

26 May 2023

# KESM Industries

## Still in the Red

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**KESM's 9MFY23 results disappointed.** Its net loss widened due to further decline in loading volume while wages remained elevated. Making the situation worse, other expenses increased 6% on higher utility costs which took effect earlier this year. We widen our FY23F net loss forecast by 59% and slash our FY24F net profit forecast by 81%, reduce our TP by 16% to RM6.91 (from RM8.26) but maintain our MARKET PERFORM call.

**Below expectations.** 9MFY23 net loss of RM5.4m came wider than both our full-year net loss forecast of RM4.3m and the full-year consensus loss estimate of RM5.4 respectively. The variance against our forecast came from the weak showing at its burn-in and testing services.

**Results' highlights.** YoY, 9MFY23 revenue dipped 12.8% primarily due to lower volume in burn-in and test services. Not helping, the electronic manufacturing service (EMS) segment's contribution was largely diminished as it was scaled down as the operation was no longer financially viable owing to increased material costs. Despite a reduction in headcount, the group's employee benefit expenses remained relatively elevated due to an increase in wage rates. Furthermore, the implementation of higher utility rates earlier this year led to a 6% rise in other expenses. As a result, the group's net loss widened to RM5.4m (vs. profit of RM1.9m in 9MFY22).

**Not out of the woods.** After discontinuing its EMS business and older generation products, KESM is focused on the transition to new chips for electric vehicles (EVs). With an investment of approximately RM140m in new test equipment, the group expects a gradual increase in loading volume. While we are positive on KESM's strategic move, we acknowledged the uncertain conditions in the semiconductor industry. The expected recovery in China's economy, which was anticipated to drive demand growth, is progressing much slower than initially anticipated. This prevailing climate adds a level of uncertainty to the group's journey of returning to the black.

**Forecasts.** We widen our FY23F net loss forecast by 59% and slash our FY24F net profit forecast by 81%.

Consequently, we cut our TP by 16% to RM6.91 (from RM8.26) based on a lower FY24F PBV of 0.85x (previously 1.0x) to reflect the group's sluggish recovery to the black coupled with deteriorating sentiment surrounding the tech space. There is no adjustment to our TP based on ESG given a 3-star rating as appraised by us (see Page 4).

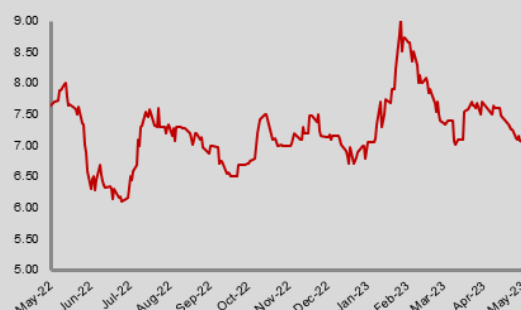
We like KESM for: (i) being a proxy to the promising prospects of automotive semiconductors, (ii) being one of the largest independent burn-in and test service provider in Malaysia to potentially benefit from MNCs expansions in the country, and (iii) its physical presence in China to ride on the government's ambitious plans for the semiconductor industry. However, we remain cautious for 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 ↔

Price : RM6.81  
Target Price : RM6.91 ↓

## Share Price Performance



KLCI 1,402.5  
YTD KLCI chg -3.0%  
YTD stock price chg -6.2%

## Stock Information

Shariah Compliant Yes  
Bloomberg Ticker KESM MK Equity  
Market Cap (RM m) 292.6  
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%  
Abrdn Plc 3.7%

## Summary Earnings Table

FY July (RM m)	2022A	2023F	2024F
Revenue	246.7	208.8	252.5
EBIT	1.1	(10.0)	(1.8)
PBT	4.2	(7.7)	0.6
Net profit	0.2	(6.8)	0.5
<b>Core Net Profit</b>	<b>0.2</b>	<b>(6.8)</b>	<b>0.5</b>
Consensus (NP)	-	-5.4	2.1
Earnings Revision	-	-59%	-81%
Core EPS (sen)	0.5	-15.9	1.2
Core EPS grwth (%)	-94.5	-3203.4	107.8
DPS (sen)	7.5	7.5	7.5
BV/Share (RM)	8.4	8.2	8.1
Core PER (x)	1436	-46.3	594.2
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

26 May 2023

## Results Highlights

	3Q	2Q	QoQ	3Q	YoY	9M	9M	YoY
FYE July (RM m)	FY23	FY23	Chg	FY22	Chg	FY23	FY22	Chg
<b>Revenue</b>	<b>57.8</b>	<b>56.0</b>	<b>3.3%</b>	<b>58.2</b>	<b>-0.6%</b>	<b>166.6</b>	<b>191.1</b>	<b>-12.8%</b>
EBITDA	9.1	-0.3	3540.0%	10.4	-12.4%	17.1	47.5	-64.0%
EBIT	-0.8	-0.7	-11.6%	-1.8	55.6%	-2.9	7.2	-141.0%
PBT	-1.3	-1.7	23.4%	-1.9	33.5%	-4.7	6.8	-168.6%
Taxation	0.1	0.0	640.0%	-0.4	128.5%	0.3	-2.7	110.5%
<b>Net Profit</b>	<b>-1.2</b>	<b>-0.7</b>	<b>-64.7%</b>	<b>-2.3</b>	<b>49.3%</b>	<b>-3.4</b>	<b>4.2</b>	<b>-182.7%</b>
<b>Core Net Profit</b>	<b>-1.6</b>	<b>-2.4</b>	<b>32.8%</b>	<b>-2.0</b>	<b>19.6%</b>	<b>-5.4</b>	<b>1.9</b>	<b>-377.7%</b>
EPS (sen)	-3.7	-5.5	32.8%	-4.6	19.6%	-12.6	4.5	-377.7%
DPS (sen)	0.0	0.0		1.5		0.0	1.5	
EBITDA margin	15.8%	-0.5%		17.9%		10.3%	24.9%	
EBIT margin	-1.4%	-1.3%		-3.2%		-1.8%	3.7%	
PBT margin	-2.2%	-3.0%		-3.3%		-2.8%	3.6%	
PATAMI margin	-2.7%	-4.2%		-3.4%		-3.2%	1.0%	
Effective tax rate	-8.6%	-0.9%		20.0%		-6.0%	-38.9%	

26 May 2023

## 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	3.85	3.51	-8.83%	4,765.5	Y	12/2023	10.3	14.0	31.6%	35.5%	37.2	27.5	5.0	14.0%	1.7	0.4%
GHL SYSTEMS BHD	OP	0.790	1.05	32.91%	896.1	Y	12/2023	3.0	3.4	21.3%	12.9%	26.3	23.4	1.7	6.5%	0.0	0.0%
INARI AMERTRON BHD	MP	2.26	2.46	8.85%	8,436.4	Y	06/2023	9.0	10.2	-14.1%	13.1%	25.1	22.2	3.3	13.3%	8.6	3.8%
JHM CONSOLIDATION BHD	MP	0.730	0.800	9.59%	439.4	Y	12/2023	5.3	5.9	40.0%	10.6%	13.7	12.4	1.3	9.8%	0.5	0.7%
KELINGTON GROUP BHD	OP	1.36	1.92	41.18%	874.5	Y	12/2023	8.7	9.0	1.1%	3.2%	15.6	15.1	3.1	21.3%	2.4	1.8%
KESM INDUSTRIES BHD	MP	6.81	6.91	1.47%	292.9	Y	07/2023	(15.8)	1.2	-3500.0%	-92.6%	N.A.	549.6	0.8	-1.9%	7.5	1.1%
LGMS BHD	OP	1.09	1.50	37.61%	497.0	Y	12/2023	3.5	5.9	26.2%	69.8%	31.3	18.4	5.0	17.4%	0.0	0.0%
MALAYSIAN PACIFIC INDUSTRIES BHD	UP	25.72	15.26	-40.67%	5,115.6	Y	06/2023	41.8	105.8	-74.7%	153.3%	61.2	24.3	2.5	4.1%	35.0	1.4%
NATIONGATE HOLDINGS BHD	OP	1.21	1.40	15.70%	2,509.5	Y	12/2023	5.0	6.1	20.4%	22.8%	24.3	19.8	7.7	37.1%	0.3	0.2%
OPPSTAR BHD	UP	1.89	1.30	-31.22%	1,202.4	N	12/2023	3.1	4.0	18.1%	29.6%	61.4	47.4	41.8	90.7%	0.8	0.4%
PIE INDUSTRIAL BHD	OP	3.35	4.05	20.90%	1,286.5	Y	12/2023	22.5	25.3	22.0%	12.5%	14.9	13.2	2.1	14.6%	7.0	2.1%
SKP RESOURCES BHD	UP	0.990	1.20	21.21%	1,546.7	Y	03/2023	9.7	7.9	-11.1%	-17.9%	10.2	12.5	1.7	17.8%	4.8	4.8%
UNISEM (M) BHD	MP	2.86	2.75	-3.85%	4,613.4	Y	12/2023	8.9	13.8	-41.2%	55.7%	18.6	16.7	1.9	5.9%	6.0	2.1%
Simple Average										-22.4%	28.6%	27.5	21.4	6.0	19.3%		1.5%

Source: Kenanga Research

26 May 2023

**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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