Technology

Value Emerges After Recent Pullback

OVERWEIGHT

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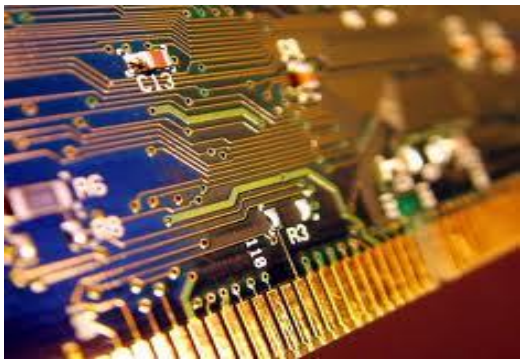
We maintain our **OVERWEIGHT** stance on the technology sector moving into 3QCY22, premised on resilient chip demand as the Semiconductor Industry Association (SIA) reported 23% YoY increase in semiconductor sales for 1QCY22. Meanwhile, shipment numbers for car sales and consumer end-devices did not reflect the same optimism. We attribute this to the sporadic lockdowns in China, causing backlogs to pile up. We remain selectively positive on the sector, favouring companies that were unjustifiably bashed down but still holds strong fundamentals to weather through this high inflationary and rising interest rate environment. Despite weakening shipment numbers for global smartphones (1QCY22: -8.9% YoY), the US smartphone manufacturer was the only brand to record a slight growth of 2.2% YoY and is expected to keep its production unchanged for its upcoming new model. As such, we like **INARI (OP; TP: RM3.30)** for being in the US smartphone supply chain with a brand that is able to continue growing its loyal user base. With the Chinese government easing back on lockdowns, car sales in the EU and China posted encouraging numbers (May 2022: +68% MoM and +15.6% MoM respectively), resuming the recovery trend. This bodes for **MPI (OP; TP: RM38.10)** given its strong automotive exposure and more importantly having a head start in next-generation packages that is gradually being adopted in electric vehicles. Shifting away from the intensive competition surrounding household cleaning products, we believe **PIE (OP; TP: RM3.70)** offers an exciting investment case given its exposure to unique clients with stable order visibility. The new Chinese customer (relating to ASIC computer hardware) secured as a result of trade diversion is expected to contribute meaningfully to the group's earnings in FY22.



Favouring resilient fundamentals. We maintain our **OVERWEIGHT** stance on the technology sector moving into 3QCY22 premised on resilient chip demand, particularly in the automotive space. For 1QCY22, the Semiconductor Industry Association (SIA) reported a 23% YoY increase in semiconductor sales with April continuing the trend at 21% YoY. The growth came from all geographical regions while the Americas led the pack with a 40.9% YoY jump. Meanwhile, car sales data and shipment numbers of consumer electronics (smartphone and laptop) seems to lag behind SIA's reported growth. We believe this is likely due to macro challenges such as the lockdown in China causing massive logistical problems, resulting in backlogs which will be delivered with the easing of lockdown restrictions. That said, we remain selectively bullish on the sector, favouring companies that were unjustifiably bashed down but still holds strong fundamentals to weather through this high inflationary and rising interest rate environment.

US smartphone manufacturer keeps production forecast. Despite waning demand for consumer devices (e.g. smartphone and laptop), as evident by the latest 1QCY22 global smartphone shipment numbers which fell 8.9% YoY, the US smartphone manufacturer was the only one to eke out a 2.2% YoY shipment growth. In addition, it is expected to keep its smartphone production flat YoY for its upcoming model that is slated to launch in September 2022. We see this as an encouraging sign against the backdrop of supply chain challenges from the sporadic lockdowns in China as well as the cautious inflation data that could potentially dampen consumer spending. On this front, we continue to like **INARI (OP; TP: RM3.30)** as a proxy to the US smartphone manufacturer's supply chain which is expected to remain resilient owing to its ability to command pricing and market share.

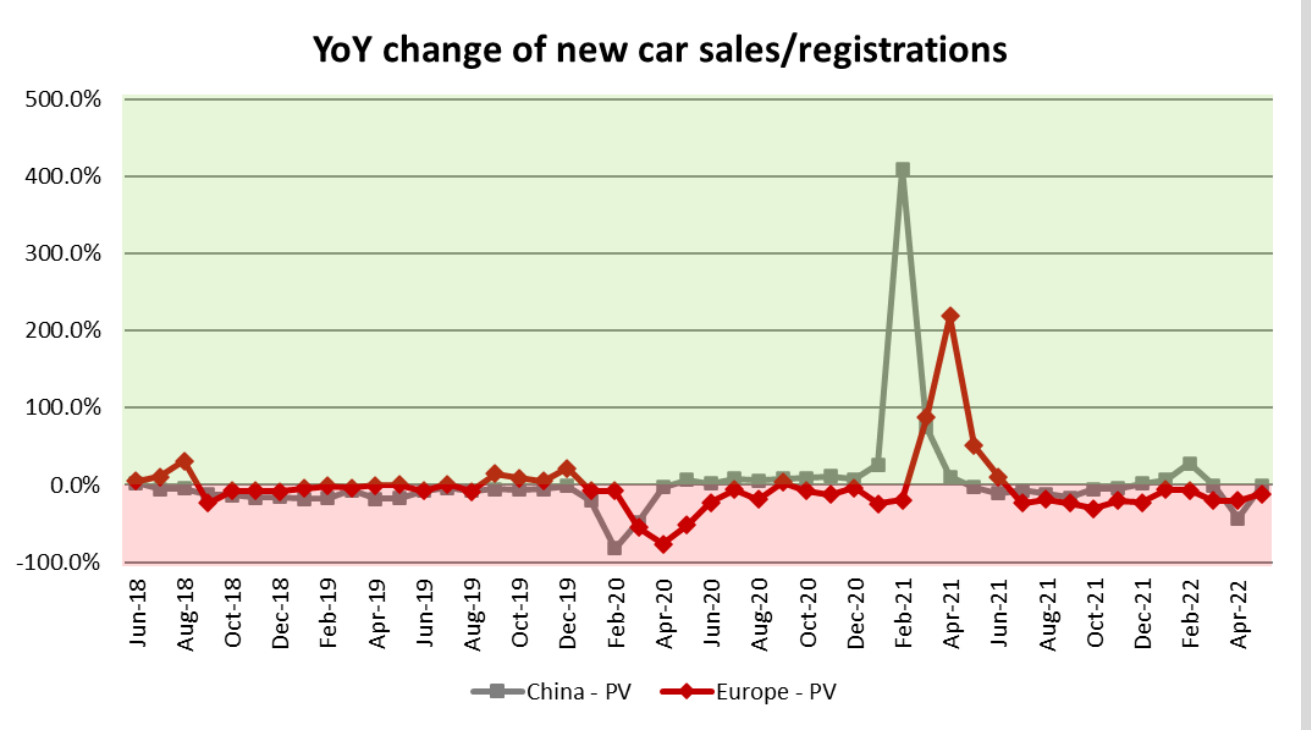
Worldwide Smartphone Sales to End Users by Vendor (m of units)

	Shipments (units)			Growth		Market Share		
Company	1Q22	4Q21	1Q21	QoQ	YoY	1Q22	4Q21	1Q21
Samsung	73.6	68.9	74.5	6.8%	-1.2%	23%	19%	22%
Apple	56.5	84.9	55.3	-33.5%	2.2%	18%	23%	16%
Xiaomi	39.9	45.0	48.6	-11.3%	-17.9%	13%	12%	14%
Oppo	27.4	30.1	37.5	-9.0%	-26.9%	9%	8%	11%
Vivo	25.3	28.3	35.0	-10.6%	-27.7%	8%	8%	10%
Others	91.4	105.2	93.9	-13.1%	-2.7%	29%	29%	27%
Total	**314.1**	**362.4**	**344.8**	**-13.3%**	**-8.9%**	**100%**	**100%**	**100%**

Source: IDC

Stabilising of automotive chips supply is expected to drag beyond 2022 mainly due to the punishing zero-Covid policy in China which has resulted in logistical challenges. Thankfully, the Chinese government has begun easing back on the restrictions which led to early improvements in May after a slump in the previous months. China car sales rose 68% MoM in May 2022 to 1.62m units while Europe car sales recorded 15.6% MoM increase to 791,546 units during the same period. While these numbers are still a YoY decline (China -1.4% and Europe -11.2%), we look forward to a resumption of the recovery phase as production gradually returns to normalcy. This bodes well for **MPI (OP; TP: RM32.90)** which has 38% revenue exposure to automotive and a unique advantage being the only local outsourced semiconductor assembly and test (OSAT) that is capable of packaging next-generation chips that uses materials such as silicon carbide (SiC) and gallium nitride (GaN). MPI has also proven itself as one of the most resilient tech companies as evident by its eight consecutive quarters of revenue growth throughout the pandemic. We maintain our earnings forecasts and OP call for MPI but lower our TP to RM32.90 (from RM38.10) to reflect the broad-based re-pricing of tech valuations amidst the higher terminal rate. We now value MPI at a lower PER of 19x FY23F (from 22x) which is at a 20% discount to peer's average forward PER to reflect its low share liquidity.

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



Source: CAAM, ACEA

In line with automotive recovery trend, we believe that **D&O (OP; TP: RM4.50)** will continue to benefit from robust demand for its automotive LEDs as we observed car manufacturers are increasing the usage of LEDs as one of the key differentiation factors in the new vehicle launches, especially for electric vehicles (EV). This trend is observed in upcoming models such as the SAIC IM L7 which consists of >6,000 LEDs compared to an average internal combustion engine vehicle with c.500-700 LEDs. We raised FY23F earnings forecast by 6.5% to RM182m and maintain our OP recommendation for D&O. Similarly, we lower our TP to RM4.50 (from RM5.40) to reflect the broad-based re-pricing of tech valuations amidst the higher terminal rate. Our revised TP is based on a 25x FY24F PER (from 45x FY22F PER), in line with the average forward PER of original brand manufacturers (OBM) with design capabilities. We roll forward our valuation base year to FY24 as believe our FY24F earnings of RM222.5m better capture D&O's earnings potential as an OBM and a top five players in the global automotive LED space. While **JHM (MP; TP: RM1.40)** is also involved in automotive LEDs, the group is mainly focused on module assembly of headlamps and taillamps (falling short of designing LEDs). Again, we lower our TP for JHM to RM1.40 (from RM1.50) to reflect the broad-based re-pricing of tech valuations amidst the higher terminal rate. While keeping our earnings forecasts, we roll forward our valuation base year. Our revised TP is based on a 17.5x FY23F PER (from 22x FY22F PER), in line with the average forward PER of general suppliers along the LED value chain.

Refreshing catalyst. We have identified **PIE (OP; TP: RM3.70)** as one of our top picks in the sector owing to its unique clientele base as well as the ability to continue growing its margins amid various macro challenges such as labour shortages and rising component cost. Having been able to avoid the intensive competition surrounding household cleaning products, PIE has been presented with opportunities to take on reputable customers that provides strong order visibility, such as the big customer win (34% of group revenue) for a home entertainment product last year which grew the group's revenue above the RM1b mark. Building upon its achievement, the group had earlier this year secured another major Chinese customer (relating to application-specific integrated circuit or ASIC computer hardware) due to regulatory challenges in China which has forced the customer to relocate its production to Malaysia and PIE has been selected as their preferred vendor. The Chinese customer has decided to consign all the production materials, shielding PIE from rising component cost. Having only to bear the labour cost, this arrangement is expected to translate into better margins for PIE.

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

(i) **PIE (OP; TP: RM3.70).** We like PIE for its unique clientele exposure, providing a refreshing catalyst other than the highly competitive household cleaning products in the EMS segment. Riding on the big customer win back in FY21 which grew the group's revenue above the RM1b mark, PIE has secured another major Chinese customer that is relocating its production of application-specific integrated circuit (ASIC) computer hardware to Malaysia due to regulatory challenges in China. We believe this customer will be the main earnings driver for FY22 as PIE has dedicated an upcoming 120k sq ft factory and has received approval from the local government to bring in more foreign workers for this Chinese customer.

(ii) **INARI (OP; TP: RM3.30).** Being in the US smartphone supply chain, particularly in 5G radio frequency (RF) components, continues to be beneficial for INARI as the US smartphone brand was the only one to eke out YoY shipment gain of 2.2% in 1QCY22 while global shipment numbers were down 8.9% during the same period. The US smartphone manufacturer is expected to keep its smartphone production flat YoY for its upcoming model, an encouraging sign. Meanwhile, INARI is also working to grow other revenue streams from the data centre, automotive and memory space which could potentially morph into future earnings drivers.

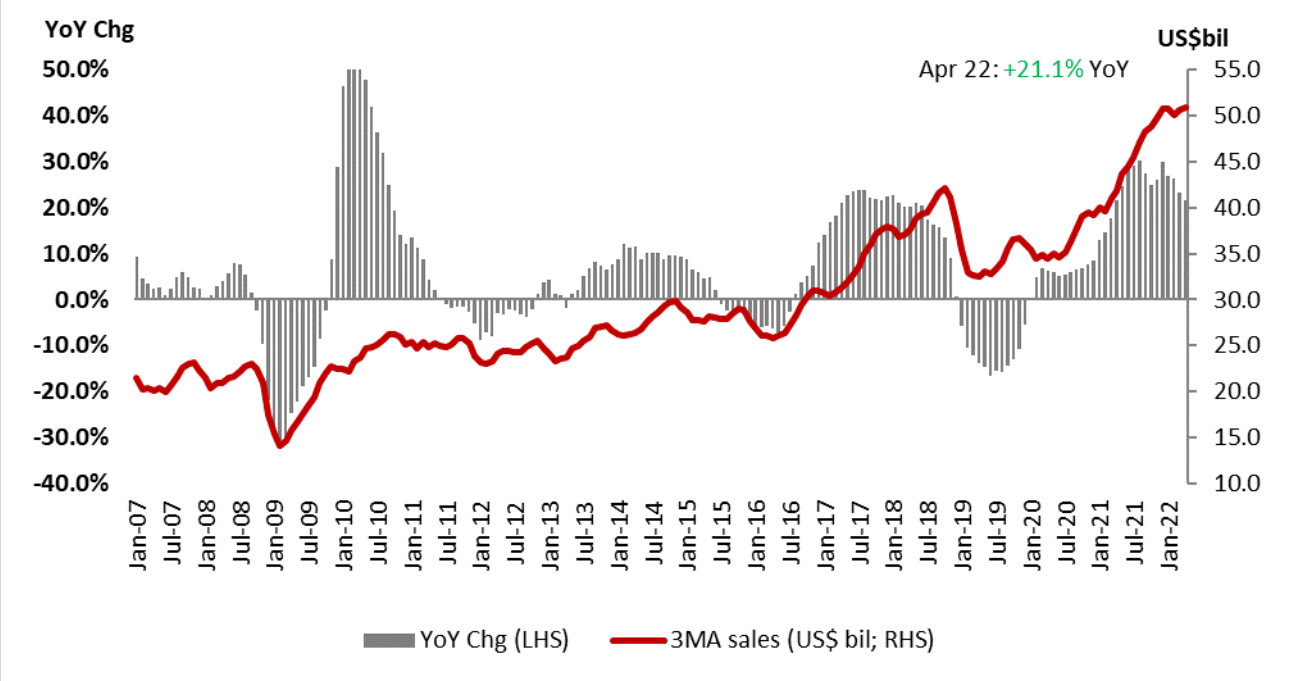
(iii) **MPI (OP; TP: RM32.90).** Having a healthy revenue exposure with 38% from automotive and 32% from data centre puts MPI is a comfortable spot to continue benefiting from the recovery in automotive as well as growing demand for digitalisation which in turn translates into data centre expansions. The group also has 22% revenue exposure in the communication segment where it is mainly involved in 5G infrastructure which will continue to be in good demand as development of 5G infrastructure still lags behind the vast 5G consumer devices that have been sold for the past 2-3 years. More importantly, MPI has future proofed their prospects by being the only OSAT in Malaysia capable of packaging wide bandgap (e.g. GaN and SiC) chips that have superior properties compared to the common silicon.

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

	Shipments (units)			Growth		Market Share		
Company	1Q22	4Q21	1Q21	QoQ	YoY	1Q22	4Q21	1Q21
Lenovo	18.6	21.7	20.9	-14.5%	-11.1%	24%	25%	25%
HP	15.9	18.6	19.3	-14.9%	-17.8%	20%	21%	23%
Dell	13.8	17.2	13.0	-19.7%	6.1%	18%	19%	16%
Apple	7.0	6.8	6.4	2.3%	8.6%	9%	8%	8%
Asus	5.6	6.2	4.6	-9.6%	20.6%	7%	7%	6%
Acer	5.5	6.1	5.9	-9.4%	-5.5%	7%	7%	7%
Others	11.5	11.7	13.4	-1.8%	-14.1%	15%	13%	16%
Total	**77.9**	**88.4**	**83.5**	**-11.9%**	**-6.8%**	**100%**	**100%**	**100%**

Source: Gartner

Global Semiconductor Sales and YoY growth



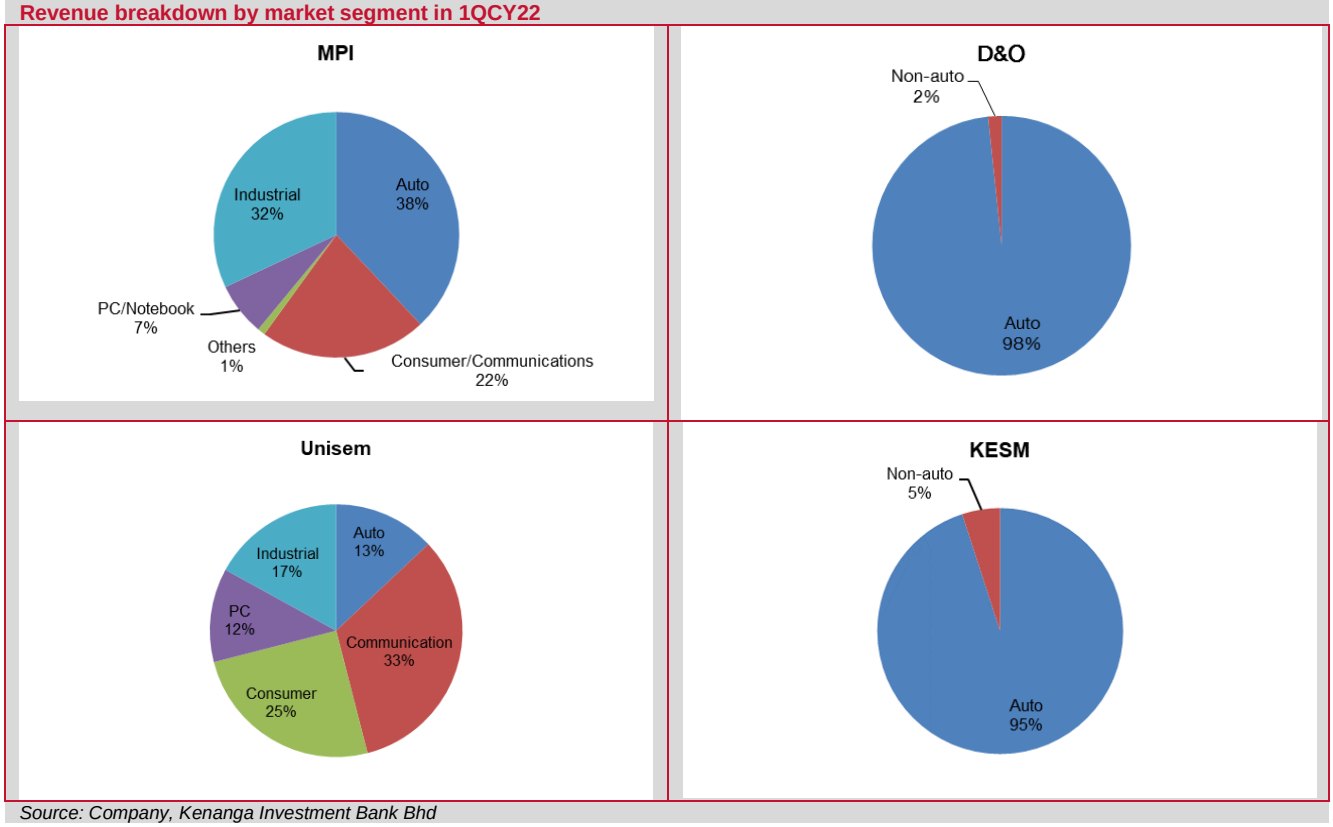
Source: SIA

WSTS Semiconductor Sales Forecasts by Product Type (Fall 2021 Q4 Update)

	US$ bil				YoY %			
	2020	2021	2022F	2023F	2020	2021	2022	2023F
Discrete Semiconductors	**23.8**	**30.3**	**33.4**	**34.7**	*-0.3*	*27.4*	*10.2*	*3.8*
Optoelectronics	**40.4**	**43.4**	**43.5**	**45.2**	*-2.8*	*7.4*	*0.3*	*3.7*
Sensors	**15.0**	**19.1**	**22.2**	**23.0**	*10.7*	*28.0*	*15.7*	*3.6*
Integrated Circuits	**361.2**	**463.0**	**547.3**	**576.8**	*8.4*	*28.2*	*18.2*	*5.4*
Analog	55.7	74.1	88.3	93.3	*3.2*	*33.1*	*19.2*	*5.7*
Micro	69.7	80.2	89.4	94.1	*4.9*	*15.1*	*11.4*	*5.3*
Logic	118.4	154.8	187.0	200.5	*11.1*	*30.8*	*20.8*	*7.3*
Memory	117.5	153.8	182.7	188.9	*10.4*	*30.9*	*18.7*	*3.4*
Total	**440.4**	**555.9**	**646.5**	**679.7**	***6.8***	***26.2***	***16.3***	***5.1***

Source: WSTS

Revenue breakdown by market segment in 1QCY22



Source: Company, Kenanga Investment Bank Bhd

Malaysian Technology Peers Comparison

Name	Last Price @ 17/06/22 (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	4.04	4,998.1	Y	12/2022	28.0%	15.3%	34.0%	15.5%	41.4	30.9	26.8	6.0	5.1	17.1%	0.5%	4.50	OP
GHL SYSTEMS BHD	1.35	1,541.0	Y	12/2022	22.7%	7.0%	22.1%	13.9%	61.7	50.5	44.4	3.4	3.2	6.3%	0.0%	1.40	MP
INARI AMERTRON BHD	2.63	9,750.2	Y	06/2022	22.5%	7.0%	20.7%	7.1%	25.6	23.8	22.2	6.2	6.7	28.2%	3.8%	3.30	OP
JHM CONSOLIDATION BHD	1.19	663.5	Y	12/2022	10.7%	15.2%	38.6%	15.8%	25.9	18.7	16.1	2.8	2.4	12.6%	0.4%	1.40	MP
KELINGTON GROUP BHD	1.14	733.0	Y	12/2022	59.6%	1.7%	38.9%	1.8%	22.8	16.7	16.4	3.8	3.2	19.4%	1.5%	1.90	OP
KESM INDUSTRIES BHD	6.6	283.9	Y	07/2022	-0.2%	4.6%	-54.3%	294%	84.6	185.0	46.9	0.9	1.0	1.1%	0.7%	7.50	MP
MALAYSIAN PACIFIC INDUSTRIES BHD	29.5	5,867.4	Y	06/2022	18.0%	6.0%	19.4%	5.5%	22.6	19.0	18.0	4.4	3.8	16.6%	1.1%	32.90	OP
P.I.E. INDUSTRIAL BHD	3.07	1,179.0	Y	12/2022	18.3%	11.9%	28.2%	11.7%	17.5	13.7	12.2	22.1	1.8	13.5%	1.8%	3.70	OP
SKP RESOURCES BHD	1.61	2,515.4	Y	03/2023	17.3%	7.7%	27.5%	6.3%	13.6	12.8	11.9	2.9	2.6	20.0%	3.9%	2.10	OP
UNISEM (M) BHD	2.58	4,161.7	Y	12/2022	14.0%	10.0%	22.1%	11.3%	23.9	19.6	176	2.2	2.0	10.4%	2.0%	3.75	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.***

Published and printed by:

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