

15 August 2022

Technology

Penang to Continue Thriving

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OVERWEIGHT



We observed a slew of unfavourable earnings releases from large US tech companies (Micron, Intel, Nvidia and AMD) over last week. While this may cast a gloomy outlook for the tech space, we believe that Penang semiconductor ecosystem in Malaysia remains unique due to Malaysia's neutral stance in the US-China tech battle. We are sanguine that local tech players will continue to thrive with the FDIs inflow over the past two years as well as another potential wave of trade diversion due to recent events such as: (i) the passing of the USD52b CHIPS Act, and (ii) U.S. House Speaker Nancy Pelosi's stunt visit to Taiwan which will continue to benefit Malaysia. As share prices have rebounded on the back of favourable US CPI data, we keep our cherry picking approach in such turbulent environment by tweaking our calls (solely based on valuation) for **MPI (MP; TP: RM34.50)**, **KGB (OP; TP: RM1.60)** and **UNISEM (MP; TP: RM3.35)** while reiterating our top picks for the sector being **INARI (OP; TP: RM3.45)** and **PIE (OP; TP: RM3.70)**.



Recent earnings release from US tech players. Over last week, we observed a few major US semiconductor companies such as Micron Technology, Intel Corp, Nvidia Corp and Advanced Micro Devices Inc reporting underwhelming quarterly earnings that missed both internal guidance and consensus estimates. These companies attributed the expectation gap to various reasons such as a rapid decline in economic activity, lengthening PC replacement cycle, reduced gaming activity as gamers return to their workplace, decline in crypto mining activities, as well as internal execution issues. In addition, these companies also lowered their sales guidance (presented in the table below) for the following quarter as they expect inventory adjustments to take place in the

near future. Interestingly, these companies have reassured that no job cuts are necessary despite lower sales and some like Micron has even indicated intention to continue expanding manufacturing capacity as it anticipates receiving government grants following the recently passed \$52b CHIPS Act.

<u>Company</u>	<u>Guidance</u>
Micron Technology	<p>Micron cut its current quarter revenue forecast and hinted at potential negative cash flow in the coming three months. The group indicated a challenging quarter on the back of inventory adjustments in the cloud, industrial and automotive spaces.</p> <p>The group indicated that job cuts are not necessary.</p> <p>On a positive note, Micron also intends to invest up to USD40b by 2030 as it anticipates government grants and credits following the passing of the USD52b CHIPS Act. The proposed investment is estimated to create 40,000 jobs.</p>
Intel Corp	<p>Intel missed its second quarterly target as it reported earnings decline of 79% on a 17% decline in sales. YoY. The company lowered its full-year revenue expectations from three months ago to USD65b-USD68b.</p> <p>The group attributed the disappointing results to the rapid decline in economic activity which was further exacerbated by its internal execution issues.</p> <p>The group indicated that job cuts are not necessary.</p>

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Nvidia Corp	<p>Nvidia missed projections as revenue fell 33% YoY and 44% QoQ. The group attributed the disappointing results to the weakening sentiment in the gaming industry where it suffered 50% revenue drop in that segment. "Our gaming product sell-through projections declined significantly as the quarter progressed," Jen-Hsun Huang, founder and CEO of NVIDIA said. He further added, "As we expect the macroeconomic conditions affecting sell-through to continue, we took actions with our Gaming partners to adjust channel prices and inventory."</p> <p>The group indicated that job cuts are not necessary.</p>
Advanced Micro Devices Inc	<p>AMD lowers its forecast for its third quarter sales in the range of USD6.5b to USD6.9b while consensus had projected sales of USD6.8b. Gross profit margin was guided at 54% which was slightly below estimate of 54.2%. The group attributed the slowdown to the lengthening PC replacement cycle.</p> <p>"We have taken a more conservative outlook on the PC business," AMD CEO Dr. Lisa Su said in an earnings call, "So, a quarter ago, we would have thought that the PC business would be down, let's call it high-single digits [percentage]. And our current view of the PC business is that it will be down; let's call it mid-teens [percentage]."</p>

Penang is a unique ecosystem by itself. Dubbed the silicon valley of Malaysia, Penang has been the go-to location for many MNCs (Penang FDI - 2020: RM14.1b; 2021: RM76.2b; 1Q2022: RM6.3b) looking to expand their capacity. While the recent earnings release and outlook guidance provided by those four US companies discussed above may have cast a gloomy outlook, we remain sanguine that local semiconductor players will continue to thrive given that Malaysia remains an impartial country in the long-standing tech battle between US and China. In addition, the two major recent events: (i) passing of the USD52b CHIPS Act, and (ii) U.S. House Speaker Nancy Pelosi's stunt visit to Taiwan will likely create another wave of trade diversion and local semiconductor players are in favour to take on any opportunities thanks to Malaysia's impartial stance.

With the recent rally in technology stocks price on the back of favourable inflation data in the US, we take the opportunity to re-evaluate companies under our coverage that have limited upside as we continue to take on a cherry picking approach in this turbulent environment. While we like **MPI** for its long-term prospects in the automotive space, its fair value has almost met our fair value. As such, we downgrade our call to **MARKET PERFORM** from **OUTPERFORM** with a **target price of RM34.50** (based on 19x FY23F EPS) which includes a +5% TP adjustment based on ESG (given a 4-star rating as appraised by us).

We also adjusted our **target price on KGB to RM1.60** (previously RM1.90) to reflect lower forward peer average FY23F PER of 23x (previously 27x) while keeping our **OUTPERFORM** call. There is no adjustment to KGB's TP based on ESG (given a 3-star rating as appraised by us). Keeping with the consistency of adjusting in accordance to peers, we also lower our **target price for UNISEM to RM3.35** (previously RM3.85) on lower peers' average forward FY23F PER of 20x and downgrade our call to **MARKET PERFORM** from **OUTPERFORM** as its share price is nearing our fair value.

Overall, we maintain our 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 client which will be the main earnings driver for FY22 for which 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. There is no adjustment to TP based on ESG (given a 3-star rating as appraised by us).
- (ii) **INARI (OP; TP: RM3.45).** 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 in 1HCY22 while global shipment numbers were down. 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 spaces which could potentially morph into future earnings drivers. Our target price includes a +5% adjustment based on ESG (given a 4-star rating as appraised by us).

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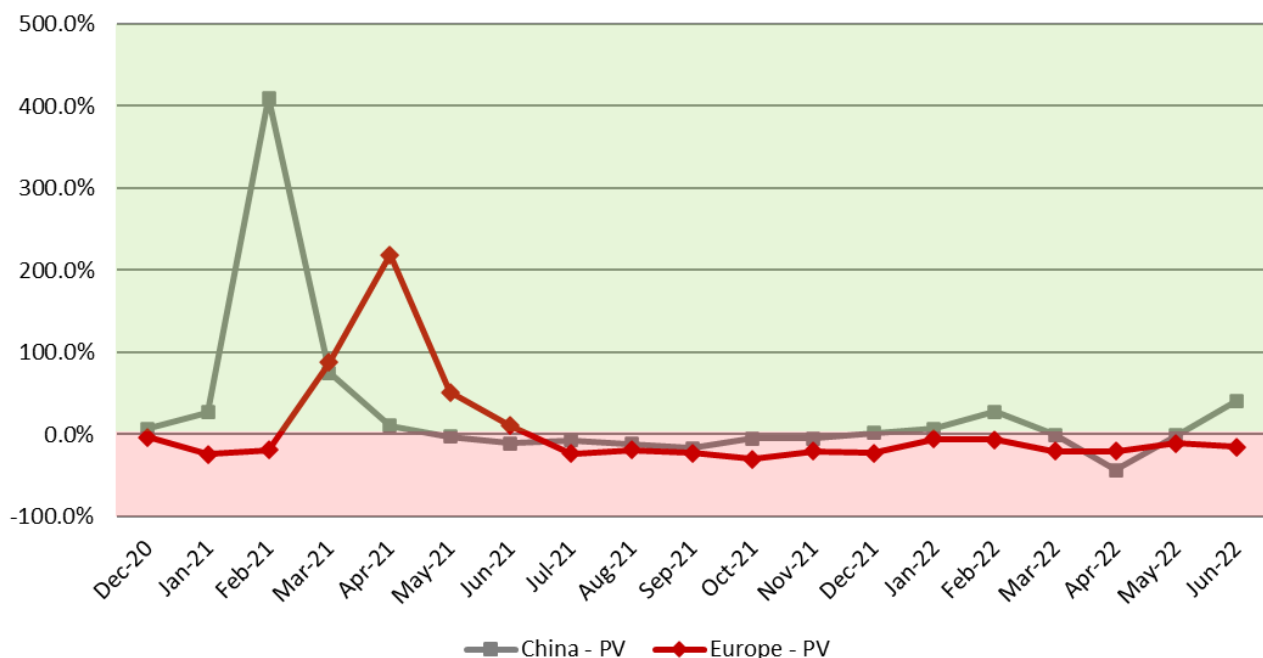
Worldwide Smartphone Sales to End Users by Vendor (m of units)

Company	Shipments (units)			Growth		Market Share		
	2Q22	1Q22	2Q21	QoQ	YoY	2Q22	1Q22	2Q21
Samsung	62.4	73.6	59.1	-15.2%	5.6%	22%	23%	19%
Apple	44.6	56.5	44.4	-21.1%	0.5%	16%	18%	14%
Xiaomi	39.5	39.9	53.1	-1.0%	-25.6%	14%	13%	17%
Vivo	24.8	25.3	31.7	-2.0%	-21.8%	9%	8%	10%
Oppo	24.7	27.4	32.8	-9.9%	-24.7%	9%	9%	10%
Others	89.9	91.4	92.3	-1.6%	-2.6%	31%	29%	29%
Total	285.9	314.1	313.4	-9.0%	-8.8%	100%	100%	100%

Source: IDC

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

YoY change of new car sales/registrations



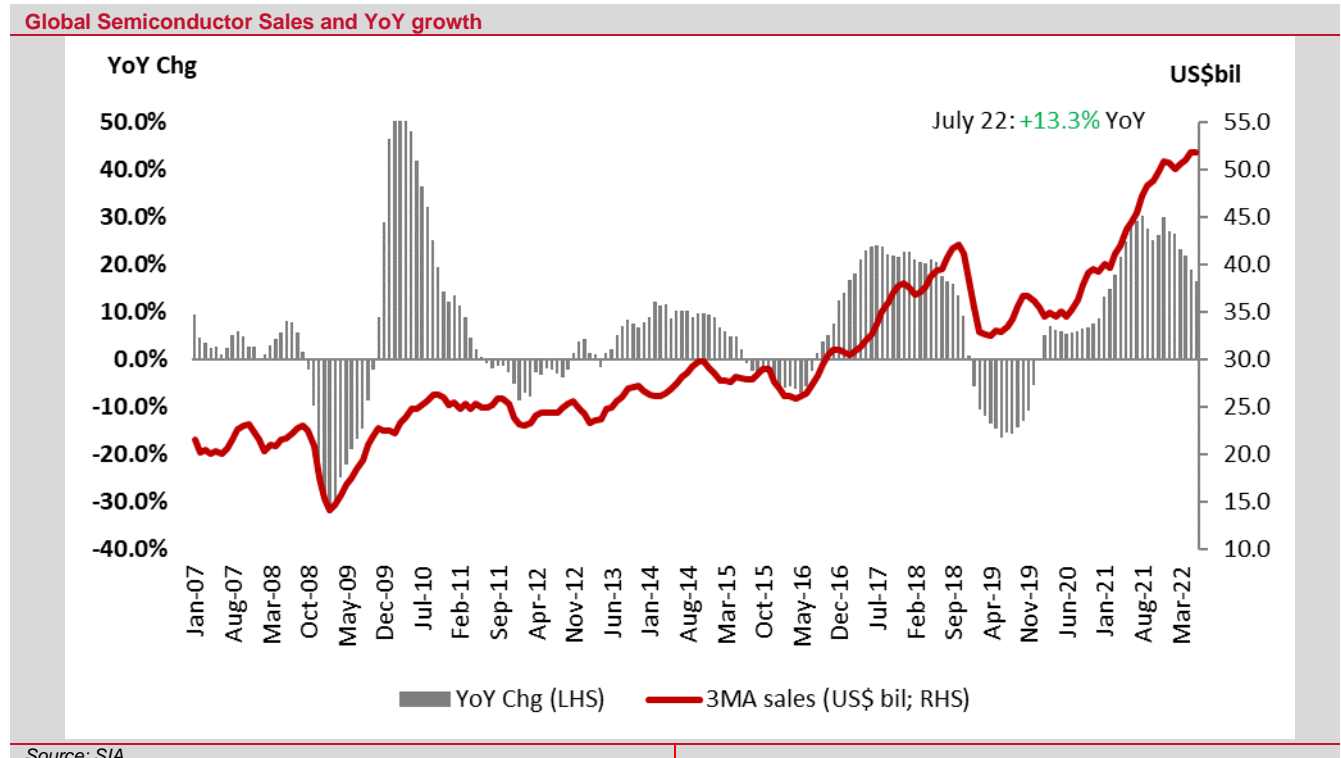
Source: CAAM, ACEA

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

Company	Shipments (units)			Growth		Market Share		
	2Q22	1Q22	2Q21	QoQ	YoY	2Q22	1Q22	2Q21
Lenovo	17.9	18.6	20.4	-3.8%	-12.5%	25%	24%	25%
HP	13.5	15.9	18.6	-14.9%	-27.5%	19%	20%	23%
Dell	13.3	13.8	14.0	-3.7%	-5.3%	18%	18%	17%
Apple	6.4	7.0	5.8	-9.1%	9.3%	9%	9%	7%
Asus	4.7	5.6	4.9	-16.0%	-4.3%	7%	7%	6%
Acer	5.1	5.5	6.3	-7.9%	-18.7%	7%	7%	8%
Others	11.2	11.5	12.4	-2.8%	-9.5%	16%	15%	15%
Total	72.0	77.9	82.4	-7.5%	-12.6%	100%	100%	100%

Source: Gartner

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WSTS Semiconductor Sales Forecasts by Product Type (Spring 2022)

	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

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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 BHD	4.09	5,060.2	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	1.19	1,358.4	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	2.92	10,828.5	Y	06/2022	22.5%	7.0%	20.7%	7.1%	26.0	24.2	22.6	6.3	3.9	15.9%	3.7%	3.45	OP
JHM CONSOLIDATION BHD	1.31	730.5	Y	12/2022	10.7%	15.2%	19.1%	27.2%	27.5	23.1	18.22	3.0	2.5	11.0%	0.4%	1.30	MP
KELINGTON GROUP BHD	1.27	816.6	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%	1.60	OP
KESM INDUSTRIES BHD	7.30	314.0	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	32.04	6,372.6	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%	34.50	MP
P.I.E. INDUSTRIAL BHD	3.28	1,259.7	Y	12/2022	13.6%	11.8%	8.7%	18.4%	20.8	19.1	16.1	2.4	2.2	11.3%	2.1%	3.70	OP
SKP RESOURCES BHD	1.62	2,531.0	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	3.01	4,855.4	Y	12/2022	14.0%	10.0%	22.1%	11.3%	22.5	18.4	16.6	2.1	1.9	10.4%	2.2%	3.35	MP

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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