

02 June 2017

## KESM Industries Bhd

### 9M17 Within Expectations

KESM delivered yet another positive set of results with 9M17 earnings jumping 35% to RM30.6m on higher demand for burn-in and testing services. Going forward, focus will remain towards growing the testing business for automotive semiconductors – an area of high growth potential. With 9M17 CAPEX of RM81.2m already far exceeding the RM30.0m spent in the entire FY16, we remain optimistic on the company's prospects ahead. We retain our **OUTPERFORM** call with an unchanged TP of RM15.20.

**9M17 meets expectations.** KESM registered a 3Q17 NP of RM10.6m (+6.3% QoQ, +40.0% YoY). This brought the 9M17 numbers to RM30.6m (+35.1% YoY) which was within expectations at 78.8% of our full-year estimates and 79.8% of the consensus, respectively. Absence of dividends was also expected, although we project FY17E NDPS of 9.0 sen later in the year.

**YoY,** 3Q17 revenue surged 20.1% to RM85.0m, driven by higher demand for burn-in and testing services. Meanwhile, NP increased by a still higher 40.0% to RM10.6m, aided by a larger proportion of high margin testing services (relative to low margin EMS business) which more than offset the 30.7% increase in depreciation expense and 24.0% increase in other expenses such as repairs, maintenance, utilities and professional fees. **9M17** revenue grew by 17.5% RM248.2m as the capital investments in prior years bear fruit. Furthermore, EBIT increased by a larger quantum of 26.6% (EBIT margins expanded 1.0ppt to 14.0%). Effective tax rate also came in lower at 12.7% (-3.1ppt) compared to 15.7% resulting in net earnings of RM30.6m (+35.1%) and net margins of 12.3% (+1.6ppt).

**QoQ,** 3Q17 revenue increased 2.3% to RM85.0m, while NP grew 6.3% to RM10.6m. This improvement to KESM's bottom-line came despite a 9.9% increase in depreciation expense (as additional machinery and test equipment were installed during the reporting period), which was offset by the larger proportion of high margin testing services mentioned above. In particular, note that "raw materials and consumables used" which is typical of EMS business decreased 20.7% from RM10.0m in 2Q17 to RM7.9m in 3Q17. Along with the lower effective tax rate of 13.4% (-0.6ppt), net margins expanded to 12.5% (+0.5ppt).

**Building upon KESM's forte.** Going forward, focus will remain towards growing the testing business, primarily in automotive semiconductors. Automotive semiconductors currently account for c.70%-80% of KESM's revenue base and represent an area of high growth, driven by rising car production by global automakers and increased chip content within vehicles. Among the initiative taken to capitalise on these trends include a massive CAPEX plan over the next two years, developing technologies such as the test-during-burn-in (TDBI) to take on more complex/ higher margin products. Given the longer product life cycles of automotive semiconductors and recurring nature of the business, we also envisage that KESM would benefit from better long-term earnings visibility and smoothed quarterly delivery.

**Retain OUTPERFORM.** Post earnings release, we keep our FY17E/FY18E estimates unchanged. We also maintain **OUTPERFORM** the stock with an unchanged TP of RM15.20. Our TP is based on the ascribed 15.0x PER on FY18E EPS of RM1.01. Our valuation comes in-line with local OSAT players MPI and UNISEM, both of which we have assigned up-cycle valuations in view of the industry's recovery and favorable macro-economic factors. Risks to our call include: (i) lower-than-expected sales and margins, and (ii) longer-than-expected gestation periods.

## OUTPERFORM ↔

**Price:** RM13.64  
**Target Price:** RM15.20 ↔

**Expected Capital Gain:** RM1.56 +11.4%  
**Expected Div. Yield:** RM0.09 +0.7%  
**Expected Total Return:** RM1.65 +12.1%

**KLCI Index** 1,763.11

### Stock Information

Bloomberg Ticker	KESM MK
Bursa Code	9334
Listing Market	Main Market
Shariah Compliant	Yes
Issued shares	43.0
Market Cap (RM m)	586.7
Par value per share (RM)	1.00
52-week range (H)	13.80
52-week range (L)	4.00
Free Float	42%
Beta	0.6
3-mth avg daily vol:	52,092

### Major Shareholders

SUNRIGHT LTD	48.4%
COLLERY PETER	5.0%
WONG TEE FATT	5.0%

### Summary Earnings Table

FY July (RM m)	2016A	2017E	2018E
Revenue	285.7	315.1	351.8
EBIT	36.7	44.5	50.2
PBT	36.2	44.5	50.8
Net profit	30.7	38.8	44.3
<b>Core Net Profit</b>	<b>30.7</b>	<b>38.8</b>	<b>44.3</b>
Consensus (NP)		38.4	45.5
Earnings Revision (%)		-	-
Core EPS (sen)	70.2	88.9	101.4
Core EPS growth (%)	80.2	26.5	14.1
DPS (sen)	7.5	9.0	10.3
BV/Share (RM)	6.6	7.4	8.3
Core PER	19.4	15.3	13.4
PBV (x)	2.1	1.8	1.6
Net. Gearing	-0.3	-0.1	-0.3
Div. Yield (%)	0.5	0.7	0.8

### Share Price Performance



	1 mth	3 mths	12 mths
Absolute (%)	11.8%	37.5%	235.1%
Relative (%)	10.6%	35.3%	227.2%

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## Results Highlights

	3Q	2Q	QoQ	3Q	YoY	9M	9M	YoY
FYE July (RM'm)	FY17	FY17	Chg	FY16	Chg	FY17	FY16	Chg
<b>Revenue</b>	<b>85.0</b>	<b>83.1</b>	<b>2.3%</b>	<b>70.8</b>	<b>20.1%</b>	<b>248.2</b>	<b>211.2</b>	<b>17.5%</b>
EBITDA	29.8	27.5	8.5%	22.5	32.4%	83.0	68.6	21.0%
EBIT	12.2	11.5	6.5%	9.1	34.9%	34.7	27.4	26.6%
PBT	12.3	11.6	5.6%	9.2	32.9%	35.0	26.9	30.4%
Taxation	-1.6	-1.6	1.2%	-1.6	0.0%	-4.4	-4.2	4.8%
<b>PAT</b>	<b>10.6</b>	<b>10.0</b>	<b>6.3%</b>	<b>7.6</b>	<b>40.0%</b>	<b>30.6</b>	<b>22.6</b>	<b>35.1%</b>
<b>Net Profit</b>	<b>10.6</b>	<b>10.0</b>	<b>6.3%</b>	<b>7.6</b>	<b>40.0%</b>	<b>30.6</b>	<b>22.6</b>	<b>35.1%</b>
EPS (sen)	24.7	23.2	6.3%	17.6	40.0%	71.1	52.6	35.1%
DPS (sen)	0.0	0.0		0.0		0.0	0.0	
EBITDA margin	35.1%	33.1%		31.8%		33.4%	32.5%	
EBIT margin	14.4%	13.8%		12.8%		14.0%	13.0%	
PBT margin	14.4%	14.0%		13.0%		14.1%	12.7%	
PATAMI margin	12.5%	12.0%		10.7%		12.3%	10.7%	
Effective tax rate	-13.4%	-14.0%		-17.9%		-12.7%	-15.7%	

Source: Company, Kenanga Research

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## Peer Comparison

NAME	Price (1-Jun-17)	Mkt Cap	PER (x)			Est. Div. Yld.	Fwd ROE	P/BV	Net Profit (RMm)			1Y Fwd Growth (%)	2Y Fwd Growth (%)	Target Price (RM)	Rating
	(RM)	(RMm)	Historical	1Y Fwd	2Y Fwd				(x)	Historical	1Y Fwd				
KESM	13.64	596.1	19.4	15.3	13.4	0.7%	12.0%	2.1	30.7	38.8	44.3	26.5%	14.1%	15.2	OP
<b>Core Coverage</b>															
MPI	12.42	2,606.8	17.4	14.4	13.9	2.2%	16.8%	2.7	149.9	180.7	188.2	20.5%	4.2%	14.85	OP
UNISEM	3.50	2,568.3	16.0	15.0	14.8	3.4%	12.1%	1.8	160.5	171.1	174.0	6.6%	1.7%	3.55	MP
NOTION	1.17	383.5	147.5	15.1	10.9	2.6%	6.8%	1.4	2.6	25.4	35.2	876.9%	38.6%	1.66	OP
SKPRES	1.31	1,610.0	15.4	12.2	10.9	3.2%	24.4%	3.5	104.5	131.8	148.2	26.1%	12.4%	1.40	MP
PIE	2.31	887.1	22.8	13.4	12.1	3.5%	15.8%	2.4	38.9	66.4	73.6	70.7%	10.8%	2.87	OP
Peer Average			<b>43.8</b>	<b>14.0</b>	<b>12.5</b>	<b>3.0%</b>	<b>15.2%</b>	<b>2.3</b>				<b>200.2%</b>	<b>13.5%</b>		

Source: Bloomberg, Kenanga Research

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**Stock Ratings are defined as follows:****Stock Recommendations**

OUTPERFORM : A particular stock's Expected Total Return is MORE than 10%  
MARKET PERFORM : A particular stock's Expected Total Return is WITHIN the range of -5% to 10%  
UNDERPERFORM : A particular stock's Expected Total Return is LESS than -5%

**Sector Recommendations\*\*\***

OVERWEIGHT : A particular sector's Expected Total Return is MORE than 10%  
NEUTRAL : A particular sector's Expected Total Return is WITHIN the range of -5% to 10%  
UNDERWEIGHT : A particular sector's Expected Total Return is LESS than -5%

**\*\*\*Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.**

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