

VALUATION MASTER CLASS



Electronics an undervalued dividend play?

Is Radiant Opto-



Valuation Master Class

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Sector: Info Tech



Asian manufacturer of blacklight modules used for smartphones & laptops with 4 factories and an annual capacity of 160m units

My value estimate: TWD120

(Upside 17%)

BUY



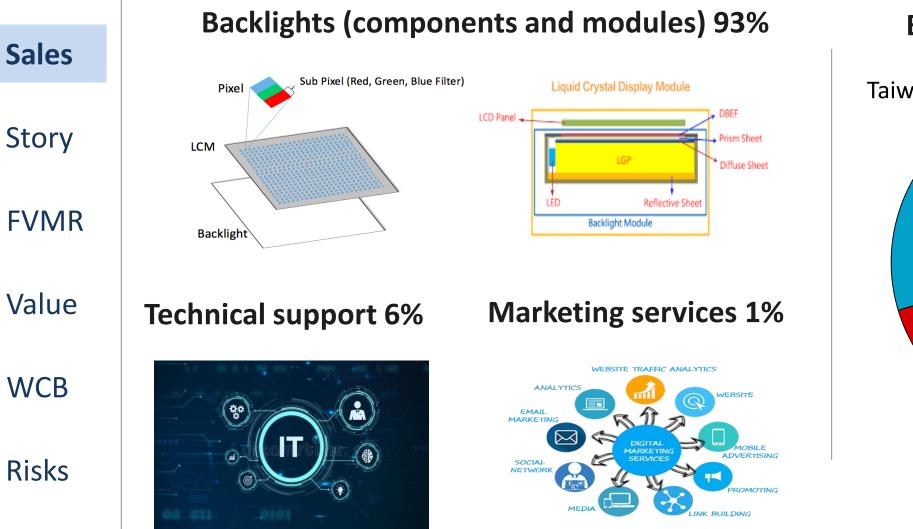
3 things to know about this company

- End markets mature, no opportunities to grow
- ★ Lack of investments translate into zero revenue growth
- Massive dividend yield secured by strong cash generation

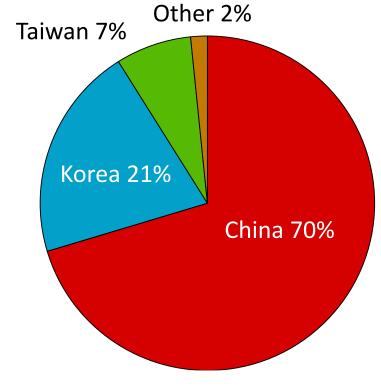
Key statistics		
Analyst consensus (9)	PE ratio	Dividend yield
TWD115 (Upside 13%)	7 x	7.9%
BUY		

Revenue breakdown 2020





Breakdown by region



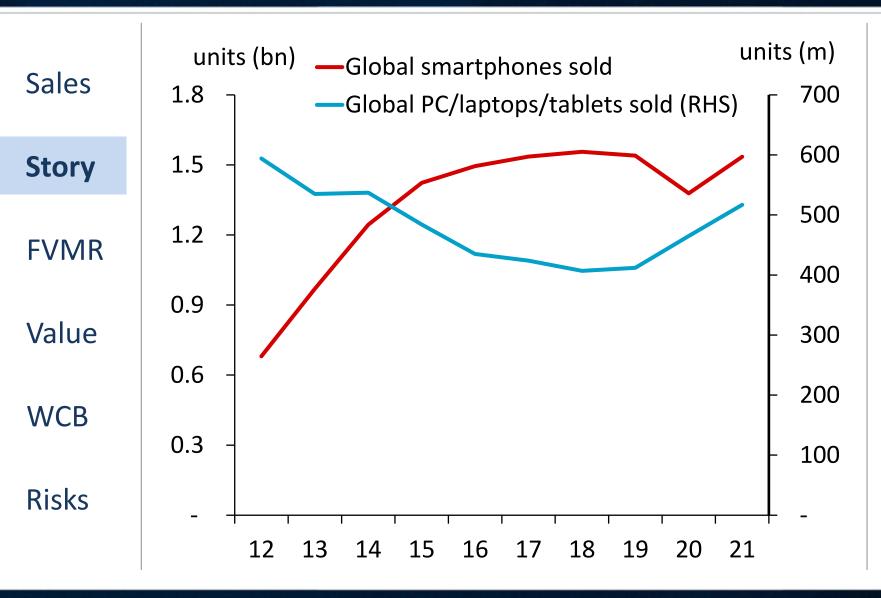
Sideward movement could last much longer





- ★ In July 2021, the stock price faced a sharp drop by more than 30%
 - Since then, the stock price only slowly recovered
 - However, it seems like the 50DMA could pass the 200 DMA soon, hence turning into a positive signal
- Volume RSI has been strong recently and could provide support for a turn-around

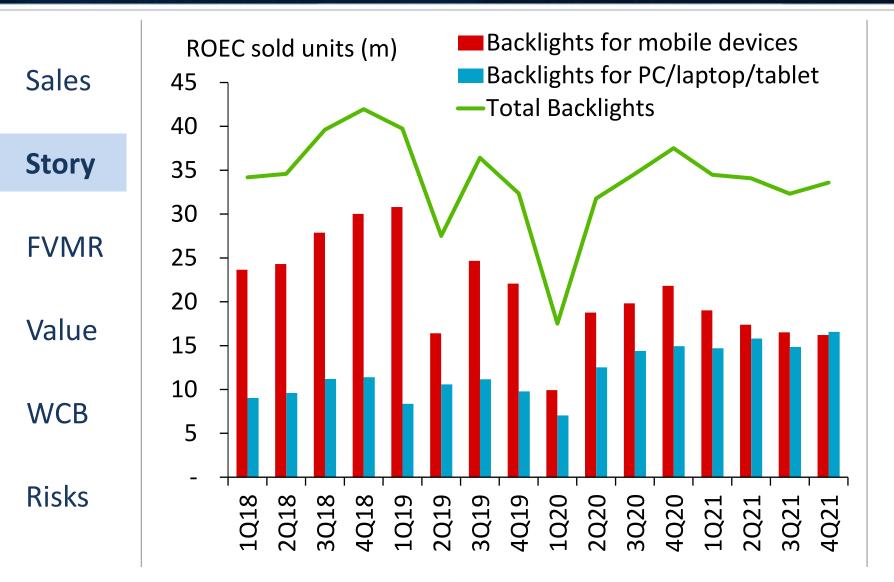
End markets mature, no opportunities to grow



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- ROEC's revenue is mainly dependent on the growth of the end markets such as computers, phones, and tablets
- A mature market for smartphones translates into low demand for displays and ROEC's backlights
 - The same goes for laptops and notebooks

Strong momentum for laptops keeps sales stable

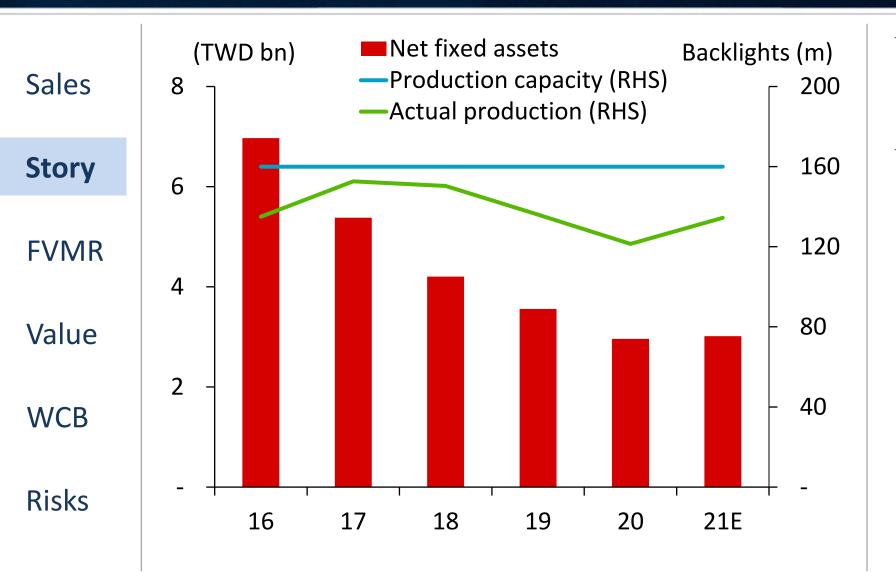


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- The company's number of sold blacklights panels fluctuated around 35m units per quarters, which is around 88% of its capacity
- In 4Q21, blacklights for PC and laptops surpassed mobile devices for the first time
 - Recently, the company also focused on blacklights for displays used in vehicles, which could partly offset the declining trend of the other two segments

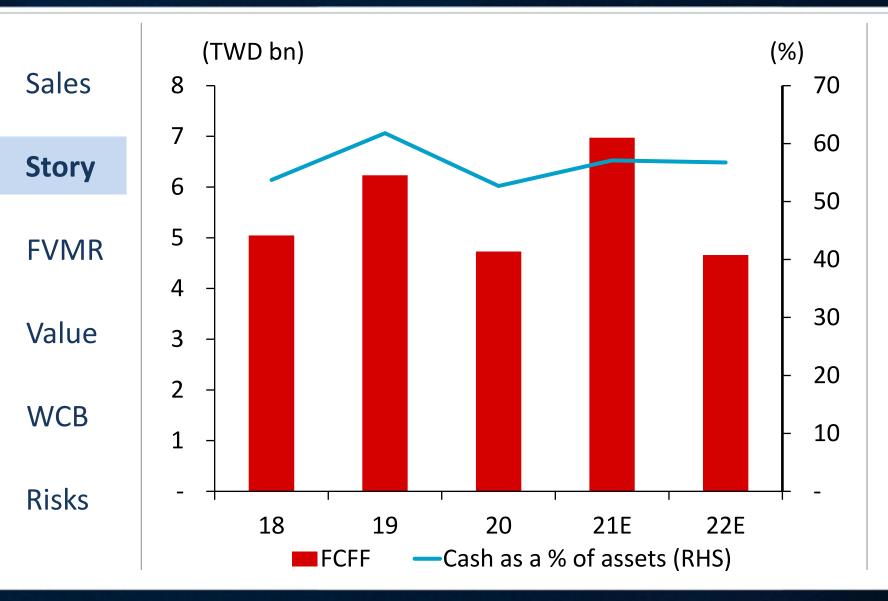
Lack of investments translate into zero revenue growth





- ROEC operates 4 factories
 with an annual capacity of
 160m backlights panels
- Over time, it didn't undergo any expansion and it is likely to not do so in the future as well
 - This means that the company faces flat or declining revenue

Cash machine ensures consistent massive dividend yield



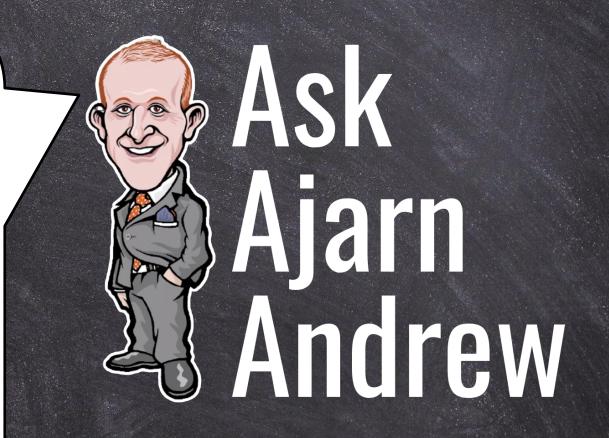


- While the company is likely to face stagnant revenue, it is a mature cash machine
 - It consistently delivered strong FCFF that were more than sufficient to cover high dividends
- On top of that, ROEC holds more than 50% of its assets in cash

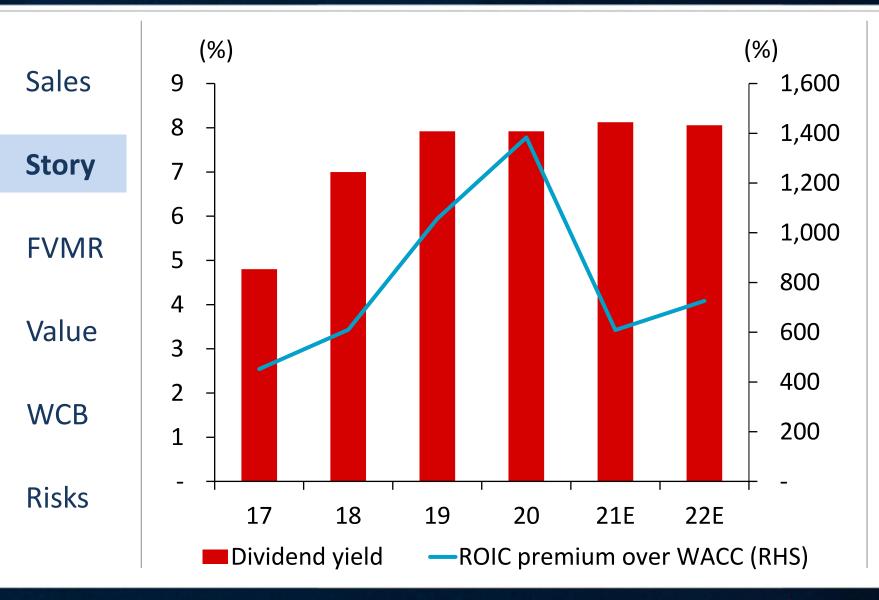
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What is the free cash flow yield?

- It measures of how much free cash flow the company generates annually relative to the company's size as measured in market capitalization.
- Here's the calculation for ROEC • FCF Viold = $FCFF = \frac{5bn}{2} = 11$
 - FCF Yield = $\frac{FCFF}{MarketCap} = \frac{5bn}{47bn} = 11\%$
- The FCF yield shows ROEC's dividendpaying potential
 - With 8% dividend yield, the company is paying slightly below its potential



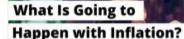
Market might place too much weight on lack of growth and overlook company's consistency





- Recently, the dividend yield grew to 8%, which is 4x higher than the Taiwanese average
 - Even if the company does not generate any growth at all, the dividend yield alone might be attractive enough
- Given its low investments, ROEC delivers an astonishing ROIC, which is more than 6x higher than WACC in 21E







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By Valuation Master Class Student

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By Andrew Stotz

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By Andrew Stotz

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What Does It Mean to Be Financially World Class?



What Is Liabilities To Assets Ratio?



What Is Growth Year Over Year?

FVMR Scorecard

* Measures a stock's attractiveness relative to all other companies * Attractiveness is based on four elements Fundamentals, Valuation, Momentum, and Risk Scale from 1 (Best) to 10 (Worst)

EARNINGS

MANAGENEWY

FVMR

PRICE

Strong fundamentals at a cheap price



es	Fundamentals	w				В	Valuation	W	/			В
	(%)	Dec-17	Dec-18	Dec-19	Dec-20	PTM**	(x)	Dec-17	Dec-18	Dec-19	Dec-20	PTM**
	Operating profit margin	10.5	10.7	11.0	11.3	14.5	Price-to-sales	0.6	0.9	0.7	1.1	0.8
ry	Recurring net margin	7.3	11.3	10.2	8.3	10.8	Price-to-earnings	8.5	7.7	6.5	12.9	7.3
·	Asset turnover	107.9	96.8	101.5	105.4	97.9	Price-to-book	1.4	1.8	1.3	2.0	1.
	Return on assets	7.9	10.9	10.4	8.7	10.6	PE-to-EPS growth (PEG)	0.1	0.1	nm	nm	0.
	Recurring return on equity	17.1	24.7	21.6	16.4	22.0	EV/EBIT	3.0	4.5	2.4	6.2	2.
	Momentum	w				В	Risk	v	/			В
ue	Momentum	w				В	Risk	W	4			В
ue	Momentum (%)	W Dec-17	7 Dec-18	Dec-19	Dec-20	B PTM**	Risk (x)	M Dec-17	/ Dec-18	Dec-19	Dec-20	
ue				Dec-19 4.0	Dec-20 0.0					Dec-19 2.0	Dec-20 1.9	PTM*
ue	<u>(%)</u>	Dec-17	' (0.8)			PTM**	(x)	Dec-17	Dec-18			PTM*
ue CB	(%) Revenue growth	Dec-17 17.7 87.5	7 (0.8) 5 52.5	4.0	0.0 (19.1)	PTM** 10.5	<mark>(x)</mark> Current ratio	Dec-17 1.6	Dec-18 1.6	2.0	1.9	B PTM* 1. (86.9 67.
	(%) Revenue growth Recurring EPS growth	Dec-17 17.7 87.5	7 (0.8) 5 52.5 8 20	4.0 (4.9)	0.0 (19.1)	PTM** 10.5 14.3	(x) Current ratio Net debt-to-equity (%)	Dec-17 1.6 (69.9)	Dec-18 1.6 (77.7)	2.0 (81.0)	1.9 (66.8)	PTM* 1. (86.9

Note: Benchmarking against 1 080 non-fir

Note: Benchmarking against 1,080 non-financial companies in Taiwan.

VMC Student Report

Risks

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Recently, I created a short online course explaining my FVMR investing approach

EARNINGS

I usually sell it for \$97 but for a limited time I am offering it for FREE



ATAN49CENTENY

FVMR

PRICE

Consensus sees small upside



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Story	
Story	

FVMR

Sales

Recommendation	Oct-21	Nov-21	Dec-21	Current
Strong buy	2	2	1	2
Buy	2	3	2	2
Hold	7	6	6	5
Sell	-	-	-	-
Strong sell	-	-	-	-
Average score	2.3	2.3	2.3	2.2
Price target	Oct-21	Nov-21	Dec-21	Current
Median	119	119	119	115
Mean	122	120	120	119

9 analysts



pside: 13%

- Most analysts issued a HOLD recommendation, while 4 recommend a BUY
- ★ Consensus expects declining revenue from 21E onward
 - Still, they expect ROEC to maintain its great margin, delivering consistent profits over time

WCB

Value

Risks

Analyst	consensus 3-year forecast	
		Î

(%)	18	19	20	21E	22 E	23 E
Revenue growth	2.5	4.0	(0.0)	1.0	(2.8)	(3.7)
Gross margin	15.5	18.1	19.0	18.4	18.1	17.6
EBIT margin	9.5	13.0	14.3	13.2	12.7	12.6
Net margin	9.3	10.5	9.3	10.1	10.2	10.2

Profit & loss statement

Story	(YE Dec, NT\$ m)	2019A	2020A	2021E	2022E
Story	Revenue	56,121	56,093	56,654	55,521
	Cost of goods & services	(45,959)	(45,420)	(46,456)	(45,527)
	Gross profit	10,161	10,673	10,198	9,994
	SG&A	(3,069)	(2,803)	(3,173)	(3,109)
FVMR	Other operating (exp)/inc	205	126	155	158
	EBIT	7,297	7,996	7,180	7,043
	Interest expense (net)	631	437	403	476
	Other non-operating inc/(exp)	99	99	118	116
Value	Earnings before taxes (EBT)	8,027	8,532	7,701	7,634
Income	Income tax	(2,372)	(1,718)	(1,925)	(1,909)
WCB	Earnings after taxes (EAT)	5,655	6,814	5,776	5,726
	Equity income/Minority interest	-	-	-	-
	Earnings from cont. operations	5,655	6,814	5,776	5,726
	Forex/Exceptionals before tax	215	(1,587)	(0)	-
	Net profit	5,870	5,228	5,776	5,726



- The company is likely to \star continue delivering strong and stable profits
 - **Revenue could decline** • slightly as some display manufacturers (e.g., LG) shift to OLED technology

Risks

Sales

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Balance sheet - assets

Sales					
Story					
	<u>(YE Dec, NT\$ m)</u>	2019A	2020A	2021E	<u>2022E</u>
	Cash & short-term investments	31,232	29,424	33,992	33,313
	Accounts receivable	11,600	14,941	14,478	14,189
FVMR	Inventories	2,297	3,435	2,839	2,782
	Other current assets	255	226	283	278
	Total current assets	45,384	48,027	51,593	50,561
	Long-term investments	-	-	-	-
Value	Net fixed assets	3,558	2,961	3,013	3,034
	Intangible assets	13	17	21	24
	Goodwill	-	-	-	-
	Other long-term assets	1,583	4,846	4,895	5,091
WCB	Total assets	50,539	55,852	59,521	58,710



- Cash holding of 50% of total \star assets is massive
 - Still, the company has no • plans to use the cash for investments

Risks

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Balance sheet - liabilities

Sales					
Story	(YE Dec, NT\$ m)	2019A	2020A	2021E	2022E
Story	Overdrafts & short-term loans	8,925	9,756	10,825	9,026
FVMR	Accounts payable	8,786	11,475	10,324	9,485
	Other current liabilities	4,679	4,452	6,232	6,107
	Total current liabilities	22,390	25,683	27,381	24,618
	Long-term debt	79	42	46	47
	Other long-term liabilities	641	764	772	780
	Total liabilities	23,110	26,489	28,199	25,445
Value	Minority interest	-	-	-	-
value	Paid-up capital - Common shares	9,376	9,376	9,376	9,376
	Paid-up capital - Preferred shares	-	-	-	-
	Retained earnings	20,976	22,477	24,437	26,379
WCB	Revaluation/Forex/Others	(2,924)	(2,491)	(2,491)	(2,491)
VVCD	Total equity	27,429	29,363	31,322	33,265
	Total liab & shareholders' equity	50,539	55,852	59,521	58,710

The company has almost no long-term debt, thought is does have short term debt, leading to a negative net debt-to-equity ratio of 0.7x

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Risks



Ratios

Sales

Story

FVMR

Value

WCB

Risks



 Dividend payout is high which means it has an attractive dividend yield

(YE Dec)	2019A	2020A	2021E	2022
General growth (YoY, %)				
Revenue	4.0	(0.0)	1.0	(2.0
Assets	(15.8)	10.5	6.6	(1.4
Gross profit	21.9	5.0	(4.5)	(2.0
Operating profit	43.0	9.6	(10.2)	(1.
Attributable profit	16.5	(10.9)	10.5	(0.
EPS	16.5	(10.9)	10.5	(0.
Recurring EPS	31.4	12.3	(10.0)	(0.
Du Pont analysis (%)				
Net profit margin	10.5	9.3	10.2	10
Revenue per NT\$100 of assets	101.5	105.4	98.2	93
Assets/equity (x)	2.1	1.9	1.9	1
Return on equity	22.1	18.4	19.0	17
Others (%)				
Effective tax rate	28.8	24.7	25.0	25
Dividend payout ratio	66.1	58.8	67.3	67

Ratios (cont.)

Sales	(YE Dec)	2019A	2020A	2021E	2022E
	Internal liquidity (x)				
	Current ratio	2.0	1.9	1.9	2.1
Ctory	Quick, or acid test ratio	1.9	1.7	1.8	1.9
Story	Working cap. mgmt (Days)				
	Inventory conversion period	17	23	24	22
	Receivables collection period	97	85	93	93
FVMR	Days from raw mat to coll	115	108	118	115
	Payables deferral period	96	80	84	78
	Cash conversion cycle	19	28	33	37
	Profitability ratios (%)				
Value	Gross profit margin	18.1	19.0	18.0	18.0
	EBIT margin	13.0	14.3	12.7	12.7
	EBIT return on avg assets	13.2	15.0	12.4	11.9
	Return on average assets	10.6	9.8	10.0	9.7
WCB	Financial risk (x)				
	Liabilities-to-assets (%)	45.7	47.4	47.4	43.3
	Debt-to-equity	0.3	0.3	0.3	0.3
	Net debt-to-equity	(0.8)	(0.7)	(0.7)	(0.7)
Risks	Times-interest-earned	27.5	38.3	33.1	29.5
	Effective interest rate (%)	2.9	2.5	2.4	2.7



 ★ EBIT margin on a slightly lower level given an increase of low-cost manufacturers

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A. Stotz Investment Research Stock Picking Checklist

<text>

 Inspired by Peter Lynch's ten baggers (A stock that has gone up 10x)

* Based on our extensive research

* 9 factors that drive long-term share price performance



Long-term share price performance potential



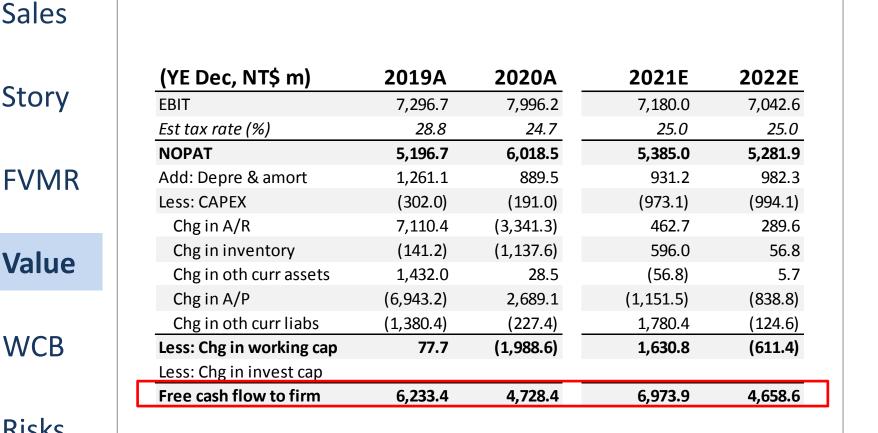
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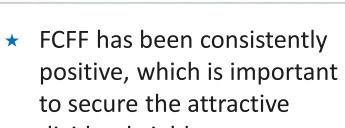
	A. Stotz Investment Research			Good / Moderate / Weak
Sales	Stock Picking Checklist	Potential	Comment	<
	 Management – Management has a proven commitment to growth 	Weak	Revenue remained almost constant over the years; no capacity expansion planned	past few
Story	2. Growth – Product and industry can support a decade of 10%+ annual growth	Weak	End-markets (e.g., smartphones, laptops) bed mature	come
FVMR	3. Sustainable – Competitive strategy creates sustainably high gross margin	Moderate	Competition is intense and existing players an challenged by low-cost manufacturers	re la
WCB	4. Quality – Good earnings quality, non- core items are small or non-existent	Good	Low fluctuations; net profit has been consiste positive	ently
	5. Efficiency – In the long run sales grow faster than assets	Weak	Production capacity has a ceiling; investment factories would be required to grow	s in new
Ratios	6. Tight – Relatively low cash conversion cycle, negative is best	Moderate	Cash conversion is moderately high and stood days in 2020	d at 28
Value	7. Cash flow – Operating cash flow is consistently positive	Good	The company is a cash flow machine	
Risks	8. Capacity – Company has access to capital to fund growth	Good	It has 50% of its assets in cash	
	9. Inexpensive – Valuation is reasonable, avoid very expensive stocks	Good	Trades cheap on both 21E PE and PB compare Taiwanese Info Tech, but low EPS growth	ed to

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Free cash flow





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to secure the attractive dividend yield

Risks

WCB

Value

Sales

Story

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Value estimate

Sales

Story

FVMR

Value

WCB

Risks

3-year average	Consensus	My assumptions		
Revenue growth (CAGR)	(1	8) (1.7))	
Gross margin	18	.0 17.7		
EBIT margin	12	.8 12.4		
Net margin	10	.2 10.0		
My valuation method Market: Taiwan	1.0			
Market risk-free rate				
Market equity risk premium	8.0			
Market return	9.0		_	
Company beta (x)	1.0	Valuation Method	•	
COE	9.0	FCFF		
WACC	7.8			



- Similar to consensus, I expect declining revenue but a strong margin
- ★ Given the lack of investment plans, I set the terminal growth rate to 0%

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Forecast assumptions

This is not investment advice and it's not a recommendation.

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Value estimate



Sales Story FVMR WCB Ratios

Value

Risks

Bear TWD109 (Upside 7%)



Base TWD120

(Upside 17%)



Bull TWD131 (Upside 28%)



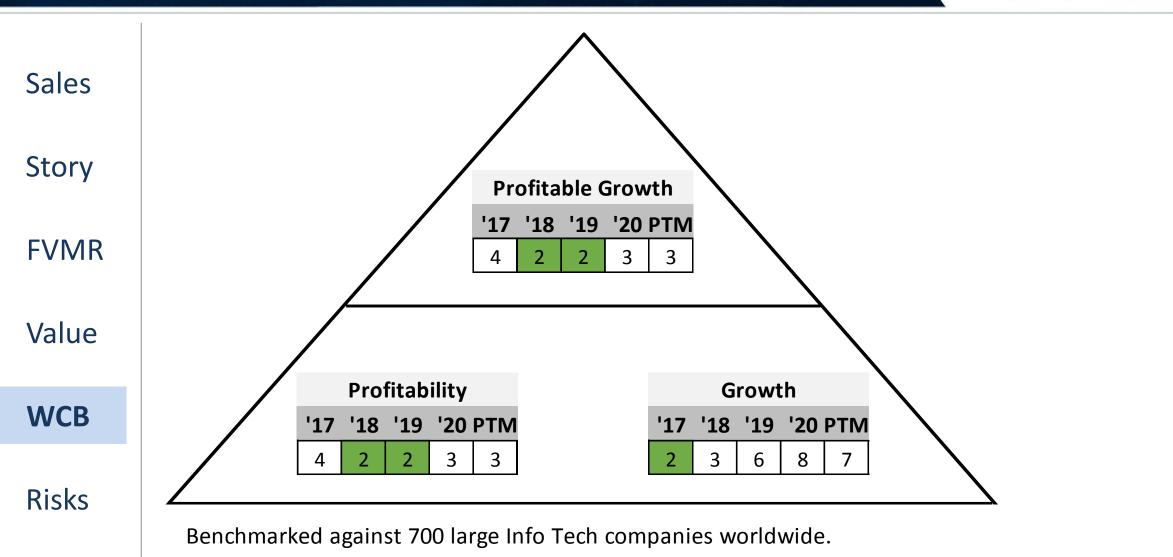
World Class Benchmarking Scorecard

- We identify a company's competitive position relative to global peers
- We use a composite rank of profitability and growth, called "Profitable Growth"
 Scale from 1 (Best) to 10 (Worst)



Strong profitability offsets weak growth





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Key risk is intensified price competition



Story FVMR Value

Sales

WCB

Risks

 Low-cost competitors from China could pressure the company to reduce prices

- ★ High customer concentration
- ★ Failure to keep up with technological changes

CONCLUSION

- Management has no alignment to growth; revenue remains flat
- Strong balance sheet and cash flow generation secure massive dividend yield
- Valuation is expensive, making it an interesting dividend play



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Is Radiant Opto-Electronics an undervalued dividend play?