

## LUMAX INTERNATIONAL CORP (Value Investors Club) – April 2020

			2020	2021
<b>Price:</b>	61.90	<b>EPS</b>	6.7	0
<b>Shares Out. (in M):</b>	107	<b>P/E</b>	9.2	0
<b>Market Cap (in \$M):</b>	220	<b>P/FCF</b>	8.2	0
<b>Net Debt (in \$M):</b>	-98	<b>EBIT</b>	30	0
<b>TEV (\$):</b>	122	<b>TEV/EBIT</b>	4.1	0

### Executive Summary

In a world full of uncertainty, we have a soft spot for services businesses with a high proportion of recurring revenues. Lumax International is a Taiwan-based engineering services company servicing clients in the petrochemical, energy utility and semiconductor sectors in its home market and in two key regions in Mainland China.

Its consultancy business specializes in automation and process control design service for complex industrial projects. As the exclusive agent for an important Emerson Electric product line, they have become the Taiwanese market leader, established themselves in Northern China and lately expanded in the Fujian province, where many Taiwanese-owned plants operate. They are a direct beneficiary of new infrastructure projects launched in Mainland China and of a move towards more professional, outsourced maintenance once they enter operations.

Its maintenance services business unit operates from centres covering most metropolitan areas in China and a brand new major centre North of Taipei.

The company is currently valued at 4x EV/EBIT and yields 5% with a more than reasonable 50% dividend payout ratio. As usual with our posts, the balance sheet sports a strong net cash position representing 32% of its market capitalization, providing a strong buffer for the recession coming our way.

EBIT margins have been on the up, reaching 16% in 2019 from its 12-year average of 12.7%, reflecting higher revenue contribution from services and a reduced focus on their lower-margins electronics trading business.

Dramatically lower oil prices are bound to have a negative impact medium-term but it could be argued that this has already been reflected in the current share price.

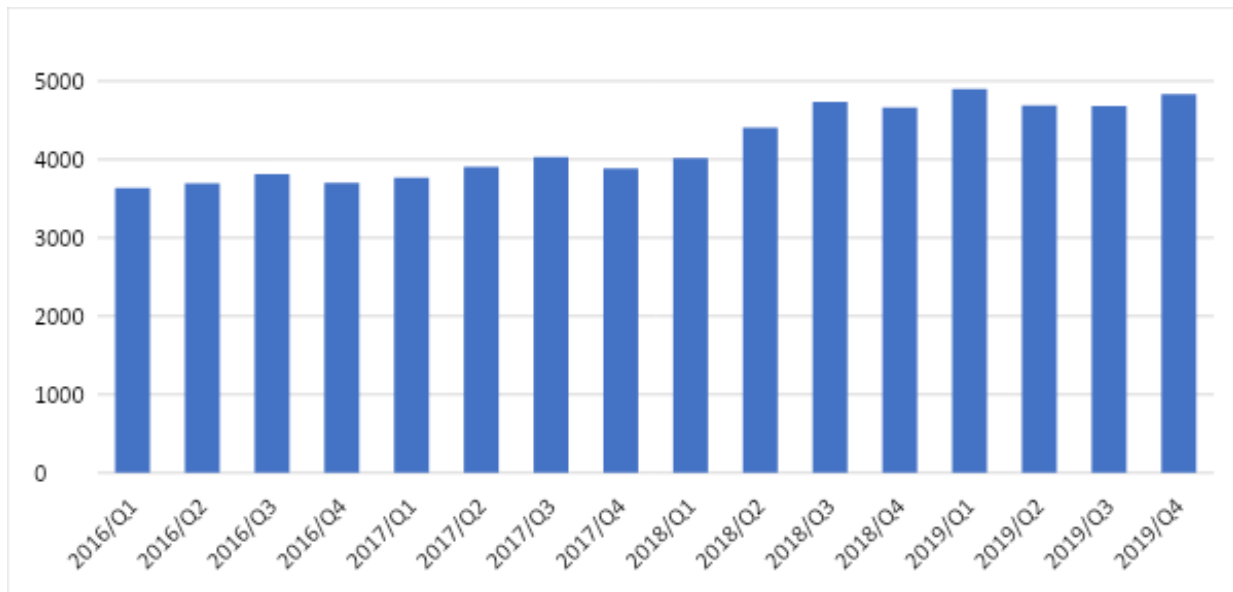
### Stable and Diversified Customer Base

Domestically, their customers read like a Who's Who of Taiwanese industrials such as TSMC, Formosa Plastics and the nuclear plants of Taiwan Power Company. In China, customers tend to be State-Owned-Enterprises (SOEs) which are current beneficiaries of an infrastructure investment cycle in nuclear power plants and petrochemical and semiconductors plants.

### Growth

After a few years of weaker investment activity by clients, their order book hit an all-time high at the end of 2019, boding well for next year's earnings, while maintenance fees representing 40% of this year's revenue provides a safe recurring base to grow from.

The Chinese government has pushed for more local investments to counteract the impact from the Trade War that is slowing down the economy. TSMC is also expanding its operations in Taiwan.



### Electronics and Communications Division

The company has operated a specialized Electronics and Communications trading business which has been consistently profitable, but which has operated at lower margins averaging 5%. This has proven to be a drag on the Process Control business unit's 30% margins. The trading business also required larger working capital, dragging the overall company's Return on Invested Capital. Fortunately, management has over the past decade gradually focused on its core process control consultancy and maintenance business and has downsized and refocused its trading business, speaking to management's capital allocation skills. The Trading division has seen its share of revenues reduced to only 28% in 2018 from 46% in 2011.

What is left of the trading business has now been refocused on Internet of Things opportunities, which should see improved margins.

### Capital Allocation and Corporate Governance

Lumax's five founders are all engineers by training and all still active in the company. They do not meet investors as a matter of policy, but the IR representative, Vincent Ma (Vincent\_Ma@elumax.com), can clearly explain the Board's positions on strategy, capital allocation and general corporate governance subjects. We have found him both knowledgeable and professional in our interactions with him. Financial disclosure is available in English on <https://www.elumax.com/en/> and Mr. Ma will provide updated bookings and an updated presentation in English on a quarterly basis if you ask to be on his email distribution list.

An investment in Lumax allows us to benefit from its stable and cash-generating domestic business while being exposed to the higher growth coming from the continuing industrialization of Mainland China and its move to more professional, outsourced maintenance services of its mission-critical infrastructure.

We also like that we get the benefit of strong capital allocation skills, good corporate governance and the local expertise to manage project and maintenance contracts with Chinese SOEs. This is not an easy task which can be daunting for international players, even with a local presence. It is for instance telling that Lumax is the exclusive distributor for Emerson Electric in two provinces.

**Risks**

- Lower oil price weighs on the planned investment plans of their petrochemicals industry clients and prospects
- Increased political tensions between US/Taiwan and China impacting Taiwanese companies operating in Mainland China.

**Catalysts**

- Backlog turns into revenues over the next 18 months
- Expanding margins as installation projects roll into maintenance ones

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