



# Wah Lee Industrial (3010 TT)

## Upgrade to BUY

□ TW 50 □ TW Mid-Cap100 □ MSCI

### MasterLink Research

Analyst: Steven Su  
stevensu@masterlink.com.tw

### Contact Information

Carolyn Chan  
digiwww95@masterlink.com.tw

### Recommendation

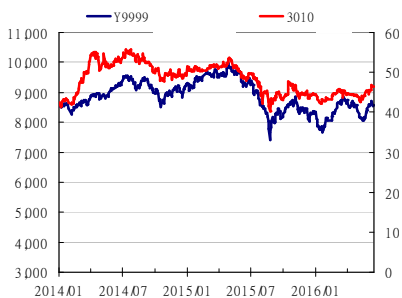
Date:	2016/06/16
Share Price (NT\$):	46
Target Price (NT\$):	56
52-wk Range (NT\$):	40.2-53.3
TWSE:	8513.02

### Company Data

Capital Size (US\$/mn):	71
Market Cap (US\$/mn):	358
20d Avg Vol (lots):	131
PER (*16E):	8.21
PBR (*16E):	1.02
Foreign Ownership:	21.50
TCRI	4

Price Performance	1-m	3-m	6-m
Absolute (%)	6.9	1.5	6.8
Relative to TAIEX	6.5	-2.0	6.7

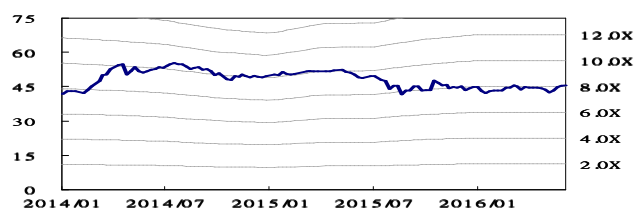
Key Changes	Current	Previous
Recommendation	BUY	HOLD
Target Price (NT\$)	56	45
Revenue (NT\$/mn)	40,701	39,670
Gross Margin (%)	9.61	9.17
Operating Margin (%)	3.65	3.27
EPS (NT\$)	5.65	5.29
BVPS (NT\$)	45.3	44.9



## Improved Product Mix; Profit to Hit Five-year High

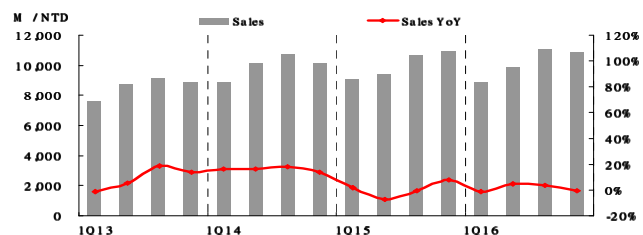
- **2Q16 EPS of NT\$1.14 hit an annual trough in 2016.** Wah Lee's most product lines have enjoyed seasonal strength and are likely to post sales growth of more than 10% QoQ in 2Q16 except for solar business. We estimate Wah Lee's 2Q16 sales of NT\$9.86bn (up 10.8% QoQ); its margin would decline to 9.5% given higher sales weight of lower-margin FPD products with estimated operating income of NT\$339mn (up 9.8% QoQ and 20.8% YoY). Lack of gain on disposal of shares, we expect decline in investment income. Coupled with taxation on retained earnings, we expect Wah Lee's 2Q16 EPS of NT\$1.14 to hit an annual trough.
- **Improved product mix and gross margin.** We expect Wah Lee's ICT plastic materials sales growth of high single digit to top the other product lines in 2016. This is because engineering plastic materials applied to electronics products and connectors are rising steadily. Additionally, we see rising sales contribution of the following applications: (1) USB Type C connectors and DDR4, (2) medical packaging and tube materials, and (3) sales contribution of its food packaging is on the rise. Furthermore, given ICT plastic materials' margin above average, we anticipate improved product mix and margin increase.
- **Better gross margin of green energy materials.** Solar products account for nearly 70% of green energy product sales. Wah Lee is the distributor of GCL-Poly's (3800:HK) wafer and Giga Solar's (3691 TT) silver and aluminum paste in China. In 2016, considering low margin and inventory risk of solar wafer in addition to limited profit contribution, Wah Lee has been lowering wafer sales. On top of downward price pressure of LED materials, we expect green energy materials sales to exhibit annual sales decline yet full-year margin increase.
- **Upgrade to BUY.** We revise up FY16 EPS estimate from NT\$5.29 to NT\$5.65. Considering that its major growth driver will come from high-margin engineering plastic division this year as low-margin solar wafer sales proportion will gradually decline, improved product mix will boost Wah Lee's sales. In addition, as its profit is expected to hit a five-year record high, we upgrade Wah Lee to BUY with a TP of NT\$56.

Exhibit 1: P/E Band



Source: MasterLink

Exhibit 2: Sales and YoY Growth



Source: MasterLink



**Wah Lee is a semiconductor material and equipment distributor. Green energy material was Wah Lee's major growth driver in 2015.**

Wah Lee was established in 1968 and is a semiconductor material and equipment distributor. Major product lines can be divided as semiconductor processing material, IT/Telecom processing material, FPD equipment and material, green energy and others; 2015 sales weights of these divisions are 21.3%, 40.5%, 17%, 16.6% and 4.5% respectively. Given solar market's rebound alongside rising market share of Giga Solar's front-side silver paste in China, the green energy materials' enjoyed the highest sales growth of 20% YoY. FPD materials prices dropped by 30% due to industry rivalry, and hence it suffered from the most notable sales decline of 11% YoY. For sales breakdown by region, Taiwan, China and others represented 57%, 40% and 3% of Wah Lee's sales, respectively.

Exhibit 3: Wah Lee's Product Mix

Product	FY15 Sales mix	FY15 Sales YoY	Applications	Clients
Semiconductor	21%	-4%	JSR photoresist, photoresist stripper, processing chemical, slurry	TSMC, UMC, Micron, Winbond, Macronix
IT/Telecom	41%	1%	High-end engineering plastic materials applied to IT/Telecom casings, peripheral components (such as connector), photoresist dry film, CCL direct bond copper material, PCB/MB processing equipment & disposable	Hon Hai, Foxlink, P-two, Asustek, Largan, Compeq, Unimicron
FPD	17%	-11%	OLED modules, Polarizing plates, panel facilities and process chemicals	AUO, Innolux, Chinese white-box handset companies
Green Energy	17%	20%	Solar: silicon wafer, silver and aluminum paste	Motech, Eton, Chinese clients
			LED: ingot, EPI material, PA9T	Lextar, I-Chiun, Everlight
			Wind Power: blade materials	China clients
			LiFePO4 battery: cathode/anode materials, separator	China clients
Others	5%	3%		

Source: Company

**Thanks to improved product mix in 1Q16 and CWE's gain on disposal of How Weih, EPS of NT\$1.45 hit a record high.**

Wah Lee logged 1Q16 sales of NT\$8.9bn (down 18.6% QoQ). Thanks to rising sales weight of high-margin ICT materials and reduced solar wafer shipments, its margin of 9.9% was higher than 9.2% in 4Q15. For non-operating income, as its subsidiary, CWE, booked disposal gain of How Weih, Wah Lee's net income reached NT\$337mn (up 5.9% QoQ). EPS of NT\$1.45 hit a record high in recent years.

**Despite robust sales of core business in 2Q16, Wah Lee's profit is expected to hit a full-year trough due to shrinking investment gain and taxation**

Wah Lee's most product lines have enjoyed seasonal strength except for solar business, and are likely to post sales growth of more than 10% QoQ. We estimate Wah Lee's 2Q16 sales of NT\$9.86bn (up 10.8% QoQ); its margin is however expected to lower to 9.5% given higher sales weight of lower margin FPD products with estimated operating income of NT\$339mn (up 9.8% QoQ and 20.8% YoY). Lack of gain on disposal, we expect decline in investment income. Coupled with retained earnings, we expect Wah Lee's 2Q16 net income of NT\$265mn (down 21.4% QoQ) and NT\$1.14 to hit an annual trough.



**ICT materials division's sales and profit growths to top among Wah Lee's product lines, which will improve its product mix.**

ICT materials are Wah Lee's major source of income; the division's major products are engineering plastic materials; Jan-May16 sales growth of 9% YoY was significantly higher than 0-5% YoY in the past. Looking into 2016, we expect Wah Lee's ICT plastic materials sales growth of high single digit to top the other product lines in 2016. This is because engineering plastic materials applied to electronics products and connectors are rising steadily. Additionally, we see rising sales contribution of the following applications: (1) USB Type C connectors and DDR4, (2) medical packaging materials, and (3) food packaging's sales contribution is on the rise. Furthermore, given ICT plastic materials' margin above average, we anticipate improved product mix and margin increase.

**Thanks to solar product lines' adjustment, Wah Lee's green energy sales might undergo small decline, which could instead help improve its margin.**

Solar products and LED materials account for 68% and 19% of Wah Lee's green energy product sales. Wah Lee is the distributor of GCL-Poly (3800:HK)'s wafer and Giga Solar's (3691 TT) silver and aluminum paste selling to China. In 2016, considering low margin and inventory risk of solar wafer in addition to limited profit contribution, Wah Lee has been lowering wafer sales. On top of downward price pressure of LED materials, we expect green energy materials sales to exhibit annual sales decline yet full-year margin increase.

**As improved product mix could boost sales, we expect Wah Lee's 2016 profit to hit a five-year high. We hence upgrade Wah Lee to BUY.**

Wah Lee plans to distribute cash dividend of NT\$2.7, which translates into cash dividend yield of nearly 6%. We revise up FY15 EPS estimate from NT\$5.29 to NT\$5.6. Considering that its major growth driver will come from high-margin engineering plastic division this year as low-margin solar wafer sales proportion will gradually decline, improved product mix will boost Wah Lee's sales. In addition, as its profit is expected to hit a five-year record high, we upgrade Wah Lee to BUY with a TP of NT\$56.

**Risks.**

1. RMB and USD fluctuations could lead to Forex loss.
2. Clients' inventory adjustment could result in operational risk.



Comprehensive income statement					Consolidated Balance Sheet				
NT\$m					NT\$m				
Year-end Dec. 31	FY13	FY14	FY15	FY16F	Year-end Dec. 31	FY13	FY14	FY15	FY16F
	IFRS	IFRS	IFRS	IFRS		IFRS	IFRS	IFRS	IFRS
Net sales	34,398	39,901	40,044	40,701	Cash	2,985	2,487	2,100	2,030
COGS	31,294	36,327	36,382	36,792	Marketable securities	354	243	335	365
Gross profit	3,104	3,574	3,661	3,910	A/R & N/R	9,473	11,148	11,029	11,271
Operating expense	2,085	2,305	2,320	2,422	Inventory	3,081	3,567	4,041	3,847
<b>Operating profit</b>	<b>1,019</b>	<b>1,269</b>	<b>1,342</b>	<b>1,487</b>	Others	1,181	1,762	1,352	1,352
Total non-operate. Inc.	620	499	313	357	Total current asset	17,074	19,207	18,857	18,864
Pre-tax profit	1,639	1,768	1,655	1,844	Long-term invest.	4,253	4,837	4,926	4,926
Total Net profit	1,239	1,368	1,228	1,407	Total fixed assets	1,344	1,800	2,454	3,054
Minority	80	90	98	101	Total other assets	456	475	494	494
<b>Net Profit</b>	<b>1,159</b>	<b>1,278</b>	<b>1,130</b>	<b>1,306</b>	<b>Total assets</b>	<b>23,127</b>	<b>26,318</b>	<b>26,731</b>	<b>27,338</b>
<b>EPS (NT\$)</b>	<b>5.01</b>	<b>5.52</b>	<b>4.88</b>	<b>5.65</b>	Short-term Borrow	3,993	5,286	3,702	3,702
<b>Y/Y %</b>	<b>FY13</b>	<b>FY14</b>	<b>FY15</b>	<b>FY16F</b>	A/P & N/P	6,264	6,583	7,018	6,877
Sales	9.0	16.0	0.4	1.6	Other current liab.	537	636	575	692
Gross profit	8.6	15.1	2.4	6.8	Total current liab.	10,793	12,505	11,295	11,271
Operating profit	22.1	24.6	5.7	10.8	L-T borrow s	1,800	2,290	3,552	3,501
Pre-tax profit	24.6	7.9	(6.4)	11.5	Other L-T liab.	878	1,057	1,159	1,159
Net profit	18.2	10.2	(11.6)	15.6	<b>Total liability.</b>	<b>13,471</b>	<b>15,851</b>	<b>16,007</b>	<b>15,931</b>
EPS	18.2	10.2	(11.6)	15.6	Common stocks	2,314	2,314	2,314	2,314
<b>Margins %</b>	<b>FY13</b>	<b>FY14</b>	<b>FY15</b>	<b>FY16F</b>	Reserves	1,260	1,326	1,332	1,332
Gross	9.0	9.0	9.1	9.6	Retain eamings	6,082	6,826	7,079	7,761
Operating	3.0	3.2	3.4	3.7	<b>Total Equity</b>	<b>9,656</b>	<b>10,467</b>	<b>10,725</b>	<b>11,406</b>
EBITDA	5.0	4.7	4.5	5.0	<b>Total Liab. &amp; Equity</b>	<b>23,127</b>	<b>26,318</b>	<b>26,731</b>	<b>27,338</b>
Pre-tax	4.8	4.4	4.1	4.5					
<b>Net</b>	<b>3.4</b>	<b>3.2</b>	<b>2.8</b>	<b>3.2</b>					

Comprehensive Quarterly Income Statement					Consolidated Statement of Cash flow				
NT\$m					NT\$m				
Year-end Dec. 31	FY13	FY14	FY15	FY16F	Year-end Dec. 31	FY13	FY14	FY15	FY16F
	IFRS	IFRS	IFRS	IFRS		IFRS	IFRS	IFRS	IFRS
Net sales	8,903	9,867	11,062	10,869	Net income	1,159	1,278	1,130	1,306
Gross profit	880	941	1,054	1,035	Dep & Amort	85	98	95	104
Operating profit	309	339	424	415	Investment income	-292	-317	-408	-368
Total non-ope. inc.	136	70	68	83	Changes in W/C	-604	-1,975	79	-188
Pre-tax profit	445	409	492	498	Other adjustment	526	365	469	300
Net profit	337	265	349	357	<b>Cash flow - ope.</b>	<b>874</b>	<b>-551</b>	<b>1,365</b>	<b>1,154</b>
EPS	1.45	1.14	1.51	1.54	Capex	-519	-519	-649	-600
<b>Y/Y %</b>	<b>1Q16</b>	<b>2Q16F</b>	<b>3Q16F</b>	<b>4Q16F</b>	Change in L-T inv.	-286	-3	0	0
Net sales	(1.4)	4.9	3.7	(0.6)	Other adjustment	860	-578	109	0
Gross profit	3.9	10.4	10.5	2.7	<b>Cash flow - inve.</b>	<b>55</b>	<b>-1,101</b>	<b>-539</b>	<b>-600</b>
Operating profit	0.2	20.8	23.0	1.8	Free cash flow	355	-1,071	717	554
Net profit	30.6	(7.6)	9.7	5.9	Inc. (Dec.) debt	754	811	-454	0
<b>Q/Q %</b>	<b>1Q16</b>	<b>2Q16F</b>	<b>3Q16F</b>	<b>4Q16F</b>	Cash dividend	-578	-694	-764	-625
Net sales	(18.6)	10.8	12.1	(1.7)	Other adjustment	76	898	-0	0
Gross profit	(12.7)	7.0	12.0	(1.9)	<b>Cash flow -Fin.</b>	<b>251</b>	<b>1,015</b>	<b>-1,218</b>	<b>-625</b>
Operating profit	(24.2)	9.8	24.8	(2.0)	Exchange influence	227	140	5	0
Net profit	5.9	(21.4)	31.8	2.3	<b>Change in Cash</b>	<b>1,408</b>	<b>-498</b>	<b>-387</b>	<b>-71</b>
<b>Margins %</b>	<b>1Q16</b>	<b>2Q16F</b>	<b>3Q16F</b>	<b>4Q16F</b>	<b>Ratio Analysis</b>				
Gross	9.9	9.5	9.5	9.5	<b>Year-end Dec. 31</b>	<b>FY13</b>	<b>FY14</b>	<b>FY15</b>	<b>FY16F</b>
Operating	3.5	3.4	3.8	3.8	ROA	5.36	5.17	4.26	4.83
<b>Net</b>	<b>3.8</b>	<b>2.7</b>	<b>3.2</b>	<b>3.3</b>	ROE	12.69	12.70	10.67	11.81

\* Option exp. in IFRS

**MasterLink Securities – Stock Rating System**

**STRONG BUY:** Total return expected to appreciate 50% or more over a 3-month period.

**BUY:** Total return expected to appreciate more than 15% and less than 50% over a 3-month period.

**HOLD:** Total return expected to be between 15% to -15% over a 3-month period.

**SELL:** Total return expected to depreciate 15% or more over a 3-month period.

Additional information available on request.

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