

SECTOR UPDATE

Tech Manufacturers – Singapore

Focus On Stocks With Diversified Customer Base And Low Production Disruptions

We expect earnings weakness for stocks with huge China exposure (Nanofilm, Aztech, Innotek) due to lockdowns in China since late-1Q22. In contrast, stocks with low China exposure and a diverse customer base should deliver more resilient earnings (Venture, Frencken). Pure semiconductor names (AEM, UMS) should deliver healthy earnings but we are cautious of a slowdown in the semiconductor cycle. Our top picks are Venture and Frencken for their diversified customer base and pricing power.

WHAT'S NEW

- Tech-related companies scheduled to release their 2Q22 results between 25 July and 15 August.** Tech companies under our coverage will be releasing their 2Q22 results starting from next week with Aztech scheduled to report on 25 July and Venture on 5 August. We categorise the stocks into three groups: a) stocks with significant China exposure (Nanofilm, Aztech, Innotek), b) stocks with low China exposure and diverse customer base (Venture, Frencken), and c) pure semiconductor names with large single customers (AEM, UMS). Our top picks are Venture and Frencken as we believe their diversified customer base and majority of productions in Malaysia, which have fully relaxed its COVID-19 restrictions, should reduce the negative impact of weaker demand as well as supply chain disruptions.
- Stocks that have majority of their production bases in China could see negative earnings surprises.** In late-1Q22, China rolled out its biggest COVID-19 lockdown since the start of the pandemic as Shanghai confined residents to their homes. Although Shanghai has reopened after two months, sporadic lockdowns are still very common across China. This has caused persistent challenges to the manufacturing supply chain. Three key challenges include: a) higher costs in sourcing for raw materials due to reduced supply and higher logistics costs, b) higher labour costs due to the requirement of closed-loop manufacturing, and c) slowdown in customers' demand due to difficulties in sourcing materials and slower productions. As a result, we think Nanofilm (Shanghai), Aztech (Dongguan) and Innotek (Dongguan and Suzhou), which have majority of their production plants in China, could see negative earnings surprises in their upcoming 1H22 results. Also, these manufacturers serve customers in the consumer electronics and auto segments, which are discretionary products in nature, and could see reduced demand in a recession.
- Stocks with low China exposure and diverse customer base should deliver more resilient earnings.** We believe Venture should continue to deliver a good set of results in 2Q22 as: a) it continues to see healthy demand from most of its customers which are diversified across seven domains, and b) it has a proven capability in managing supply chain disruptions. In addition, Venture should be able to manage costs and pass on higher prices to customers given its differentiated capabilities. On the other hand, we expect Frencken to show a marginal decline in its 1H22 earnings due to higher material costs which will drag its gross margin. However, 2H22 earnings should be sequentially better as management is working to mitigate cost inflation pressures by passing on cost increases through operational initiatives, and is anticipating signs of easing supply chain constraints. Also, Frencken's diversified customer base across five segments should provide better earnings visibility.

PEER COMPARISON

Company	Ticker	Rec	Price @ 20-Jul-22 (1cy)	Target Price (1cy)	Upside/ (Downside) to TP (%)	Market Cap (US\$m)	PE 2022 (x)	PE 2023 (x)	P/B 2022 (x)	P/B 2023 (x)	EV/EBITDA 2022 (x)	EV/EBITDA 2023 (x)	ROE 2022 (%)	Yield 2022 (%)
Top BUYS														
Venture Corp	VMS SP	BUY	16.96	22.80	34.4	3,546	14.5	13.4	1.7	1.7	9.9	9.2	12.3	4.7
Frencken	FRKN SP	BUY	1.16	1.63	40.5	356	7.4	6.1	1.2	1.0	4.1	3.5	16.7	4.1
Other Coverage														
Nanofilm Tech	NANO SP	HOLD	2.13	2.72	27.7	1,011	18.0	14.6	2.9	2.5	9.4	7.9	17.0	1.1
Aztech Global	AZTECH SP	BUY	0.79	1.55	96.2	438	6.8	5.4	1.8	1.5	5.0	4.0	28.2	6.6
Innotek	INNOT SP	Under Review	0.425	n.a.	n.a.	71	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
AEM	AEM SP	BUY	4.09	5.60	36.9	908	11.4	9.6	2.7	2.2	7.6	6.5	25.6	2.1
UMS	UMSH SP	BUY	1.14	1.45	27.2	546	12.2	12.2	2.5	2.2	8.5	7.8	21.3	4.4
Average							11.7	10.2	2.1	1.8	7.4	6.5	20.2	3.8

Source: Bloomberg, UOB Kay Hian

OVERWEIGHT

(Maintained)

STOCKS UNDER COVERAGE

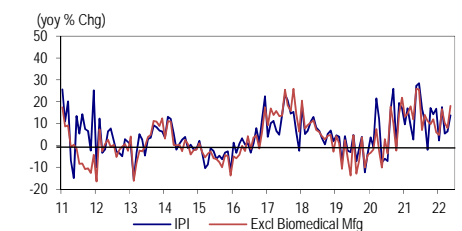
Company	Rec	Target Price (S\$)	Share Price (S\$)	UOBK 2022 Estimated Earnings (S\$m)
Top BUYS				
Venture	BUY	22.80	16.96	85 (+13% yoy)
Frencken Group	BUY	1.63	1.16	13 (-22% yoy)
Other coverage				
Nanofilm	HOLD	2.72	2.13	20* (+12% yoy)
Aztech Global	BUY	1.55	0.79	18 (+5% yoy)
Innotek	UR#	n.a.	0.425	n/a due to loss
AEM	BUY	5.60	4.09	25 (+52% yoy)
UMS Holdings	BUY	1.45	1.14	19 (+12% yoy)

Source: UOB Kay Hian

Under review

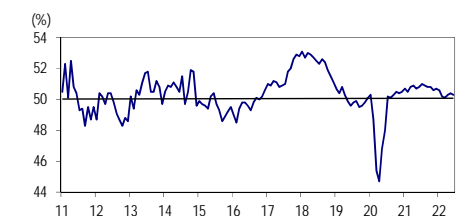
* 1H22 earnings due to absence of 1Q22 results reporting

SINGAPORE INDUSTRIAL PRODUCTION



Source: CEIC

PURCHASING MANAGER INDEX



Source: CEIC

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- **Pure semiconductor names should report healthy earnings but we are cautious of a slowdown in the semiconductor cycle.** Although we expect both AEM and UMS to report healthy earnings growth for 2Q22, we are wary of a slowdown in the semiconductor cycle after two years of strong chip demand that was partially boosted by the supply chain disruptions caused by the COVID-19 pandemic. Chipmakers' fortunes rose in the early days of the pandemic as demand for electronics from stuck-at-home consumers and reduced supply due to manufacturing and logistics issues caused semiconductor demand to soar. Amid the supply crunch, businesses across the chip value chain raced to stockpile chips so they could handle further disruptions. In TSMC's latest earnings call, it warned that its customers might now draw on those chip reserves rather than place new orders. TSMC also said it would trim its capex for 2022 by 10% to US\$40b. South Korean chipmaker SK Hynix is also considering reducing its 2023 capex by 25%. On 7 Jun 22, Intel CFO said that he expected the US chipmaker's 2Q22 earnings to take a hit due to customers working through stockpiled inventory instead of placing new orders. In addition, demand for electronics is softening as PC shipments in 2Q22 fell 12.6 yoy, according to consulting firm Gartner. The crypto crash could be another drag on the chip market as crypto miners cease operations. Shipments of graphics cards fell 19% yoy in 1Q22, according to consulting firm Jon Peddie Research.

ACTION

- **Maintain OVERWEIGHT but be selective on names with diversified customer base and lower China exposure.** We recommend investors to focus on our top picks, Venture and Frencken as we believe their diversified customer base and majority of productions in Malaysia, which have fully relaxed its COVID-19 restrictions, should reduce the negative impact of weaker demand as well as supply chain disruptions.

Venture Corp (VMS SP/BUY/Target: S\$22.80)

- **Expect earnings to grow 13% yoy but remain flat qoq; demand from customers remain healthy.** We expect Venture to report 2Q22 earnings of S\$85m (+13% yoy, +1% qoq). Venture continues to see healthy demand from most of its customers. Despite the increasingly uncertain environment, Venture should be able to deliver relatively resilient performance given its highly diversified customer base across seven technology domains. In addition, most of VMS' customers are in industrial segments such as life science, medical and testing, which are less sensitive to consumer sentiment.
- **Maintain BUY and target price of S\$22.80,** pegged at +1SD above its forward mean PE, of 19.5x on 2022F earnings. Currently, VMS offers an attractive dividend yield of 4.7%.

Frencken Group (FRKN SP/BUY/Target: S\$1.63)

- **Expect continued weakness in 2Q22 results but look forward for a better 2H22.** We expect 2Q22 earnings of S\$13m (-22% yoy / +2% qoq) as impacts from supply chain disruptions, higher cost pressures from raw materials, rising energy prices and workforce disruptions will take time to ease. However, we expect 2H22 earnings to be sequentially better as management is working to mitigate cost inflation pressures by passing on cost increases through operational initiatives and is anticipating signs of easing supply chain constraints. In the mid to longer term, Frencken would benefit from positive market trends in 5G, Internet Of Things and artificial intelligence.
- **Maintain BUY with target price of S\$1.63,** pegged to 10.4x 2022F PE, based on historical mean PE. Currently, Frencken trades at an attractive 7x 2022F PE.

NanoFilm Technologies (NANO SP/HOLD/Target: S\$2.72)

- **Expect lacklustre 1H22 earnings due to margin pressure from production disruption in China and more cautious outlook of major customer.** We expect Nanofilm to report 1H22 earnings of S\$20m (+12% yoy / -55% hoh vs 2H21), falling short of our estimated 26% yoy growth in 2022 earnings. The weakness can be mainly attributable to production disruptions caused by the two-month lockdown in Shanghai in April and May 22, and is likely to impact gross margins from higher labour and raw material costs due to logistical challenges. Moving forward, we also see a more cautious outlook from Nanofilm's largest customer, as it had announced in Jul 22 that it is planning to slow hiring and spending growth next year in some divisions to cope with a potential economic downturn.
- **Maintain HOLD with a target price of S\$2.72.** We value Nanofilm based on PEG of 1.0x (growth based on three-year EPS CAGR of 23% from 2021-24). Our target PE multiple of 23x 2022F PE is at a slight discount vs Nanofilm's peers' 25x 2022F PE.

Aztech Group (AZTECH SP/BUY/Target: S\$1.55)

- **Expect marginal earnings growth for 2Q22 but turning more cautious on consumer sentiment and margin weakness.** We expect Aztech to report 2Q22 earnings of S\$18m (+5% yoy, +22% qoq), where the 1H22 of S\$30m will fall short of our expectation of S\$36m mainly due to production disruption in China. Hence, we will be looking at a potential 10% cut in our 2022 earnings estimate of S\$90m. This should have an impact on Aztech's revenue and gross margin as higher logistics and labour costs may not be fully passed on to customers. In addition, Aztech's key product of surveillance camera, which is discretionary in nature, may see slower demand in a more uncertain environment.
- **Maintain BUY and target price of S\$1.55**, pegged to 13.3x 2022F earnings, which is based on its Singapore and Malaysia peers' average.

Innotek (INNOT SP/UNDER REVIEW/Target: n.a.)

- **Innotek issued a profit guidance for 1H22 on 14 July**, highlighting that it expects to report a net loss for 1H22 due to increased operating costs as labour and manufacturing costs have risen, while disruptions to the global supply chain have resulted in higher cost of raw materials and prolonged movement restrictions imposed within China as part of its "zero-COVID" policy. These restrictions severely impacted Innotek's major customers' businesses in China, which in turn hampered Innotek's revenue growth in 1H 22.
- **We thus place the stock UNDER REVIEW pending further information** from its 1H22 results. Our last call was BUY with a PE-based target price of S\$1.20, based on a 12x 2022F PE.

AEM Holdings (AEM SP/BUY/Target: S\$5.60)

- **Expect 2Q22 earnings to grow strongly yoy but decline qoq.** We are expecting AEM to report 2Q22 earnings of S\$25m (+52% yoy, -39% qoq), with the sequential decline from an exceptionally strong 1Q22 mainly driven by the uptake in new generation equipment and tools and the consolidation of CEI Limited, which was acquired in 1H21. We also believe that there could have been some front-loading of orders in 1Q22 as the major customer attempts to mitigate the risk of supply chain constraints. On 7 Jun 22, Intel CFO stated that he expected the US chipmaker's 2Q22 earnings to take a hit due to customers working through stockpiled inventory instead of placing new orders.
- **Maintain BUY and target price of S\$5.60.** The target price is pegged to 2022 earnings of 15.6x, or +2SD to its historical five-year range, supported by a forward ROE of 25.6%. This compares to the Singapore peer average forward PE of 10.1x and forward ROE of 20.6%. The valuation peg is supported by the positive outlook for AEM from 2022 onwards and the anticipated cyclical upturn of AEM's business.

UMS Holdings (UMSH SP/BUY/Target: S\$1.45)

- **Expect a healthy yoy and stable qoq earnings growth for 2Q22.** We are expecting UMS to report 2Q22 earnings of S\$19m (+12% yoy / -2% qoq), as the company should enjoy continued strength in semiconductor demand, as well as consolidation of sales from JEP starting in 2Q21. We understand that factory utilisation levels at the downstream semiconductor manufacturers, including UMS, will stay elevated in 2022-23. Specifically for UMS, the order backlog for AMAT's Semi Systems segment has shown sustained growth over the past four consecutive quarters, providing revenue visibility for UMS into 2023.
- **Maintain BUY with target price of S\$1.45**, pegged to 15.4x 2022F earnings, or +2SD above its historical five-year average. We believe UMS could trade at a premium over peers due to its timely new capacity expansion to drive earnings growth above the industry average.

SECTOR CATALYSTS

- Increasing capex spending by upstream global tech manufacturers.
- Better-than-expected 2Q22 sales and net profit numbers.

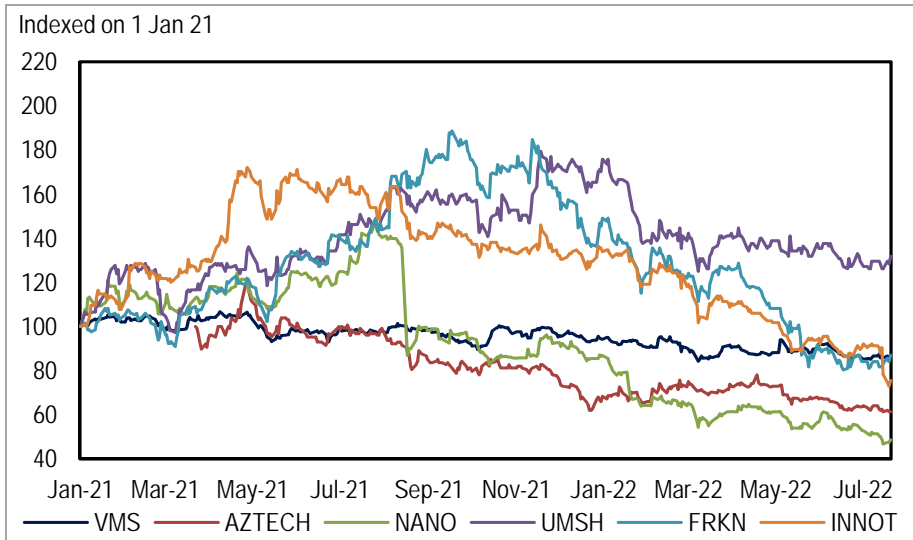
ASSUMPTION CHANGES

- No changes to our forecasts.

RISKS

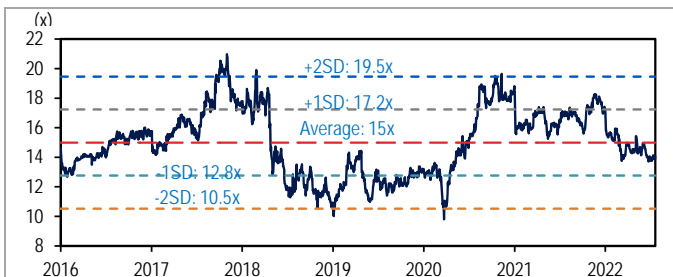
- Reduced demand for electronic goods as a result of global recession.
- Escalation of geopolitical tension and trade conflict between the US and China.

RELATIVE SHARE PRICE COMPARISON



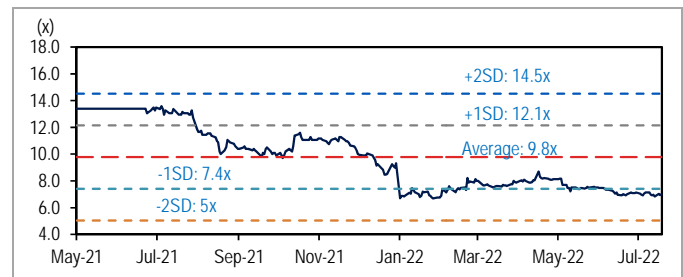
*AZTECH listing date on 11 Mar 21
Source: Bloomberg, UOB Kay Hian

VENTURE CORP 12-MONTH FORWARD PE BAND



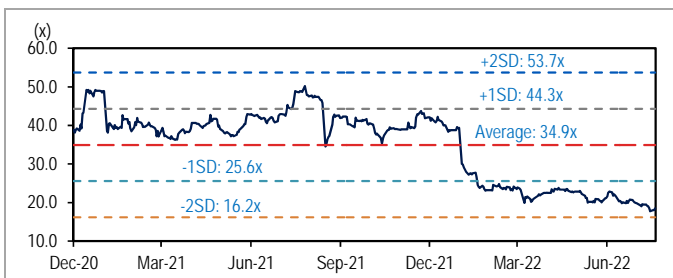
Source: Bloomberg, UOB Kay Hian

AZTECH GLOBAL 12-MONTH FORWARD PE BAND



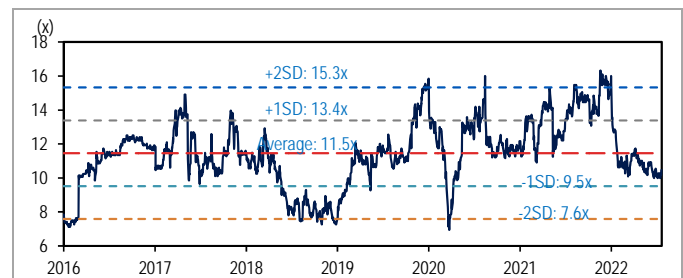
Source: Bloomberg, UOB Kay Hian

NANOFILM TECHNOLOGIES 12-MONTH FORWARD PE BAND



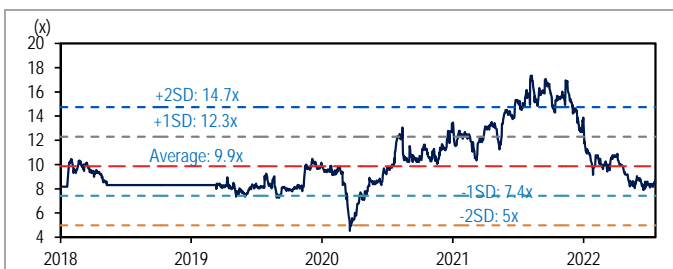
Source: Bloomberg, UOB Kay Hian

UMS HOLDINGS 12-MONTH FORWARD PE BAND



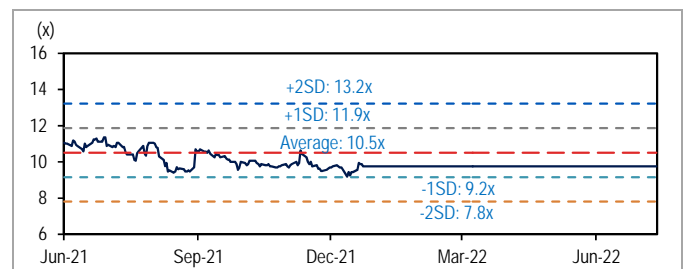
Source: Bloomberg, UOB Kay Hian

FRENCKEN GROUP 12-MONTH FORWARD PE BAND



Source: Bloomberg, UOB Kay Hian

INNOTEK 12-MONTH FORWARD PE BAND



Source: Bloomberg, UOB Kay Hian

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