

SECTOR UPDATE

Technology – Malaysia

The Stars Are Aligning; Capitalising Windows Before Cyclical Upturn Again

Conditions for sector risk-on are falling in place after the materialisation of de-rating events alongside appealing valuations. Meanwhile, our empirical study on the sector cyclicity against the BM Tech Index also suggests that the sector upswing could be on the cards. While earnings vulnerability is still looming, not all segments are gloom and doom. We prefer companies that are still benefitting from structural growth themes. Upgrade to OVERWEIGHT.

WHAT'S NEW

- **Risk-reward trade-off improved after rounds of selldown on de-rating events.** Our contrarian downgrade since Dec 21 saw BM Tech Index plunging as sharp as -43% mid-October, before narrowing to -32% early-22. Dampeners such as global uncertainty shocks (high inflations, global slowdown, tightening policies, Russian-Ukraine war, escalating US-China tech-race) alongside slower growth (base normalisation, demand slowdown and inventory excess) are falling in place, sending valuation down to -0.5SD to -1SD below their five-year mean levels (from +2SD since end-21). Conditions for turning more bullish on the sector are in a constellation especially after rounds of de-rating alongside appealing valuations. Additionally, the trifecta of Fed hawkishness, stringency of China's zero-Covid restrictions alongside supply chain disruptions are peaking off, setting a base for this cyclical sector to outperform again in 2023.
- **Light at the end of tunnel for turning risk-on?** On top of a better risk-reward profile, our empirical research on the sector cyclicity against the Bursa Malaysia Technology Index (BM Tech Index) suggests that the index could be on the brink for upswing again after 12 months of consolidation. According to the overleaf chart, the past 15 years study on the relationship of BM Tech Index and global semiconductor sales showed that the bottoming of BM Tech Index happened between the second to seventh month (average 4.5 months) after the onset of global semiconductor yoy sales contraction, while we are currently on the third month of yoy sales contraction (Oct 22 data). This suggests that investors tend to look ahead of fundamental weaknesses with better visibility and capitalising on the upturning point of long-term structural sector growth. We believe this cyclical pattern could repeat itself again this time.
- **Earnings vulnerability still looming; but not all are gloom and doom.** While global PC and smartphone giants are still reportedly cutting component orders and scaling back expansion (to the extent of downsizing - International Data Corporation forecasted -6.5% smartphone shipment growth in 2022 and cut growth to 2.3% in 2023), our channel checks with the local OSAT and equipment makers suggest that the automobile (EV), medical and renewable energy (RE)-related orders are still seeing resilient demand. Indeed, the SPE bellwethers shared that >1/3 of orderbook backlog are made up of these sub-segments which are still seeing healthy growth.

ACTION

- **Upgrade to OVERWEIGHT** on a cherry-picking approach to structural growth themes. While we have previously ascribed a more conservative valuation across all the tech/semicon names under our coverage, we are selectively ascribing a higher valuation to stocks with good growth prospects stemming from: a) front-runners of trade diversion, b) equipment/solution providers for next-generation technologies – ie EV/higher electrification, medical devices and RE. We like companies with strong orderbook backlog such as Greatech, Pentamaster, and Coraza for their unique value propositions, alpha growths and strong demand visibility. We also like VS Industry (VS) for its undemanding valuation vs superior growth profile.

PEER COMPARISON

Company	Tickers	Rating	Share Price 05 Dec 22 (RM)	Target Price (RM)	Market Cap (RMm)	PE			EV/EBITDA		P/BV	Dividend Yield	
						2021 (x)	2022F (x)	2023F (x)	2021 (x)	2022F (x)	2022F (x)	2022F (%)	2023F (%)
Technology – Electronic Manufacturing Services (EMS)													
ATA IMS	AIB MK	SELL	0.255	0.292	306.7	73.6	(5.3)	(21.0)	0.4	0.4	0.4	(6.6)	(1.7)
SKP Resources	SKP MK	BUY	1.69	2.00	2,640.4	16.7	15.6	12.8	3.3	2.9	2.9	4.0	4.9
VS Industry	VSI MK	BUY	0.935	1.40	3,588.1	20.7	15.6	13.7	1.9	1.8	1.8	2.9	3.3
Technology – Semiconductors (OSAT: Outsourced Semiconductor Assembly and Test, SPE: Semiconductor Production Equipment)													
Globetronics	GTB MK	BUY	1.18	1.50	789.9	15.4	16.7	15.2	2.6	2.5	2.5	4.8	5.3
Greatech	GREATEC MK	BUY	5.06	6.30	6,339.4	46.0	48.3	28.1	14.7	11.3	11.3	n.a	n.a
Inari Amertron	INRI MK	BUY	2.78	3.10	10,377.2	26.2	25.7	22.6	4.1	4.0	4.0	3.5	4.0
Pentamaster Corp	PENT MK	BUY	4.63	5.20	3,293.4	46.4	36.5	31.2	5.8	4.5	4.5	0.5	0.6
Vitrox Corp	VITRO MK	BUY	7.63	9.22	7,207.7	42.5	34.9	29.0	10.1	8.5	8.5	1.0	1.2

Source: UOB Kay Hian

OVERWEIGHT

(Upgraded)

OSAT: FORWARD PE



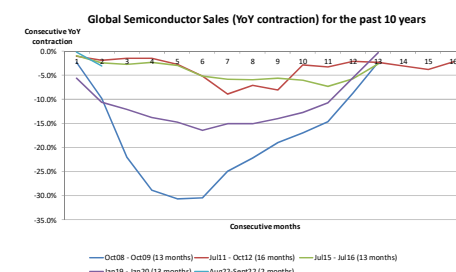
*OSAT: Outsourced Semiconductor Assembly and Test
Source: UOB Kay Hian

SPE: FORWARD PE



*SPE: Semiconductor Production Equipment
Source: UOB Kay Hian

GSS GROWTH DOWNCYCLE FOR THE PAST 10 YEARS



Source: Semiconductor Industry Association (SIA), UOB Kay Hian

ANALYST(S)

Desmond Chong

+603 2147 1980

desmondchong@uobkayhian.com

ESSENTIALS

- Worsening export curbs – a double-edged sword?** Following the escalation of the US-China tech race - with the latest curb being the tighter restriction on the sale of semiconductor equipment to Chinese companies, global semiconductor stocks (from front-end to back-end) have broadly retreated >10% on concerns of supply chain disruption. While such concern is warranted (where OSAT and SPE players have already been impacted by slower delivery since 4Q21), this could accelerate the US-China trade diversion which would benefit the small-cap star performers ie SFP, Coraza and Cnnergz. Our ground check suggests that the queries from MNC on supply chain reconfiguration are still encouraging.
- Local OSAT players' 2022 sales expected to moderate to 9%/5% yoy in 2022/2023 respectively.** While higher semiconductor content following the proliferation of EV and autonomous driving is still expected to drive growth (LMC Automotive projecting that light vehicle unit production will increase 6.0% in 2022 and 4.9% in 2023), shipments of smartphones continue to see headwinds from weakening demand owing to geopolitical tensions and ongoing supply chain constraints (International Data Corporation forecasted - 9.1% smartphone shipment growth in 2022 and cut growth to 2.3% in 2023). Note that worldwide smartphone shipments declined 9.7% yoy in 3Q22. This marks the fifth consecutive quarter of decline for the smartphone market. Meanwhile on the local front, smartphone-related OSAT players are guiding for a softer outlook for next two quarters.
- Local equipment makers: Decent growth; orderbook backlog at all time-high.** Although the growth is coming off from a high base, 2022/23 sales growth are still estimated at a decent 8%/24% on the back of the ongoing investment cycle for EV/autonomous driving, medical and RE even after the strong growth of 45% in 2021. This outperforms global benchmarks due to the US-China trade diversion and the entrenchment of manufacturing capabilities. Meanwhile, orderbook backlogs for most of the companies remain elevated at all-time high levels but delivery remains a challenge due to supply chain disruptions. Nonetheless, the delay was merely a time issue rather than a cancellation.
- Local EMS players bouncing back from a lacklustre 2022 on order rechanneling and revival of foreign labour hiring.** While we are cognisant of the general slowdown in light of the weakening consumer demand, we still expect both SKP and VS' sales to register high-teens growth on a net basis. Note that VS is benefitting following the fallout of its peer from the common customer's business engagement while SKP is still the front-runner for new products commercialisation from its key customer. Meanwhile on the manpower supply which is the much needed driver to fuel structural growth, our latest channel checks reveal that EMS players have already onboarded 100% of the required workforce while having the capacities ready to take on additional jobs.
- Downside risks include:** a) longer-than-expected inflation, b) deeper recession, c) more hawkish US monetary policies, d) slower-than-expected sales, e) higher-than-expected cost, and f) more disruptions caused by the COVID-19 pandemic.
- For SPE exposure, we like Greatech and Pentamaster** for their solid orderbook backlog (early-November: RM888m for Greatech; >RM500m for Pentamaster) with >50% exposure to high-margin EV and/or RE alongside their respective unique value proposition (strategic exposure in the renewable energy, medical and EV industries offer better dynamics to weather cyclicalities vs peers) alongside their robust growth. We also like CORAZA (BUY, Target: RM1.10) for its respective strategic portfolio exposure, aggressive capacity expansion and growing relevance in major customers' high margin products. Meanwhile, non-rated Cnnergz is also benefitting from the border reopening and the acceleration of trade diversion via its exposure to trade winners destinations such as Thailand, Vietnam and Indonesia.
- For EMS, we like VSI** as it offers a better investment proposition than its peers, with exposure to strategic customers alongside being the clear winner of the trade diversion. VSI is benefitting from the fallout from other EMS players following order rechanneling. We expect VSI to register a two-year net profit CAGR of 23% (from FY22-24), notwithstanding the new meaningful contracts pipeline. Current valuation has also been overly conservative in ignoring its valuable China assets and Seeing Machine Limited.

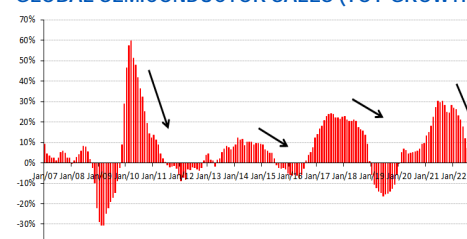
GLOBAL SEMICONDUCTOR SALES FORECAST

Fall 2022	Amounts in US\$M			Year on Year Growth in %		
	2021	2022	2023	2021	2022	2023
Americas	121,481	142,138	143,278	27.4	17.0	0.8
Europe	47,721	53,774	54,006	27.3	12.6	0.4
Japan	43,887	48,064	48,230	19.8	10.0	0.4
Asia Pacific	342,967	336,151	311,008	26.5	-2.0	-7.5
Total World - \$M	555,955	580,126	556,522	26.2	4.4	-4.1
Discrete Semiconductors	30,337	34,098	35,060	27.4	12.4	2.8
Optoelectronics	43,404	43,777	45,381	7.4	0.9	3.7
Sensors	19,148	22,262	23,086	28.0	16.3	3.7
Integrated Circuits	463,002	479,989	453,041	28.2	3.7	-5.6
Analog	74,106	89,054	90,952	33.1	20.8	1.6
Micro	80,221	78,790	75,273	15.1	-1.8	-4.5
Logic	114,837	177,238	175,191	30.8	14.5	-1.2
Memory	163,839	134,407	111,624	30.9	-12.6	-17.0
Total Products - \$M	555,955	580,126	556,522	26.2	4.4	-4.1

Note: Numbers in the table are rounded to whole millions of dollars, which may cause totals by region and totals by product group to differ slightly.

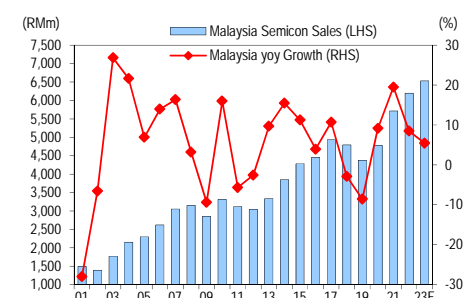
Source: World Semiconductor Trade Statistics (WSTS)

GLOBAL SEMICONDUCTOR SALES (YOY GROWTH)



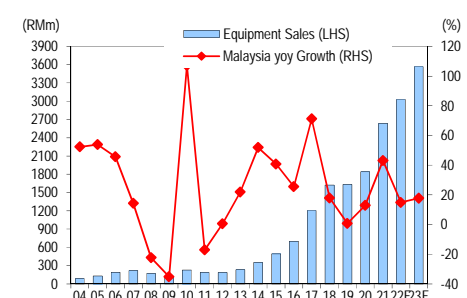
Source: Bloomberg, SIA, UOB Kay Hian

MALAYSIA OSAT SALES GROWTH



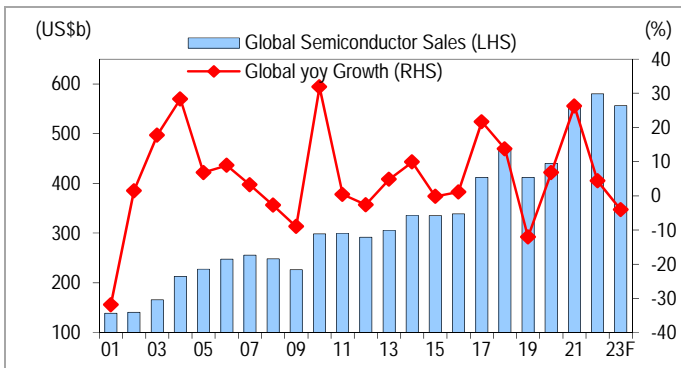
Source: Bloomberg, UOB Kay Hian

MALAYSIA EQUIPMENT MAKER SALES GROWTH

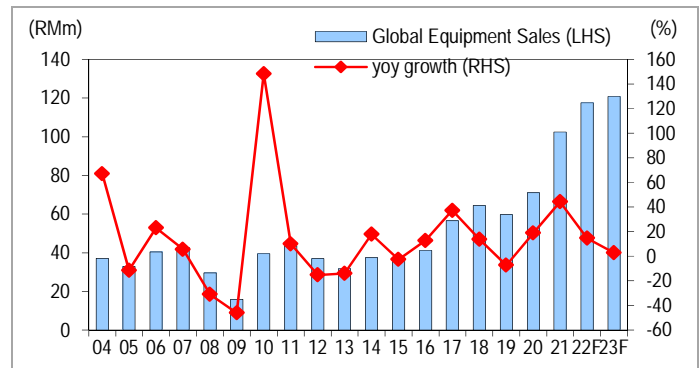


Source: Bloomberg, UOB Kay Hian

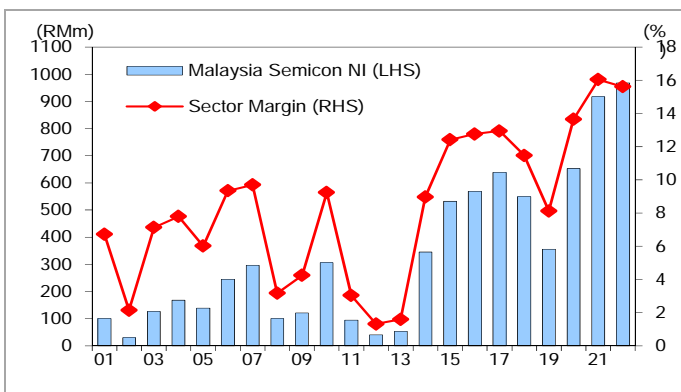
GLOBAL SEMICONDUCTOR SALES AND GROWTH



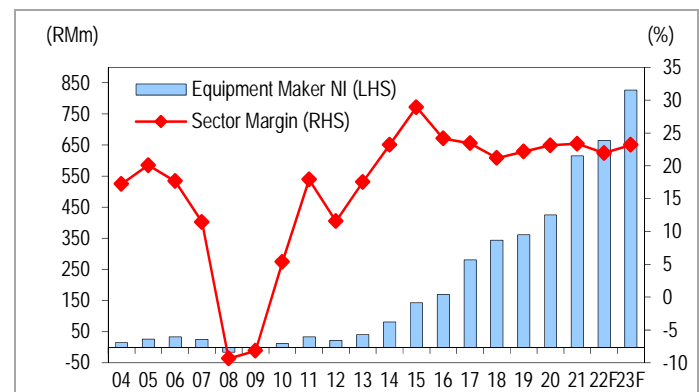
GLOBAL EQUIPMENT MAKER SALES AND GROWTH



MALAYSIA OSAT NET PROFIT AND MARGIN



MALAYSIA EQUIPMENT MAKER NET PROFIT AND MARGIN



TECHNOLOGY DOWNCYCLE PLOT AGAINST BURSA MALAYSIA TECHNOLOGY INDEX



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