

22 September 2023

KESM Industries

Returns to the Black in 4QFY23

By Samuel Tan | samueltan@kenanga.com.my

KESM reported narrower-than-expected FY23 losses as it returned to the black in 4QFY23 owing to improved contribution from the burn-in and test segment, coupled with reduced losses at the discontinued EMS segment. However, its earnings volatility remains. We raise our FY24F net profit to RM2.7m (from RM0.53m), lift our TP by 2% to RM7.06 (from RM6.91) but maintain our MARKET PERFORM call.

Above expectations. KESM's FY23 core net loss of RM4.9m was narrower than both our net loss forecast of RM6.8m and the consensus net loss estimate of RM6.1m. The variance against our forecast came largely from the turnaround at its burn-in and testing services in the 4QFY23.

Results' highlights. YoY, KESM's FY23 revenue dipped 7.5% due to reduced volume from burn-in and test services. The impact was further exacerbated by the absence of the electronic manufacturing service (EMS) segment's contribution as the group decided to scale down the operation, citing that it was no longer financially viable with the rising increased material costs which it was not able to pass on to customers. The group then focused its efforts solely on revamping its burn-in and test operations with a strategic investment of RM143m over the past quarters which led to early signs of fruition in the 4QFY23 where it returned into the black (vs. our expectation of another quarterly loss). As a result, the group's net loss was capped at RM4.9m.

Still premature. This reported 4QFY23 marks the group's first quarterly profit of RM0.3m, putting an end to the losing streak over the last six quarters. While it's an encouraging sign, we retain our conservative view on the company given its highly volatile nature in terms of earnings delivery compared to industry peers. With its strategic RM143m capex completed, the group indicated it is now focused on the transition to new chips for electric vehicles (EVs), which is expected to gradually increase in loading volume. However, we remain cautious given prevailing uncertainties within the semiconductor industry.

Forecasts. We increase FY24F net profit to RM2.7m (from RM0.53m) and introduce our FY25F earnings projecting a 67% growth.

We tweak our TP up by 2% to RM7.06 (from RM6.91) based on an unchanged FY24F PBV of 0.85x, representing a c.20% discount to the average PBV of 1.1x of companies in the technology-related space that are loss-making or barely breaking even, i.e. JCY, AEMULUS, ATAIMS and JHM (MP; TP: RM0.70) to reflect KESM's low share liquidity. There is no adjustment to our TP based on ESG given a 3-star rating as appraised by us (see Page 4).

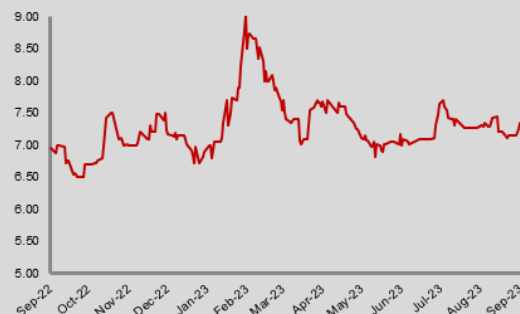
We like KESM for: (i) its exposure to the promising automotive semiconductors space, (ii) being one of the largest independent burn-in and test service provider in Malaysia to potentially benefit from MNCs expansions in the country, and (iii) its physical presence in China to ride on the government's ambitious plans for their 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) slower-than-expected ramp-up in volume for burn-in and test services, (ii) slower-than-expected adoption of new semiconductor modules in automobiles, and (iii) sudden decline in customer forecast.

MARKET PERFORM ↔

Price : RM7.05
Target Price : RM7.06 ↑

Share Price Performance



KLCI 1,4048.2
YTD KLCI chg -3.2%
YTD stock price chg 0.4%

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)	6.21
3-mth avg daily vol:	1,850.2
Free Float	27.9%
Beta	1.0

Major Shareholders

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

Summary Earnings Table

FY July (RM m)	2023A	2024F	2025F
Revenue	228.3	267.8	286.5
EBIT	(4.3)	1.7	3.4
PBT	(2.2)	2.8	4.7
Net profit	(4.9)	2.7	4.4
Core Net Profit	(4.9)	2.7	4.4
Consensus (NP)	-	0.7	5.1
Earnings Revision	-	399%	-
Core EPS (sen)	-11.5	6.2	10.3
Core EPS grwth (%)	-2345.0	153.8	67.3
DPS (sen)	-	-	-
BV/Share (RM)	8.2	8.3	8.4
Core PER (x)	-61.3	114.0	68.2
PBV (x)	0.9	0.8	0.8
Net. Gearing (x)	-0.4	-0.4	-0.4
Div. Yield (%)	-	-	-

22 September 2023

Results Highlights

	4Q	3Q	QoQ	4Q	YoY	12M	12M	YoY
FYE July (RM m)	FY23	FY23	Chg	FY22	Chg	FY23	FY22	Chg
Revenue	61.7	57.8	6.7%	55.7	10.8%	228.3	246.7	-7.5%
EBITDA	12.6	9.1	38.1%	8.8	43.2%	29.7	56.3	-47.3%
EBIT	2.3	-0.8	382.4%	-2.3	201.1%	-0.6	4.9	-112.7%
PBT	1.5	-1.3	216.2%	-2.6	158.1%	-3.2	4.2	-175.0%
Taxation	-1.2	0.1	-1173.0%	0.1	-1408.8%	-0.9	-2.6	64.5%
Net Profit	0.3	-1.2	126.6%	-2.5	112.6%	-3.1	1.7	-287.9%
Core Net Profit	0.3	-1.6	120.0%	-2.5	112.6%	-4.9	0.2	-2338.9%
EPS (sen)	0.7	-3.7	120.0%	-5.8	112.6%	-0.1	0.0	-2338.9%
DPS (sen)	0.0	0.0		6.0		0.0	7.5	
EBITDA margin	20.4%	15.8%		15.8%		13.0%	22.8%	
EBIT margin	3.8%	-1.4%		-4.1%		-0.3%	2.0%	
PBT margin	2.4%	-2.2%		-4.7%		-1.4%	1.7%	
PATAMI margin	0.5%	-2.7%		-4.5%		-2.2%	0.1%	
Effective tax rate	-79.0%	-8.6%		-3.5%		28.7%	-60.6%	

22 September 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	3.53	2.30	-34.8%	4,371.0	Y	12/2023	5.2	9.2	-33.7%	77.1%	67.8	38.2	4.9	7.3%	0.9	0.3%
GHL SYSTEMS BHD	OP	0.820	0.980	19.5%	930.3	Y	12/2023	2.7	3.0	8.9%	13.4%	30.5	26.9	1.7	5.8%	0.0	0.0%
INARI AMERTRON BHD	OP	2.90	4.17	43.8%	10,848.0	Y	06/2024	10.4	12.4	20.5%	18.8%	27.8	23.4	4.1	14.9%	9.9	3.4%
JHM CONSOLIDATION BHD	MP	0.800	0.700	-12.5%	481.8	Y	12/2023	3.1	4.6	-17.8%	48.7%	25.6	17.2	1.4	5.9%	0.5	0.6%
KELINGTON GROUP BHD	OP	1.48	2.15	45.3%	954.3	Y	12/2023	9.7	10.2	12.6%	4.8%	15.3	14.5	3.3	23.5%	2.7	1.8%
KESM INDUSTRIES BHD	MP	7.05	7.06	0.1%	303.3	Y	07/2024	6.3	10.2	-44.9%	63.0%	114.0	68.2	0.8	0.8%	0.0	0.0%
LGMS BHD	OP	1.08	1.32	22.2%	492.5	Y	12/2023	3.1	5.3	12.7%	70.4%	34.7	20.4	5.0	15.7%	0.0	0.0%
MALAYSIAN PACIFIC INDUSTRIES BHD	MP	27.00	24.05	-10.9%	5,370.2	Y	06/2024	80.9	118.2	162.5%	46.1%	33.4	22.8	2.5	7.8%	35.0	1.3%
NATIONGATE HOLDINGS BHD	OP	1.36	1.75	28.7%	2,820.5	Y	12/2023	5.2	7.0	26.5%	34.4%	26.1	19.4	8.5	38.6%	0.3	0.2%
OPPSTAR BHD	MP	1.57	1.82	15.9%	998.8	N	12/2023	4.5	6.1	34.0%	36.3%	35.2	25.8	6.3	19.3%	1.1	0.7%
PIE INDUSTRIAL BHD	OP	3.00	3.61	20.3%	1,152.1	Y	12/2023	17.7	20.0	-4.2%	13.4%	16.9	15.0	1.9	11.7%	7.0	2.3%
SKP RESOURCES BHD	MP	1.01	0.950	-5.9%	1,578.0	Y	03/2024	6.3	7.1	-31.6%	12.5%	16.0	14.2	1.8	11.4%	3.2	3.2%
UNISEM (M) BHD	UP	3.29	2.65	-19.5%	5,307.0	Y	12/2023	7.5	13.3	-50.2%	76.8%	43.7	24.7	2.2	5.0%	6.0	1.8%
Simple Average										0.6%	33.2%	30.5	22.9	3.4	12.9%		1.2%

Source: Kenanga Research

22 September 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.**

This document has been prepared for general circulation based on information obtained from sources believed to be reliable but we do not make any representations as to its accuracy or completeness. Any recommendation contained in this document does not have regard to the specific investment objectives, financial situation and the particular needs of any specific person who may read this document. This document is for the information of addressees only and is not to be taken in substitution for the exercise of judgement by addressees. Kenanga Investment Bank Berhad accepts no liability whatsoever for any direct or consequential loss arising from any use of this document or any solicitations of an offer to buy or sell any securities. Kenanga Investment Bank Berhad and its associates, their directors, and/or employees may have positions in, and may effect transactions in securities mentioned herein from time to time in the open market or otherwise, and may receive brokerage fees or act as principal or agent in dealings with respect to these companies. Kenanga Investment Bank Berhad being a full-service investment bank offers investment banking products and services and acts as issuer and liquidity provider with respect to a security that may also fall under its research coverage.

Published by:

KENANGA INVESTMENT BANK BERHAD (15678-H)
 Level 17, Kenanga Tower, 237, Jalan Tun Razak, 50400 Kuala Lumpur, Malaysia
 Telephone: (603) 2172 0880 Website: www.kenanga.com.my E-mail: research@kenanga.com.my

