

Issuer: Avi-Tech Electronics Limited

Security: Avi-Tech Electronics Limited

Meeting details:

Date: 31 October 2017

Time: 11.00 a.m.

Venue: 19A Serangoon North Avenue 5, 6th floor, Singapore 554859

Company Description

Avi-Tech Electronics Limited provides burn-in, engineering, and manufacturing services for the semiconductor, electronics, and life sciences industries. Its Burn-in and Related Services segment offers static, dynamic, test during, and high power burn-in services for semiconductor manufacturers; and tape and reel services. The company's Burn-In Boards and Boards Related Products segment designs and manufactures a range of burn-in boards for various types of burn-in oven systems, as well as boards for other types of reliability tests, such as high temperature operating life test and highly accelerated stress test. Its Engineering Services and Equipment Distribution segment is involved in the design, development, and turnkey outsourced manufacturing and system integration of semiconductor equipment and lab-automation systems for the life sciences and biotech industries. This segment also distributes and services third-party mixed signal testers; and offers technical services. The company operates in Singapore, the United States, Malaysia, Thailand, the Philippines, Taiwan, China, and Germany. Avi-Tech Electronics Limited was incorporated in 1981 and is headquartered in Singapore.

(Source: http://www.sgx.com/wps/portal/sgxweb/home/company_disclosure/stockfacts?code=BKY)

Q1. In the Letter to Shareholders (pages 5-6 of the annual report), one of the achievements highlighted was the group’s ability in the Manufacturing and PCBA Services business to leverage on their expertise to “design and produce new burn-in boards to our customers’ requirements”.

As reported in the Operation review (page 14), the gross profit margin fell marginally from 32.3% in FY16 to 29.5% in FY17.

Looking at Note 32 (page 111 – Segment information), margins across the board fell.

Segment revenue and results

The following is an analysis of the Group’s revenue and results by reportable segment:

	Burn-in Services		Manufacturing and PCBA Services		Engineering		Eliminations		Total	
	2017 \$'000	2016 \$'000	2017 \$'000	2016 \$'000	2017 \$'000	2016 \$'000	2017 \$'000	2016 \$'000	2017 \$'000	2016 \$'000
CONTINUING OPERATIONS										
Revenue										
External revenue	9,070	8,965	19,715	13,704	11,197	11,271	-	-	39,982	33,940
Inter-segment revenue	-	-	1,120	822	-	-	(1,120)	(822)	-	-
Total revenue	9,070	8,965	20,835	14,526	11,197	11,271	(1,120)	(822)	39,982	33,940
Segment results										
Interest expense									(16)	(28)
Interest income		38.3%		39.0%		15.9%		16.4%	462	392
Rental income									419	752
Unallocated income									390	581
Unallocated expense									(604)	(589)
Profit before income tax									8,021	7,854
Income tax expense									(990)	(1,476)
Profit for the year									7,031	6,378
									17.6%	18.8%

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(Source: Company annual report; margins as estimated)

With higher revenue, the group should have enjoyed greater economies of scale. Together with the robust demand for the group’s services and products, the positive global trends and higher requirements, one would have expected the margins to increase.

- a) **Can management help shareholders understand why, despite the strong performance of the semiconductor sector, the group has not been able to capture a greater share of the value-add?**
- b) Specifically, as shown in the Financial review (page 21), Cost of sales increased by 22.6%, mainly attributable to the 33.7% jump in cost of material and equipment. **Can the company explain what led to the 33.7% increase in cost of material and equipment to \$19.6 million?**

Q2. As disclosed in Note 4 (page 95 - Capital management policies and objectives), the company’s management reviews the capital structure on a regular basis. The capital structure consists of debt, cash and cash equivalent and equity.

The group's capital management approach is to ensure that it will be able to continue as a going concern and to maximise the return to stakeholders through the optimisation of the debt and equity balance, and to ensure that all externally imposed capital requirements are complied with.

As at 30 June 2017, the group has a gearing of 1% (page 19).

While the company has adopted a dividend policy of distributing not less than 30% of the group's consolidated net profit after tax and non-controlling interest excluding non-recurring, one-off and exceptional items, for the financial year, the group's return on equity is affected by the excess level of cash held.

The group has also generated a healthy level of cash flow from operations of \$8.2 million in FY2017.

Cash and cash equivalents in the consolidated statement of cash flows at end of year was \$7.5 million (page 96) and a further \$22 million in fixed and call deposits (with maturity more than 3 months) (page 96). The group also holds bonds with fair value of \$2.3 million as at 30 June 2017 (page 98).

- a) **In view of the growth in the core business, what are the capital expenditure/working capital to fund the organic growth of the business?**
- b) In the Letter to shareholders, it was re-iterated that group remains committed and open to "exploring other profitable businesses including projects and accretive mergers and acquisitions, which present a synergistic fit with our service offerings". **On this front, can the board update shareholders on the opportunities?**
- c) As stewards of shareholders' funds, the board has been prudent in safeguarding the funds. Out of \$26.7 million raised in the Initial Public Offering (IPO) a decade ago, more than \$5.2 million remain un-used. **Given that the board and company has not found the right opportunity to deploy cash that can create long term shareholders value, would the board re-evaluate the capital structure and return the excess cash to shareholders?**

Q3. The issue of long tenured non-executive director was brought up following the Annual Report for the financial year ended 30 June 2016.

The Nominating committee (NC) comprises Mr Goh Chung Meng (as Chairman), Mr Khor Thiam Beng and Mr Michael Grenville Gray.

Mr Goh was first appointed to the board on 16 October 2001 while both Mr Khor and Mr Gray were first appointed to the board on 30 October 2006.

Mr Goh would have served on the board for more than 16 years and Mr Khor and Mr Gray would have served on the board for 11 years each.

Mr Khor Thiam Beng, Mr Michael Grenville Gray and Mr Goh Chung Meng has therefore served on the Board for more than nine years each from the respective date of their first appointment.

- a) **As required by the code, can the NC help shareholders understand how it had carried out a particularly rigorous review of each of the affected directors?**

Notwithstanding that the board considers all three long-tenured directors as independent, Guideline 2.4 of the Code of Corporate Governance 2012 issued by the Monetary Authority of Singapore requires the board to "also take into account the need for progressive refreshing of the Board".

- b) Can the company tell shareholders its plans for the progressive refreshing of the board, as required by Guideline 2.4 of the Code?

A copy of the questions for the Annual Report for the financial year ended 30 June 2016 could be found here:

<https://sias.org.sg/qa-on-annual-reports/?company=Avi-Tech%20Electronics%20Ltd>

The company's response could be found here: -----