28 March 2023

Technology | Technology

Technology

Neutral (Maintained)

Awaiting Signs Of Bottoming Out

Stocks Covered	9
Rating (Buy/Neutral/Sell):	5 / 4 / 0
Last 12m Earnings Revision Trend:	Negative

Top Picks	Target Price
CTOS Digital (CTOS MK) – BUY	MYR1.92
Unisem (M) (UNI MK) – BUY	MYR3.80
JHM Consolidation (JHMC MK) – BUY	MYR1.04

Analyst

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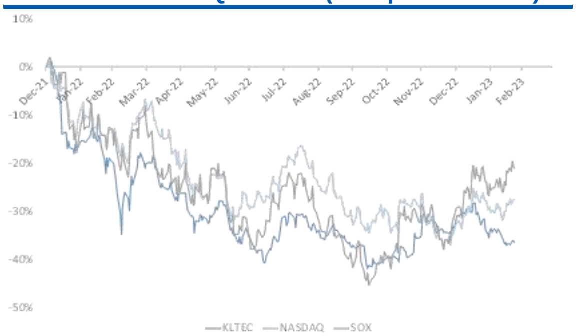
- **We favour the non-semiconductor space** given the stable demand with domestic-focused business, while the semiconductor market will remain in the doldrums in 1H23 in view of the seasonal softness and ongoing inventory adjustment for consumer products. Sector valuation is fair at its 5-year mean, capped by elevated bond yields with risk of derailed earnings. Keep NEUTRAL; Top Picks: CTOS Digital (CTOS), Unisem (M) and JHM Consolidation (JHMC).
- **4Q22 results recap.** We have a mixture of hits and misses, with better-than-expected performance coming from Datasonic Group, Globetronics Technology and Coraza Integrated Technology while Malaysian Pacific Industries underperformed. The sector's 4Q22 aggregate PATAMI contracted by 6.7% YoY and was flattish QoQ (+1.8%), with all but two companies reporting growth. As such, we lower sector FY23F earnings by 3.1%.
- **Slowdown to persist.** Non-semiconductor players should see brighter prospects given the sturdy domestic-focused business and full reopening of borders while semiconductor chip-related companies are unexciting in the near term clouded by the worsening macroeconomic outlook and low consumer confidence. The new export regulations imposed by the US on China restricting the supply of advance chips and equipment is still a concern, potentially delaying the recovery of the semiconductor sector as a whole.
- **2023 – a year of consolidation.** Global Top 10 foundry showed a sequential decline (4.7%) in 4Q22 for the first time in years and the weakness is expected to carry through in the coming quarters, amid weakening demand and inventory corrections globally on top seasonal slow 1H. World Semiconductor Trade Statistics (WSTS) has forecasted the global semiconductor market to decline by 4.1% YoY to USD557bn in 2023 while IDC projected smartphone sales to decline 1.1% YoY in 2023.
- **Sector valuation** is fair, hovering around its mean of 23x and will remain capped by quantitative tightening cycle and potential earnings risks amid higher input costs and uncertain demand. That said, their solid balance sheets and the sturdy USD (weakening bias) should partially cushion the exporters from the slowdown. We advocate investors to seek names with resilient earnings profile and an eye for growth at undemanding valuation. Exposure to automotive, servers, and high-performance computing is preferred given the relatively stable demand while monitoring for signs of bottoming out.
- **Top Picks.** We like CTOS for its domestic-focused business, leading position, and growth prospects with higher demand for its various digital solutions, analytical insights, and exposure to fintech. In the semiconductor space, we believe Unisem's undemanding valuation relative to the sector makes it a compelling preposition, given its relatively resilient earnings path and expansion-led growth from 2H23. In the smaller-cap space, we like JHMC for the encouraging upsurge in orders in the automotive lighting business and contributions from new projects at an undemanding valuation.
- **Upside/downside risks:** i) Strengthening/softening smartphone sales, ii) favourable/unfavourable FX movements, iii) strong/weak consumer demand, iv) obsolescence of technology, and v) intensifying geopolitical conflicts. The sector's ESG scores range from 2.9 to 3.3, with no major ESG risk concerns.

KLTEC vs NASDAQ vs SOX (YTD performance)



Source: Bloomberg, RHB

Company Name	Rating	Target (MYR)	% Upside (Downside)	P/E (x) Dec-23F	P/B (x) Dec-23F	ROAE (%) Dec-23F	Yield (%) Dec-23F
Coraza Integrated Technology	Buy	1.04	16.8	16.8	3.6	23.3	1.5
CTOS Digital	Buy	1.92	46.9	29.2	5.5	19.5	2.1
Datasonic Group	Buy	0.56	27.3	15.7	3.4	22.2	4.4
GHL Systems	Neutral	0.92	5.7	31.1	1.8	6.1	-
Globetronics Technology	Neutral	1.05	(1.9)	17.4	2.3	13.5	4.6
Inari Amertron	Neutral	2.60	7.8	22.7	3.4	15.2	3.7
JHM Consolidation	Buy	1.04	28.1	14.6	1.5	10.4	0.6
Malaysian Pacific Industries	Neutral	30.50	5.0	24.5	2.7	11.6	1.4
Unisem (M)	Buy	3.80	22.5	19.2	1.9	10.3	1.0

Source: Company data, RHB

Awaiting Signs Of Bottoming Out

4Q22 results recap

We have a mixture of hits and misses in the 4Q22 results of the companies within our coverage. The better-than-expected performance came from Datasonic Group (DSON MK, BUY, TP: MYR0.56), Coraza Integrated Technology's (Coraza) (CORAZA MK, BUY, TP: MYR1.04) and Globetronics Technology (GTB MK, NEUTRAL, TP: MYR1.05). DSON benefited from stronger-than-expected orders for smart card- and passport-related solutions, while CORAZA showed better topline growth and margins, thanks to cost efficiency initiatives. GTB's 4Q22 results were supported by a write-back of over-accrual of expenses. Meanwhile, the disappointment came from Malaysian Pacific Industries (MPI MK, NEUTRAL, TP: MYR30.50) where its Suzhou plant continued to be undermined by low utilisation rates, on top of increased costs.

Meanwhile, the results of CTOS Digital (CTOS MK, BUY, TP: MYR1.92), GHL Systems (GHL) (GHLS MK, NEUTRAL, TP: MYR0.92), Inari Amertron (INRI MK, NEUTRAL, TP: MYR2.60) and Unisem (M) (UNI MK, BUY, MYR3.80) were in line, with better YoY numbers for most – thanks to stronger orders and favourable FX movements. The sector's 4Q22 aggregate core PATAMI contracted by 6.7% YoY and was flattish QoQ (+1.8%), with all but two companies reporting solid YoY growth. The significantly stronger numbers from DSON, CTOS and CORAZA, which helped to offset the weakness from MPI and INRI. We toned down sector FY23F earnings by 3.1%, mainly on the revisions made on MPI – as we expect to see further weakness in the following quarter, since the utilisation rate of its China plant remains low and there is weakness in the overall demand for semiconductors.

We upgraded DSON to BUY from Neutral on the back of stronger-than-expected results, sustained strong orders, and elevated earnings base, coupled with its share price weakness. We downgraded MPI to NEUTRAL from Buy, given the prolonged weakness expected for its utilisation rate and cost pressure that may weigh on its upcoming results. Guidance overall from OSAT companies under our coverage is towards a weakening QoQ performance into FY23 – with the main challenges identified as cost pressures, labour shortages, demand uncertainties, and geopolitical tensions. For non-OSAT companies, there are pockets of opportunities on the economic reopening (and ensuing pent-up demand) and various digital solution initiatives.

Figure 1: Core earnings of companies under our coverage

(MYRm)	4Q21	3Q22	4Q22	QoQ (%)	YoY (%)	FY21	FY22	YoY (%)	Comments
Coraza Integrated Technology	3.5	4.0	6.5	62.5	82.4	12.0	17.9	49.4	Above
CTOS Digital	13.5	26.4	20.6	(21.8)	52.8	45.9	85.1	85.5	In Line
Datasonic Group*	1.5	24.8	16.7	(32.8)	1017.4	(3.2)	53.5	Nm	Above
GHL Systems	6.0	4.9	7.1	44.7	18.4	20.5	17.4	(15.5)	In Line
Globetronics	14.4	11.4	14.5	27.9	0.7	48.9	46.0	(5.9)	Above
Inari Amertron**	105.6	85.8	100.5	17.2	(4.8)	105.6	100.5	(4.8)	In Line
MPI**	83.4	49.7	34.4	(30.9)	(58.8)	162.8	84.1	(48.4)	Below
Unisem	60.0	56.7	68.2	20.2	13.7	202.2	247.3	22.3	In Line
Total	**287.9**	**263.7**	**268.5**	**1.8**	**(6.7)**	**594.7**	**651.7**	**9.6**	

*Note: *FYE (Mar) and **FYE (Jun) refers to 3QFY23F and 2QFY23F*
Source: Company data, RHB

2023 – a year of consolidation

WSTS lowered its forecasts for the second time in a row during the Fall 2022 version, cutting 2022F and 2023F growth by -8.4% and -16% to USD580.1bn and USD556.6bn. A 4.1% contraction in global semiconductor industry sales was pencilled in for 2023 as the weakness in ICs is expected to continue, before seeing a recovery in 2H23. On the other hand, sensors, optoelectronics and discrete related chips are expected to grow in 2023.

For the foundry, Global Top 10 foundry showed a QoQ revenue decline (4.7%) in the 4Q22 for the first time in the past 2-3 years, signifies the end of the 2020-2023 semiconductor upcycle. The weakness is expected to carry through in the coming quarters, as guided by most semiconductor players globally, amid weakening demand and inventory corrections globally, on top of the traditionally weak seasons for most semiconductor players. The weakness is expected to carry through in the coming quarters, as guided by most semiconductor players globally, amid weakening demand and inventory corrections globally, on top of the traditionally weak seasons for most semiconductor players.

Meanwhile, SEMI expects global fab equipment spending for front-end facilities to contract by 22% YoY to USD76bn in 2023 from an all-time high of USD97bn in 2022 before staging a 21% rebound in 2024. The multi-year expansion for the foundry segment is likely to see a pick-up in front-end equipment once the weakening chip demand and inventory correction situation in the consumer and mobile devices segments settle, driven by protectionism policies by major governments around the world. Similarly, assembly and packaging equipment sales are forecasted to drop by 14.9% to USD6.1bn in 2022 and 13.3% to USD5.3bn in 2023. Meanwhile, semiconductor test equipment market sales are also expected to slow by 2.6% to USD7.6bn in 2022 and a further 7.3% slip to USD7.1bn in 2023.

Smartphone cycle is also expected to be lukewarm going into 2023 with the usual device refresh cycle and upgrading to 5G device being the main drivers, in the absence of major technology breakthrough. According to IDC, 4Q22 worldwide smartphone shipments experienced the largest ever YoY decline and the lower of 18.3% to 300.3m units, marking the largest ever decline (-11.1%) in the annual total smartphone shipment. A 1.1% decline was pencilled in for 2023 by IDC Barring from further deterioration in the macroeconomic condition, we should see the weakness persist in the 1H23, with a stronger 2H with the launch of flagships model by various major smartphone brand cushioning a further steep decline for 2023.

Domestically, total exports of electrical and electronic (E&E) products continued to show strength, albeit, at a slower pace of +8% YoY to MYR91.3bn in YTD 2023, while QoQ weakness was seen in both Jan and Feb 2023 export numbers.

Figure 2: Global Top 10 foundries' revenue

Ranking	Company	Revenue			Market Share	
		4Q22	3Q22	QoQ	4Q22	3Q22
1	TSMC	19,962	20,163	-1.0%	58.5%	56.1%
2	Samsung	5,391	5,584	-3.5%	15.8%	15.5%
3	UMC	2,165	2,479	-12.7%	6.3%	6.9%
4	GlobalFoundries	2,101	2,074	1.3%	6.2%	5.8%
5	SMIC	1,621	1,907	-15.0%	4.7%	5.3%
6	Huahong Group	882	1,200	-26.5%	2.6%	3.3%
7	PSMC	408	561	-27.3%	1.2%	1.6%
8	Tower	403	427	-5.6%	1.2%	1.2%
9	VIS	305	438	-30.3%	0.9%	1.2%
10	DB Hitek	292	334	-12.4%	0.9%	0.9%
	Total	33,530	35,168	-4.7%	97%	97%

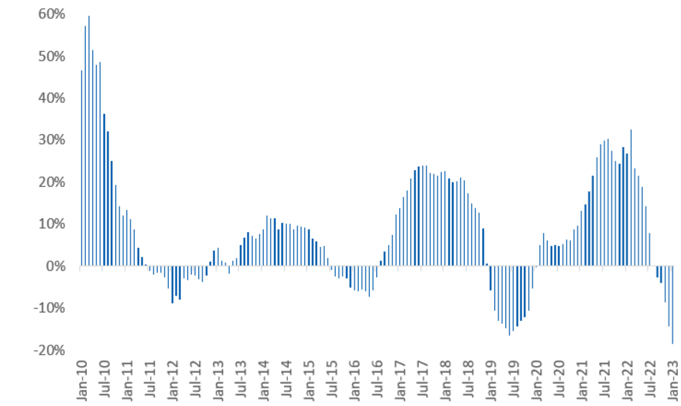
Source: TrendForce

Figure 3: Worldwide semiconductor market forecast

Fall 2022	Amounts in US$M			Year on Year Growth in %		
	2021	2022	2023	2021	2022	2023
Americas	121,481	142,138	143,278	27.4	17.0	0.8
Europe	47,757	53,774	54,006	27.3	12.6	0.4
Japan	43,687	48,064	48,280	19.8	10.0	0.4
Asia Pacific	342,967	336,151	311,005	26.5	-2.0	-7.5
Total World - $M	555,893	580,126	556,568	26.2	4.4	-4.1
Discrete Semiconductors	30,337	34,098	35,060	27.4	12.4	2.8
Optoelectronics	43,404	43,777	45,381	7.4	0.9	3.7
Sensors	19,149	22,262	23,086	28.0	16.3	3.7
Integrated Circuits	463,002	479,988	453,041	28.2	3.7	-5.6
Analog	74,105	89,554	90,952	33.1	20.8	1.6
Micro	80,221	78,790	75,273	15.1	-1.8	-4.5
Logic	154,837	177,238	175,191	30.8	14.5	-1.2
Memory	153,838	134,407	111,624	30.9	-12.6	-17.0
Total Products - $M	555,893	580,126	556,568	26.2	4.4	-4.1

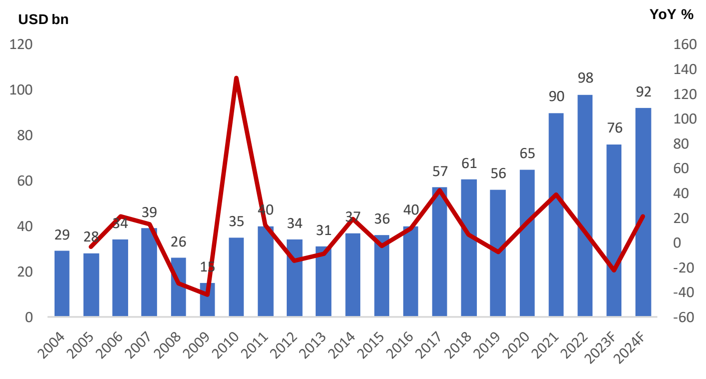
Source: World Semiconductor Trade Statistics

Figure 4: Monthly global semiconductor sales (YoY growth)



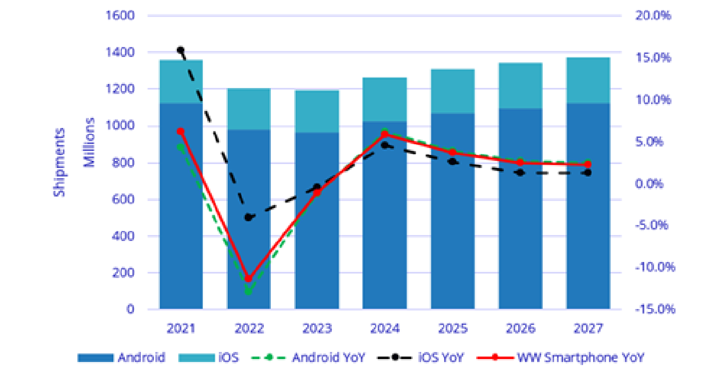
*Source: Bloomberg, RHB. *3-month moving average*

Figure 5: Fab equipment spending (USDbn)



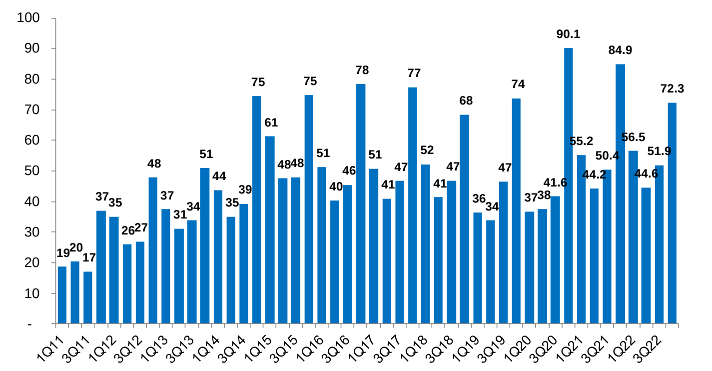
Source: SEMI, RHB

Figure 6: Worldwide smartphone shipment forecast



Source: International Data Corporation (IDC)

Figure 7: Quarterly shipments of Apple's iPhones (m units)



Source: IDC

The Tech "Cold War"

New export regulations imposed by the US on China, restricting the supply of advance chips and equipment produces remain a concern for the growth for certain equipment makers, potentially delaying the recovery of the semiconductor sector as a whole. Recently, the US Commerce Department outlined the Proposed National Security Guardrails for the USD52.7bn Creating Helpful Incentives to Produce Semiconductors (CHIPS) and Science Act of 2022 to limit the recipients of funding from investing in the expansion of semiconductor manufacturing in foreign countries of concern such as China and Russia, and limits recipients of incentive funds from engaging in joint research or technology licensing efforts with a foreign entity of concern.

To recap, on 7 Oct 2022, the US announced a fresh set of restrictions on the sale of certain advanced computing chips (16 or 14 nm or less) and devices to China, causing a further disruption to the sector – a series of moves to slow China's rise in the semiconductor space that started during former US President Donald Trump's tenure. The CHIPS and Science Act of 2022 that was enacted back in Aug 2022 aims to provide USD52.7bn for US semiconductor research, development, manufacturing, and workforce development. It also provides a 25% investment tax credit for capital expenses for the manufacturing of semiconductors and related equipment. The new enacted law ensures the US will strengthen domestic semiconductor manufacturing, design, and research to maintain scientific and technological edge and reinforce the US chip supply chain, as well as counter the rise of China at the same time.

With protectionism and self-sufficiency as remedies for major economic superpowers in the semiconductor industry, a further divergence in the supply chain will continue to take place. Most semiconductor companies including the equipment makers do have substantial exposure to China given the sheer size of the market. The supply chain realignment for both may take time and dampen the demand and advancement of the semiconductor sector in the near term. In the longer run, potential overcapacity and the loss of manufacturing efficiencies could entail price escalation for electronic devices given the higher production costs. Nonetheless, the deepening restrictions and conflict between the US and China may spur European and Asian players to develop their products and sell to the Chinese. Malaysia, a neutral ground in South-East Asia, stands to gain from the supply chain and relocation efforts by multinational corporations to diversify out of China.

Strategy

Overall guidance from chip-related companies is unexciting in the near term, clouded by the worsening macroeconomic outlook and low consumer confidence. Besides, the new export regulations imposed by the US on China restricting the supply of advance chips and equipment is still a concern, potentially delaying the recovery of the semiconductor sector as a whole. All the data aggregators and semiconductor research houses are forecasting a contraction in 2023 with a potentially stronger 2H outlook before staging a recovery in 2024. However, non-semiconductor players should see brighter prospects on the back of solid demand and our in-house expectation of 5% GDP growth in 2023, given the domestic-focused business and full reopening of borders. The sector solid balance sheets (mostly net cash positions) and relatively healthy USD/MYR should cushion exporters from the demand slowdown. Nonetheless, our in-house forecast for a weakening USD against the MYR to take place gradually may not bode well for the sector.

Sector valuation is fair, hovering around at its 5-year mean of 23x, and will remain capped by elevated bond yields, quantitative tightening cycle and the potential earnings risks amid higher input costs and uncertain demand. That said, their solid balance sheets and the sturdy USD (weakening bias) should partially cushion exporters from the overall sector slowdown. We advocate investors to seek names with a relatively resilient earnings profile, an eye for growth at undemanding valuation with exposure to automotive, servers, and high-performance computing as demand remains relatively stable while continuing to monitor for signs of bottoming out of the ongoing sector-wide inventory adjustment.

Sector Top Picks: We like CTOS for its domestic-focused business, leading position, and growth prospects that track the expansion of the digital economy – with higher demand for its various digital solutions, analytical insights, and exposure to fintech. For the semiconductor space, we prefer Unisem given its resilient earnings path and expansion-led growth in FY23 and beyond at an undemanding valuation relative to the sector. For the smaller cap space, we like JHM Consolidation for the expectation of recovery in earnings owing to the upsurge in orders for its automotive lighting business amid stronger demand and contributions from new projects, coupled with an undemanding valuation.

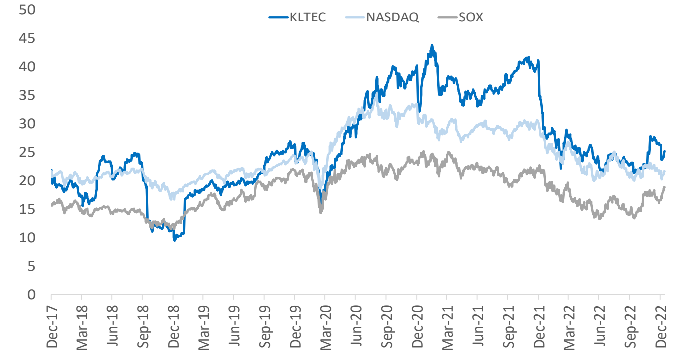
Upside/downside risks for the sector: i) Strengthening/softening smartphone sales, ii) favourable/unfavourable FX movements, iii) strong/weak consumer demand, iv) obsolescence of technology, and v) intensifying geopolitical conflicts. The sector's ESG scores range from 2.9 to 3.3, with no major ESG risk concerns.

Figure 8: Peer comparison

	Ticker	Last price	Mkt cap	P/E (x)		EPS growth (%)		P/BV (x)		ROE (%)	DY (%)
		(MYR)	(USDm)	FY23F	FY24F	FY23F	FY24F	FY23F	FY24F	FY23F	FY23F
Coraza Integrated Technology	CORAZA MK	0.87	84	16.4	13.5	54.7	21.4	3.5	NA	23.3	0.0
CTOS Digital	CTOS MK	1.33	694	29.7	25.5	21.7	16.4	5.6	5.1	19.5	2.0
Datasonic Group*	DSON MK	0.43	275	15.2	16.8	4.4	-9.4	3.3	3.1	22.1	4.6
GHL Systems	GHLS MK	0.88	226	32.5	27.6	19.8	17.8	1.8	1.7	5.6	0.0
Globetronics	GTB MK	1.06	160	17.2	14.9	-10.8	15.7	2.3	2.2	13.5	4.6
Inari Amertron**	INRI MK	2.42	2,040	23.8	21.8	-2.6	9.2	3.0	2.9	14.8	3.5
JHM Consolidation	JHMC MK	0.84	114	9.8	7.5	95.2	31.3	1.8	1.5	19.5	3.6
Malaysian Pacific Industries**	MPI MK	28.02	1,259	29.7	19.7	-37.7	50.6	2.8	2.5	9.6	1.4
Unisem (M)	UNI MK	3.05	1,111	18.9	15.6	5.3	20.7	1.9	1.8	10.3	2.3
Sector average				**22.1**	**18.7**	**11.9**	**19.0**	**2.8**	**2.6**	**14.4**	**2.8**

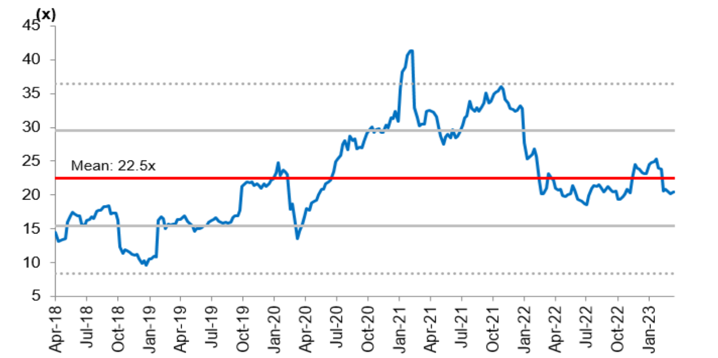
*Note: * FYE (Mar), **FYE (Jun) referring to FY24F and FY25F*
Source: Bloomberg

Figure 9: Forward P/E for KLTEC vs NASDAQ vs SOX



Source: Bloomberg, RHB

Figure 10: KLTEC's 5-year P/E band



Source: Bloomberg, RHB

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