Technology

NEUTRAL
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2QCY23 Report Card: Less Disappointing

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The sector's earnings delivery (against our expectations) was less disappointing in the recently-concluded 2QCY23 results season, vs. the last quarter. The performance of selected companies under our coverage was weighed down by the absence of a highly anticipated boost in orders despite China's reopening. Nevertheless, INARI (OP; TP: RM4.17) and MPI (MP; TP: RM24.05) registered earnings rebound, aided by adept cost management. While we keep our NEUTRAL rating on the sector, we are upbeat on selective names, i.e. (i) KGB (OP; TP: RM2.15) for its strong earnings visibility backed by a RM1.77b order book, (ii) INARI on the production ramp-up of its radio frequency (RF) products ahead of the launch of the latest edition of a US smartphone, and (ii) LGMS (OP; TP: RM1.32) on growing investment in cybersecurity by corporations on rising cyber threats.

Less disappointing. The sector's earnings delivery (against our expectations) was less disappointing in the recently-concluded 2QCY23 results season, vs. the last quarter, with 15%, 38%, and 47% of companies under our coverage coming in above, within and below our forecasts, vs. 8%, 38%, and 54% during the last quarter (see Exhibit 1), respectively.

Slow climb from the bottom. As per the previous quarter, there was little earnings boost from China's re-opening during 2QCY23. For instance, **D&O (UP; TP: RM2.60)** disappointed the most amongst others as its weaker QoQ performance missed our and consensus full-year estimates by a large margin (1HFY23 made up only <2% of full-year forecast). This was largely due to customers being hesitant to commit to higher orders amidst uncertain economic outlook which led to unabsorbed overheads following sub-optimal utilisation rates. This trend was also seen amongst other companies under our coverage, albeit less negative compared to **D&O**, such as **UNISEM (UP; TP: RM2.65)** which missed its guidance and warned of flattish performance in the subsequent quarter. **JHM (MP; TP: RM0.70)** recorded a 75% decline in its 1HFY23 earnings due to weaker industrial segments that offset gains from its automotive segment. However, the group also sees potential concerns regarding its automotive segment given that order forecasts from customers may be pointing to a weaker sequential performance.

Is the worst really over? We believe one should take the guidance for "the worst being over" by tech companies with a grain of salt still. While the guidance may hold true for selected names, it has been a "moving target" for the others, as reflected in further deterioration in their recent 2QFY23 results.

"The worst is over" earlier guidance held true for **MPI** which returned to the black vs. our quarterly loss forecast, as it was able to control cost, contained losses from its Suzhou plant in China, and pushed back the completion and hence depreciation charges from its new plant in Suxiang. While acknowledging this is not a V-shape rebound but a gradual recovery, this alone warrants an upgrade of **MPI** by us to **MARKET PERFORM** from **UNDERPERFORM.** Similarly, we turned positive on **INARI** given a significant production ramp-up of its RF products ahead of the launch of the latest edition of a US smartphone. The group guided for a strong coming quarter as the utilisation rate of its RF segment has soared >85% (from 65%) from July onwards as the upcoming US smartphone will support more frequency bands, translating to higher demand for **INARI**'s RF products.

Maintain NEUTRAL. We maintain our NEUTRAL stance on the technology sector as we consider it premature to make a sweeping assertion that the entire sector has unequivocally shifted into a positive trajectory from this point onward. Therefore, we reiterate our cherry-picking approach to be selectively positive on a few names. We are still highly confident on **KGB**'s ability to delivery resilient earnings thanks to: (i) it being a direct proxy to the front-end wafer fab expansion, (ii) its strong earnings visibility underpinned by its robust RM1.77b order book, and (iii) its strong foothold in multiple markets, i.e. Malaysia, Singapore and China. Additionally, we like **INARI** as it has indicated a very strong ramp-up of its RF business, ability to turn positive quicker than its peers and still being able to retain its lucrative profit margins amidst the rising operating cost environment. Given the rising awareness of cybersecurity, we believe **LGMS** serves as a good proxy given: (i) its involvement in the high-growth cybersecurity space, (ii) the deep moat around its business given the high entry barrier created by the tough qualification process as a vendor, and (iii) its new proprietary certification software which is expected to be the next earnings driver.

Quarterly Results Overview

	2QCY23						1QCY23					
	KENANGA			CONSENSUS			KENANGA			CONSENSUS		
	Above	Within	Below	Above	Within	Below	Above	Within	Below	Above	Within	Below
D&O			1			1			1			1
GHLSYS			1			1		1			1	
INARI		1			1				1			1
JHM			1			1			1			1
KGB	1			1				1			1	
KESM			1			1			1			1
LGMS		1			1				1			1
MPI	1					1			1			1
NATGATE		1			1			1			1	
OPPSTAR		1			1		1			1		
PIE			1			1		1			1	
SKP		1			1			1				1
UNISEM			1			1			1			1
Total	**2**	**5**	**6**	**1**	**5**	**7**	**1**	**5**	**7**	**1**	**4**	**8**
Total (%)	**15**	**38**	**47**	**8**	**38**	**54**	**8**	**38**	**54**	**8**	**31**	**61**

Source: Kenanga Research

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	3.51	2.30	-34.5%	4,346.2	Y	12/2023	5.2	9.2	-33.7%	77.1%	67.4	38.0	4.9	7.3%	0.9	0.3%
GHL SYSTEMS BHD	OP	0.800	0.980	22.5%	913.2	Y	12/2023	2.7	3.0	8.9%	13.4%	29.7	26.2	1.7	5.8%	0.0	0.0%
INARI AMERTRON BHD	OP	2.86	4.17	45.8%	10,698.4	Y	06/2024	10.4	12.4	20.5%	18.8%	27.4	23.0	4.1	14.9%	9.9	3.5%
JHM CONSOLIDATION BHD	MP	0.800	0.700	-12.5%	484.8	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	1.51	2.15	42.4%	973.6	Y	12/2023	9.7	10.2	12.6%	4.8%	15.6	14.8	3.4	23.5%	2.7	1.8%
KESM INDUSTRIES BHD	MP	7.15	6.91	-3.4%	307.6	Y	07/2023	(15.8)	1.2	-3500.0%	-92.6%	N.A.	577.1	0.9	-1.9%	7.5	1.0%
LGMS BHD	OP	1.09	1.32	21.1%	497.0	Y	12/2023	3.1	5.3	12.7%	70.4%	35.0	20.6	5.1	15.7%	0.0	0.0%
M'SIAN PACIFIC INDUSTRIES BHD	MP	28.20	24.05	-14.7%	5,608.9	Y	06/2024	80.9	118.2	162.5%	46.1%	34.8	23.9	2.7	7.8%	35.0	1.2%
NATIONGATE HOLDINGS BHD	OP	1.33	1.75	31.6%	2,758.3	Y	12/2023	5.2	7.0	26.5%	34.4%	25.5	18.9	8.3	38.6%	0.3	0.2%
OPPSTAR BHD	MP	1.48	1.82	23.0%	941.6	N	03/2024	4.5	6.1	34.0%	36.3%	33.2	24.3	6.0	19.3%	1.1	0.7%
P.I.E. INDUSTRIAL BHD	OP	2.94	3.61	22.8%	1,129.1	Y	12/2023	17.7	20.0	-4.2%	13.4%	16.6	14.7	1.9	11.7%	7.0	2.4%
SKP RESOURCES BHD	MP	1.02	0.950	-6.9%	1,593.6	Y	03/2024	6.3	7.1	-31.6%	12.5%	16.2	14.4	1.8	11.4%	3.2	3.1%
UNISEM (M) BHD	UP	3.19	2.65	-16.9%	5,145.7	Y	12/2023	7.5	13.3	-50.2%	76.8%	42.4	24.0	2.1	5.0%	6.0	1.9%
Simple Average										-0.7%	33.9%	30.5	22.8	3.4	12.7%		1.3%

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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