Technology

Finding the Lead Mares

NEUTRAL

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We maintain our NEUTRAL stance on the technology sector. World Semiconductor Trade Statistics (WSTS) projects global semiconductor sales to rise by 13.1% in CY24 (from a 8.2% decline in CY23), driven by increased demand for memory and logic ICs. Although global semiconductor sales have picked up in recent months, it takes time to be fully transmitted to local players that are mostly at the back end of the supply chain. Local players guided for a seasonally soft 1Q, followed by a mild uptick in 2Q, before a more meaningful recovery in 2H. We pick the lead mares of the herd in term of earnings recovery, namely: (i) INARI (OP; TP: RM4.05) for the robust orders from Customer B, (ii) KGB (OP; TP: RM3.40) for its robust order book of RM1.3b, and (iii) PIE (OP; TP: RM4.00) for its adeptness in attracting new customers, with at least four starting to contribute in CY24.

Bottomed out but recovery momentum lags. We maintain our **NEUTRAL** stance on the technology sector. Global semiconductor industry data aggregator and forecaster WSTS projects global semiconductor sales to rise 13.1% in CY24, driven by a rebound in memory chips (+44.8%) and logic ICs (9.6%). Geographically, the Americas (+22.3%) and Asia Pacific (+12%) are expected to lead the recovery in 2024, particularly Asia Pacific, which commands c.53% of global sales.

Global semiconductor sales bottomed out YoY in Oct 2023 (-0.5%) and turned positive in Nov (+5.3%) and Dec (+11.6%). This moderated contraction in 2023 sales to -8.2% (vs. WSTS forecast of -9.4%). The upward momentum sustained into Jan 2024 with a 15.2% YoY increase (from a low base), but a 2.1% QoQ dip attributed to the seasonal lull in 1QCY23.

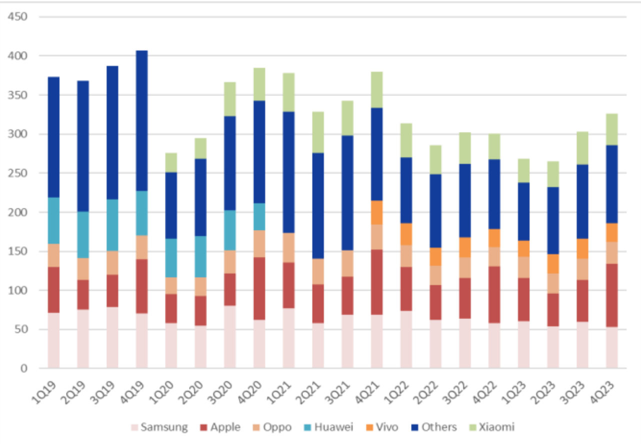
We expect a slow start to CY24 due to the seasonally slow 1QCY24 on the heels of the year-end peak demand period for consumer electronics and automotives in 4QCY23 (which has been slightly underwhelming given the weak global economy). We are also mindful of the scheduled plant shutdowns during the long Chinese New Year break, especially in China. Local players guided for a more meaningful recovery in 2HCY24. Meanwhile, we continue to stick with proven names while being on the lookout for the earnings inflection point of stocks that we currently have a **MARKET PERFORM** rating.

In the OSAT space, our preference remains with **INARI** due to its proactive strategy towards AI-related products. **INARI** has initiated low-volume production through a single line for its memory customer, with plans to expand to four lines by June 2024. The company has indicated that this venture into memory products will eventually position it to capitalise on the growing demand for AI applications, as memory plays a crucial role alongside graphical processing power. Furthermore, its foray into optical transceivers is gaining momentum, driven by the transition to 800G by customers seeking faster data transfer rates within data centres to accommodate growing AI adoption.

Meanwhile, for its radio frequency (RF) business (c.63% of group revenue), **INARI** anticipates the upcoming low cycle in 1QCY23 to be manageable, cushioned by the absence of power interruptions that occurred in the prior quarter. This coupled with the fact that the US smartphone brand commanded the leading market share of 24.7% for 4QFY24 smartphone global shipment (according to IDC) further underscores **INARI**'s relevance in the smartphone supply chain. Understanding that the smartphone market has bottomed out (see Exhibit 1), **INARI** is casting a net wider with its strategy of "China for China; Penang for the West" to capture the next smartphone upcycle in both regions via its 54.5%-owned YSIC-JV expansion, featuring a 500k sq ft plant in Yiwu that is set to be operational by mid-2024. We believe this is a timely move as news of China's smartphone market breakthrough with a home-grown 7nm processor has reportedly regained buying interest amongst China consumers.

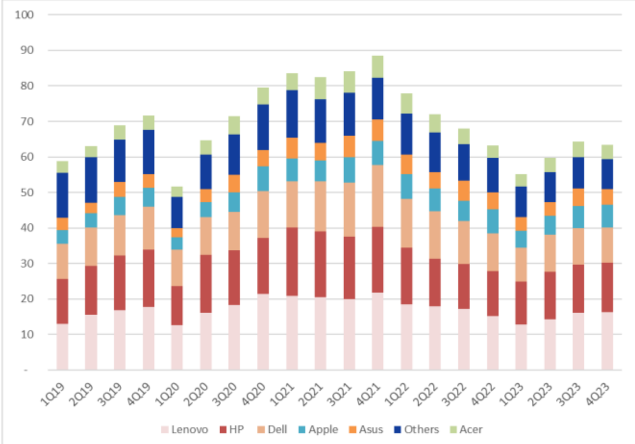
Meanwhile, the other OSAT peers such as **MPI (MP; TP: RM24.30)** and **UNISEM (UP; TP: RM2.95)** remain on our watch list for the time being as both are still in the midst of searching for a clear recovery catalyst. **MPI** has achieved breakeven level for its plant in Suzhou, China with 64% utilisation rate on brief uptick in orders for communication and smartphone-related packages which had shown signs of bottoming. To prevent further losses going forward, the group also initiated the closure of its loss-making lead frame operations at Dynacraft Industries in Penang, which incurred RM10m in losses each quarter in the past. However, this is expected to result in one-off severance payment in the upcoming quarter. Meanwhile, **UNISEM** guided that its China operation in Chengdu remains the main contributor to the group given that its Ipoh operation continues to run below optimal utilisation rate at 50%, weighing down on the group. The group expects a flattish performance in the next quarter. That said, we have observed improvements from both companies and encourage investors to consider building positions on weakness in anticipation of improved clarity on their recovery momentum in 2HCY23.

Exhibit 1: Worldwide Smartphone Sales (m units)



Source: IDC

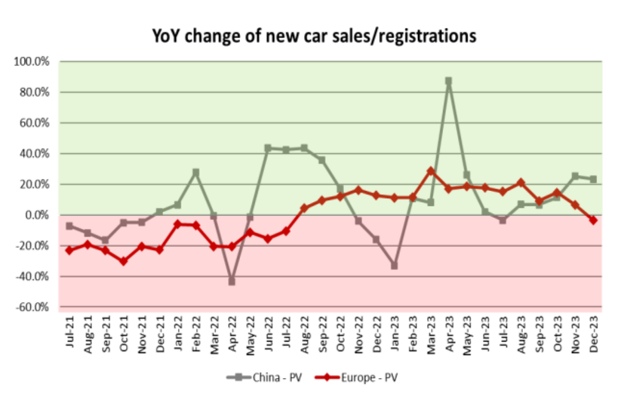
Exhibit 2: Worldwide PC Sales (m units)



Source: Gartner

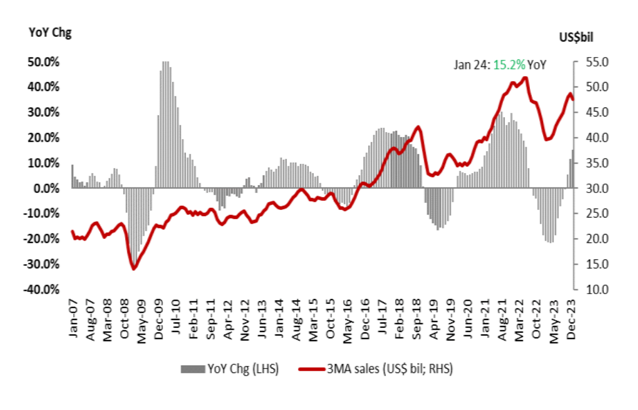
Automotive semiconductor at a divergence. The automotive semiconductor supply chain has been benefiting from the electric vehicle (EV) boom in recent years. However, the EV landscape now faces challenges as production has outpaced ecosystem readiness which led to car rental giant Hertz dumping 20,000 EVs in favour of gas-powered vehicles. Another dilemma amongst semiconductor players is whether to continue relying on China's dominance in the EV sector or to diversify into Europe's automotive market. With China already achieving the status of number one EV producer globally, the potential for further incremental capex may moderate. Not helping either is Europe's plan to impose tariffs on Chinese EVs to safeguard its own EV industry, which has lagged behind. From what we gather on the ground, semiconductor players are closely monitoring whether European governments will offer incentives to encourage supply chain relocation. Until clear policies emerge, expansion plans are likely to proceed cautiously. Consequently, we anticipate that the recovery in China, starting from a low base, may face dampening effects due to the early slowdown among Western automotive customers. This mixed outlook influences our cautious stance on automotive semiconductor companies like **D&O (MP; TP: RM3.60)**, **JHM (MP; TP: RM0.70) and MPI.**

Exhibit 3: Sales of Passenger Vehicles (% YoY)



Source: CAAM, ACEA

Exhibit 4: Global Semiconductor Sales (% YoY)



Source: SIA

We prefer EMS with diversified product and customer base. Companies with diversified portfolios and substantial exposure to industrial products are poised to outperform peers that are heavily reliant on consumer electronics as their primary revenue driver. Among them, we maintain a positive outlook on **PIE**, which has onboarded four new customers spanning sectors such as servers, medical devices, smart home technology, and drone equipment. These new customers are at the sampling phase and expect to gradually move into mass production, contributing c.8%-12% to the group's CY24 revenue. Additionally, PIE has identified a prominent customer which will fully occupy its recently renovated Plant 5 (c.100k sq ft) and is currently building up its Plant 6 (c.280k sq ft) which is expected to be operational by 4QCY24.

While we remain positive on **NATGATE (OP; TP: RM1.58)** for its longer-term prospects, its immediate-term earnings may still be dampened by the delayed ramp-up of optical transceiver products as its key customer is busy with relocating their offices and plant out from China to Malaysia.

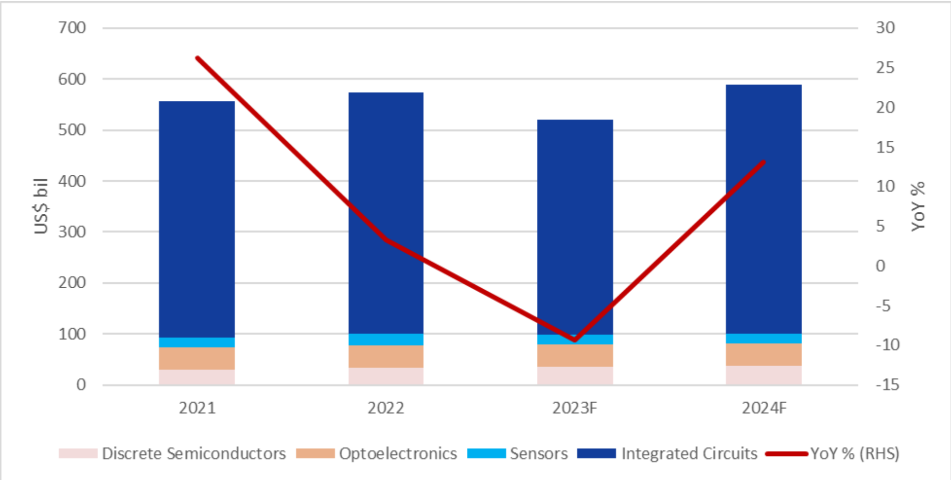
In summary, our medium-term outlook on the technology sector remains **NEUTRAL** as we expect the recovery momentum to take place gradually. There will likely be QoQ dips in subsequent quarterly earnings due to the seasonal lull in 1QCY24, presenting potential opportunities for longer-term investors to establish positions. For those who prioritise immediate certainty, we maintain a positive outlook on:

1. **INARI** for: (i) being the closest proxy to 5G adoption, (ii) being highly responsive to the market demand with the roll-out of new technologies such as double-sided moulding (DSM) and system-on-module (SOM), and (iii) its significant expansion in China, capitalising on the superpower's aggressive push for semiconductor self-sufficiency.

2. **KGB** for: (i) being a direct proxy to the front-end wafer fab expansion, (ii) its solid earnings visibility underpinned by both robust order book of RM1.3b and tender book of >RM1.9b, and (iii) its strong foothold in multiple markets, i.e. Malaysia, Singapore and China.

3. **PIE** for: (i) its comprehensive skillset, making it one of the top-choice EMS providers for MNCs, (ii) various competitive advantages it enjoys as a unit of Foxconn, and (iii) its diversified and evolving client base, from those involved in communication devices, power tools and the latest decentralised finance (DeFi) equipment.

Exhibit 5: WSTS Semiconductor Sales Forecasts*



**Fall 2023*
Source: WSTS

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	MP	3.15	3.60	14.3%	3,863.5	Y	12/2024	8.5	12.0	133.7%	41.6%	37.2	26.3	3.9	10.8%	1.4	0.4%
GHL SYSTEMS BHD	OP	0.620	0.880	41.9%	702.0	Y	12/2024	2.4	2.8	-3.5%	15.8%	25.9	22.5	1.3	5.2%	0.0	0.0%
INARI AMERTRON BHD	OP	3.21	4.05	26.2%	11,675.9	Y	06/2024	9.9	12.1	14.0%	22.1%	32.5	26.6	4.6	14.1%	9.3	2.9%
JHM CONSOLIDATION BHD	MP	0.575	0.700	21.7%	354.5	Y	12/2024	4.7	5.2	94.5%	11.0%	12.3	11.1	1.0	8.5%	0.5	0.9%
KELINGTON GROUP BHD	OP	2.71	3.40	25.5%	1,626.3	Y	12/2024	16.1	19.4	1.0%	20.5%	16.8	13.9	4.2	27.7%	4.5	1.7%
KESM INDUSTRIES BHD	MP	6.28	7.06	12.4%	275.3	Y	07/2024	6.2	10.3	-46.2%	67.2%	101.6	60.7	0.8	0.7%	0.0	0.0%
LGMS BHD	OP	0.910	1.16	27.5%	460.6	Y	12/2024	4.6	5.6	88.4%	21.8%	19.7	16.1	4.0	22.2%	0.9	1.0%
M’SIAN PACIFIC INDUSTRIES	MP	30.18	24.30	-19.5%	5,868.4	Y	06/2024	59.6	118.3	93.5%	98.3%	50.6	25.5	2.9	5.8%	35.0	1.2%
NATIONGATE HOLDINGS BHD	OP	1.54	1.58	2.6%	2,779.1	Y	12/2024	6.3	6.9	114.8%	9.6%	24.4	22.3	6.0	27.4%	1.0	0.6%
OPPSTAR BHD	OP	1.16	1.72	48.3%	755.1	Y	12/2024	3.4	5.7	3.3%	66.7%	33.7	20.2	4.8	15.1%	0.9	0.8%
PIE INDUSTRIAL BHD	OP	3.50	4.00	14.3%	1,259.7	Y	12/2024	22.2	26.1	15.7%	17.4%	15.8	13.4	2.0	13.4%	7.0	2.0%
SKP RESOURCES BHD	MP	0.880	0.850	-3.4%	1,249.9	Y	03/2024	5.7	6.4	-38.4%	13.1%	15.4	13.8	1.6	10.3%	2.8	3.2%
UNISEM (M) BHD	MP	3.68	2.95	-19.8%	5,565.1	Y	12/2024	10.2	12.7	100.1%	24.9%	36.2	29.0	2.4	6.8%	6.0	1.6%
Simple Average										31.4%	29.3%	28.8	22.3	3.0	12.9%		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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