

## I-Stone Group Berhad

### INITIAL PUBLIC OFFERING

### SUBSCRIBE

**Target Price RM 0.185**

**IPO Price RM 0.160**

#### IPO Calendar

Opening Date of Application	21/6/2019
Closing Date of Application	8/7/2019
Balloting of Application	10/7/2019
Notice of Allotment	16/7/2019
Listing Date	17/7/2019

#### Listing

Syariah Compliant	YES
Market Cap	RM195m
Outstanding Shares	1,221.0m
New IPO Shares	244.2m
Offer For Sales	122.1m
Eligible Person	12.2m
Malaysian Public	61.1m
Private Placement	170.9m

#### Major Shareholding (%)

One United Equity	27%
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## The growing need for automation and technology

iStone Group Berhad is principally involved in the design, manufacturing & modification of specialised automation machines, maintenance & technical support services and provision of data management systems. The group also provides complement product and services such as design & fabrication of precision machining parts, metal frames & panels and distribution of manufacturing automation software and hardware. Malaysia continues to be the preferred hub for Dyson for its home-appliance products production due to its well-developed electronic manufacturing services supply chain and a pervasive respect for intellectual property rights, serving as the group's key driver for earnings growth. We are ascribing a valuation of 15.5 (x) PER pegged to its FY20 EPS of 1.2 sen giving it a fair value of RM0.185, translating into a potential return of 19.6% inclusive of dividends. Our PER valuation of 15.5 (x) is within the valuation range of automation equipment peers of 8.9.x -19 .7x.

#### Investment merits

Exposure to Dyson's electronic home appliance growth

A strong entrepreneurial flair

#### Risk and threats

Customer concentration risk

Slowdown in global economy

Rapid pace of technological change raises odds of obsolescence

Labor shortage

#### Table 1: Investment Highlights & Earnings Forecasts

FYE 31st Dec	FY15	FY16	FY17	FY18	FY19(F)	FY20(F)
Revenue (RM mil)	44.1	43.1	60.4	67.6	79.6	91.0
PAT(RM mil)	4.1	4.7	8.6	11.5	12.8	14.6
CORE EPS (sen)	0.3	0.4	0.7	0.9	1.0	1.2
EBITDA (m)	5.13	5.86	10.20	13.08	14.25	16.81
Earnings Growth (%)	N.A.	15.0%	81.6%	34.2%	11.3%	14.4%
PATAMI Margin (%)	9.3%	10.9%	14.2%	17.0%	16.0%	16.1%
EBITDA Margin (%)	11.6%	13.6%	16.9%	19.4%	17.9%	18.5%
PER (x)	47.7	41.5	22.9	17.0	15.3	13.4
DPS (sen)	0.14	0.20	0.19	1.02	NA	NA
Dividend Yield (%)	0.9%	1.2%	1.2%	6.4%	NA	NA
ROE (%)	30%	29%	61%	49%	18%	17%
ROA (%)	14.7%	14.1%	20.7%	22.9%	14.7%	14.3%
Net Gearing Ratio (%)	-0.20	NETCASH	-0.05	-0.39	NETCASH	NETCASH
Price/Book Ratio (x)	14.55	12.34	14.64	8.84	2.78	2.30

Source: Inter-Pacific, Prospectus

### Investment Merits

#### **Riding on Dyson Growth**

The group is a major supplier having established a good relationship with Dyson group of companies and supplies about most of Dyson's test and inspection customised machines. Dyson is a British technology company, a popular household name that designs and manufactures heaters, bladeless fans, hand dryers and vacuum cleaners. The group's revenue expanded at a CAGR of 15.42% between 2015 and 2018 driven by increasing purchase orders from Dyson. Dyson orders increased at CAGR rate of 22.9% over the said period. Management guidance was that Dyson has been expanding its capacity annually at a rate of circa~20%. Dyson has unveiled 2 new products (light-cycle lamp and personal air purified) and an upgraded cordless vacuum (V11) in 2019. Dyson's product development led to a reported revenue expansion at a CAGR of 36.2% between 2015 and 2018. We envisage the group will continue to ride on Dyson's capacity expansion following a string of successful Dyson new product launches.

#### **Illustration 1: Logo of I-Stone Group Bhd's most prominent customer Dyson Ltd.**



Source: Dyson

#### **Product development aimed at meeting customer needs for Industry 4.0, Big Data Analytics and Deep Learning**

Given the growing need for the adoption of Industry 4.0 or latest automation technology (AI, Blockchain, for local manufacturers and multinational companies), the group is developing its own proprietary products to meet market demand for higher automation in the manufacturing process, which include deep learning systems for vision inspection machines, upgraded monitoring and manufacturing process flow (i-MES) for data management system and fully automated joint test system (i-FCT). The existing vision inspection machines that are integrated into manufacturing processes do not utilise deep learning systems and require frequent re-configuration. iStone will develop a fully automated joint test system with multiple test stations. Current test machines require operators to load units under test to various test machines. The group has developed a prototype i-FCT and is currently at the stage of making improvements to overcome teething issues. iStone intends to design and develop conveyor

automation equipment/solutions in its second D & D Centre commencing with 48 months. The rollout of new products serves as the next earnings growth inflection point.

#### **Experienced key management team and strong entrepreneurship**

I-Stone Managing Director, Tee Sook Sing and Executive Director, Chan Kok San were ex electronic engineers at Dyson and have over 16 years of experience in the manufacturing business. The key management are instrumental for product development and business growth of the group. With the experience and stability of the key personnel, we believe I-Stone remains well-positioned to pursue future growth milestones.

#### **Industry Overview**

The key drivers for specialized machinery and equipment industry are growing demand for automation in the manufacturing industry, especially in the E&E industry, for higher productivity, continuous technological advancement for higher yield, end users' growing demand for E&E industries products such as home appliance, telecommunication & consumer electronics. Lastly, government initiatives to reduce reliance on foreign labor and tax incentives to grow Malaysia's E&E supply chain and to be the preferred destination for high-technology industry investment are also growth factors. The industry envisages Dyson's Singapore electric vehicle (EV) plant commencing in 2020 may cross sell its motor/airflow/light technology. Established service or equipment suppliers may be poised to benefit from this development. Nonetheless, Malaysia continues to be the preferred hub for Dyson for its home-appliance products production due to its well-developed electronic manufacturing services supply chain and a pervasive respect for intellectual property rights.

#### **Future Expansion**

**Table 2: Use of Proceeds**

Use of proceeds	Time frame	RM mil	%
Process and product development	Within 24 months	4.200	10.7%
Repayment of borrowings	Within 12 months	13.49	34.5%
Construction of New D&D centre	Within 48 months	6.80	17.4%
Capital expenditures	Within 24 months	5.20	13.3%
Working capital requirements	Within 36 months	5.90	15.1%
Estimated listing expenses	Within 1 months	3.50	9.0%
<b>Total</b>		<b>39.09</b>	

Source: Prospectus

34.5% of proceed will be used to repay borrowings raised for the factory plant it acquired recently, at the end 2018. 17.4% will be used to construct a new design and development (D&D) centre to house the development and production of its i-FCT, currently at the prototype stage. The new centre will be located within its current vacant factory land and the centre be

used to develop E&E and mechanical designs for the specialised automation machines, laboratories for D&D activities and prototyping labs for building prototypes and testing of newly developed machines and systems.

A 13.3% portion will be used to purchase machineries and accessories. The bulk of the purchases will be CNC machines and forming machines as the upgraded CNC machines provides higher efficiency as compared to the existing CNC machines. Fourthly, 15.1% of the funds raised will be for working capital for the group and 10.7% will be used to develop new products and product features (i-FCT, i-MES and deep learning system for vision inspection machines).

### **Major Risk**

#### **Slowdown in global economy**

A slow down or down turn in consumer spending on end user electronics will have a negative impact to the group's financial performance.

#### **Dependence on one major customer**

The group has maintained a long mutual relationship with Dyson. The Dyson Group of companies contributed approximately 54.1%, 61.5%, 66.5% and 65.5% to the Group's overall revenues for FY15, FY16, FY17 and FY18. Its supply of machinery are not made under long-term contracts as is usual industry practice. The loss or reduction of orders from this major customer will negatively affect the group's financial performance. In the immediate future, the group intends enlarge its customer portfolio to diversified its customer concentration risk in.

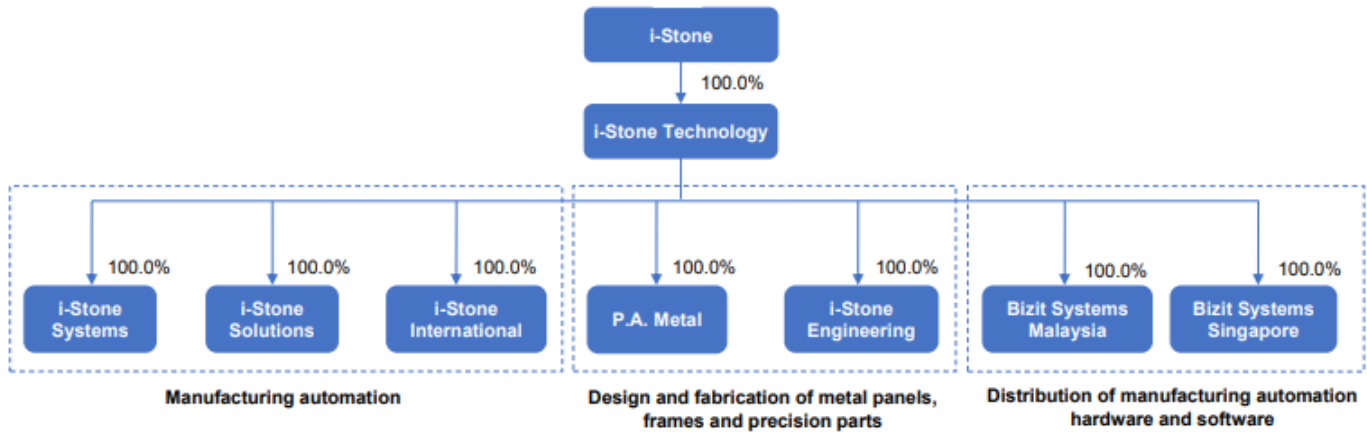
#### **Technological advancement**

Failure to keep up with industry demand for more advance automation and innovation would result in technological obsolescence which may affect I-Stone's topline growth.

#### **Labor shortage**

A shortage of labor and qualified engineers would frustrate the group's production targets. A typical manufacturing sector business in Johor Bahru suffers from attrition of engineers and production floor workers owing to far more attractive wages offered in Singapore.

**Group Structure**



Source: Prospectus

**Financials**

**Table 4: Capacity and machines assembled**

Capacity	Annual Capacity	Actual Production	Utilisation rate
FY17	600	600	100%
FY18	756	687	91%
FY19(F)	864	800	93%
FY20(F)	960	900	94%

Source: Prospectus, Inter-Pacific

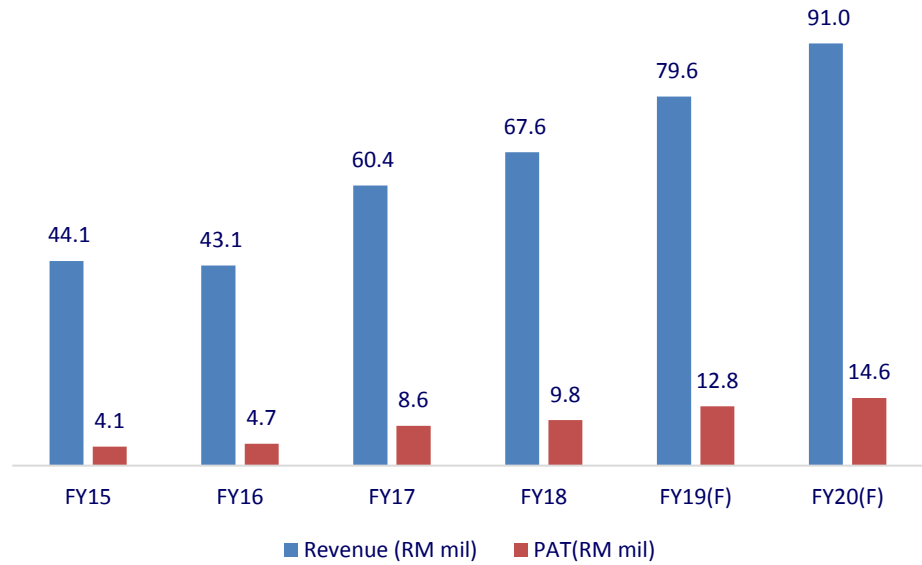
The group relocated its factory to new premises in Oct FY18 where a larger floor space consisting of 72 manufacturing bays that enhanced production process flow. As an illustration of the group’s utilization and production space, the average time for production of 1 new specialised automation machine will be equivalent to that for modifications for 4 specialised automation machines. The group assembled 482 new machines & 118 modified machines in FY17, and 568 new machines & 119 modified machines in FY18.

**Financials**

The group’s revenue and PAT at RM67.6mil and RM11.5mil in FY18 recorded a FY15 - 18 CAGR growth of 15.28% and 41% respectively. The group’s revenue growth and earnings growth were due to capacity expansion that led to higher delivery of new specialised automation machine. The group’s GP margin ranged between 31.4% and 32.9% while the PBT ranged between 9.3% and 17%. The jump in PAT margin in FY17 was due to lower orders from modified used machines which yields lower margins. The increase in orders for modified used machines in FY16 came as the result of new regulations regarding the EURO’s home electric appliance energy

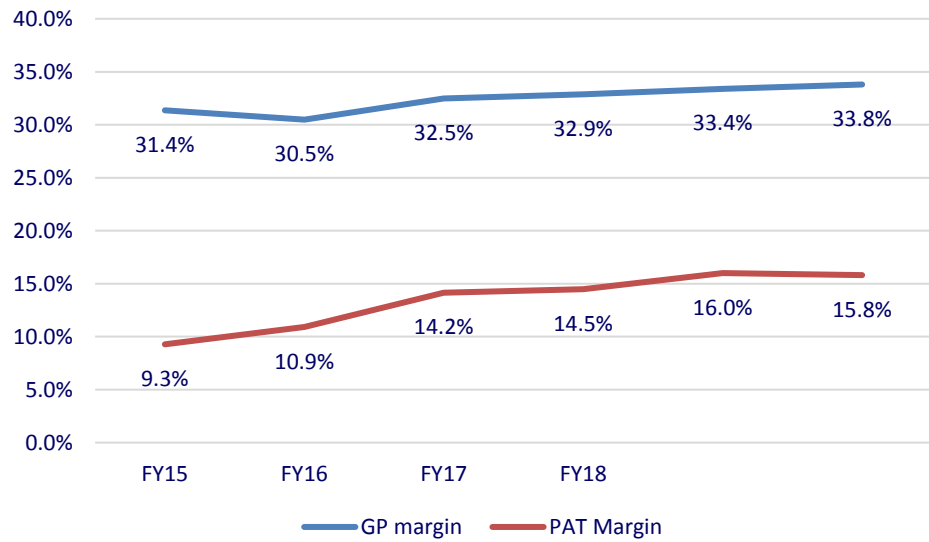
consumption. PAT margin jumped FY18, driven by gain of disposal of property, plant assets of circa~RM1.5m.

**Illustration 2: Revenue and PAT growth of 6.13% and 7.46%**



Source: Prospectus, Inter-Pacific

**Illustration 3: GP and PAT margin**



Source: Prospectus, Inter-Pacific

Upon full utilisation of IPO proceeds, the group’s balance sheet will be healthy and stable with a net gearing of 0, quick ratio of 1.7x.

**Table 5: Turnover days**

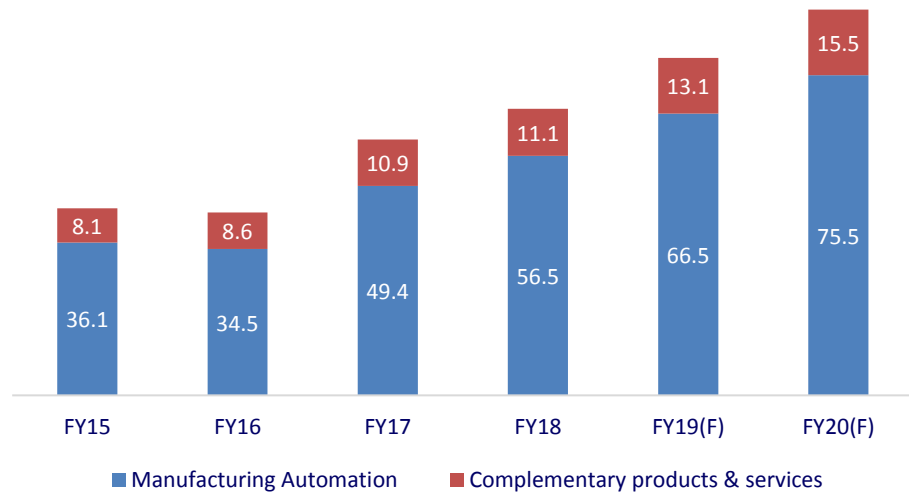
	FY15	FY16	FY17	FY18
Average trade receivables turnover days	58	92	84	76
Average trade payables turnover days	46	65	51	53
Average inventory turnover days	14	19	21	48
Current ratio	2.0	1.9	1.3	1.8

Source: Prospectus

Average trade receivables turnover days rose to 92 days in FY16 due to a change in credit period from 60 days to 90 days. Average inventory turnover days rose to 48 days in FY18 due to increase in work-in-progress orders of specialised automation machines.

The group enjoys pioneer status tax incentives at the group subsidiaries i-Stone Systems and i-Stone Solution, with a tax exemption of 70% and 100% respectively which expires/expired on 31<sup>st</sup> December 2021 and 4 December 2018 respectively. The group intends to apply for additional tax incentives for its i-FCT and conveyor automation equipment/solutions.

**Illustration 4: Revenue break down (RM mil)**



Source: Prospectus

**Table 6: Currency Denomination of Sales and Purchases**

Sales (mil)	FY15		FY16		FY17		FY18	
RM	29.8	68%	31.7	74%	37.393	62%	51.5	76%
USD	5.1	11%	3.3	8%	14.000	23%	11.0	16%
SGD	9.3	21%	8.1	19%	9.171	15%	5.1	8%
	44.2		43.1		60.38		67.6	

Source: Prospectus

Purchases (mil)	FY15		FY16		FY17		FY18	
RM	11.0	41%	11.7	47%	17.6	53%	14.6	44%
USD	7.6	28%	6.6	27%	6.1	18%	11.3	34%
SGD	7.9	29%	6.5	26%	9.4	28%	5.4	16%
Others	0.2	1%	0.1	1%	0.4	1%	2.1	6%
	26.7		24.99		33.5		33.4	

Source: Prospectus

#### **Earnings forecast**

We forecast PAT of RM12.8mil and RM14.6mil in FY19 and FY20 respectively, representing earnings growth of 11.3% in FY19 and 14.4% in FY20, driven by higher sales of specialised automation machines and higher GP margin coming from economies of scale. We are optimistic with the group's development equipment/solutions which will serve the next earnings growth inflection point. The group has not adopted a formal dividend policy.

#### **Valuation**

We ascribe 15.5 (x) PER pegged to FY20 EPS of 1.2 sen, thus establishing a fair value of RM0.185, translating a potential return of 19.6% with dividends. Our PER valuation of 15.5 (x) is within the valuation range of automation equipment peers.

**Table 7: Automation Equipment Peer Valuations**

	Mkt Cap (RM mil)	FY18 PAT Margin (%)	Trailing PER (x)	Fwd PER (x)	P/BV (x)	ROE (%)	Dvd Yied (%)
Pentamaster	1,481	22.2	21.3	17.6	3.94	20.4	NA
Mi Technovation	861.0	27.6	17.2	15.3	2.56	19	1.1
Elsoft Research	526.4	50.8	18.2	19.7	4.45	27.8	5.7
MMS Ventures	137.0	18.7	20.7	8.9	2.45	11.6	2.6
Simple Average		29.8	19.4	15.4	3.4	19.7	



**Appendices**  
**Products Overview**

**Specialised test machines**

Fully or partially automate in-process testing in different manufacturing lines

**Functional** test machines

Test specific functions (e.g. noise levels, rotational speed, durability, air flows and pressure levels)



**PCBA** machines

Test electrical characteristics of PCBAs (e.g. voltage, current, and communication protocol)



**Specialised process machines**

Fully or partially automate certain manufacturing processes such as assembly, screw, trim, glue sort and laser mark of parts and components



The group Distributes third party manufacturing automation software & hardware. Amongst them is the Minitab brand of statistical analysis software used for statistical analysis of manufacturing processes. Another is the Digi brand of wireless communication devices and related embedded modules, which are mainly used for IoT systems; and Robotic technology equipment (such as robotic arms) manufactured by Universal Robots A/S.



Source: Prospectus

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Signed



Pong Teng Siew  
Director  
Inter-Pacific Research Sdn Bhd

## Ratings System

**Ratings:**

**Description:**

SUBSCRIBE	Total return is expected to exceed 15% in the next 12 months
UNSUBSCRIBE	Total return is expected to be below -15% in the next 12 months

## Abbreviation

Abbreviation	Definition	Abbreviation	Definition
PER	Price Earnings Ratio	CAGR	Compounded Annual Growth Rate
PEG	PER to Growth	CAPEX	Capital Expenditure
EPS	Earnings per Share	DPS	Dividend per Share
FYE	Financial Year End	ROA	Return on Asset
FY	Financial Year	ROE	Return on Equity
CY	Calendar Year	PBT	Profit Before Tax
MoM	Month-on-Month	PAT	Profit After Tax
QoQ	Quarter-on-Quarter	EV	Enterprise Value
YoY	Year-on-Year	EBIT	Earnings Before Interest And Tax
YTD	Year-to-Date	EBITDA	EBIT Depreciation & Amortisation
p.a.	Per Annum	WACC	Weighted Average Cost of Capital
DCF	Discounted Cash Flow	NTA	Net Tangible Asset
FCF	Free Cash Flow	BV	Book Value
NAV	Net Asset Value		

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