

19 November 2020

## KESM Industries Bhd

### Returns to the Black

KESM managed to recover to the black with 1QFY21 CNP of RM1.2m, though accounting for only 7%/11% of our/consensus' estimates. We deem this in line with our expectation as we anticipate bulk of the earnings recovery to be reflected in subsequent quarters, particularly in 2HFY21. China and Europe's car sales continue to climb with China gaining at a quicker pace. Macro-wise, industry leader NXP has also turned slightly positive and expects the recent recovery to build a firm base for a better year going into 2021. Maintain MARKET PERFORM with a higher Target Price of RM10.60.

**Meet expectations.** KESM managed to recover to the black with 1QFY21 CNP of RM1.2m, accounting for 7%/11% of our/consensus' estimates. We deem this to be in line with our expectation as we anticipate bulk of the earnings recovery to be reflected in subsequent quarters, particularly in 2HFY21. With revenue inching steadily upwards, the net profit improvement is expected to climb at a faster pace going forward, owing to the group's high degree of operating leverage.

**Results' highlight.** YoY, 1QFY21 CNP fell 73% to RM1.2m while revenue dipped 15.6% to RM61.1m on the back of lower volume for automotive burn-in and testing services during the period. Demand for electronic manufacturing services also declined due to lower orders from customer. Do note that the YoY comparison is less meaningful as this is the first quarter of recovery post Covid-19 lockdown. We estimate the group's current utilisation rate to be at its breakeven point of 50%-55%, which is an improvement from previous quarter of 20%. QoQ comparison will serve as a better gauge for the group's recovery as 1QFY21 recorded CNP of RM1.2m (vs. CNL of RM3.3m in 4QFY20). Revenue also increased 32% to RM61.1 from RM46.3m.

**Recovery to continue.** We are positive on the group's ability to return into the black and anticipate the recovery to continue into subsequent quarters as global car sales have come off the bottom with recovery signs. China's car sales remain strong, extending its growth streak to seven consecutive month of growth. Latest data in October shows 9.3% YoY increase in passenger car sales. Electric vehicle sale in China grew at a quicker pace of 104% YoY in Oct. Europe's car sales is recovering but at a modest pace, as sales recorded 3% YoY increase in Sep but fell 7.8% in Oct. On the macro side, we notice the tone of industry leader NXP has turned slightly positive and is expecting the recovery in recent quarter to build a firm base for a better year going into 2021.

**Maintain FY21E and FY22E CNP.** While the group has been slower to recover compared to its peers, we expect to see continuous improvement from here on with better prospects in 2021.

**Maintain MARKET PERFORM with a higher Target Price of RM10.60** (previously RM8.60) based on higher CY21E PER of 21x (previously 17x), in line with its 3-year mean. We ascribe a higher PER to reflect the group's improving prospects.

**Risks to our call include:** (i) faster-than-expected recovery in vehicle sales, (ii) faster-than-expected adoption of new semiconductor modules in automobiles, and (iii) easing of the US-China trade spat which could potentially shorten the industry recovery process.

## MARKET PERFORM ↔

Price: RM10.52  
Target Price: RM10.60 ↑

Expected Capital Gain: RM0.08 0.8%  
Expected Divd. Yield: RM0.09 0.9%  
Expected Total Return: RM0.17 1.6%

KLCI Index 1,604.75

### Stock Information

Bloomberg Ticker	KESM MK Equity
Bursa Code	9334
Listing Market	Main Market
Shariah Compliant	Yes
Shares Outstanding	43.0
Market Cap (RM m)	453.3
Par value per share (RM)	1.00
52-week range (H)	12.00
52-week range (L)	5.00
Free Float	41%
Beta	1.6
3-mth avg daily vol:	79,240

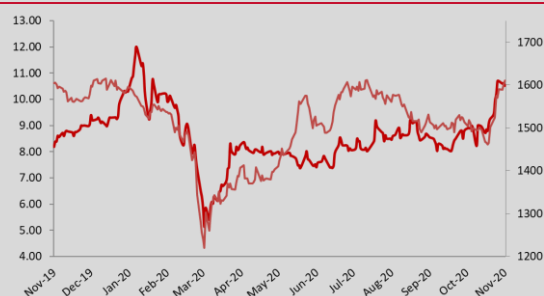
### Major Shareholders

Sunright Ltd	48.4%
KWAP	6.6%
Tan Kong Hong Alex	4.8%

### Summary Earnings Table

FY July (RM m)	2020A	2021E	2022E
Revenue	241.0	276.2	290.9
EBIT	1.9	18.6	25.8
PBT	5.7	24.6	33.0
Net profit	0.1	18.5	24.8
<b>Core Net Profit</b>	<b>0.1</b>	<b>18.5</b>	<b>24.8</b>
Consensus (NP)	N.A.	16.1	22
Earnings Revision	N.A.	0%	0%
Core EPS (sen)	0.2	43.0	57.7
Core EPS growth (%)	-98.5	19158	34.2
DPS (sen)	7.5	9.0	9.0
BV/Share (RM)	8.2	8.5	9.0
Core PER (x)	3768	24.5	18.2
PBV (x)	1.0	1.0	0.9
Net Gearing (x)	-0.6	-0.7	-0.8
Div. Yield (%)	0.9	1.1	1.1

### Share Price Performance



	1 mth	3 mths	12 mths
Absolute (%)	21.6%	24.0%	27.5%
Relative (%)	16.8%	21.8%	28.4%

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## Results Highlights

	1Q	4Q	QoQ	1Q	YoY	3M	3M	YoY
FYE July (RM m)	FY21	FY20	Chg	FY20	Chg	FY21	FY20	Chg
<b>Revenue</b>	<b>61.1</b>	<b>46.3</b>	<b>32.1%</b>	<b>72.4</b>	<b>-15.6%</b>	<b>61.1</b>	<b>72.4</b>	<b>-15.6%</b>
EBITDA	14.7	12.0	23.0%	23.6	-37.5%	14.7	23.6	-37.5%
EBIT	0.5	-2.6	-120.5%	6.9	-92.3%	0.5	6.9	-92.3%
PBT	1.5	-1.6	-190.6%	6.1	-76.3%	1.5	6.1	-76.3%
Taxation	-0.7	-1.7	-58.8%	-1.6	-57.3%	-0.7	-1.6	-57.3%
<b>Net Profit</b>	<b>0.8</b>	<b>-3.3</b>	<b>-123.3%</b>	<b>4.5</b>	<b>-83.1%</b>	<b>0.8</b>	<b>4.5</b>	<b>-83.1%</b>
<b>Core Net Profit</b>	<b>1.2</b>	<b>-3.3</b>	<b>-123.3%</b>	<b>4.5</b>	<b>-83.1%</b>	<b>1.2</b>	<b>4.5</b>	<b>-83.1%</b>
EPS (sen)	1.8	-7.6	-123.7%	10.5	-82.9%	1.8	10.5	-82.9%
DPS (sen)	0.0	6.0		0.0		0.0	0.0	
EBITDA margin	24.1%	25.9%		32.6%		24.1%	32.6%	
EBIT margin	0.9%	-5.6%		9.6%		0.9%	9.6%	
PBT margin	2.4%	-3.5%		8.5%		2.4%	8.5%	
PATAMI margin	2.0%	-7.1%		6.3%		2.0%	6.3%	
Effective tax rate	-47.5%	104.4%		-26.3%		-47.5%	-26.3%	

Source: Company, Kenanga Research

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### Malaysian Technology Peers Comparison

Name	Last Price (RM)	Market Cap (RM'm)	Shariah Compliant	Current FYE	Revenue Growth		Core Earnings Growth		PER (x) - Core Earnings			PBV (x)		ROE	Net Div Yld	Target Price (RM)	Rating
					1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	1-Yr. Fwd.			
D&O GREEN TECHNOLOGIES BERHAD	1.44	1,650.0	Y	12/2019	0.0%	14.2%	-2.5%	56.7%	28.6	29.7	18.9	2.8	2.5	13.0%	1.1%	1.20	OP
INARI AMERTRON BHD	2.60	8,551.0	Y	06/2020	37.4%	24.9%	66.7%	25.1%	54.8	33.3	26.7	7.1	7.0	21.6%	2.5%	3.14	OP
JHM CONSOLIDATION BHD	2.11	1,180.5	Y	12/2020	5.9%	24.7%	3.6%	58.2%	23.8	22.9	14.5	3.6	3.0	13.1%	1.6%	2.00	OP
KELINGTON GROUP BHD	1.61	522.6	Y	12/2020	-11.3%	29.2%	-67.8%	230%	15.6	53.7	19.9	2.4	2.5	4.9%	0.5%	1.92	OP
KESM INDUSTRIES BERHAD	10.52	452.5	Y	07/2020	14.6%	5.3%	19158%	34.2%	3768	24.5	18.2	1.0	1.0	5.0%	1.1%	10.60	MP
MALAYSIAN PACIFIC INDUSTRIES BERHAD	23.22	4,910.5	Y	06/2020	8.0%	8.0%	16.0%	11.0%	19.5	16.7	15.1	1.7	1.8	11.8%	1.9%	18.80	OP
P.I.E. INDUSTRIAL BERHAD	2.22	848.7	Y	12/2020	13.5%	13.5%	24.3%	15.0%	15.5	36.3	14.6	1.3	1.2	3.5%	1.4%	1.45	MP
SKP RESOURCES BHD	1.86	2,331.5	Y	03/2020	23.7%	9.7%	67.3%	20.7%	27.5	16.4	13.6	3.3	3.0	18.0%	3.0%	1.83	OP
UNISEM (M) BERHAD	5.56	4,082.3	Y	12/2020	9.0%	17.6%	71.9%	47.7%	49.7	28.9	19.6	2.4	2.2	7.8%	1.4%	5.15	OP

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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