

Company Research Note

Ticker	3010 TT/3010.TT
GICS Sector	Information Technology

Ratings	Not Rated
Target Price	N/A
Current Price	87.30
Upside (downside)	N/A

MarketCap (\$m)	645
Total Shares (m)	236

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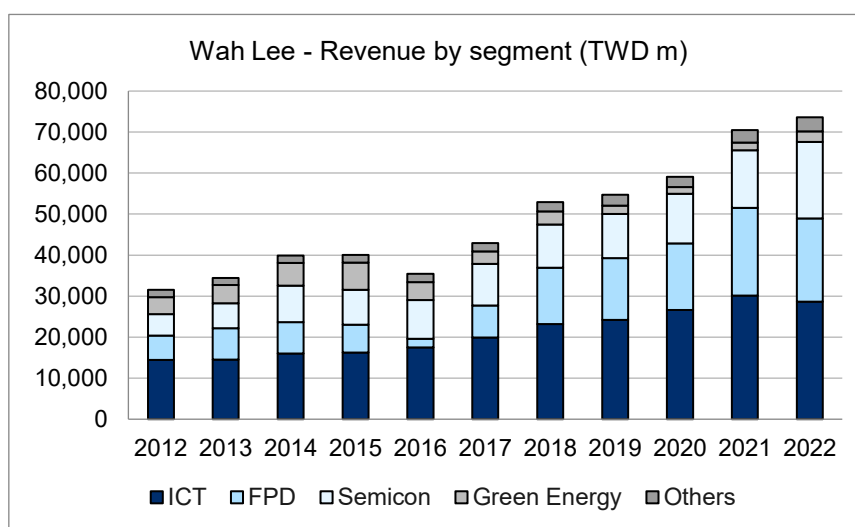
Wah Lee Industrial Corp

Leading high-end material distributor

18 August 2023

Wah Lee is a leading high-end material distributor for the technology industry in the Asia Pacific region. The company has benefited from the booming technology industry in recent years with a 10-year revenue CAGR of 8.8% and will benefit from the structural trend of advanced IC manufacturing, 5G, and New Energy in coming years. The expansion of the new distribution center in the south of Taiwan will boost the company's storage and distribution capacity, as well as fulfill the demand from new industries in the region. **The company is experiencing sales recovery in recent quarters and is currently trading at an attractive dividend yield of 7.0%.**

Chart: Annual Revenue of Wah Lee by Segment - 8.8% 10-Year CAGR



Source: Company report, DZT Research

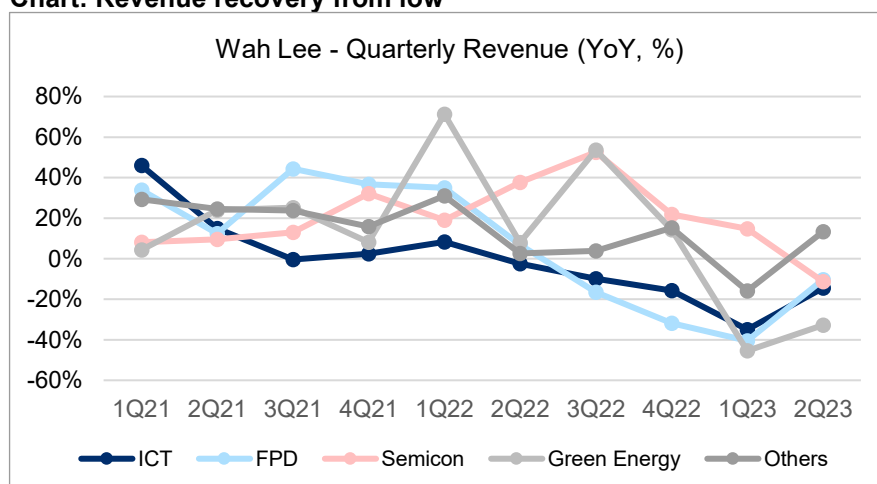
Highlights of 2Q2023 - signs of recovery

ICT and FPD segments led the revenue recovery. The company has seen continuous monthly revenue growth in 2Q and recorded quarter-on-quarter (QoQ) revenue growth of 12.4%, vs -13.4%/-13.3% in 4Q22/1Q23. The company saw a monthly topline at TWD 5.9bn in July, 25% higher than the recent monthly low of TWD 4.7bn in January 2023. From a segment perspective, the company sees the recovery of the ICT (43% of 2Q revenue) and FPD (32% of 2Q revenue) continue for the rest of the year. The semiconductor (28.5% of 2Q revenue) sees a 6.7% QoQ revenue decline. We expect strong sequential growth for the ICT and FPD segments for the second half of the year. Based on estimates of QoQ revenue growth of 15%/30%/-5%/10% and 15%/20%/0%/10% for its ICT/FPD/Semiconductor/Green Energy segment for 3Q2023 and 4Q2023 respectively, we will arrive at quarterly revenue of TWD 18.4/20.8 billion for 3Q2023/4Q2023, which add up to an annual revenue of TWD 69.8

billion for 2023. This full-year estimate represents a 5.2% YoY decline but is on par with what the company has achieved in 2021.

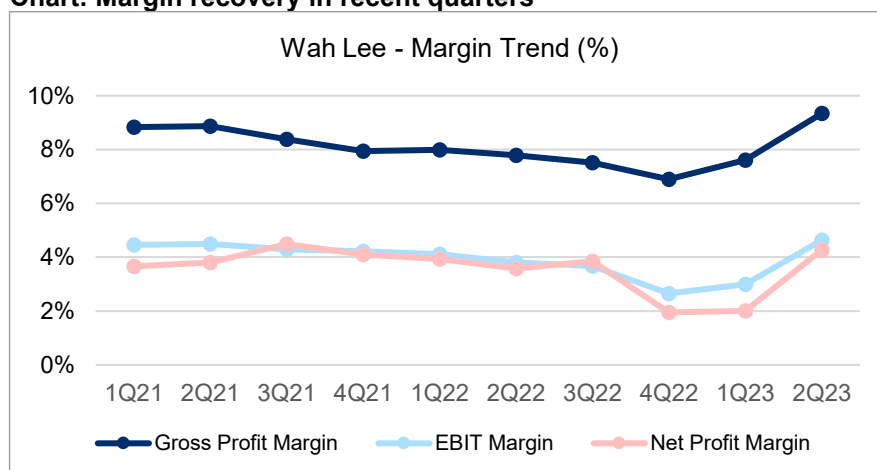
Margin improvement to continue. The company has seen strong margin recovery in recent quarters, the GPM improved by +1.7ppt QoQ in 2Q2023, and by +2.4ppt compared to the low of 6.9% in 4Q2022. This is mainly due to the faster-moving inventories and the reversal of impairment in previous quarters. Inventory days were reduced from 47.2 days in 1Q2023 to 42.0 days in 2Q2023. As the company is achieving sequential revenue growth, we expect to see margin improvement as a result of the reversal of impairment. We estimate the gross margin in the second half of the year to remain in the range of 8-9%, which is in line with the historical range.

Chart: Revenue recovery from low



Source: Company reports, DZT Research

Chart: Margin recovery in recent quarters



Source: Company reports, DZT Research

Investment thesis

1) **Playing a key role in Taiwan's high-end technology segment, the company has a track record of steady growth.** In the past 10 years, the company achieved a revenue CAGR of 8.8%, mainly driven by the semiconductor segment's CAGR of 13.5%, and 13.0% for FPD. Such

revenue growth outperforms TWSE's 10-year revenue CAGR of 3.2% by 5.6%. The company provides diversified exposure to high-growth sectors such as 5G, new energy, and advanced IC manufacturing processes. Many of the products that the company distributes feature an oligopolistic market structure.

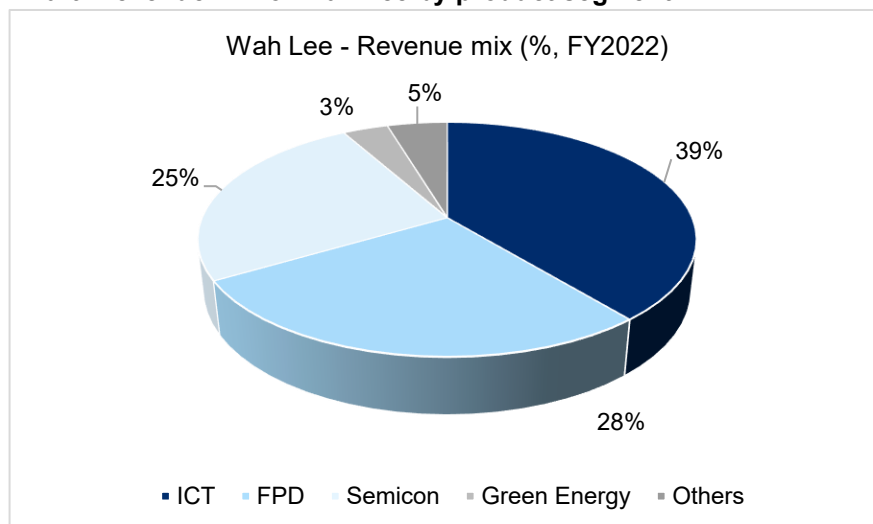
2) **At this juncture, the company is currently experiencing a strong recovery** after two quarters of weak performance as a ripple effect due to the overstocking of its customers against the backdrop of supply chain disruption in 2021 and the low consumer sentiment amid high inflation in 2022. The company registered 2Q QoQ revenue growth of 12.4%, QoQ gross profit growth of 38%, and gross margin improvement of +1.7ppt.

3) **The company is currently trading at an attractive dividend yield of 7.0%**. The company has been paying out dividends at a payout ratio of 55% to 60%.

Company background

Founded in 1968, Wah Lee is a leading material distributor for high-tech companies in Asia Pacific. The company distributes chemical materials manufactured by Japanese companies including Sumitomo, Mitsubishi Chemical, Asahi Kasei, JSR, Panasonic, etc. It reports four segments by downstream industries, namely ICT (engineering plastics, dry films, circuit board consumables), Semiconductor (photoresist liquid, chemicals), Flat Panel Display (electronic whiteboard, T-con, panel materials), and Green Energy (LED, solar energy, lithium battery-related materials), accounting for 38.0%, 30.5%, 23.7%, 2.5% in 2022 respectively, and other businesses accounted for 5.3%.

Chart: Revenue mix of Wah Lee by product segment



Source: Company reports, DZT Research

By end products, its revenue came from consumer electronics (15.8%), smartphones (7.7%), high-performance computing (4.1%, including server, and clouds), 5G communication (1.5%), EV (4.7%), green energy (3.5%),

display (driver IC and T-con, 27.6%), semiconductor (25%), GaN/SiC (0.01%). Its main targeted markets are Taiwan (57% of sales in 2022) and mainland China (36% of sales in 2022).

Business model

The company procures chemical materials from leading Japanese chemical product manufacturers and provides a one-stop shop for its customers. The company's value-add includes:

- 1) **Management of inventories** of specialized chemical materials for the customers. Such specialized chemical material usually requires stringent standards for handling which often requires special permits from regulators. The company usually maintains inventories of one month's consumption of its customers.
- 2) **Provision of technical support** to its customers for the usage of chemical materials. In general, the upstream Japanese suppliers do not deal with the downstream manufacturing companies directly. Instead, these Japanese suppliers provide specifications of respective chemical materials to Wah Lee and provide training to Wah Lee's engineers in Japan. These engineers, in turn, provide just-in-time and on-site technical support to their customers.

With over 50 years of history, the company has built strong relationships with suppliers, mainly Japanese chemical material manufacturers. The top 10 suppliers accounted for about 40% of its procurement. The company currently runs 6 distribution centers and is setting up a southern logistic center in Tainan City, Taiwan. The new warehouse covers an area of 40,000 sqm, built to meet the demand of newly established semiconductor and optoelectronic plants in southern Taiwan. The new distribution center is expected to commence operation as early as 2025.

Segment highlights

The **ICT segment** accounted for 39.0% of the company's revenue in 2022 with a 10-year CAGR of 7.1%. The segment offers exposure to high-end ICT devices, automotive, and EV markets. Examples of its products include:

- Optical grade plastics used by cameras were eventually installed in smartphones, ADAS (advanced driver assistance system), and DMS (driver monitoring system), and surveillance systems.
- Temperature enduring nylon used in PCs, notebooks, servers, and 5G smartphones.
- High-end engineering plastics that are used in auto parts, EVs, and EV charging stations. One product worth featuring is Mitsubishi Engineering-Plastic Corporation's polycarbonate which has a characteristic of superior impact strength, superior transparency, heat resistance of up to 120 degrees, and excellent electrical insulation.
- Copper clad laminate (CCL) with low Dk, and low Df used for 5G high-end PCB. One product line worth featuring is Asahi Kasei's dry film which can be used in COF/TAB driver IC substrate, lead frame, PBGA/CSP package substrate, touch panel, and metal etching. The

material features high resolution, high plating stability, and ease of striping. As such the product has an oligopoly position in the area.

Based on our research, notable customers in this segment include Lotes (ticker 3533 TT), Argosy (3217 TT), Nanya PCB (8046 TT), Unimicron (3037 TT), Kinsus (3189 TT), Delta Electronics (2308 TT), Hon Hai Precision (2317 TT), ASUSTek Computer (2357 TT) and LITEON Technology (2301 TT).

The **semiconductor segment** accounted for 25.3% of the company's revenue in 2022 with a 10-year CAGR of 13.5%. The segment offers exposure to the advanced front-end IC manufacturing processes which produce ICs for the 5G, AIoT, high-performance computing, and EVs. Examples of its products include:

- Photoresist and PR (photoresist) stripper
- Bulk chemicals
- Chemical Mechanical Polishing (CMP) slurries used in polishing processes
- Specialty gases (dozens of types) used in various processes

Based on our research, notable customers in this segment include TSMC (2330 TT), Taiwan Surface Mounting Technology Corp (6278 TT), Nanya Technology Corp (2408 TT), United Microelectronics Corporation (UMC US/ 2303 TT), and Vanguard International Semiconductor Corporation (5347 TT). A major foundry customer accounted for 1/3 of the segment revenue. Powerchip Technology Corporation (6670 TT), SMIC (981 HK).

The **Flat Panel Display (FPD)** segment accounted for 27.6% of the company's revenue in 2022 with a 10-year CAGR of 13.0%. FPD products include display terminal system products, OLED components, and TV motherboard and control wafers, used for manufacturing of LCD, touch panels, and other opto-electric-related products. The company also distributes 50-70 inch digital whiteboards to branded display customers in ODM mode. Sales of the digital whiteboard have been driven by the upgrades of the school facilities in the North American market in the past and the company is expanding to the European market.

The main customers include Taiwan Surface Mounting Technology Corp (6278 TT), Innolux Corp (3481 TT), Boe Technology Group Co., Ltd (000725 CH), and Coretronic Corporation (5371 TT).

The **green energy segment** accounted for 3.5% of the company's revenue in 2022. The company distributes cathode, anode components, and electrolytes to lithium battery manufacturers in mainland China, as well as separator film in Taiwan. In addition, the company also generates revenue from its solar plants. The company has built solar plants with a capacity of 54 MW as of the end of 2021 and plans to achieve a capacity of 100 MW by the end of 2023. Beyond 2023, the company has plans to build another 60 MW in the next two years. Hence, the company plans to provide

Renewable Energy Certificates (REC) to its customers for carbon rights trading. Solar power generation accounted for 30-40% of the segment revenue in 2022.

Investment Holdings

There are four main associate investment companies listed below. They contributed a total of TWD 881.3 million in 2022, accounting for 24.9% of the company's profit before tax. Of these associate companies, the biggest is Chang Wah Electro Materials Inc., the stake of which was valued at USD 222 million, accounting for 33.7% of Wah Lee's market value. The earnings contributed by these major associate companies accounted for 24.9% of the company's profit before tax in 2022.

Table: Profit attributed by selected associate companies

Associate company	Business	Stake (%)	Profit attributable (TWD m)
Chang Wah Electro Materials Inc. (6548 TT)	Material and equipment supplier for IC packaging	29%	624.4
Nagase Wah Lee Plastics	Resin, SABIC specialties and SABIC petrochemical	40%	164.7
Wah Hong Industrial Corp (8240 TT)	Opto-electronics material, precise coating, high performance materials, thermal material, precision processing	26%	73.3
ORC Wah Lee Technology Corp	ORC exposure machine and lamps	35%	18.9
Total			881.3

Source: Company report, DZT Research

Capex, convertible bond, and dividend policy

The main capex item for the company is the building and construction of its logistic center, which has cost the company TWD 1.2 billion for the land parcel. This was 70% funded by bank loans. There is a remaining TWD 1.2 to 1.3 billion to spend for the construction and building, between 2023 and 2025.

For its solar plants, the capex is usually 70% to 80% funded by bank financing. The expected ROI of the solar plant is more than 10%. The investment cost is estimated to be around TWD 50 million (equivalent to USD 1.6 million) per MW.

The company issued zero-coupon 3-year convertible bonds with a total notional value of TWD 2 billion in August 2021, with an initial conversion price of TWD105.3. Following the adjustment for the dividend of FY2022, the current conversion price is TWD 85.4.

Lastly, the company has paid out dividends with payout ratios between 55% and 56% in the past.

Key management

The company was founded by Mr. Chang, Ray-Ching (张瑞钦先生) who remains a member of the board. Mr. Chang, Tsuen-Hsien (张尊贤先生), the

son of the founder, was appointed the chairman of the board in May 2023. Before assuming the position of chairman, he has been working with the company for over 30 years, including the position of CEO since 2016. He obtained his bachelor's degree in electronics engineering and biomedical engineering from the University of Southern California. He has spearheaded the development of the company's FPD and Green energy business units. Since he became the CEO of the company, total sales have increased by 107%.

Financials
Income Statement

TWD million

	2018A	2019A	2020A	2021A	2022A
Revenue	52,935	54,682	59,081	70,515	73,570
COGS	-48,725	-50,497	-54,280	-64,533	-68,004
Gross Profit	4,210	4,185	4,801	5,983	5,567
SG&A	-2,460	-2,484	-2,509	-2,570	-2,596
Others	-3	-89	-110	-46	36
Operating Profit	1,747	1,574	2,108	3,073	2,643
Tax expense	-541	-407	-590	-907	-809
Profit After Tax	1,489	1,559	2,046	3,109	2,726
Net Profit	1,346	1,416	1,859	2,843	2,485
EPS (TWD)	5.70	6.00	7.88	12.05	10.53

Growth

Revenue (YoY %)		3.3%	8.0%	19.4%	4.3%
EBIT (YoY %)		-9.9%	33.9%	45.8%	-14.0%
Net Profit (YoY %)		5.2%	31.3%	52.9%	-12.6%
EPS (YoY %)		5.2%	31.3%	52.9%	-12.6%

Balance Sheet

TWD million

	2018A	2019A	2020A	2021A	2022A
Net PPE	2,001	3,800	3,786	4,741	6,356
Intangible	118	343	317	320	404
Other NCA	1,119	1,289	1,885	2,023	1,941
Non Current Assets	7,626	9,988	10,814	13,040	14,826
Receivable	13,332	13,587	15,225	16,871	14,596
Inventories	5,012	3,936	4,287	5,194	6,428
Other Current Assets	3,324	4,551	5,376	7,506	6,603
Cash	2,542	2,349	3,053	3,275	6,715
Total Asset	31,836	34,411	38,755	45,887	49,169
Payable	6,145	5,888	7,444	8,614	7,938
Other Payable	9,252	9,226	10,215	11,793	13,084
Current Liabilities	15,397	15,114	17,659	20,407	21,022
Long Term Debt	2,616	4,510	4,107	5,536	7,424
Other LT Liabilities	1,414	1,502	2,081	2,228	2,183
Total Liability	19,427	21,126	23,847	28,170	30,628
Equity	12,409	13,285	14,908	17,717	18,541

Key Ratios

	2018A	2019A	2020A	2021A	2022A
Profitability					
GPM (%)	8.0%	7.7%	8.1%	8.5%	7.6%
EBIT Margin (%)	3.3%	2.9%	3.6%	4.4%	3.6%
Net Margin (%)	2.5%	2.6%	3.1%	4.0%	3.4%
ROE (%)	12.2%	12.6%	15.3%	19.9%	15.3%
Operation					
SG&A as Sales (%)	4.6%	4.5%	4.2%	3.6%	3.5%
Effective Tax (%)	26.6%	20.7%	22.4%	22.6%	22.9%
A/R Days	92	91	94	87	72
A/P Days	46	43	50	49	43
Financial					
Financial leverage	2.57	2.59	2.60	2.59	2.65
Asset Turnover	1.66	1.59	1.52	1.54	1.50
Gearing	1.57	1.59	1.60	1.59	1.65

Cashflow Statement

TWD million

	2018A	2019A	2020A	2021A	2022A
PBT	2,030	1,966	2,636	4,016	3,536
Adjustment	111	103	339	187	612
Change in WC	-3,618	-3,573	-3,460	-3,514	-3,588
Tax Payment	-434	-399	-454	-668	-897
CFO	-1,910	1,798	1,208	2,316	3,779
PPE Investment	-105	-427	-211	-1,162	-1,832
Other investment	-366	-1,211	24	-1,726	577
CFI	-471	-1,638	-186	-2,888	-1,255
Net Borrowing	3,023	-115	551	902	1,200
Other Financing	350	818	-127	1,050	877
CFF	2,610	-37	-339	934	472
Change in Cash	92	-193	705	222	3,440
Cash (beginning)	2,450	2,542	2,349	3,053	3,275
FX adjustment	-137	-317	22	-140	445
Cash (ending)	2,542	2,349	3,053	3,275	6,715

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