

22 March 2023

KESM Industries

New Test Platforms Ready to Roll

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KESM's new test platforms for its automotive customers are currently undergoing qualification. Upon commissioning, they will handle new chips for EVs, raising its overall utilisation rate from 50% currently to 70% by CY24. On a more subdued note, KESM is still facing weakening demand in its non-automotive segment, higher electricity cost and rising depreciation. We now project a loss in FY23F (from a profit previously), cut our FY24F net profit forecast by 22%, trim our TP RM8.24 (from RM8.26) but maintain our MARKET PERFORM call.

Key takeaways from our meeting with KESM are as follows:

1. With the major capex of RM145m completed for new burn-in and test equipment, the new test platforms for its automotive customers are gradually being certified. KESM expects its utilisation rate for the automotive business (c.70% of group revenue) to begin trending upwards to 70% in CY24 from the current level of 50–55% in 2QFY23. The new test platforms will handle updated chips related to advanced driver-assistance system (ADAS) and tyre pressure monitoring system (TPMS) for electric vehicles.
2. However, it is still facing challenges in terms of higher electricity cost (+5% QoQ) on increased tariff from 2023 and weakening loading volume for its non-automotive (c. 30% of group revenue) burn-in and test business. Meanwhile, its depreciation is expected to trend up from c.RM9m/quarter to RM10–11m/quarter as the new equipment has been fitted into its facility.
3. KESM indicated that its EMS business has been scaled down to a level that it has no material bearing on its overall operation. The group will maintain its current workforce of 1,900 workers who will be able to cover the operations of its new test platform. However, there will still be lingering unabsorbed overhead of c.RM2–3m due to the ongoing reskilling of workers from the EMS segment to the burn-in and test business.

Forecasts. We now project a RM4.3m net loss in FY23F (from a RM1.2m net profit) and cut our FY24F net profit forecast by 22%.

We also trim our TP to RM8.24 (previously RM8.26) based on an unchanged FY24F PBV of 1x. There is no adjustment to our TP based on ESG given its 3-star rating as appraised by us (see Page 4).

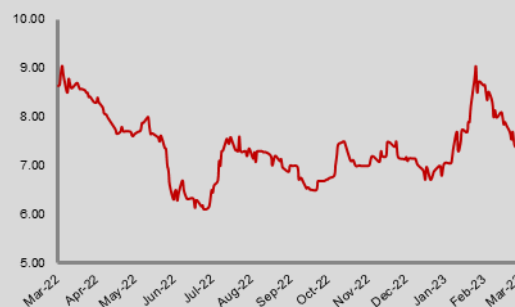
Investment thesis. We like KESM for: (i) being a proxy to the promising prospects of automotive semiconductors, (ii) being one of the largest independent burn-in and test service providers in Malaysia to potentially benefit from MNCs' expansions in the country, and (iii) its physical presence in China 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 transition period. Maintain **MARKET PERFORM**.

Risks to our call include: (i) delays in the ramp-up in volume for burn-in and test services, (ii) slow adoption of new semiconductor modules in automobiles, and (iii) additional restructuring cost in its EMS division.

MARKET PERFORM ↔

Price : **RM7.35**
Target Price : **RM8.24** ↓

Share Price Performance



KLCI 1,406.6
YTD KLCI chg -5.9%
YTD stock price chg 4.7%

Stock Information

Shariah Compliant	Yes
Bloomberg Ticker	KESM MK Equity
Market Cap (RM m)	316.2
Shares Outstanding	43.0
52-week range (H)	9.52
52-week range (L)	6.10
3-mth avg daily vol:	17,405.2
Free Float	27.0%
Beta	0.8

Major Shareholders

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

Summary Earnings Table

FY July (RM m)	2022A	2023F	2024F
Revenue	246.7	208.8	252.5
EBIT	1.1	(7.2)	0.7
PBT	4.2	(4.8)	3.2
Net profit	0.2	(4.3)	2.9
Core Net Profit	0.2	(4.3)	2.9
Consensus (NP)	-	-2.6	2.4
Earnings Revision	-	-459%	-22%
Core EPS (sen)	0.5	-10.0	6.7
Core EPS growth (%)	-94.5	-2051.7	166.6
DPS (sen)	7.5	7.5	7.5
BV/Share (RM)	8.4	8.2	8.2
Core PER (x)	1436	-73.6	110.5
PBV (x)	0.9	0.9	0.9
Net. Gearing (x)	-0.4	-0.4	-0.5
Div. Yield (%)	1.0	1.0	1.0



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Income Statement						Financial Data & Ratios					
FY Jul (RM m)	2020A	2021A	2022A	2023F	2024F	FY Jul (RM m)	2020A	2021A	2022A	2023F	2024F
Revenue	241.0	248.3	246.7	208.8	252.5	Growth (%)					
EBITDA	64.6	65.6	52.6	48.6	59.2	Revenue	-21.6	3.0	-0.6	-15.4	20.9
EBIT	1.9	7.9	1.1	(7.2)	0.7	EBITDA	-21.7	1.6	-19.9	-7.5	21.7
Finance costs	3.8	3.1	3.1	2.4	2.5	EBIT	-75.3	317.4	-85.7	-734.5	110.0
PBT	5.7	11.0	4.2	(4.8)	3.2	PBT	-40.3	94.1	-61.6	-213.8	166.6
Taxation	(5.6)	(3.7)	(2.6)	0.5	(0.3)	Net Profit	-98.5	4073	-94.5	-2052	166.6
Minority Interest	0.0	0.0	0.0	0.0	0.0	Core Net Profit	-98.5	4073	-94.5	-2052	166.6
Net Profit	0.1	4.0	0.2	(4.3)	2.9	Profitability (%)					
Core Net Profit	0.1	4.0	0.2	(4.3)	2.9	EBITDA Margin	26.8	26.4	21.3	23.3	23.4
Balance Sheet						EBIT Margin	0.8	3.2	0.5	-3.4	0.3
FY Jul (RM m)	2020A	2021A	2022A	2023F	2024F	PBT Margin	2.4	4.4	1.7	-2.3	1.3
Fixed Assets	131.6	126.4	175.3	184.7	156.3	Net Profit Margin	0.0	1.6	0.1	-2.1	1.1
Intangible Assets	0.0	0.0	0.0	0.0	0.0	Core Net Margin	0.0	1.6	0.1	-2.1	1.1
Other FA	4.2	4.1	4.8	4.8	4.8	Effect. Tax Rate	24.7	10.0	10.7	10.7	10.7
Inventories	6.1	7.8	1.9	0.9	2.0	ROE	0.0	1.1	0.1	-1.2	0.8
Receivables	34.4	46.8	48.3	40.1	49.5	ROA	0.0	1.0	0.1	-1.0	0.7
Other CA	3.5	5.3	10.9	10.9	10.9	DuPont Analysis					
Cash	239.0	229.6	189.3	178.3	199.5	Net Margin (%)	0.0	1.6	0.1	-2.1	1.1
Total Assets	414.5	415.9	425.6	415.0	418.2	Assets Turnover (x)	0.58	0.60	0.58	0.50	0.60
Payables	24.3	30.4	26.1	22.9	26.5	Leverage Factor (x)	1.16	1.14	1.17	1.17	1.18
ST Borrowings	21.1	7.4	11.9	11.9	11.9	ROE (%)	0.0	1.1	0.1	-1.2	0.8
Other ST Liability	2.8	1.4	0.0	0.0	0.0	Leverage					
LT Borrowings	4.5	6.4	15.4	15.4	15.4	Debt/Asset (x)	0.1	0.0	0.1	0.1	0.1
Other LT Liability	5.5	6.9	9.9	9.9	9.9	Debt/Equity (x)	0.1	0.0	0.1	0.1	0.1
Net Assets	356.3	363.4	362.4	354.8	354.5	Net Cash/(Debt)	213.4	215.8	162.0	151.0	172.2
Share Capital	43.7	43.7	43.7	43.7	43.7	Net Debt/Equity (x)	-0.6	-0.6	-0.4	-0.4	-0.5
Reserves	312.6	319.7	318.7	311.2	310.8	Valuations					
Total Equity	356.3	363.4	362.4	354.8	354.5	EPS (sen)	0.2	9.3	0.5	-10.0	6.7
Cashflow Statement						Core EPS (sen)	0.2	9.3	0.5	-10.0	6.7
FY Jul (RM m)	2020A	2021A	2022A	2023F	2024F	NDPS (sen)	7.5	9.0	7.5	7.5	7.5
Operating CF	86.5	37.1	43.8	58.3	55.3	BVPS (RM)	8.3	8.4	8.4	8.2	8.2
Investing CF	(28.2)	(42.0)	(33.5)	(70.0)	(30.0)	PER (x)	3298	79.0	1436	-73.6	110.5
Financing CF	(50.2)	(15.7)	6.3	(4.1)	(4.1)	Core PER (x)	3298	79.0	1436	-73.6	110.5
						Net Div. Yield (%)	1.0	1.2	1.0	1.0	1.0
						PBV (x)	0.9	0.9	0.9	0.9	0.9

Source: 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	4.15	3.51	-15.42%	5,136.6	Y	12/2023	10.3	14.0	31.6%	35.5%	40.1	29.6	5.4	14.0%	1.7	0.4%
GHL SYSTEMS BHD	OP	0.860	1.05	22.09%	981.7	Y	12/2023	3.0	3.4	21.3%	12.9%	28.7	25.4	1.8	6.5%	0.0	0.0%
INARI AMERTRON BHD	MP	2.38	2.60	9.24%	8,884.4	Y	06/2023	10.2	11.5	-3.2%	12.7%	23.3	20.7	3.5	15.0%	9.7	4.1%
JHM CONSOLIDATION BHD	MP	0.780	0.800	2.56%	469.7	Y	12/2023	5.3	5.9	40.0%	10.6%	14.7	13.3	1.3	9.8%	0.5	0.6%
KELINGTON GROUP BHD	OP	1.40	1.92	37.14%	900.2	Y	12/2023	8.7	9.0	1.1%	3.2%	16.1	15.6	3.2	21.3%	2.4	1.7%
KESM INDUSTRIES BHD	MP	7.35	8.24	12.11%	316.2	Y	07/2023	(10.0)	6.7	-2250.0%	-32.6%	N.A.	110.3	0.9	-1.2%	7.5	1.0%
LGMS BHD	OP	1.18	1.50	27.12%	538.1	Y	12/2022	3.5	5.9	26.2%	69.8%	33.9	19.9	5.4	17.4%	0.0	0.0%
MALAYSIAN PACIFIC INDUSTRIES BHD	UP	27.86	20.00	-28.21%	5,541.3	Y	06/2023	81.1	130.6	-51.0%	61.0%	34.4	21.3	2.6	7.9%	35.0	1.3%
NATIONGATE HOLDINGS BHD	OP	1.36	1.50	10.29%	2,820.5	Y	12/2023	5.5	6.5	32.2%	18.6%	24.9	21.0	8.2	39.6%	0.0	0.0%
OPPSTAR BHD	OP	2.24	1.30	-41.96%	1,425.1	N	12/2023	3.1	4.0	18.1%	29.6%	72.7	56.1	49.5	90.7%	0.8	0.4%
PIE INDUSTRIAL BHD	OP	3.44	4.05	17.73%	1,321.1	Y	12/2023	22.5	25.3	22.0%	12.5%	15.3	13.6	2.1	14.6%	7.0	2.0%
SKP RESOURCES BHD	UP	1.30	1.20	-7.69%	2,031.1	Y	03/2023	9.7	7.9	-11.1%	-17.9%	13.4	16.5	2.3	17.8%	4.8	3.7%
UNISEM (M) BHD	MP	3.09	3.10	0.32%	4,984.4	Y	12/2023	15.4	17.2	2.1%	11.4%	20.1	18.0	1.9	10.0%	6.0	1.9%
Simple Average										-6.7%	18.2%	24.9	21.0	6.8	20.3%		1.3%

Source: Kenanga Research

Stock ESG Ratings:

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

☆ 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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