

COMPANY UPDATE

**AEM Holdings (AEM SP)**

Cautious On Rally From AI Hype; Earnings Could Miss On Overoptimistic Estimates

**AEM's one-month share price rally of about 30% was largely driven by the increased interest in AI-related stocks from positive developments in the space since May 23. AI-related chips account for only about 3% of total semiconductor sales and will not be able to offset weakness in other segments such as smartphones and PCs. Also, consensus earnings estimate for AEM appears too optimistic. Downgrade to SELL with an unchanged target price of S\$2.87.**

WHAT'S NEW

- **One-month share price rally of about 30% largely driven by increased interest in AI-related stocks is overdone.** AEM Holdings' (AEM) share price has rallied along with many semiconductor-related stocks since the strong sales forecast by US-listed Nvidia in late-May 23, which has driven positive development in the AI-related space. We believe the sharp rally in AEM's share price is overdone despite possible longer-term benefits from the secular growth in the semiconductor sector driven by the increasing adoption of AI-related chips, with global semiconductor demand expected to be weak in 2023. AEM's near-term earnings are expected to remain weak.
- **AI-related chips account for only a small share of total semiconductor sales with all other segments expected to contract in 2023.** The small share (c.3%) of AI-related chips will not be able to lift global semiconductor sales out of decline for 2023. BCA Research's Jun 23 review of major semiconductor consuming sectors paints a subdued picture for global semiconductor demand: a) mobile phones, PCs and tablets, which account for c.40% of semiconductor sales, are seeing sluggish consumer demand due to overconsumption in previous years (global shipments of mobile phones and PCs plunged by around 14% and 30% in 1Q23), and b) automobiles, servers and industrial electronics, which account for about 30% of semiconductor sales, will experience <5% growth for 2023. Such small increase will not be enough to offset lower demand in the consumer electronic goods sector in the near term.
- **There is a good chance that 2023/24 earnings estimates have more than factored in most of the upside potential and consensus earnings estimate appears too bullish.** Even after cutting our earnings significantly after 1Q23 results, AEM's 1Q23 earnings still forms only 20% of our 2023 earnings estimate and our 2023/24 earnings estimate are 4%/24% below consensus estimate. AEM's 1Q23 earnings of S\$15.6m (-62% yoy) were below our expectations. This was due to weak net margin, which fell 5.4ppt yoy to 10.2% in 1Q23, due to: a) change in product mix as revenue contribution from the high margin consumables segment fell, and b) revenue from the services segment, which has lower margin, rising 53% yoy.

KEY FINANCIALS

Year to 31 Dec (S\$m)	2021	2022	2023F	2024F	2025F
Net turnover	565	870	580	639	705
EBITDA	126	184	113	124	135
Operating profit	112	160	96	107	119
Net profit (rep./act.)	92	128	77	88	98
Net profit (adj.)	92	128	77	88	98
EPS (S\$ cents)	33.5	41.4	24.9	28.4	31.7
PE (x)	11.9	9.6	15.9	14.0	12.5
P/B (x)	2.7	2.5	2.3	2.0	1.8
EV/EBITDA (x)	8.6	5.9	9.7	8.8	8.1
Dividend yield (%)	1.9	2.6	1.6	1.8	2.0
Net margin (%)	16.3	14.7	13.3	13.7	13.9
Net debt/(cash) to equity (%)	(33.5)	3.2	(26.9)	(30.6)	(33.7)
Interest cover (x)	95.3	140.1	43.0	92.3	158.3
ROE (%)	30.0	28.8	15.0	15.2	15.2
Consensus net profit	-	-	80	116	134
UOBKH/Consensus (x)	-	-	0.96	0.76	0.73

Source: AEM, Bloomberg, UOB Kay Hian

SELL

(Downgraded)

Share Price	S\$3.97
Target Price	S\$2.87
Upside	-27.7%

COMPANY DESCRIPTION

AEM prides itself on being a global leader in test innovation and provides comprehensive test solutions for the semiconductor and electronics industries, spanning test handlers, testers, consumables and data analytics.

STOCK DATA

GICS sector	Semiconductor Equipment
Bloomberg ticker:	AEM SP
Shares issued (m):	308.9
Market cap (S\$m):	1,226.2
Market cap (US\$m):	915.1
3-mth avg daily t'over (US\$m):	4.7

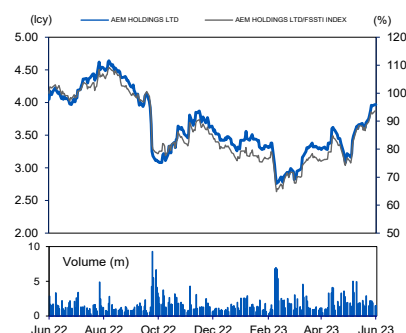
Price Performance (%)

52-week high/low	S\$ 4.71/S\$ 2.70			
<b>1mth</b>	<b>3mth</b>	<b>6mth</b>	<b>1yr</b>	<b>YTD</b>
23.3	40.8	9.1	(5.0)	16.1

Major Shareholders

Temasek Hldgs	11.3%
EPF	9.4%
FY23 NAV/Share (S\$)	1.76
FY23 Net Cash/Share (S\$)	0.47

PRICE CHART



Source: Bloomberg

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### STOCK IMPACT

- **The latest guidance from AEM in 1Q23 indicates an uncertain near-term outlook**, with AEM maintaining its 2023 revenue guidance of S\$500m but indicating that it may be revised up or down as second half visibility becomes clearer. The "down" was newly added. On the other hand, AEM highlighted that the future of the semiconductor industry has never been more promising beyond 2023 and it is seeing flickers of positive signs across the industry.
- **Major customer Intel generates around 30% of total revenue from data centre & AI segment in 1Q23 but this has been declining** due to a decrease in server volume as customers are tempering purchases to reduce existing inventories in a softening data centre market. In its latest guidance in 1Q23 results release, Intel also highlighted that it expects the macroeconomic uncertainty and the challenging market condition will continue during 2023
- **While AI development is positive for semiconductor demand, its contribution is limited in the near term.** The chances are low that global semiconductor producers' stock prices will continue to rally through 2H23, as the surge in AI chip demand helps only a few companies while the boom in smartphone chips benefitted a much larger pool of semiconductor players. Nvidia is the major beneficiary as revenue from its data centre business grew 14% yoy in 1Q23. This is because many cloud service providers buy Nvidia's AI chips to use in existing data centres to improve operating performances and efficiencies. On the other hand, new data centres, which can benefit more chip companies by using more chips, are experiencing slower growth. Two major data centre chip suppliers, AMD and Intel, have not seen any increase in revenue. AMD revenues from its data centre & AI group remained almost flat in 1Q23 and Intel's plunged by 38% yoy. In addition, AI chips only accounted for about 3% of global semiconductor sales, much lower than the one-third share for smartphone chips. China boosted its overseas purchases of processor and controller chips in 2H19 and 2020 to build up domestic inventory, but is now in a destocking process.

### EARNINGS REVISION/RISK

- We maintain our earnings forecasts.

### VALUATION/RECOMMENDATION

- **Downgrade to SELL with an unchanged target price of S\$2.87.** This is based on 11.5x 2023F PE, pegged to 0.5SD above AEM's long-term forward mean PE.

### SHARE PRICE CATALYST

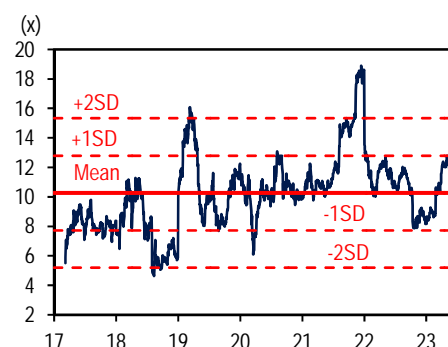
- Positive surprise in future revenue guidance and winning of more new customers.

### PEER COMPARISON

Company	Ticker	Trading Curr (lcy)	Price @ 19 Jun 23 (lcy)	Market Cap (US\$m)	PE		P/B		EV/EBITDA		ROE 2023 (%)	Yield 2023 (%)	Net Gearing (%)
					2023 (x)	2024 (x)	2023 (x)	2024 (x)	2023 (x)	2024 (x)			
AEM	AEM SP	SGD	3.97	915	15.9	14.0	2.3	2.0	9.7	8.8	15.0	1.6	(25.9)
<b>SGX-listed peers</b>													
UMS	UMSH SP	SGD	1.07	535	10.4	9.5	1.9	1.7	7.7	7.1	19.2	4.7	(5.9)
Frencken	FRKN SP	SGD	0.94	300	15.7	11.3	1.0	0.9	7.2	5.7	6.5	1.9	(4.2)
ISDN	ISDN SP	SGD	0.54	178	9.2	7.8	1.1	1.0	5.3	4.8	12.5	2.8	(6.8)
Grand Venture	GVTL SP	SGD	0.515	130	15.6	10.4	1.4	1.2	6.7	5.2	9.1	1.4	31.1
Avi-Tech	AVI SP	SGD	0.26	33	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	(61.5)
<b>Average</b>					<b>12.7</b>	<b>9.8</b>	<b>1.3</b>	<b>1.2</b>	<b>6.7</b>	<b>5.7</b>	<b>11.8</b>	<b>2.7</b>	
<b>Others</b>													
Teradyne	TER US	USD	111.06	17,219	40.2	24.2	7.0	6.5	25.2	17.9	18.4	0.4	(30.2)
Advantest	6857 JP	JPY	19200	25,919	38.4	28.1	8.6	7.3	25.5	20.0	23.6	0.7	(9.4)
Cohu	COHU US	USD	40.77	1,938	20.7	15.9	2.0	1.8	12.1	9.7	9.8	0.0	(27.4)
Hirata	6258 JP	JPY	8820	669	19.6	16.1	1.5	1.4	13.3	11.0	7.7	1.1	31.3
Astronics	ATRO US	USD	17.88	583	n.a.	27.7	n.a.	n.a.	16.9	9.0	n.a.	n.a.	75.9
<b>Average</b>					<b>29.7</b>	<b>22.4</b>	<b>4.8</b>	<b>4.2</b>	<b>18.6</b>	<b>13.5</b>	<b>14.9</b>	<b>0.6</b>	

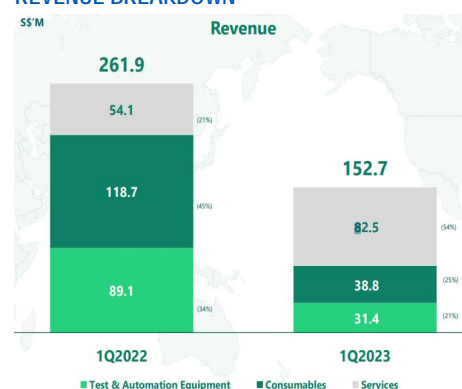
Source: Bloomberg, UOB Kay Hian

### FORWARD PE RANGE



Source: Bloomberg, UOB Kay Hian

### REVENUE BREAKDOWN



Source: AEM, UOB Kay Hian

### PROFIT & LOSS

Year to 31 Dec (\$m)	2022	2023F	2024F	2025F
Net turnover	870.5	580.3	639.4	704.7
EBITDA	183.8	112.6	124.3	134.8
Deprec. & amort.	23.5	16.9	16.9	15.8
EBIT	160.3	95.7	107.4	119.0
Associate contributions	(0.3)	(0.3)	(0.3)	(0.3)
Net interest income/(expense)	(1.3)	(2.6)	(1.3)	(0.9)
<b>Pre-tax profit</b>	<b>158.7</b>	<b>92.8</b>	<b>105.7</b>	<b>117.9</b>
Tax	(31.4)	(15.8)	(18.0)	(20.0)
Minorities	0.5	0.0	0.0	0.0
<b>Net profit</b>	<b>127.8</b>	<b>77.0</b>	<b>87.8</b>	<b>97.9</b>
Net profit (adj.)	127.8	77.0	87.8	97.9

### BALANCE SHEET

Year to 31 Dec (\$m)	2022	2023F	2024F	2025F
Fixed assets	76.9	70.7	64.5	59.5
Other LT assets	138.1	147.1	156.1	165.1
Cash/ST investment	127.8	275.9	302.1	229.5
Other current assets	462.8	316.6	347.5	382.3
<b>Total assets</b>	<b>805.6</b>	<b>810.3</b>	<b>870.2</b>	<b>836.4</b>
ST debt	13.7	13.7	116.0	0.0
Other current liabilities	154.5	115.2	122.9	131.7
LT debt	129.7	116.0	0.0	0.0
Other LT liabilities	14.3	14.3	14.3	14.3
Shareholders' equity	485.0	542.8	608.6	682.0
Minority interest	8.4	8.4	8.4	8.4
<b>Total liabilities &amp; equity</b>	<b>805.6</b>	<b>810.3</b>	<b>870.2</b>	<b>836.4</b>

### CASH FLOW

Year to 31 Dec (\$m)	2022	2023F	2024F	2025F
<b>Operating</b>	<b>(32.1)</b>	<b>203.6</b>	<b>83.2</b>	<b>88.7</b>
Pre-tax profit	127.3	77.0	87.8	97.9
Tax	31.4	15.8	18.0	20.0
Deprec. & amort.	23.5	16.9	16.9	15.8
Associates	2.8	0.3	0.3	0.3
Working capital changes	(197.6)	106.8	(23.1)	(26.0)
Other operating cashflows	(19.5)	(13.2)	(16.6)	(19.2)
<b>Investing</b>	<b>(38.4)</b>	<b>(19.2)</b>	<b>(18.2)</b>	<b>(18.1)</b>
Capex (growth)	(4.3)	(20.0)	(20.0)	(20.0)
Investments	(12.8)	0.0	0.0	0.0
Proceeds from sale of assets	0.6	0.0	0.0	0.0
Others	(21.9)	0.8	1.8	1.9
<b>Financing</b>	<b>(18.6)</b>	<b>(36.3)</b>	<b>(38.7)</b>	<b>(143.2)</b>
Dividend payments	(36.2)	(19.3)	(21.9)	(24.5)
Issue of shares	0.0	0.0	0.0	0.0
Proceeds from borrowings	50.0	0.0	0.0	0.0
Loan repayment	(15.4)	(13.7)	(13.7)	(116.0)
Others/interest paid	(17.1)	(3.4)	(3.1)	(2.8)
<b>Net cash inflow (outflow)</b>	<b>(89.1)</b>	<b>148.1</b>	<b>26.2</b>	<b>(72.6)</b>
<b>Beginning cash &amp; cash equivalent</b>	<b>216.2</b>	<b>127.8</b>	<b>275.9</b>	<b>302.1</b>
Changes due to forex impact	0.7	0.0	0.0	0.0
<b>Ending cash &amp; cash equivalent</b>	<b>127.8</b>	<b>275.9</b>	<b>302.1</b>	<b>229.5</b>

### KEY METRICS

Year to 31 Dec (%)	2022	2023F	2024F	2025F
<b>Profitability</b>				
EBITDA margin	21.1	19.4	19.4	19.1
Pre-tax margin	18.2	16.0	16.5	16.7
Net margin	14.7	13.3	13.7	13.9
ROA	16.9	9.5	10.4	11.5
ROE	28.8	15.0	15.2	15.2
<b>Growth</b>				
Turnover	53.9	(33.3)	10.2	10.2
EBITDA	45.5	(38.7)	10.4	8.5
Pre-tax profit	42.8	(41.5)	14.0	11.5
Net profit	38.6	(39.7)	14.0	11.5
Net profit (adj.)	38.6	(39.7)	14.0	11.5
EPS	23.7	(39.7)	14.0	11.5
<b>Leverage</b>				
Debt to total capital	22.5	19.0	15.8	0.0
Debt to equity	29.5	23.9	19.1	0.0
Net debt/(cash) to equity	3.2	(26.9)	(30.6)	(33.7)
Interest cover (x)	140.1	43.0	92.3	158.3

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