Technology

Riding on the Chip Crunch

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OVERWEIGHT

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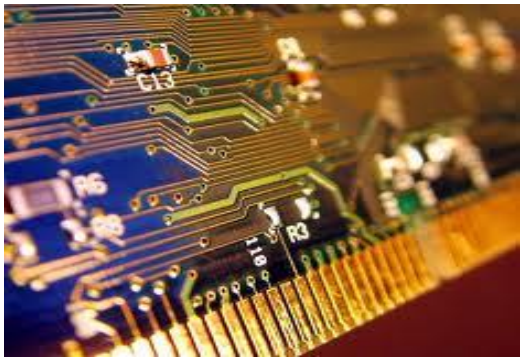
We reiterate our OVERWEIGHT call on the technology sector for 4QCY21. Demand for the latest iPhone 13 has shot off the charts as China which accepted bookings ahead of the US, reported pre-orders exceeding 5m units (vs. iPhone 12 per-orders of 2m units globally), causing even Apple's official website to slow to a crawl due to overwhelming traffic. This was mainly attributable to the cheaper pricing (of up to 800 yuan) in China while prices in the US remained unchanged. We expect the demand for iPhone to remain robust on the back of spectrum reallocation around the world which will continue to boost the smartphone replacement cycle, benefiting INARI (OP; TP: RM4.80). In line with global move towards 5G adoption, Malaysia is also switching off its 3G connectivity to free up the 2100Mhz and 900Mhz for redeployment towards 4G and 5G. With demand for consumer electronics and automotive (especially EVs) showing no signs of slowing, wafer fabs in Asia continue to see the need to expand their capacity, further reinforcing our investment thesis on Kelington Group (OP; TP: RM2.50), as a prime beneficiary. On the e-payment front, we recommend positioning into GHL Systems (OP; RM2.30) to ride the return of consumer spending as many states in Malaysia are advancing into Phase 3 of the NRP, increasing the likelihood of both local and cross border travel bubble.



iPhone 13 craze. We reiterate our OVERWEIGHT call on the technology sector going into 4QCY21. We are positive on the recently launched iPhone 13 that took place on 14th Sept 2021, featuring a new OLED panel supporting up to 120Hz refresh rate which is the first ever implementation in Apple's smartphone line-up. Observing the pre-order trend, China which accepted bookings ahead of the US, reported iPhone 13 pre-orders exceeding 5m units (vs. iPhone 12 pre-order of 2m units globally), causing even Apple's official website to slow to a crawl due to overwhelming traffic. This was mainly attributable to the cheaper pricing in China while US pricing remained unchanged. As a comparison, 5,199 yuan gets you the iPhone 13 Mini while the iPhone 13 and iPhone 13 Pro starts from 5,999 yuan and 7,999 yuan respectively, meaning China buyers are able to enjoy a discount of 300 yuan to 800 yuan compared to the corresponding model in the iPhone 12 series.

Shutting off 3G will boost smartphone replacement cycle. Due to the finite availability of spectrums, switching off older generation connectivity has been an on-going process around the world to repurpose these spectrums for newer generation connectivity. As part of the JENDELA initiative, the Malaysian government has set a deadline to fully switch off 3G connectivity by end 2021. This will avail the 2100Mhz and 900Mhz spectrum for strengthening the 4G network as well as facilitating the adoption of 5G network, making this the second reallocation exercise. Recall in 2020, the switch from analogue TV to digital TV freed up the 700Mhz spectrum for local telco companies to expand their coverage. Switching off 3G means that more Malaysians will be able to enjoy VoLTE (voice over LTE) which provides better call clarity and more importantly, internet browsing speed will remain on 4G (instead of dropping down to 3G) while making voice calls. However, not all 4G phones support VoLTE, meaning voice calls made on a non-VoLTE ready device will fall back onto the 2G network (not on Malaysia's switch-off schedule yet) which is not ideal in this modern age. That said, we believe the spectrum reallocation initiative around the world further reinforce our investment thesis that **INARI (OP; TP: RM4.80)** will continue to enjoy strong demand for its radio frequency (RF) component testing thanks to the adoption of 5G network and the on-going replacement cycle of older iPhone devices.

Noises from China power shortage. As a result of limited coal supplies and toughening emissions standards by the Chinese government, there has been reported cases of power shortage in the Jiangsu province of China where cities such as Kunshan and Suzhou are home to many outsourced semiconductor testing and assembly (OSATs) companies, including

Inari and **MPI (OP; TP: RM56.20)**. We recently contacted the respective management, learning that the situation is manageable with very little impact to overall operations. As China approaches the Golden Week holiday (Oct 1-7), both companies have reaffirmed that the break has been well accounted for in their delivery schedules and revenue recognition will remain on track. Tracking other regional peers, Apple suppliers such as Unimicron Technology (iPhone PCBA) and Concraft Holdings (iPhone speaker) only had to halt production for a short period (up to 5 days) while others like Pegatron Corporation (iPhone assembler) had no issue thanks to back-up generators. We also gather from our channel checks that going forward, the semiconductor industry and enterprises engaged in high-tech solutions will be exempted from the on-going power supply reduction in China. This is in-line with the Chinese government's semiconductor self-sufficiency efforts.

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

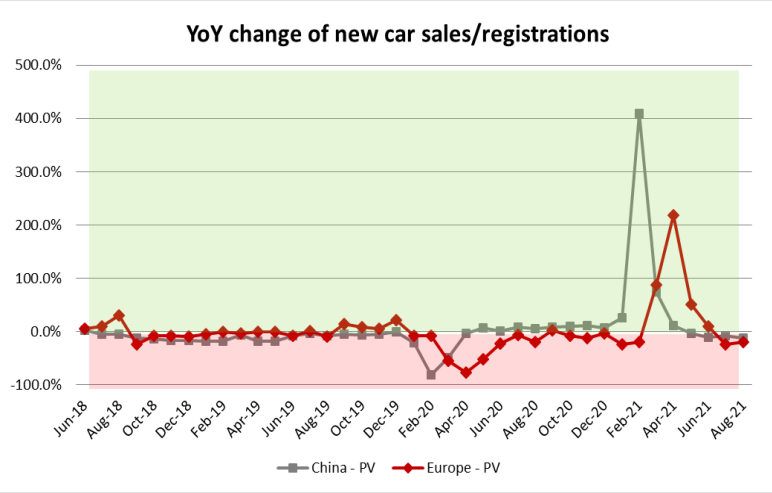
	Shipments (units)			Growth		Market Share		
Company	**2Q21**	**1Q21**	**2Q20**	**QoQ**	**YoY**	**2Q21**	**1Q21**	**2Q20**
Samsung	57.7	76.6	54.8	-24.6%	5.5%	18%	20%	18%
Xiaomi	51.1	48.9	28.3	4.4%	80.5%	16%	13%	10%
Apple	49.3	58.6	38.4	-15.9%	28.3%	15%	16%	13%
Oppo	33.6	38.4	23.6	-12.4%	42.4%	10%	10%	8%
Others	137.2	116.8	151.9	17.4%	-9.7%	42%	41%	51%
Total	**328.9**	**378.0**	**296.9**	**-13.0%**	**10.8%**	**100%**	**100%**	**100%**

Source: Gartner

Capacity is still playing catch-up to chip demand. The semiconductor shortage is persisting as demand on the consumer end for laptops and smartphones are still on the rise. According to Gartner, total laptop shipment for 2QCY21 rose 4.6% YoY where Lenovo (having the largest market share of 24%) recorded its fifth straight YoY growth, thanks to its in-house manufacturing operations which helped alleviate the component shortage problem compared to its peers. However, certain enterprise PC models continued to face long lead-times of up to 120 days and selling prices have continued to rise. Meanwhile, smartphone shipment rose 10.8% YoY in 2Q21 with Samsung taking the No.1 spot. Going forward, we believe Apple will be able to contend for the top spot in the second half of 2021 as the festive season draws near, supported by a trifecta of tailwinds from (i) cheaper pricing in China, (ii) lack of alternatives from Huawei (no GMS support) and Samsung (skipped the Note series launch) and (iii) improved specifications and higher storage capacity with no extra charges.

Automotive on the other hand has been experiencing tapering sales figures as chip shortage continues to negatively impact the sector significantly. China recorded is fourth consecutive month of YoY decline for May (-2.7%), June (-11.1%), July (-7.0%) and Aug (-11.7%) while Europe car sales recorded +51.3%, +10.4%, -23.2% and -19.1% for the same period from May to Aug. Note that this is due to supply constraint and not waning demand, as eager buyers in the US continued to push up the average car sale price to a record high of US$42,736 in July (+8.2% YoY), rising for the fourth straight month.

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



Source: CAAM, ACEA

TSMC and other wafer fab players had in recent earnings call stated that they are planning to build more capacity for the automotive industry which typically takes 12-18 months, this explains why automotive semiconductor players (e.g. Infineon, ST Micro and Renesas) are already locking in orders 1-2 years in advance. Such development continues to favour our hidden gem pick, **Kelington Group (OP; TP: RM2.50)**, as a prime candidate to benefit from fab expansions in Asia. Even with share price surging more than 3.2x (inclusive of free warrants) since our non-consensus initiation report on 11 Nov 2020, it still remains as our high conviction buy as the group is expecting more ultra-high purity gas system (UHP) job awards from fabs in China and Singapore.

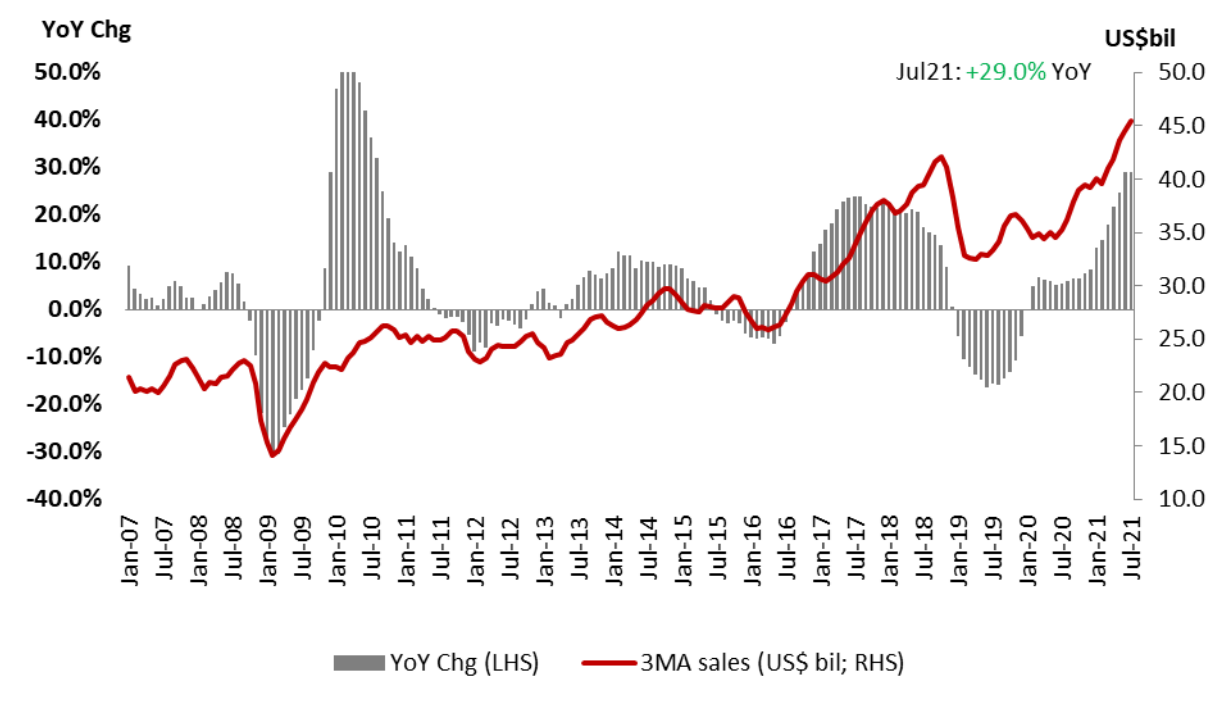
The urge to splurge returns. With many states in Malaysia advancing into Phase 2 and Phase 3 of the national recovery plan (NRP), we have observed a pent-up demand for dine-ins and travel booking after a long period of staying at home. For instance, the recent reopening of flight routes to Langkawi saw tickets selling fast and airlines expect demand to remain elevated till end of Dec 2021. Using this as an early indicator, we believe the reopening of Genting Highlands and other tourist spots in the near future will lead to higher offline-based transactions for credit cards which yield a higher merchant discount rate (MDR). Therefore, we recommend positioning into **GHL Systems (OP; RM2.30)** to ride the return of consumer spending. In addition, discussion of a travel bubble among neighbouring countries is surfacing as vaccination rates are improving. This will be a boon for GHL which has already established a strong presence in the ASEAN region with more than 383k touchpoints. Hence, we expect GHL to enjoy accelerated growth upon the re-opening of borders.

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

(i) **Kelington Group (OUTPERFORM, TP: RM2.50).** Kelington Group recently clinched its largest job win worth RM420m, doubling its existing order-book which was already at an all-time high level prior to this win. The job entails a turnkey construction of a new semiconductor fab in Kuching for a US-listed memory company which will begin immediately as the US client is scrambling for capacity to keep up with the surge in memory chip demand. This brings YTD order wins to a new high of RM764m while its order-book hits a record RM822m, nearing its current market cap. We expect more fab expansion to come and KGB is in a favourable position to benefit from more UHP jobs, with the management showing no signs of slowing down in terms of securing new jobs. The group's tender-book remains elevated at RM1.1b.

(ii) **GHL (OUTPERFORM, TP: RM2.30).** In the recent 2QCY21, GHL saw a QoQ increase for its merchant footprint as the e-pay segment grew 3.4% to 45,200 while the TPA segment climbed 3.2% to 114,000. We believe this trend will likely continue as there is an urgent need for currently cash-based merchants to digitalise their payment acceptance system in order to remain relevant in the current situation where adoption of e-wallet is being accelerated due to the pandemic. As vaccination rate surges and more areas in Malaysia enter into Phase 2 and Phase 3 of the National Recovery Plan, we expect an improvement in the retail and leisure segments which typically contributes higher margin per transaction.

Global Semiconductor Sales and YoY growth



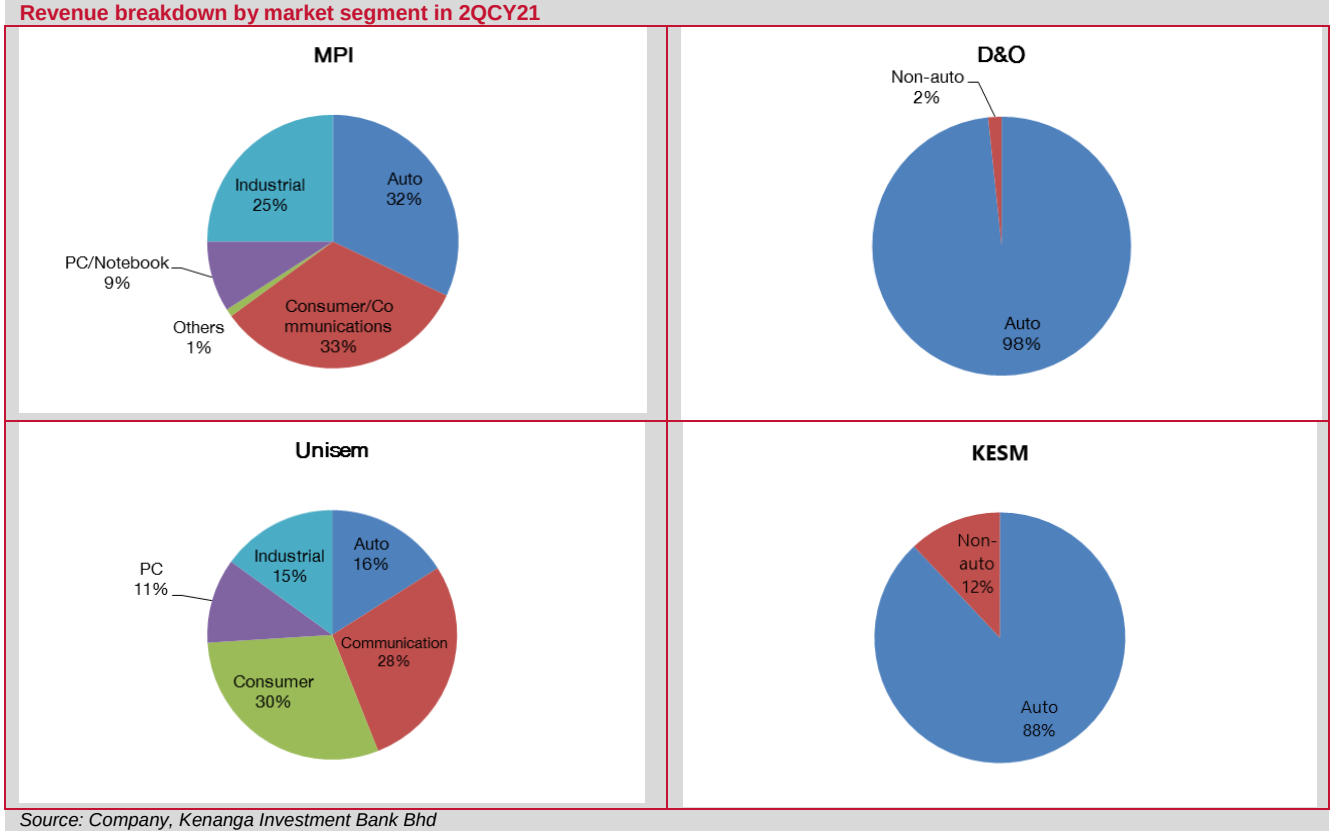
Source: SIA, Kenanga Research

WSTS Semiconductor Sales Forecasts by Product Type (Spring 2021 Q2 Update)

	US$ bil				YoY %			
	2019	2020	2021F	2022F	2019	2020	2021	2022F
Discrete Semiconductors	**23.9**	**23.8**	**29.4**	**30.9**	-0.9	-0.3	23.5	5.3
Optoelectronics	**41.6**	**40.4**	**43.1**	**45.0**	9.3	-2.8	6.8	4.2
Sensors	**13.5**	**15.0**	**18.7**	**19.8**	1.2	10.7	24.8	6.0
Integrated Circuits	**333.4**	**361.2**	**459.7**	**510.8**	-15.2	8.4	27.3	11.1
Analog	53.9	55.7	71.9	76.8	-8.2	3.2	29.1	6.8
Micro	66.4	69.7	77.3	80.9	-1.2	4.9	10.9	4.7
Logic	106.5	118.4	149.4	162.3	-2.5	11.1	26.2	8.7
Memory	106.4	117.5	161.1	190.8	-32.6	10.4	37.1	18.4
Total	**412.3**	**440.4**	**550.9**	**606.5**	**-12.0**	**6.8**	**25.1**	**10.1**

Source: WSTS

Revenue breakdown by market segment in 2QCY21



Source: Company, Kenanga Investment Bank Bhd

Malaysian Technology Peers Comparison

Name	Last Price @ 23/06/21 (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	5.97	7,155.9	Y	12/2021	58.9%	15.8%	148%	16.1%	120.5	48.6	41.9	14.5	11.5	23.7%	0.3%	6.00	OP
GHL SYSTEMS BHD	1.86	2,123.2	Y	12/2021	4.3%	36.3%	8.4%	41.8%	73.5	67.8	47.8	4.4	4.0	6.5%	0.0%	2.30	OP
INARI AMERTRON BHD	3.84	14,144.0	Y	06/2021	22.5%	14.6%	19.2%	14.7%	36.0	30.2	26.3	8.7	8.0	26.4%	2.3%	4.80	OP
JHM CONSOLIDATION BHD	1.86	1,037.1	Y	12/2020	10.4%	15.8%	0.5%	65.2%	46.0	45.8	27.7	5.2	4.5	9.9%	0.7%	1.90	MP
KELINGTON GROUP BHD	1.74	1,118.8	Y	12/2021	25.5%	40.1%	84.7%	45.7%	52.1	28.2	19.4	5.4	4.7	16.7%	0.9%	2.50	OP
KESM INDUSTRIES BHD	12.56	540.3	Y	07/2020	4.9%	6.4%	4072%	250%	131.0	37.4	25.0	1.5	1.4	3.8%	0.7%	11.40	MP
MALAYSIAN PACIFIC INDUSTRIES BHD	45.2	8,990.1	Y	06/2021	10.0%	10.0%	11.3%	10.0%	32.2	28.8	26.2	7.1	8.0	15.6%	0.7%	56.20	OP
P.I.E. INDUSTRIAL BHD	3.83	1,470.9	Y	12/2021	59.9%	7.5%	31.2%	27.0%	24.0	18.3	14.4	2.3	2.0	11.1%	2.5%	4.15	OP
SKP RESOURCES BHD	1.91	2,984.1	Y	03/2022	12.3%	12.4%	21.7%	12.4%	21.6	17.7	15.8	4.1	3.7	21.0%	2.8%	2.60	OP
UNISEM (M) BHD	8.76	7,065.3	Y	12/2021	18.5%	7.0%	64.3%	8.5%	42.5	28.6	26.4	3.5	3.2	12.1%	0.7%	9.80	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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