned a score - '0' for data not available, '+1' for improving trajectory, positive change, 'Yes', better than peers or a positive number if historical is not available and '-1' for declining trajectory, negative change, 'No', lower than peers or a negative number. The total of the scores of all the sub-parameters is divided by the total number of sub-parameters is the score of each of the three parameters.

The sub-parameters may be different for different industries depending on the key areas to monitor for each industry. A company should achieve a minimum score of 50 for an average ESG rating.

FYE 30 Jun	FY21A	FY22A	FY23E	FY24E	FY25E
Key Metrics					
P/E (reported) (x)	29.1	32.8	22.1	19.6	17.3
Core P/E (x)	31.8	25.0	22.1	19.6	17.3
P/BV (x)	8.0	4.0	4.1	4.1	4.0
P/NTA (x)	8.0	4.0	4.1	4.1	4.0
Net dividend yield (%)	3.5	3.8	4.5	5.1	5.8
FCF yield (%)	3.5	3.9	2.7	4.9	5.5
EV/EBITDA (x)	22.5	15.6	14.1	12.7	11.4
EV/EBIT (x)	29.2	19.3	17.1	15.0	13.3

INCOME STATEMENT (MYR m)

Revenue	1,428.7	1,547.9	2,146.8	2,291.1	2,451.7
EBITDA	448.6	524.2	608.1	673.4	747.5
Depreciation	(102.7)	(100.9)	(107.0)	(105.5)	(104.3)
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	345.9	423.3	501.0	567.9	643.2
Net interest income / (exp)	6.6	22.9	23.5	21.7	22.0
Associates & JV	0.0	0.0	0.0	0.0	0.0
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	352.5	446.2	524.6	589.6	665.1
Income tax	(21.5)	(54.9)	(56.7)	(61.0)	(65.4)
Minorities	(0.2)	(0.3)	0.0	0.0	0.0
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	330.7	391.0	467.8	528.6	599.8
Core net profit	345.0	405.2	467.8	528.6	599.8

BALANCE SHEET (MYR m)

Cash & Short Term Investments	904.9	1,971.0	1,798.1	1,817.8	1,836.0
Accounts receivable	251.7	266.9	403.0	428.0	455.8
Inventory	157.5	147.0	266.1	278.0	291.1
Reinsurance assets	0.0	0.0	0.0	0.0	0.0
Property, Plant & Equip (net)	472.2	499.5	492.5	487.0	482.7
Intangible assets	2.2	2.3	2.3	2.3	2.3
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	30.7	8.0	8.0	8.0	8.0
Total assets	1,819.3	2,894.8	2,970.1	3,021.1	3,076.0
ST interest bearing debt	1.1	0.0	0.0	0.0	0.0
Accounts payable	287.7	262.6	320.0	328.5	338.0
Insurance contract liabilities	0.0	0.0	0.0	0.0	0.0
LT interest bearing debt	0.0	0.0	0.0	0.0	0.0
Other liabilities	153.0	121.0	119.0	140.0	160.0
Total Liabilities	441.8	383.8	439.4	468.2	497.9
Shareholders Equity	1,373.0	2,505.1	2,524.7	2,546.9	2,572.1
Minority Interest	4.5	6.0	6.0	6.0	6.0
Total shareholder equity	1,377.4	2,511.0	2,530.7	2,552.9	2,578.1
Total liabilities and equity	1,819.3	2,894.8	2,970.1	3,021.1	3,076.0

CASH FLOW (MYR m)

Pretax profit	352.5	446.2	524.6	589.6	665.1
Depreciation & amortisation	102.7	100.9	107.0	105.5	104.3
Adj net interest (income)/exp	(6.6)	(22.9)	(23.5)	(21.7)	(22.0)
Change in working capital	41.6	(32.2)	(197.8)	(28.3)	(31.5)
Cash taxes paid	(24.6)	(25.1)	(56.7)	(61.0)	(65.4)
Other operating cash flow	14.5	14.3	0.0	0.0	0.0
Cash flow from operations	486.7	504.1	377.1	605.8	672.6
Capex	(97.1)	(109.7)	(100.0)	(100.0)	(100.0)
Free cash flow	389.5	394.4	277.1	505.8	572.6
Dividends paid	(218.0)	(433.2)	(448.0)	(506.2)	(574.3)
Equity raised / (purchased)	0.5	(1.3)	0.0	0.0	0.0
Change in Debt	144.5	1,082.5	0.0	0.0	0.0
Other invest/financing cash flow	1.4	21.2	20.0	20.0	20.0
Effect of exch rate changes	0.0	0.0	0.0	0.0	0.0
Net cash flow	317.9	1,063.7	(150.9)	19.6	18.3

FYE 30 Jun	FY21A	FY22A	FY23E	FY24E	FY25E
Key Ratios					
Growth ratios (%)					
Revenue growth	35.0	8.3	38.7	6.7	7.0
EBITDA growth	70.2	16.9	16.0	10.7	11.0
EBIT growth	111.8	22.4	18.4	13.3	13.3
Pretax growth	103.8	26.6	17.6	12.4	12.8
Reported net profit growth	111.6	18.2	19.7	13.0	13.5
Core net profit growth	114.8	17.4	15.5	13.0	13.5
Profitability ratios (%)					
EBITDA margin	31.4	33.9	28.3	29.4	30.5
EBIT margin	24.2	27.3	23.3	24.8	26.2
Pretax profit margin	24.7	28.8	24.4	25.7	27.1
Payout ratio	115.3	98.1	100.0	100.0	100.0
DuPont analysis					
Net profit margin (%)	23.1	25.3	21.8	23.1	24.5
Revenue/Assets (x)	0.8	0.5	0.7	0.8	0.8
Assets/Equity (x)	1.3	1.2	1.2	1.2	1.2
ROAE (%)	25.7	20.2	18.6	20.8	23.4
ROAA (%)	21.0	17.2	16.0	17.6	19.7
Liquidity & Efficiency					
Cash conversion cycle	25.9	19.1	36.3	53.6	54.4
Days receivable outstanding	58.7	60.3	56.2	65.3	64.9
Days inventory outstanding	54.4	51.0	48.4	61.1	61.0
Days payables outstanding	87.2	92.2	68.3	72.8	71.4
Dividend cover (x)	0.9	1.0	1.0	1.0	1.0
Current ratio (x)	3.1	6.7	6.0	6.0	6.0
Leverage & Expense Analysis					
Asset/Liability (x)	4.1	7.5	6.8	6.5	6.2
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)	na	na	na	na	na
Debt/EBITDA (x)	0.0	0.0	0.0	0.0	0.0
Capex/revenue (%)	6.8	7.1	4.7	4.4	4.1
Net debt/ (net cash)	(903.8)	(1,971.0)	(1,798.1)	(1,817.8)	(1,836.0)

Source: Company; Maybank IBG Research

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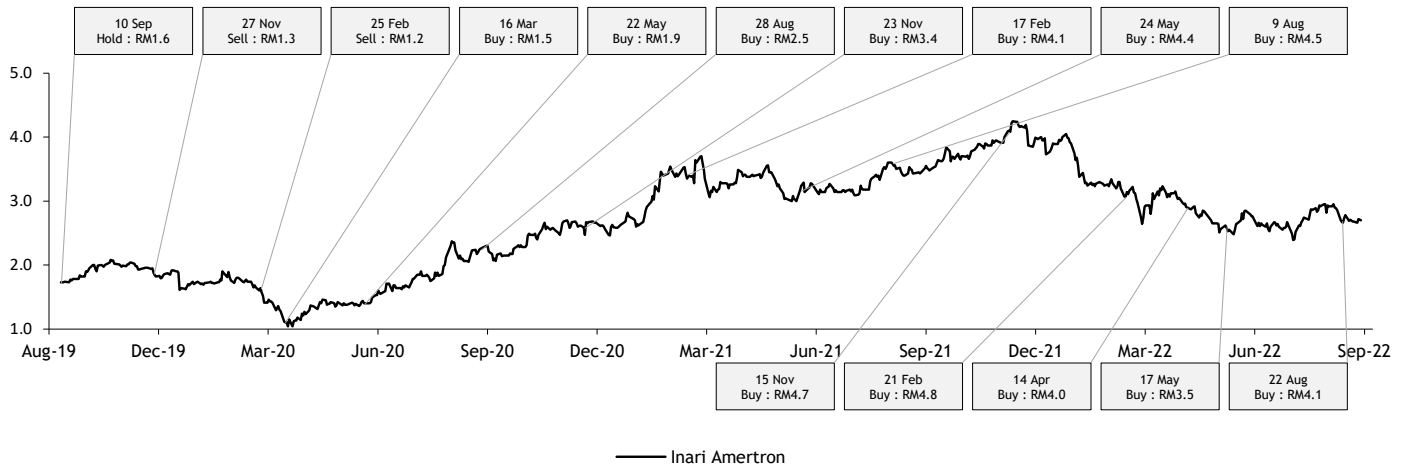
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