SECTOR UPDATE

Technology – Malaysia

EMS: On New Avenues To Spearhead Growth

Our Johor trip suggests that the worst is behind for cEMS with sectorial risk-reward calculus tilting towards the favourable side. Besides margin improvement from higher operational efficiency, we see additional impetus stemming from: a) a higher degree of vertical integration; b) a wider market reach; c) technological advancement; and d) new prospects from trade diversion, suggesting that the sector could gain further traction even after the recent V-shaped earnings recovery. Maintain OVERWEIGHT.

OVERWEIGHT

(Maintained)

WHAT'S NEW

- **A fruitful trip with surprising findings.** We came away from our recent Johor EMS trip with our positive conviction reaffirmed, after learning that the worst is over for consumer-centric EMS (cEMS) with its key customers replenishing orders after sharp inventory adjustment. Besides margin improvement from higher operational efficiency, we see additional impetus stemming from: a) higher degree of vertical integration, b) wider market reach, c) technological advancement, and d) new prospects from trade diversion. We also discovered dark horses from our channel checks, which are discreetly nurturing new business opportunities that could see phoenix-like recovery in the mid-term.

- **VS: Parating Na Ako Pilipinas!** Recall that the group has incorporated a new subsidiary in Philippines to take on sizeable orders from this key customer as part of its customer diversification strategy. While management is cognisant of the execution risks considering the different market landscapes in the Philippines, management believes that the new venture has a favourable risk-reward ratio, considering: a) its experience in supporting key customers' sub-operations, b) favourable export tariffs from the Philippines to the US on wider product offerings, c) higher utilisation hence margin enhancement that can be reaped via the cross-selling of its four new capabilities, and d) more job tender wins on multi-site offerings. To be more prudent, the group will adopt an asset-light model to begin with (ie renting factory premises which leads to a lower breakeven point).

- **SKP: Strong recovery in sight; ready to take on new customers.** The group has finally charted yoy growth again in 4QFY24, underpinned by its major customer's inventory replenishment post correction which has lasted for five consecutive quarters. On a positive note, management shared that the key customer has been on a ramp-up mode. We do not discount the possibility of higher volume loadings for its household products given the year-end seasonality. In terms of new prospects, the group remains hopeful of seizing its third new trade-diversion related opportunity which could fill up its ample capacity.

- **AIMFLEX: Three-pronged approach to ignite lightspeed growth.** New management which emerged in 2022 shared its vision in spearheading the company to new heights. Riding on its platform as a manufacturing test and automation company, the group is entrenching its first growth pillar capability as functional testers, process machines and automation provider for EMS and OBMs premised on wider solutions and customer footprints which still serves as the bread-and-butter business. Meanwhile, its second growth pillar is premised on the uptake of advanced machine ODM and assembly, with the group seeing higher traction on wider reach into the medical, test and instrumental fields. Lastly, its third growth pillar is premised on its own platform, related to the state-of-the-art automation for rapid data growth and high-bandwidth applications. The group is in close discussion with its partners which could see new breakthroughs in the medium term.

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PEER COMPARISON

Company	Tickers	Rating	Share Price 4 Jul 24 (RM)	Target Price (RM)	Market Cap (RMm)	PE Curr (x)	PE 1Y Fwd (x)	PE 2Y Fwd (x)	EV/EBITDA Curr (x)	EV/EBITDA 1Y Fwd (x)	P/BV 1Y Fwd (x)	Dividend Yield Curr (x)	Dividend Yield 1Y Fwd (x)
Technology – Electronic Manufacturing Services (EMS)													
CAPE EMS	CEB MK	BUY	0.93	1.33	922.6	18.2	12.5	10.8	17.0	12.5	1.4	0.6	2.4
NationGate Holdings	NATGATE MK	BUY	1.91	2.15	3,961.2	61.4	29.3	25.0	17.8	20.4	7.7	0.0	0.0
SKP Resources	SKP MK	BUY	1.21	1.36	1,890.5	19.5	15.2	13.0	11.4	9.4	2.0	3.2	4.1
VS Industry	VSI MK	BUY	1.28	1.56	4,927.3	26.4	28.6	18.0	12.5	13.0	2.2	1.7	1.6

Source: Bloomberg, UOB Kay Hian

ACTION

- **We increase VS's FY25-26 earnings estimates by 7-12% to account for higher loadings from key customers with its new venture into the Philippines.** Maintain BUY with a higher target price of RM1.56 (from RM1.40) based on rollover 21x 2025 PE. We increase SKP's FY25-26 earnings estimates by 4-10% to account for higher loadings from both its key and new customers. Upgrade to BUY with a higher target price of RM1.36 (from RM1.10) based on rollover 15x 2025 PE.

ESSENTIALS

- **VS: Eyeing new contracts; discussions still in infancy stage.** We understand that VS is still being approached by new MNC customers, with discussions of prospective contracts at different stages of evaluation. Based on the recent customer acquisition trend, we believe any prospective contracts could carry better margins. We are not assuming any new customer wins for now. Assuming that a RM500m contract is secured with full contribution in FY25 on a net margin of 5.5%, the earnings accretion would be 9%.

- **SKP: Enhancing capabilities vertically to take advantage of widened product assortment.** To leverage its vertical integration capabilities, the group is currently focusing on expanding its printed circuit board assembly, injection moulding and engineering capabilities to take advantage of a widened product assortment. The group has also successfully obtained the certificate of completion and compliance for its new factory building measuring 6.4 acres (with additional capacity of +50% from the current base). Note that it is also being approached by new MNC customers and is at the early stages of evaluation.

- **NationGate: Exploring new prospects to drive growth beyond organic target.** Beyond the ramp-up from a low base in 2023, NationGate is also spearheading growth via: a) new customer acquisitions, and b) new business collaborations (via JVs) which could require new premises to house these trade diversion-related opportunities. We believe the drivers could come from the consumer electronics segment (via active collaboration with GoldTek Technology), semiconductor segment (assembly and testing services), and computing power infrastructure and server space. Note that the group had recently acquired a 100% equity stake in Hesechan Industries S/B, which comes with a land area of 272,900 sf, to supplement its expansion plan. Should these prospects crystalise, the group could exceed its net profit growth target of over 30%.

  Note that NationGate has officially been appointed the approved OEM for the world's leader in AI computing. While the earnings contribution from this segment is still meagre thus far, the door-opening opportunity provides a new platform for the group to ride on the booming AI demand and trade diversion opportunities. Meanwhile, there is significant potential for increased earnings through deeper engagement in advanced process manufacturing. On the corporate front, NationGate has been transferred to the Main Market of Bursa Malaysia from 24 May 24 via the accelerated transfer process by the Securities.

- **CAPE: Aggressively scouting for new prospects that best fit into its mid-volume high mix model.** Besides promising growth prospects from: a) its wire communication equipment (expanded its product portfolio after acquisition with access to new markets), and b) Customer A (consumer electronics products; carries the highest gross margin; volume capacity +50% following its synergistic M&A activities), the group is eyeing for at least three new prospects that could see meaningful earnings contribution by 2H24. These products are related to LED lighting, EV charging stations, renewable energy devices, IoT control modules (US-based MNC leading in communication standards) and other segments. Meanwhile, its orderbook as at end-Apr 24 was strong at RM200.1m.

VSI – LATEST EARNINGS ESTIMATES

YE 31 Dec	Net Profit (RMm)	Yoy % chg
2023	188.8	+11
2024F	174.5	-6
2025F	277.7	+63

Source: UOB Kay Hian

SKP – LATEST EARNINGS ESTIMATES

YE 31 Dec	Net Profit (RMm)	Yoy % chg
2023	96.8	-33
2024F	124.8	+29
2025F	146.0	+17

Source: UOB Kay Hian

NATIONGATE – LATEST EARNINGS ESTIMATES

YE 31 Dec	Net Profit (RMm)	Yoy % chg
2023	64.5	-24
2024F	135.1	+109
2025F	158.6	+17

Source: UOB Kay Hian

CAPE – LATEST EARNINGS ESTIMATES

YE 31 Dec	Net Profit (RMm)	Yoy % chg
2023	50.8	+45
2024F	73.9	+16
2025F	85.4	+7

Source: UOB Kay Hian

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