

09 March 2023

## KESM Industries

### Green Shoots of Recovery

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KESM's 1HFY23 results met expectations. The group registered a net loss as revenue declined 18.2% due to lower loading volume from the burn-in and test segment, and the cessation of its EMS segment. Nevertheless, revenue improved 6.1% QoQ despite the lockdowns in China. The group anticipates a better 2HFY23 as it transitions into new EV chips. We keep our earnings forecasts but raise our asset-based TP by 25% to RM8.26 (from RM6.60). Maintain MARKET PERFORM.

**Within expectations.** 1HFY23 net loss of RM3.8m (vs. net profit of RM3.9m in 1HFY22) was within our expectation as the group had already pre-empted the investment community on the weaker performance in 2QFY23 owing to lockdowns in China.

**Results' highlight. YoY,** 1HFY23 revenue came in 18.2% lower owing to reduced volume for its burn-in and test services as well as the loss of contribution from the electronic manufacturing service (EMS) segment which was scaled down as it was considered no longer lucrative due to elevated material cost. However, on a QoQ basis, it is worth noting that the group's 2QFY23 (Nov-Jan) revenue trended 6.1% higher despite the lockdown restrictions in China as well as the Chinese New Year break in January. Operating expenses were inevitably higher QoQ due to the new electricity tariff that took effect in 2023 as well as increased depreciation for new equipment.

**Tail-end of its restructuring.** Following the cessation of its EMS business and older generation products, KESM is looking forward to the transitioning of new chips relating to electric vehicles (EV). The group has invested c.RM140m worth of new test equipment and is anticipating a gradual uptick in loading volume towards the 2HFY23.

**Forecasts. Maintained.**

Although forecasts are maintained, we raise our TP by 25% to RM8.26 (from RM6.60) based on FY24F PBV of 1x (previously 0.8x) as we rolled forward our valuation base. We remove the discount to its PBV valuation owing to improving prospects as it transitions into new EV-related projects. There is no adjustment to our TP based on ESG given a 3-star rating as appraised by us (see Page 4).

We like KESM for: (i) being a proxy to the promising prospects of automotive semiconductors, (ii) being one of the largest independent burn-in and test service provider in Malaysia to potentially benefit from MNCs expansions in the country, and (iii) its physical presence in China to ride on the government's ambitious plans for the semiconductor industry. However, we remain cautious in the immediate term as the group still faces potential risk of sub-optimal loading volume during the transitional period. Maintain MARKET PERFORM.

**Risks to our call include:** (i) faster-than-expected ramp-up in volume for burn-in and test services, (ii) faster-than-expected adoption of new semiconductor modules in automobiles, and (iii) sudden surge in customer forecast.

## MARKET PERFORM ↔

<b>Price:</b>	<b>RM7.85</b>	
<b>Target Price:</b>	<b>RM8.26</b>	↑
<b>Expected Capital Gain:</b>	<b>RM0.41</b>	<b>5.2%</b>
<b>Expected Divd. Yield:</b>	<b>RM0.09</b>	<b>1.1%</b>
<b>Expected Total Return:</b>	<b>RM0.50</b>	<b>6.4%</b>

**KLCI Index** 1,454.7

### 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)	337.7
52-week range (H)	9.52
52-week range (L)	6.10
Free Float	27.9%
Beta	0.8
3-mth avg daily vol:	16,878.5

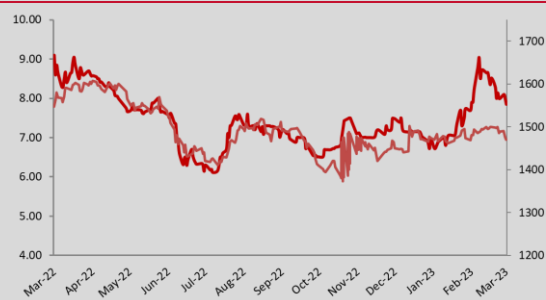
### Major Shareholders

Sunright Ltd	48.4%
Tan Kong Hong Alex	4.8%
Abrdn Plc	3.7%

### Summary Earnings Table

FY July (RM m)	2022A	2023F	2024F
Revenue	246.7	239.0	256.4
EBIT	1.1	(1.0)	1.6
PBT	4.2	1.3	4.1
Net profit	0.2	1.2	3.7
<b>Core Net Profit</b>	<b>0.2</b>	<b>1.2</b>	<b>3.7</b>
Consensus (NP)	-	-0.4	5.3
Earnings Revision	-	-	-
Core EPS (sen)	0.5	2.8	8.5
Core EPS growth (%)	-94.5	443.8	205.4
DPS (sen)	7.5	7.5	7.5
BV/Share (RM)	8.3	8.2	8.3
Core PER (x)	1366	251.2	82.2
PBV (x)	0.8	0.8	0.8
Net. Gearing (x)	-0.4	-0.4	-0.5
Div. Yield (%)	1.1	1.1	1.1

### Share Price Performance



	1 mth	3 mths	12 mths
<b>Absolute (%)</b>	<b>-3.6%</b>	<b>9.8%</b>	<b>-8.7%</b>
<b>Relative (%)</b>	<b>-2.9%</b>	<b>10.6%</b>	<b>-1.8%</b>



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## Results Highlights

	2Q	1Q	QoQ	2Q	YoY	6M	6M	YoY
FYE July (RM m)	FY23	FY23	Chg	FY22	Chg	FY23	FY22	Chg
<b>Revenue</b>	<b>56.0</b>	<b>52.8</b>	<b>6.1%</b>	<b>64.3</b>	<b>-12.9%</b>	<b>108.8</b>	<b>132.9</b>	<b>-18.2%</b>
EBITDA	-0.3	8.3	-103.2%	13.8	-101.9%	8.0	37.1	-78.5%
EBIT	-0.7	-1.4	46.7%	0.2	-419.6%	-2.1	9.0	-123.5%
PBT	-1.7	-1.7	0.0%	0.1	-1454.4%	-3.4	8.8	-138.6%
Taxation	0.0	0.2	-90.2%	-1.1	101.3%	0.2	-2.3	107.4%
<b>Net Profit</b>	<b>-0.7</b>	<b>-1.5</b>	<b>53.2%</b>	<b>-1.0</b>	<b>28.6%</b>	<b>-2.3</b>	<b>6.5</b>	<b>-134.7%</b>
<b>Core Net Profit</b>	<b>-2.4</b>	<b>-1.5</b>	<b>-60.6%</b>	<b>1.0</b>	<b>-337.8%</b>	<b>-3.8</b>	<b>3.9</b>	<b>-197.6%</b>
EPS (sen)	-5.5	-3.4	-60.6%	2.3	-337.8%	-8.9	9.1	-197.6%
DPS (sen)	0.0	0.0		0.0		0.0	0.0	
EBITDA margin	-0.5%	15.6%		21.5%		7.3%	27.9%	
EBIT margin	-1.3%	-2.6%		0.4%		-1.9%	6.8%	
PBT margin	-3.0%	-3.2%		0.2%		-3.1%	6.6%	
PATAMI margin	-4.2%	-2.8%		1.5%		-3.5%	2.9%	
Effective tax rate	-0.9%	-9.0%		-907.2%		-5.0%	-25.8%	

Source: Company, Kenanga Research

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## Malaysian Technology Peers Comparison

Name	Rating	Last Price (RM)	Target Price (RM)	Upside (%)	Mkt Cap (RM'm)	Shariah Compliant	Current FYE	Core EPS (sen)		Core EPS Growth		PER (x) – Core Earnings		PBV (x)	ROE (%)	Net Div. (sen)	Net Div. Yld (%)
								1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.
D&O GREEN TECHNOLOGIES BHD	UP	4.53	3.51	-22.52%	5,606.9	Y	12/2023	10.3	14.0	31.6%	35.5%	43.8	32.3	5.9	14.0%	1.7	0.4%
GHL SYSTEMS BHD	OP	0.920	1.05	14.13%	1,044.5	Y	12/2023	3.0	3.4	21.3%	12.9%	30.7	27.2	1.9	6.5%	0.0	0.0%
INARI AMERTRON BHD	MP	2.49	2.60	4.42%	9,295.0	Y	06/2023	10.2	11.5	-3.2%	12.7%	24.4	21.7	3.7	15.0%	9.7	3.9%
JHM CONSOLIDATION BHD	MP	0.830	0.800	-3.61%	500.0	Y	12/2023	5.3	5.9	40.0%	10.6%	15.6	14.1	1.4	9.8%	0.5	0.6%
KELINGTON GROUP BHD	OP	1.52	1.92	26.32%	977.4	Y	12/2023	8.7	9.0	1.1%	3.2%	17.5	16.9	3.5	21.3%	2.4	1.6%
KESM INDUSTRIES BHD	MP	7.85	8.26	-15.92%	337.7	Y	07/2023	2.8	8.6	500.0%	208.3%	281.7	92.2	0.9	0.3%	7.5	1.0%
LGMS BHD	OP	1.22	1.50	22.95%	556.3	Y	12/2023	3.5	5.9	26.2%	69.8%	35.1	20.6	5.6	17.4%	0.0	0.0%
MALAYSIAN PACIFIC INDUSTRIES BHD	UP	29.20	20.00	-31.51%	5,807.8	Y	06/2023	81.1	130.6	-51.0%	61.0%	36.0	22.4	2.8	7.9%	35.0	1.2%
NATIONGATE HOLDINGS BHD	OP	1.42	1.50	5.63%	2,945.0	Y	12/2023	5.5	6.5	32.2%	18.6%	26.0	21.9	8.6	39.6%	0.0	0.0%
P.I.E. INDUSTRIAL BHD	OP	3.51	4.05	15.38%	1,348.0	Y	12/2023	22.5	25.3	22.0%	12.5%	15.6	13.9	2.2	14.6%	7.0	2.0%
SKP RESOURCES BHD	UP	1.38	1.20	-13.04%	2,156.1	Y	03/2023	9.7	7.9	-11.1%	-17.9%	14.2	17.5	2.4	17.8%	4.8	3.5%
UNISEM (M) BHD	MP	3.02	3.10	2.65%	4,871.5	Y	12/2023	15.4	17.2	2.1%	11.4%	19.6	17.6	1.9	10.0%	6.0	2.0%
Simple Average										-6.6%	17.7%	25.2	21.4	3.4	14.5%		1.3%

Source: Bloomberg, Kenanga Research

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**Stock ESG Ratings:**

	Criterion	Rating		
<b>GENERAL</b>	Earnings Sustainability & Quality	★	★	☆
	Corporate Social Responsibility	★	★	★
	Management/Workforce Diversity	★	★	☆
	Accessibility & Transparency	★	★	☆
	Corruption-Free Pledge	★	★	★
	Carbon-Neutral Initiatives	★	★	☆
<b>SPECIFIC</b>	Foreign Worker Welfare	★	★	★
	Supply Chain Auditing	★	★	★
	Waste disposal / pollution control	★	★	☆
	Energy Efficiency	★	★	★
	Work Site Safety	★	★	★
	Digital Transformation	★	★	☆
<b>OVERALL</b>		★	★	★

☆ denotes half-star  
★ -10% discount to TP  
★★ -5% discount to TP  
★★★ TP unchanged  
★★★★ +5% premium to TP  
★★★★★ +10% premium to TP

**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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