Technology

Demand Resurgence

OVERWEIGHT

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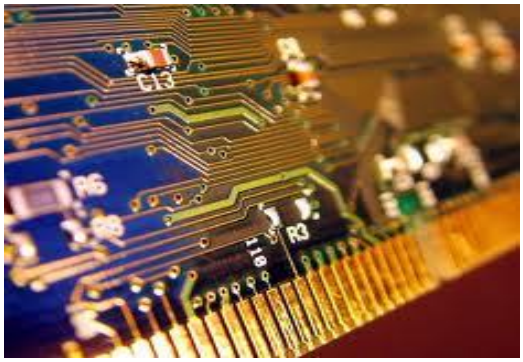
We reiterate our OVERWEIGHT call on the technology sector for 2QCY21 on the back of intensifying demand for semiconductors despite the pandemic. We view the recent retracement (-16% off the peak) in the KL Technology index as a healthy breather following a 79% rally since the last correction in September 2020 and hence is a great opportunity for investors to position for growth prospects in the coming quarters. One important fact to understand is that the current chip shortage is mainly demand-led and not a supply issue. The elevated demand is due to a confluence of several events such as: (i) sharp increase in demand for consumer end-point devices owing to the work-from-home trend, (ii) higher game console sales as gaming hours climbed tremendously (as evident from Steam logged-in hours) which have remained elevated, (iii) booming automotive sales as consumers opt for private vehicles instead of public transportations to maintain social distancing, (iv) expansion in data centres to accommodate higher web computing activities (i.e. e-learning, web conferencing, media streaming), and (v) massive surge in crypto mining activities fuelled by the surge in crypto-currency prices. With fundamental demand for chips expected to remain strong throughout the entire 2021, we believe the current market consolidation is favourable for position building. We have selected **INARI (OP, TP: RM4.00)** to ride the multi-year growth from 5G adoption in smart phones, **MPI (OP, TP: RM43.00)** for its exciting prospects from EV manufacturers adopting SiC power modules, and **KGB (OP, TP: RM2.60)** which will benefit from another record-year due to massive expansion of activities in the semiconductor front-end space.



Opportunity to accumulate. We reiterate our OVERWEIGHT call on the technology sector going into 2QCY21 as the demand for semiconductor continues to intensify after a remarkable year in 2020 despite the pandemic. We see the recent share price retracement (-16% off the peak) in the KL Technology index as a healthy breather following a 79% rally since the last correction in September 2020. With fundamental demand for chips expected to remain strong throughout the entire 2021, we believe the consolidation serves as an opportunity for investors to reposition for greater growth in the coming quarters ahead. Note that the World Semiconductor Trade Statistics (WSTS) is anticipating a 10.9% growth in 2021 (vs. 6.8% in 2020).

It's demand resurgence, not supply disruption. One important fact to understand is that the current chip shortage is mainly due to a demand issue, not a supply disruption. The heightened demand for chips was led by a confluence of several events such as the (i) sharp increase in demand for consumer end-point devices owing to the work-from-home trend, (ii) higher game console sales as gaming hours climbed tremendously (as evident from Steam logged-in hours) which have remained elevated, (iii) boom in automotive sales as consumers opt for private vehicle instead of public transport to maintain social distancing, (iv) expansion in data centres to accommodate higher web computing activities (i.e. e-learning, web conferencing, media streaming), and (v) massive surge in crypto mining activities due to the rise in cryptocurrency prices.

5G is the new frontier of growth. The global smartphone industry registered a 12.5% sales decline in 2020 which we believe was due to consumers holding off purchases in anticipation of new 5G smart phones. This is clearly evident in Apple's recent iPhone 12 launch (with 5G support), resulting in its 4QCY20 shipment skyrocketing 97% QoQ and 15% YoY. Subsequently, Apple has regained the pole position in terms of smartphone market share and recorded all-time high revenue in its latest quarterly results. Our positive stance for the smartphone space is in line with Gartner's 11% growth forecast for 2021, with 5G smartphone to account for 35% of total sales. The upward trajectory in laptop sales is also expected to continue following an 11% shipment growth in 4QCY20 to bring 2020 full-year growth to 4.8%, highest in 10 years. Laptop

brands such as Lenovo, Apple Acer and Asus recorded double-digit growth and key distributor such as VSTEC also indicated that lead time has doubled. This is in tandem with our observation as Lenovo (commanding largest market share of 27%) is showing 6-10 weeks waiting-time on their website for models with decent specifications.

Worldwide Smartphone Sales to End Users by Vendor (m of units)

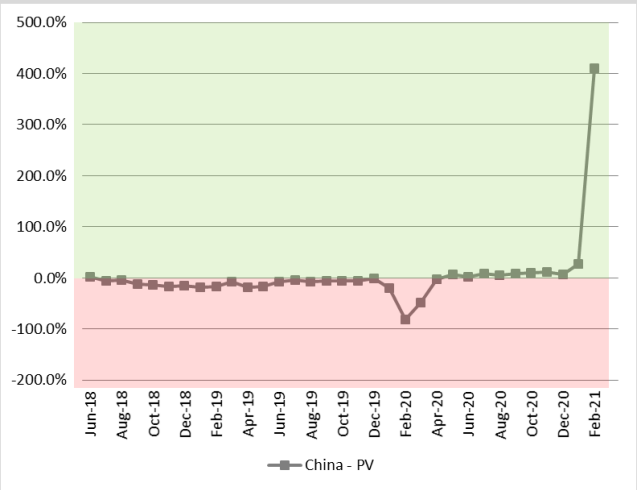
	Shipments (units)			Growth		Market Share		
Company	4Q20	3Q20	4Q19	QoQ	YoY	4Q20	3Q20	4Q19
Apple	79.9	40.6	69.6	96.9%	14.9%	21%	11%	17%
Samsung	62.1	80.8	70.4	-23.1%	-11.8%	16%	22%	17%
Xiaomi	43.4	44.4	32.4	-2.2%	33.9%	11%	12%	8%
Oppo	34.4	29.9	30.5	15.0%	12.9%	9%	8%	8%
Huawei	34.3	51.8	58.3	-33.8%	-41.1%	9%	14%	14%
Others	130.4	119.1	145.5	9.5%	-10.3%	34%	33%	36%
Total	**384.6**	**366.7**	**406.6**	**4.9%**	**-5.4%**	**100%**	**100%**	**100%**

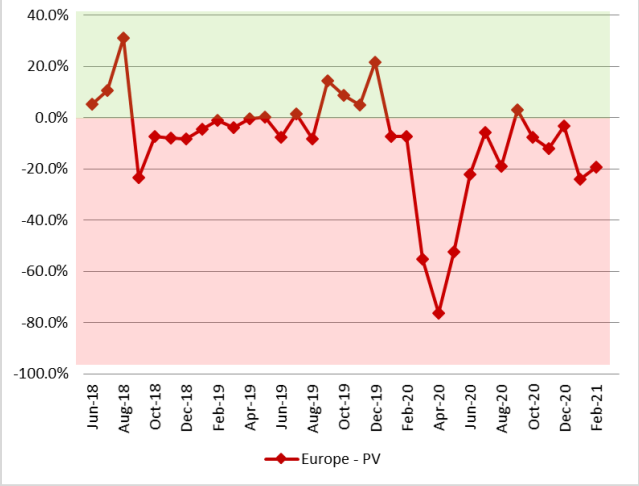
Source: Gartner

China car sales grew for 10 consecutive months. Growth streak continued as China extended its car sales growth to ten consecutive months since the rebound from Covid-19 in May 2020, with the recent numbers in Feb 2021 recording a staggering 410% YoY growth with 1.156 mil units sold. While the bullish numbers are partly due to a low-base effect in Feb 2020 (starting of Covid-19), it still recorded a positive growth of 2.7% YoY when compared to Feb 2019. Demand for automotive continued to be driven by the premium segment where consumer purchases are largely centred on sport utility vehicles (SUV) and crossovers. We expect the positive sentiment to continue in 2021, boosted by various government initiatives such as: (i) extension of subsidies and tax exemptions for new purchase of electric vehicles until 2022, (ii) lower VAT on used cars at 0.5%, (iii) attractive credit services offered by the financial sector to consumers, and (iv) cash subsidy of up to US$1,400 per vehicle.

Europe car sales impacted by a third Covid-19 wave. After coming off the second wave in Oct 2020 with a narrow decline of 3.3% YoY, Europe car sales regressed to double-digit declines again as a third wave of Covid-19 hits the region. Jan and Feb 2021 recorded decline of 24% and 19%, respectively. With the number of new COVID-19 cases rising rapidly, an extension of the lockdown is inevitable for many European countries, resulting in a shutdown of car showrooms. However, we remain optimistic for automotive demand in the region, with emphasis in 2H 2021, as vaccination has begun.

Passenger vehicle (PV) sales/registrations growth (% YoY)





Source: CAAM, ACEA

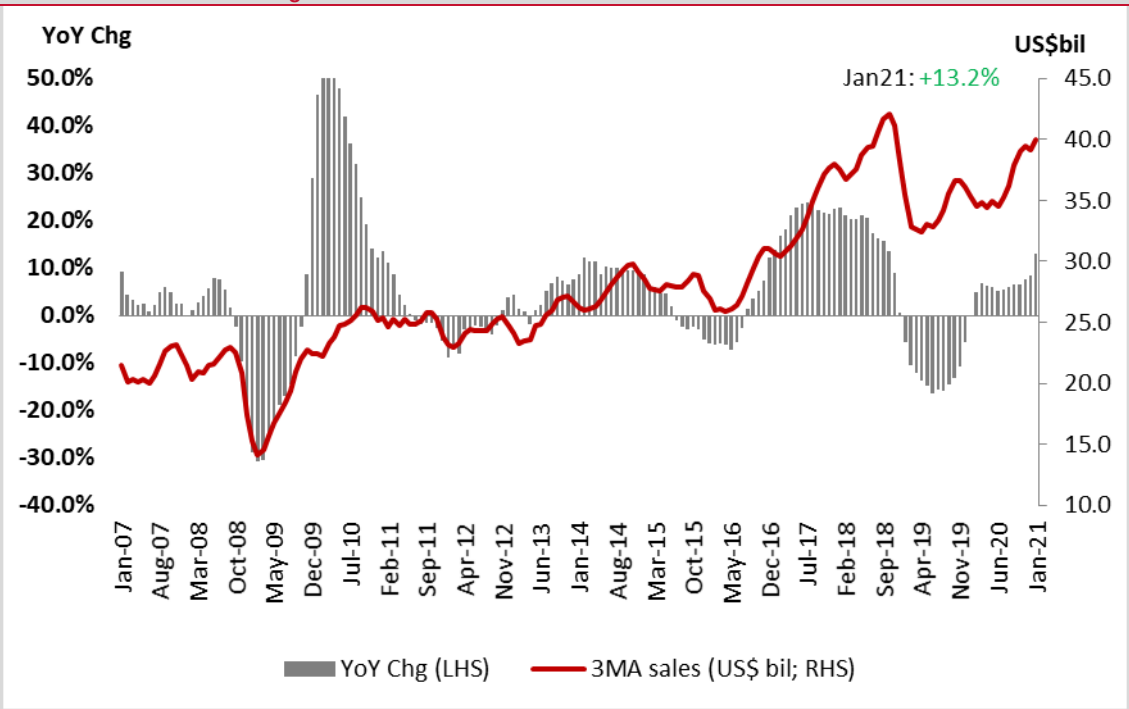
Maintain OVERWEIGHT stance on the technology sector. Our top picks are:-

(i) **INARI (OUTPERFORM, TP: RM4.00).** The group recorded back-to-back record earnings and is expecting orders to remain elevated going into 3QFY21 (FYE June), defying typical seasonality. We attribute this to robust orders for higher RF filters as the latest US flagship smartphone is still highly sought after by consumers. Unlike the previous models, this latest one supports 5G connectivity which is one of the main attractions for buyers. Hence, we believe this time around, the demand among consumers will not be limited to the tech enthusiasts whom upgrade yearly but also the huge replacement cycle coming from existing users still using 4-5 year old models. Inari is currently running at 90% utilisation and is anticipating more testers to be installed on higher customer forecast. In addition, the semiconductor shortage we are seeing in the market now is mainly due to increased consumer spending on electronic gadgets. Firms which took a cautious approach on capex last year are now facing capacity constraint. To alleviate the bottleneck, many firms are scrambling for floor space which puts Inari in a sweet spot, having recently completed its massive 680k sq. ft. expansion in Batu Kawan, of which 480k sq. ft. remain unutilised. This positions Inari perfectly to welcome multinational corporations (MNCs) as potential customers.

(ii) **MPI (OUTPERFORM, TP: RM43.00).** We expect the group's earnings to remain healthy owing to increasing demand for its power management chip packaging service that is mainly used for data centres and laptops. We believe data centres around the world will continue to expand due to higher web computing usage (such as video conferencing, e-learning, and media streaming). Orders for radio-frequency front-end (RFFE) packaging modules are expected to remain elevated thanks to 5G adoption in smartphones along with China's move to source components locally, benefiting its Suzhou plant. Furthermore, the group's venture into silicon carbide (SiC) power modules offers promising prospects given its increasing popularity among EV manufacturers.

(iii) **KGB (OUTPERFORM, TP: RM2.60).** We are of the view that the global chip shortage situation will continue deep into 1H 2021 and possibly extending into 2H 2021 as well. As such, many front-end wafer fabrication firms are allocating huge capex this year to expand capacity in order to alleviate bottlenecks that were largely driven by increased demand for electronic gadgets and the structural shift towards electric vehicles (EV) among car manufacturers. This could translate into more UHP-related jobs for the group, building upon current order-book of RM358m (vs. FY20 revenue of RM389m). China in particular is committed to "vigorously support" its local semiconductor as the country pushes for self-sufficiency in chip-manufacturing according to the head of China's Ministry of Industry and Information Technology (MIIT). Memory chip makers in Singapore are also eyeing fab expansion given that memory shortage is getting more severe, as evident by the surge in GPU prices due heightened crypto mining activities, machine learning in data centres and online gaming. As such, we believe KGB is in the limelight to benefit from such expansions as its tender-book now stands at RM900m, spread evenly across Malaysia, Singapore and China. Being regarded as a preferred vendor among large MNCs, the group is in a favourable position to benefit from various on-going expansions by chip makers in these regions.

Global Semiconductor Sales and YoY growth



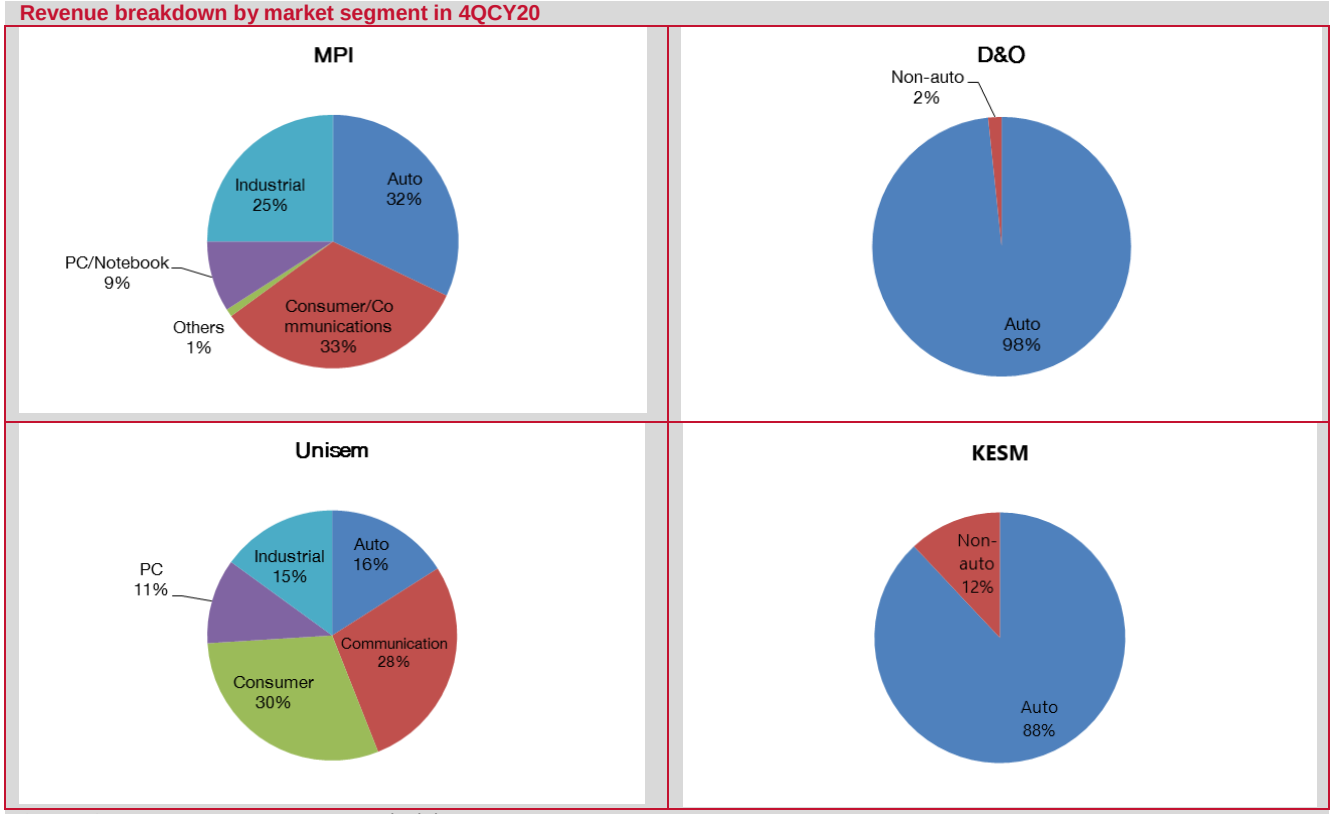
Source: SIA, Kenanga Research

WSTS Semiconductor Sales Forecasts by Product Type (Fall 2020)

	US$ bil				YoY %			
	2018	2019	2020F	2021F	2018	2019	2020	2021F
Discrete Semiconductors	**24.1**	**23.9**	**23.8**	**26.2**	11.3	-0.9	-0.3	10.0
Optoelectronics	**38.0**	**41.6**	**40.4**	**44.0**	9.2	9.3	-2.8	8.8
Sensors	**13.4**	**13.5**	**15.0**	**17.5**	6.2	1.2	10.7	16.8
Integrated Circuits	**393.3**	**333.4**	**361.2**	**400.6**	14.6	-15.2	8.4	10.9
Analog	58.8	53.9	55.7	64.1	10.8	-8.2	3.2	15.2
Micro	67.2	66.4	69.7	76.3	5.2	-1.2	4.9	9.4
Logic	109.3	106.5	118.4	133.9	6.9	-2.5	11.1	13.0
Memory	158.0	106.4	117.5	126.4	27.4	-32.6	10.4	7.6
Total	**468.8**	**412.3**	**440.4**	**488.3**	**13.7**	**-12.0**	**6.8**	**10.9**

Source: WSTS

Revenue breakdown by market segment in 4QCY20



Source: Company, Kenanga Investment Bank Bhd

Malaysian Technology Peers Comparison

Name	Last Price @ 19/03/21 (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.	1-Yr. Fwd.		
D&O GREEN TECHNOLOGIES BHD	4.25	4,963.1	Y	12/2019	44.3%	21.9%	102.4%	21.3%	79.9	39.5	32.5	9.6	8.3	21.0%	0.9%	4.20	OP
INARI AMERTRON BHD	3.28	10,951.7	Y	06/2020	37.4%	24.9%	80.1%	15.8%	67.6	38.1	32.9	8.9	8.5	23.3	2.5%	4.00	OP
JHM CONSOLIDATION BHD	1.9	1,059.4	Y	12/2020	44.8%	13.3%	132.9%	13.8%	60.4	25.9	22.8	5.9	4.7	18.1%	0.6%	2.35	MP
KELINGTON GROUP BHD	1.95	626.7	Y	12/2020	9.5%	13.3%	42.6%	14.1%	30.6	21.5	18.8	4.0	3.5	16.2%	1.2%	2.60	OP
KESM INDUSTRIES BHD	11.7	503.3	Y	07/2020	-3.0%	18.7%	10633%	113%	5959	55.5	26.1	1.6	1.6	2.8%	0.7%	14.20	MP
MALAYSIAN PACIFIC INDUSTRIES BHD	37.36	7,430.8	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%	43.00	OP
P.I.E. INDUSTRIAL BHD	3.44	1,321.1	Y	12/2020	59.9%	7.5%	60.0%	15.8%	28.2	17.7	15.2	2.7	2.3	13.1%	2.7%	4.00	OP
SKP RESOURCES BHD	2.26	2,824.7	Y	03/2020	23.7%	2.4%	67.3%	32.2%	40.8	24.4	18.5	4.9	4.4	18.0%	2.7%	3.00	OP
UNISEM (M) BHD	7.69	6,150.4	Y	12/2020	18.5%	7.0%	64.3%	8.5%	45.7	27.8	25.6	3.7	3.4	7.8%	0.7%	10.00	OP

Source: 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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