CBRS Free Research Reports

ALLIANCE RESEARCH

KDN: PP 7766/03/2011 (028011)

AIC Corp Bhd

28 February 2010

HOLD

Target Price: RM1.33

INITIATING COVERAGE

Waiting for re-rating catalysts

INVESTMENT HIGHLIGHTS

- **Replacement of gold wires in semiconductor packaging with copper.** AIC has the ability to utilise copper instead of the commonly-used gold for the interconnection between the chip to the external leads. The copper wiring-based Semiconductor packaging has similar reliability and performance to that of gold, but allows for 80%-90% saving in material cost. Part of the cost savings accrue to clients, resulting in lower average selling price but the savings will allow AIC to expand margins, and drive earnings growth going forward. AIC expects copper wire semicon-packaging will raise to about 40% of orders from 20% currently.
- **Venture into medical and life science instrument production.** To reduce its dependence on the semicon industry and lessen revenue and earnings volatility, AIC has ventured into production of high precision medical instruments and parts for life science equipment. Its clients include world leading medical equipment suppliers. AIC expects healthy growth in sales of these products, and such instruments typically command better margins than semicon-related machining services.
- **Rising commodity prices.** AIC's raw material costs consist mostly of traded metals e.g. aluminium, gold and copper. Its margins would thus be affected by the prices of these metals in the global market. While the switching of gold to copper wiring should reduce its exposure to volatile gold prices, AIC would be increasingly exposed to copper price movements instead.
- **Initiated with HOLD rating.** Pegging PER11 of 11.9x to EPS11 of 11.2sen, we value AIC Corp at the derived target price of RM1.33/share based on 1) cost-reduction measures 2) better earnings prospects. Due to the limited upside, we initiate coverage on AIC with a HOLD call.

Investment Data

Stock Code	**9547**
Website	**www.aic.com.my**
IR Contact	**wwt@aic.com.my**
Price	RM1.24
Potential upside	7.26%
Expected yield	NA
Expected return	7.26%
Indices Constituent	Main Market
Market / Sector	Semiconductor
Market cap	RM221.8 m
Issued shares @ RM0.50 par	178.9m
52 week high/low	RM1.27/RM0.78
3m avg daily vol	0.1m shares

	Old	New
Recomm.	-	**HOLD**
TP	-	**RM1.33**

Major s/holders	**%**
Tian Chuan Goh	20.4
Jotech Holdings Bhd	16.1
Est. Free Float	63.5

Key Stock Statistics	2011F	2012F
EPS (sen)	11.2	12.0
PER (x)	11.9	9.5
Dividend/Share (sen)	N/A	N/A
NTA/Share (RM)	1.25	1.29
Book Value/Share	0.88	0.91
Issued Cap. (m shares)	173.9	173.9
52-weeks Share Price Range	RM1.27 - RM0.57	

Per Share Data	2009	2010	2011F	2012F
Book Value (RM)	0.67	0.77	0.88	0.91
Cash Flow (sen)	0.11	0.16	0.20	0.23
Earnings (sen)	4.90	8.90	11.12	11.99
Payout Ratio	N/A	N/A	N/A	N/A
PER (x)	9.8	11.4	11.9	9.5
P/CF (x)	11.3	7.8	6.2	5.4
P/BV (x)	1.9	1.6	1.4	1.4
DY (%)	NA	NA	NA	NA
ROE (%)	7.3	11.5	12.3	12.5
Net Gearing (X)	0.14	0.09	0.13	0.10

Sources: Alliance Research, Bloomberg

P&L Analysis (RM m)

FYE Dec	2009	2010	2011F	2012F
Revenue	133.4	167.4	187.7	200.1
Operating Profit	13.3	19.6	24.2	25.8
Depreciation	15.1	14.1	15.2	15.5
Interest Expenses	3.0	2.4	2.8	3.2
Pre-tax Profit	10.7	17.4	22.5	24.1
Effective Tax Rate (%)	3.3	14.6	13.7	13.7
Net Profit	8.5	15.5	19.4	20.8
Operating Margin (%)	10.0	11.7	12.9	12.9
Pre-tax Margin (%)	8.0	10.4	12.0	12.0
Net-Margin (%)	6.4	9.3	10.3	10.4

Balance Sheet and Other Financial Data

FYE Dec	2008	2009	2010
Total Assets	192.4	197.8	209.7
Fixed Assets	105.2	97.4	104.2
Current Assets	68.2	79.5	76.8
LT Assets	124.2	118.3	133.0
Current Liabilities	32.8	34.5	39.5
LT Liabilities	41.9	36.7	26.0
Share Capital	173.9	173.9	173.9
Shareholders Funds	108.3	116.8	134.1

Sources: Alliance Research, Bloomberg

Background

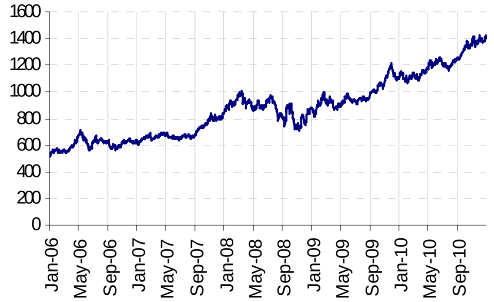
AIC Corp Bhd (AIC) is involved in the semiconductor industry, specifically:

- **The design, development, engineering, testing and assembly of packaging** for integrated circuit chips/smart card modules
- **Precision machining:** Manufacturing of photonic and Radio Frequency ("RF") microwave devices, manufacturing of precision medical equipment; manufacturing of high precision tooling, mould and die sets; and the design and manufacturing of turnkey automation systems.

For further detail on AIC and photos of its products, refer to Appendix on page X

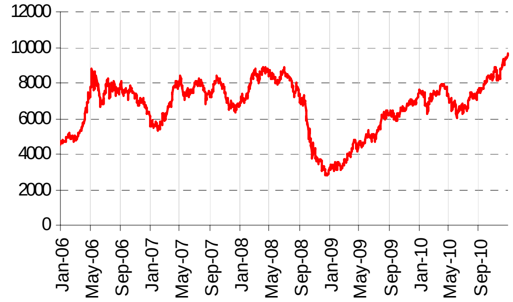
Investment case

Gold Spot Price, USD / tr oz



Sources: Bloomberg, Alliance Research

Copper Spot Price, USD / Mtr. Tn



Sources: Bloomberg, Alliance Research

- **Replacement of gold wires in Semiconductor packaging with copper.** AIC has the ability to utilise copper instead of the commonly-used gold for the interconnects between the chip to the external leads. The company has mass produced copper bonding packages since 2008 to its Taiwanese semiconductor players. The copper wiring-based Semiconductor packaging has similar reliability and performance to that of gold, but allows for 80% - 90% saving in material cost. Part of the cost savings accrue to clients, resulting in lower average selling price but the savings will allow AIC to expand margins, and drive earnings growth going forward. AIC expects copper wire Semiconductor packaging will rise to about 40% of orders from 20% currently.

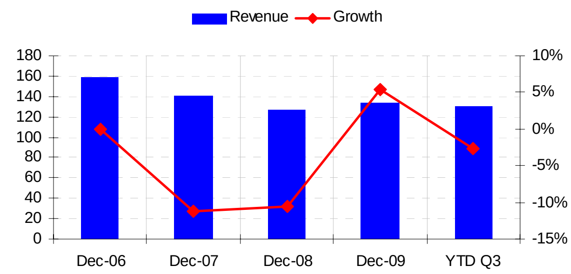
- **Venture into medical and life science instrument production.** To reduce its dependence on the semicon industry and lessen revenue and earnings volatility, AIC has ventured into production of high precision medical instruments and parts for life science equipment. Among the instruments produced include surgical callipers, broach handles and clamps. Its clients include world leading medical equipment suppliers According to management, the business utilises existing machinery and expertise in precision machining; hence other than training, minimal investment was required. AIC expects healthy growth in sales of these products, and such instruments typically command better margins than semicon-related machining services.

- **Secured supply chain & partnership with C-TPAT customers & vendors.** As mentioned by the management, AICS is a validated site by the US Customs according to the C-TPAT requirements. Being validated to have a secure supply chain brings benefits to AICS customers in areas of customs clearance for products imported into US. It will put AICS in a better position when they pursue further expansion on US based customers. The management is currently not in a position to disclose specifically on projects which they are working with the US based customers.

- **Production Ramp up.** Management has plans to invest capex particularly in machinery and building, of RM60m in 2011 to increase its capacity in QFN and copper bonding. Expansion would be for both its Kulim and Bayan Lepas plants. AIC plans to expand its Kulim plant by 150,000 sq ft. whereas Prodelcon is looking to shift its plant in Penang to a bigger site.

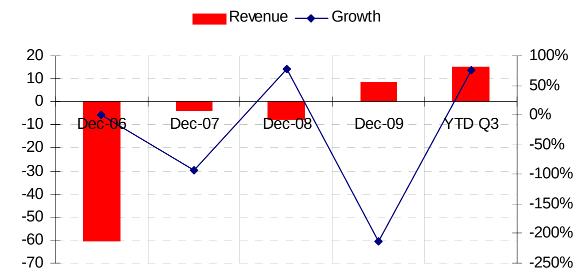
Financial Highlights

AIC's Revenue



Sources: Alliance Research, AIC

AIC's Profit



Sources: Alliance Research, AIC

- In 2008, Semiconductor packaging contributed 86.3% of total revenue but in 2009 its contribution fell to 80%. This is due to a) strengthening of ringgit vs USD as 60% of the Semiconductor segment's sales are denominated in USD b) fall in unit price due to rising orders of copper wire-based packaging at the expense of gold wire-based packaging c)full year revenue contribution from the precision machining segment in 2009 as Prodelcon was acquired only towards end of 2008.

- Meanwhile, contribution from precision machining has risen from 9.5% of AIC's total revenue in 2008 to 18.9% in 2009, underpinned by its venture into manufacturing of medical and surgical instruments. It is worth noting that the reason for the low contribution in 2008 was due to the fact that Prodelcon was acquired only towards the end of 2008. Management expects this business to see double-digit growth; thus precision machining's contribution is expected to rise to 40% by FY12.

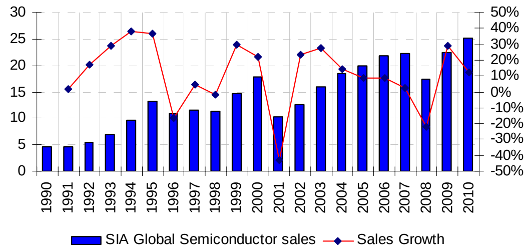
- YTD FY10, semiconductor packaging accounted of 71.9% of total revenue and 33.6% of operating profit. Meanwhile precision machining contributed 27% of total revenue and 52% of operating profit.

- AIC is unlikely to declare any dividends in the near term given its expansionary plans. In tandem with the expansion, AIC net gearing could possibly rise to 0.2x as it may require debt financing for its plans.

- For FY11 and FY12, revenue is expected to drop xx% as unit sales price is dropping for Semiconductor packaging due to the shift towards increasing copper wire-based packaging. However, net profit is set to grow xx% in FY11 and xx% in FY12 as margins expand in Semiconductor packaging operations and the production of medical instruments increase.

Industry Outlook

Global Semiconductor Sales



Sources: SIA, Bloomberg

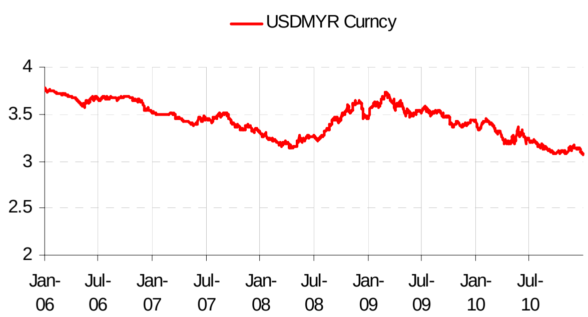
- **The Semiconductor Industry Association (SIA) is forecasting 6% sales growth of semiconductors in 2011**, driven mainly by demand from production of tablets and smartphones. Based on this expectation, AIC is projecting 10% revenue growth in FY11. The revenue growth is higher than estimated by the SIA due to steadily rising acceptance of copper as gold wiring substitute in Semiconductor packaging and higher orders of precision medical instruments.

- **Penang is increasingly a hub for manufacturing of precision medical instruments**. To reduce dependence on the semicon sector, the Penang State Government had in recent years encouraged medical instrumentation manufacturers to establish production facilities. Among the major names already present include B. Braun, Symmetry Medical, St. Jude Medical, Ambu, etc. Many of them are already clients of AIC. Demand for medical instrumentation is expected to rise approximately 10% p.a. in the next 5 years in tandem with population growth and rising affordability for better healthcare.

Key Investment Risks

- **Weakening of USD against MYR.** Most of AIC's sales are denominated in USD, JPY and EUR. However, about 35% of its cost of goods sold is denominated in USD, mainly raw materials, while the rest is in ringgit (particularly labour and overhead costs). AIC margins would thus be influenced by forex rate movements, of which if unfavourable may impact negatively to its bottom line. In mitigation, the company is closely monitoring to hedge the risk by entering forward contracts.

USDMYR Currency



Source: Bloomberg

- **Global economy downturn.** AIC's Semiconductor packaging products are dependant on demand for semiconductors, which ultimately depend on demand for electronic consumer goods e,g, computers and mobile phones. Such items are discretionary consumer goods, which mean consumer purchases would depend on sentiment and disposable income levels. Thus, AIC could be adversely affected in times of economic downturn. In mitigation, demand for precision medical instruments is more inelastic which should reduce revenue and earnings volatility.

- **Rising commodity prices.** AIC's raw material costs consist mostly of traded metals e.g. aluminium, gold and copper. Its margins would thus be affected by the prices of these metals in the global market. While the switching of gold to copper wiring should reduce its exposure to volatile gold prices, AIC would be increasingly exposed to copper price movements instead.

Valuation

Competitive Analysis

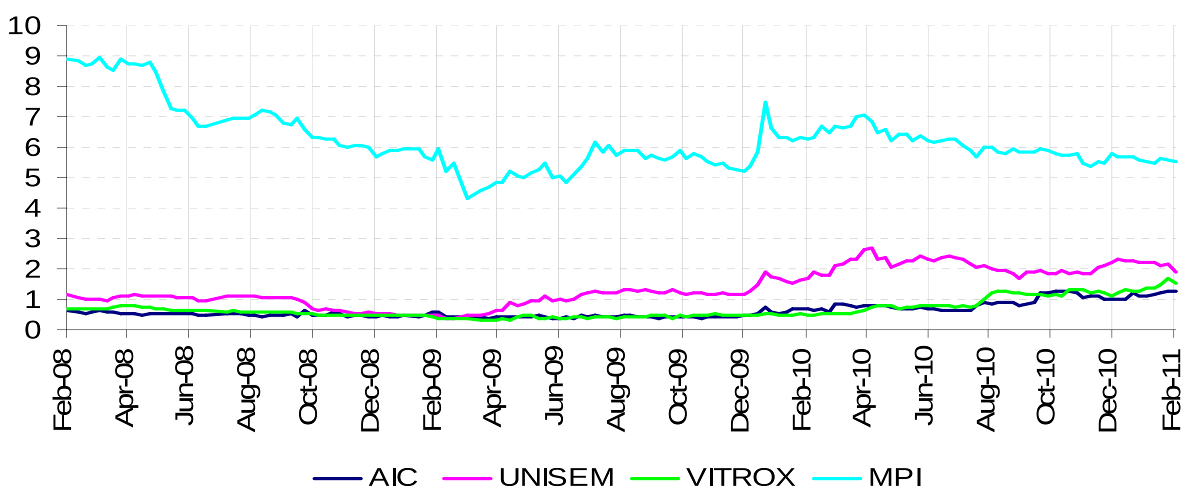
Comparative Valuation	AIC Corp	Vitrox	Unisem	MPI
Share Price (RM) @ date	1.24	1.52	1.92	5.55
Market Cap (RM m)	215.6	235.6	1294.4	1164.9
Ave. Daily 3Mths Vol. (m)	0.10	0.16	1.98	0.03
PER FY11 (x)	11.9	6.8	7.3	10.6
PER FY12 (x)	9.5	6.1	7.7	9.4
P/NTA	1.3	4.8	1.3	1.5
Yield	NA	2.9	5.6	5.4

Source: Alliance Research, Bloomberg

Pegging at the target PER11 of 11.9x to EPS11 of 11.2sen, we value AIC Corp at the target price of RM1.33/share based on 1) cost-reduction measures 2) better earnings prospects.

Other supporting charts/information

Price for AIC, Vitrox, Unisem and MPI



Sources: Bloomberg

APPENDIX

Company Background/Overview

AIC Corporation Berhad was incorporated in Mar 1990 under the name Autoindustries Corporation Sdn. Bhd and was listed on Bursa Malaysia on Dec 1994 and assumed its present name on Apr 1997 to reflect its diversification from the automotive industry. Starting as an automotive parts manufacturer, AIC diversified into the semiconductor, plastics, precision metal and information technology industries between 1995 to 1998 through acquisitions of companies and JVs into new businesses. AIC had since 2006 commenced and in 2008 completed the divestment of its non-core business and is now focused on serving the semiconductor and higher value-added technology sector.

Under AIC Corporation Bhd, there are 2 main subsidiaries, namely AIC Semiconductor Sdn Bhd (AICS) and Prodelcon Sdn Bhd. AICS provides one-stop solution services of package design and development, engineering and test development, packaging, assembly and test of integrated circuit chips/smart card modules and drop-shipment and distribution centre services..

Meanwhile, Prodelcon's principal activities are the manufacturing and provision of high precision machining and assembly services for the components of photonics and RF microwave products, surgical instruments, body implants, manufacturing of high precision tooling, mould and die sets; and the design and manufacturing of turnkey automation systems.

CORPORATE STRUCTURE	
SEMICONDUCTOR	
AIC Technology Sdn Bhd	100%
• AIC Semiconductor Sdn Bhd	94%
PRECISION TOOLING & AUTOMATION	
Prodelcon Sdn Bhd	100%
OTHERS	
AIC Properties Sdn Bhd	100%
AIC-Toptek Communications Sdn Bhd	100%
Custom Tooling Engineering (Malaysia) Sdn Bhd	100%
Custom Tooling (Malaysia) Sdn Bhd	100%
Integral CAD Technologies Sdn Bhd	100%
• Alpha Mediatech Sdn Bhd	100%
AIC Inspirasi Sdn Bhd	100%

Sources: AIC

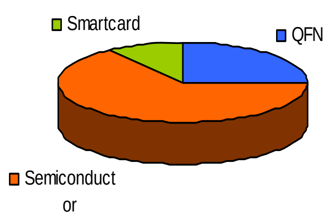
Products

AICS provides the design and development for the leaded packages such as Dual Flat-pack No-Lead, Plastic Dual In-Line Package, Plastic Leaded Chip Carrier, Quad Flat-pack No-Lead and so on. On top of that, AICS also does packaging, assembly and test of integrated circuit chips and smart card modules. AICS also provides drop-shipment and distribution centre services.

AICS' main products consist of Quad Flat-pack No-Lead (QFN), Small Outline Integrated Circuit (SOIC), Radio Frequency Identification (RFID) and Smart Card Modules (SCM). In 2010, QFN and Smart card modules accounted for 35% of AICS revenue. In order to utilize the copper wire technology, management intends to ramp up the QFN production from 30 million pieces per month to 50 million pieces per month.

The company aims to ramp up the production to more than 1 billion pieces in the end of 2011 in tandem with high demand.

AICS Composition of Revenue



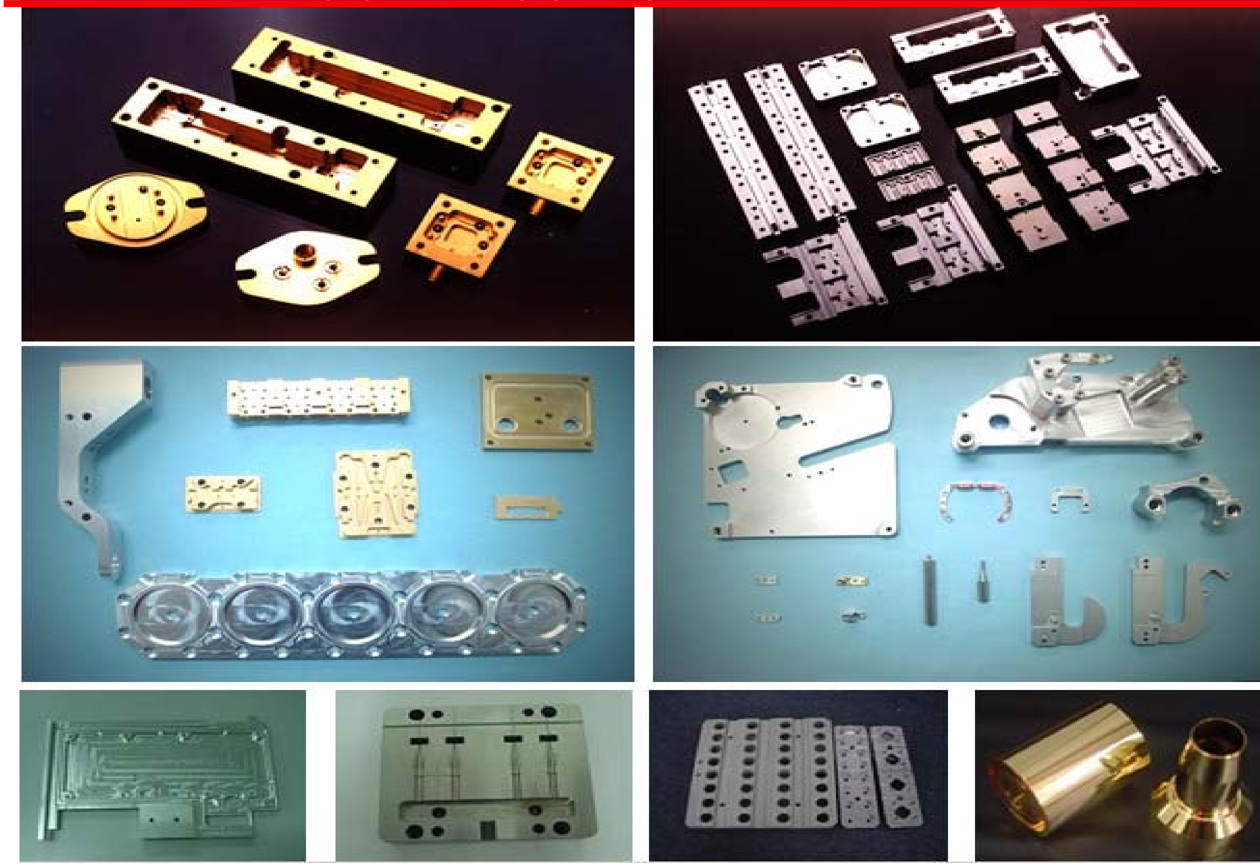
Sources: Alliance Research, AIC

Meanwhile, Prodelcon manufactures and provides high precision machining services for the components of photonics and RF microwave devices.

It also manufactures high precision tooling, mould and die sets. By utilising its machines, it also provides the design and fabrication for IC molds and automation equipment of AICS.

Additionally Prodelcon designs and manufactures turnkey automation systems. Leveraging on its manufacturing of high precision tooling, mould and die sets, Prodelcon has ventured into the life sciences and surgical instrument manufacturing.

Prodelcon Sdn Bhd: High precision equipment parts

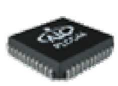


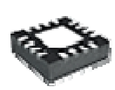
AICS MAIN PRODUCTS

Leaded Packages

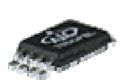

DFN
Dual Flat-pack No-Lead


PDIP
Plastic Dual In-Line Package


PLCC
Plastic Leaded Chip Carrier


QFN
Quad Flat-pack No-Lead


SOIC
Small Outline Integrated Circuit


TSSOP
Thin Shrink Small Outline Package

Smart Card Modules


SCM
Smart Card Modules

Source: AIC

Management and Board

Datuk Maj (H) Goh Tian Chuan is the Executive Chairman of AIC Corporation Bhd. He was appointed to the board on 15 June 2006. Besides, he is the Executive Chairman of Jotech Holdings Berhad (“Jotech”) and Nakamichi Corporation Berhad (“NCB”).

Ooi Boon Pin is the Executive Director and the Group Chief Executive Officer of the company. He was appointed to the board on 20 August 2008 as an Executive Director and group Chief Executive Officer of AIC. He is also a Non-Independent and Non-Executive Director and a member of the Audit and Nomination Committees of Jotech and a council member of the Penang Skills Development Centre.

Chen Heng Mun is the Executive Director and the Chief Financial Officer of the company. He was appointed to the board on 1 August 2007. He is also an Executive Director of NCB and a Non-Independent and Non-Executive Director of AutoV Corporation Berhad (formerly know as AV Ventures Corporation Berhad).

Yahya Bin Razali is the Independent Non-Executive Director of the company. He was appointed to the board on 15 June 2006. Besides, he was appointed as the Chairman of the Nomination Committee on even date and is a member of the Audit Committee and Remuneration Committee.

Ng Kok Hok was appointed to the board on 1 September 2007 as an Independent Non-Executive Director. On the same date, he was appointed as Chairman of Audit Committee and Remuneration Committee and is a member of the Nomination Committee of the Company.

Liew Cheng Yok was appointed to the board on 20 August 2008 as a Non-Independet non-Executive Director of AIC and was appointed to the Audit Committee on 23 November 2009.

Recommendation Framework

STOCK RECOMMENDATIONS

OUTPERFORM	:	The stock's total return is expected to exceed KLCI's total return by 10% or more in the next 12 months.
MARKET PERFORM	:	The stock's total return is expected to be within +10% or –10% of KLCI's total return.
UNDERPERFORM	:	The stock's total return is expected to be below KLCI's total return by 10% or more in the next 12 months.
TRADING BUY	:	The stock's total return is expected to exceed KLCI's total return by 10% or more within the next 3 months.
TRADING SELL	:	The stock's total return is expected to be below KLCI's total return by 10% or more within the next 3 months.
NOT RATED	:	Stock is not within our regular coverage

SECTOR RECOMMENDATIONS

OVERWEIGHT	:	The industry as defined by the analyst is expected to outperform the KLCI over the 12 months.
NEUTRAL	:	The industry as defined by the analyst is expected to perform in line with KLCI over the 12 months.
UNDERWEIGHT	:	The industry as defined by the analyst is expected to underperform the KLCI over the next 12 months.
total return	**=**	**capital gain + dividend yield**

Common Abbreviation

Adex = Advertising Expenditure
bn = billion
BV = Book Value
CF = Cashflow
CAGR = Compounded Annual Growth rate
Capex = Capital Expenditure
CY = Calendar Year
Div yld = Dividend Yield
DCF = Discounted Cashflow
DPS = Dividend Per Share
EBIT = Earnings Before Interest & Tax
EBITDA = EBIT before Depreciation and Amortisation
EPS = Earnings per share
EV = Enterprise Value
1QFY12/07 = 1st Quarter for FY Dec 07
2HFY12/07 = 2nd Half for FY Dec 07

FCF = Free Cashflow
FV = Fair Value
FY = Financial Year
KLCI = Kuala Lumpur Composite Index
m = million
MoM = month on month
MP = Market Perform
NAV = Net Assets Value
NM = Not Meaningful
NTA = Net Tangible Assets
NR = Not Rated
p.a. = per annum
PAT = Profit after tax
Pretax profit = Profit before tax
PE = Price Earnings Ratio

PEG = PE ratio to growth
PER = PE ratio
QoQ = Quarter on Quarter
OP = Outperform
RM = Ringgit
RM bn = RM billion
RM m = RM million
ROA = Return on Assets
ROE = Return on Equity
ROSF = Return on shareholders funds
TP = Target Price
UP = Under Perform
WACC = Weighted Average Cost of Capital
YoY = Year on Year
YTD = Year to date

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ALLIANCE RESEARCH SDN BHD (290395-D)
Level 18, Menara Multi-Purpose
Capital Square
8, Jalan Munshi Abdullah
50100 Kuala Lumpur, Malaysia
Tel: +60(3) 2692 7788
Fax: +60(3) 2717 6622