

29 May 2024

KESM Industries

New Capabilities Could Do Better

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KESM's 9MFY24 results disappointed due to a weak pick-up in the demand for its burn-in and test services. Nonetheless, it turned around in 9MFY24 from a loss last year driven by improved sales after it upgraded its capabilities. We remain concerned over its quarterly earnings volatility. We cut our FY24-25F earnings forecasts by 35% and 21%, respectively, tweak our TP down to RM7.04 (from RM7.06) but maintain our MARKET PERFORM call.

KESM's 9MFY24 core net profit of RM1.2m disappointed, coming in at only 43% of both our full-year forecast and the full-year consensus estimate. The variance against our forecast came largely from a slow pick-up in the demand for its automotive product services.

YoY, KESM's 9MFY24 revenue increased by 12% driven by improved performance from its burn-in and test services for automotive chips. This growth followed a portfolio realignment and capacity restructuring a few quarters ago, transitioning to newer chip technologies and phasing out legacy products. It turned around with a core net profit of RM1.2m in 1HFY24 (vs. a net loss of RM5.4m in 1HFY23) despite a 24% jump in depreciation (arising from the investment in new equipment) and higher utility cost.

QoQ, its 3QFY24 revenue eased 0.9% as 3Q is typically its weakest quarter. Its core net profit fell 19.6% due to hefty depreciation from new equipment.

Outlook. We remain concerned over its quarterly earnings volatility.

On a brighter note, it has successfully completed the qualification process for most of its new equipment, positioning it for mass volume production. The equipment upgrade enables the group to handle more advanced automotive chips, capitalising on the growing adoption of electric vehicles. However, demand in the non-automotive sector remains weak, and the additional capacity in this segment may weigh on the group.

Forecasts. We cut our FY24-25F earnings forecasts by 35% and 21%, respectively.

Valuations. We tweak our TP down to **RM7.04** (from RM7.06) based on an unchanged FY24F PBV of 0.85x, in line with companies in the technology-related space that are loss-making or barely breaking even, i.e. **JCY (Not Rated)**, **ATAIMS (Not Rated)** and **JHM (MP; TP: RM0.61)** to reflect its earnings volatility. There is no adjustment to our TP based on ESG given a 3-star rating as appraised by us (see Page 4).

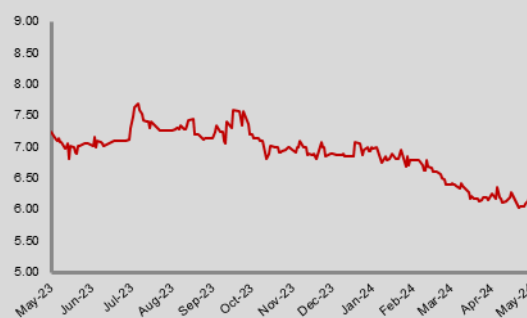
Investment case. We like KESM for: (i) its presence in the promising automotive semiconductor space, (ii) being one of the largest independent burn-in and test service providers in Malaysia potentially benefiting from MNC expansion here, and (iii) its physical presence in China riding on the Chinese government's ambitious plans for its semiconductor industry. However, we remain cautious over 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 the production volume under burn-in and test services, (ii) slower-than-expected adoption of new semiconductor modules in automobiles, and (iii) a sharp decline in customer forecasts.

MARKET PERFORM ↔

Price : **RM6.37**
Target Price : **RM7.04** ↓

Share Price Performance



KLCI 1,615.8
YTD KLCI chg 11.1%
YTD stock price chg 10.5%

Stock Information

Shariah Compliant Yes
Bloomberg Ticker KESM MK Equity
Market Cap (RM m) 274.0
Shares Outstanding 43.0
52-week range (H) 8.00
52-week range (L) 6.41
3-mth avg. daily vol. 19,572.2
Free Float 27.9%
Beta 0.7

Major Shareholders

Sunright Ltd 48.4%
Tan Kong Hong Alex 4.8%
Abrdn Plc 3.8%

Summary Earnings Table

FY July (RM m)	2023A	2024F	2025F
Revenue	228.3	260.8	279.5
EBIT	(4.3)	0.7	2.4
PBT	(2.2)	1.8	3.7
Net profit	(4.9)	1.7	3.5
Core Net Profit	(4.9)	1.7	3.5
Consensus (NP)	-	2.7	4.4
Earnings Revision	-	-35%	-21%
Core EPS (sen)	-11.5	4.0	8.1
Core EPS Growth (%)	-2345	134.9	102.8
DPS (sen)	0.0	0.0	0.0
BV/Share (RM)	8.2	8.3	8.4
Core PER (x)	-55.4	158.9	78.4
PBV (x)	0.8	0.8	0.8
Net. Gearing (x)	-0.4	-0.4	-0.4
Div. Yield (%)	-	-	-

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Results Highlights

	3Q	2Q	QoQ	3Q	YoY	9M	9M	YoY
FYE July (RM m)	FY24	FY24	Chg	FY23	Chg	FY24	FY23	Chg
Revenue	61.2	61.8	-0.9%	57.8	5.8%	186.5	166.6	12.0%
EBITDA	12.4	13.9	-10.8%	9.1	35.9%	41.0	17.1	139.9%
EBIT	0.2	1.6	-87.0%	-0.8	125.6%	4.7	-2.9	258.7%
Interest Expense	-1.0	-1.1	9.6%	-0.5	-100.2%	-3.1	-1.3	-145.3%
EI	0.0	0.0		0.0		0.0	-2.0	
PBT	1.2	0.6	108.8%	-1.3	189.8%	3.5	-4.7	174.2%
Taxation	-1.1	-0.4	-151.0%	0.1	-1049.5%	-2.3	0.3	-927.2%
Net Profit	0.1	0.1	-19.6%	-1.2	109.4%	1.2	-3.4	133.8%
Core Net Profit	0.1	0.1	-19.6%	-1.6	107.0%	1.2	-5.4	121.6%
EPS (sen)	0.3	0.3	-19.6%	-3.7	107.0%	2.7	-12.6	121.6%
DPS (sen)	0.0	0.0		0.0		0.0	0.0	
EBITDA margin	20.2%	22.5%		15.8%		22.0%	10.3%	
EBIT margin	0.3%	2.6%		-1.4%		2.5%	-1.8%	
PBT margin	1.9%	0.9%		-2.2%		1.9%	-2.8%	
PATAMI margin	0.2%	0.2%		-2.7%		0.6%	-3.2%	
Effective tax rate	-90.5%	-75.3%		-8.6%		-66.5%	-6.0%	

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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	MP	3.72	3.60	-3.2%	4,606.5	Y	12/2024	8.5	12.0	133.7%	41.6%	44.0	31.1	4.6	10.8%	1.4	0.4%
GHL SYSTEMS BHD	OP	1.05	1.08	2.8	1,198.6	Y	12/2024	2.4	2.8	-3.5%	15.8%	43.9	38.0	2.2	5.2%	0.0	0.0%
INARI AMERTRON BHD	OP	3.40	4.00	17.6%	12,790.5	Y	06/2024	9.4	11.8	8.6%	25.8%	36.1	28.7	4.8	13.4%	8.9	2.6%
JHM CONSOLIDATION BHD	MP	0.620	0.610	-1.6%	372.7	Y	12/2024	3.3	4.1	40.0%	21.7%	18.6	15.2	1.1	6.2%	0.5	0.8%
KELINGTON GROUP BHD	OP	3.06	4.10	34.0%	2,045.3	Y	12/2024	16.1	19.4	1.0%	20.5%	19.0	15.7	4.8	27.7%	4.5	1.5%
KESM INDUSTRIES BHD	MP	6.37	7.04	10.5%	274.0	Y	07/2024	4.0	8.1	-65.1%	102.8%	158.9	78.4	0.8	0.5%	0.0	0.0%
LGMS BHD	OP	1.55	1.16	-25.2%	706.8	Y	12/2024	4.6	5.6	88.4%	21.8%	33.5	27.4	6.8	22.2%	0.9	0.6%
MALAYSIAN PACIFIC INDUSTRIES BHD	OP	38.88	46.84	20.5%	7,734.4	Y	06/2024	74.5	138.0	141.8%	85.2%	52.2	28.2	3.7	7.2%	35.0	0.9%
NATIONGATE HOLDINGS BHD	OP	1.86	1.58	-15.1%	3,857.5	Y	12/2024	6.3	6.9	114.8%	9.6%	29.5	26.9	7.2	27.4%	1.0	0.5%
OPPSTAR BHD	OP	1.47	1.72	17.0%	941.2	Y	03/2024	3.4	5.7	3.3%	66.7%	42.7	25.6	6.1	15.1%	0.9	0.6%
PIE INDUSTRIAL BHD	OP	6.25	6.75	8.0%	2,400.3	Y	12/2024	22.2	28.7	15.7%	29.3%	28.2	21.8	3.6	13.4%	7.0	1.1%
SKP RESOURCES BHD	MP	1.11	0.850	-23.4%	1,734.2	Y	03/2024	5.7	6.4	-38.4%	13.1%	19.5	17.3	2.0	10.3%	2.8	2.5%
UNISEM (M) BHD	MP	4.14	3.70	-10.6%	6,678.1	Y	12/2024	10.2	12.7	100.1%	24.9%	40.7	32.6	2.7	6.8%	6.0	1.4%
Simple Average										31.7%	31.6%	35.7	27.1	3.9	12.8%		1.0%

Source: Kenanga Research

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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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