

28 December 2021

Technology

Semiconductor Remains a Growth Sector

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OVERWEIGHT



We reiterate our OVERWEIGHT call on the technology sector for 1QCY22 as we continue to observe aggressive expansions among semiconductor players. **INARI (OP; TP: RM4.80)** recently committed RMB463m (c.RM299m) cash to form a JV with China Fortune-Tech Capital (a VC firm incorporated by SMIC) to set up a plant in China, offering OSAT-related businesses. Meanwhile, Western Digital has set aside RM1b for a new plant in Sarawak while Intel has proposed an RM30b expansion in Penang. There were also a slew of fab expansions in Singapore by GlobalFoundries, Micron and Siltronic as front-end players scrambled to increase capex to solve the chip shortage situation. Out of the five names mentioned above, **KGB (OP; TP: RM2.50)** has secured orders from four of them, further reinforcing our investment thesis of KGB as a prime proxy for front-end semiconductor expansion which is expected to continue in the near to medium term. We believe the recent decline in Inari's share price is an overreaction given that Apple's recent initiative to strengthen its in-house wireless connectivity system is targeted towards 5G modem rather than replacing its existing RF suppliers. On the prosperity tax, we see negligible impact (c.1%-3%) to the stock under our coverage thanks to exemptions like pioneer tax status and reinvestment allowance. We continue to like **GHL (OP; TP: RM2.30)** as a proxy to the recovery in consumer spending as the economy reopens coupled with higher adoption of e-payment in Asia.



Capacity expansion on the rise. We reiterate our OVERWEIGHT call on the technology sector going into 1QCY22 as we continue to observe aggressive expansions among local and global semiconductor players. **INARI (OP; TP: RM4.80)** for instance has recently committed 100% equity shares of its wholly-owned subsidiary, Amertron Technology (Kunshan), and RMB463m (c.RM299m) cash to form a JV with China Fortune-Tech Capital (a VC firm incorporated by SMIC) to set up a plant in China, offering OSAT related businesses. Having already established a strong presence among western customers, Inari is looking to expand its reach into the growing Chinese market as China's semiconductor self-sufficient rate still lags behind its goal despite SMIC announcing three expansions in

a row for 2021. Being the second-largest semiconductor consumption market, only 16% of the chips are made locally (vs. the goal of 70%). This means that opportunity for semiconductor growth in China is still bright and Inari's aggressive move to diversify its revenue stream is timely as demand for the US smartphone brand is facing issues due to chip shortage and to a certain extent rising inflation rate. While sales volume may not hit its initial target, the US smartphone manufacturer indicated that a record holiday season is still on track.

In addition, we saw Western Digital setting aside RM1b for a new plant in Sarawak and recently Intel proposed an RM30b expansion in Penang which is expected to create 4,000 jobs upon completion in 2024. Over in Singapore, there were a slew of fab expansions from GlobalFoundries, Micron and Siltronic as front-end players continued to increase capex in an effort to solve the chip shortage situation. Out of the five names mentioned, **KGB (OP; TP: RM2.50)** has secured orders from four of them, further reinforcing our investment thesis of KGB as a prime proxy for front-end semiconductor expansion which is expected to continue in the near to medium term. This is evident by Micron allocating US\$150b capex over the next decade and Siltronic setting aside EUR2b for the next three years.

Overreaction over Apple's in-house wireless connectivity efforts. A recent Bloomberg article speculated that Apple's move to reinforce their in-house wireless chip could eventually replace offerings from Broadcom and Skyworks. We believe this is a misconception because Broadcom's wireless chips (Bluetooth, WiFi) has been used in many generations of Apple's product line-ups and will remain as well for future generations (recall that Broadcom and Apple signed a \$15b deal in 2020

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for future chip supply) of Apple products thanks to its superior performance. On the radio-frequency front end (RFFE) side, Broadcom, Skyworks and Qorvo have always been working closely with Apple and all three players play an important role due to their respective expertise in certain areas of the RFFE system (high band, mid band, low band). Furthermore, with the massive number of patents and intellectual property rights registered over the years by these three players, it does not make sense for Apple to reinvent the wheel. Therefore, we believe what Apple is trying to develop in-house is the 5G modem instead. Recall that they bought Intel's modem operation for US\$1b in 2019 but have yet to launch any product. That said, we deem the recent decline in Inari's recent share price as an overreaction.

Little impact from one-off prosperity tax. The Malaysian government had in its latest Budget 2022 introduced a one-off (applicable to FY22 only) prosperity tax of 33% on chargeable income above RM100m while chargeable income below RM100m will be taxed at the statutory rate of 24%. Given that most of the technology companies under our coverage enjoy exemptions (e.g. pioneer status, investment tax allowance and reinvestment allowance) which will still be valid even with the prosperity tax implemented, we foresee a negligible impact (c.1%-3%) to our earnings forecasts. Such impact could be easily mitigated with initiatives such as an accelerated capex in FY22 which is what **D&O (OP; TP: RM6.60)** is planning.

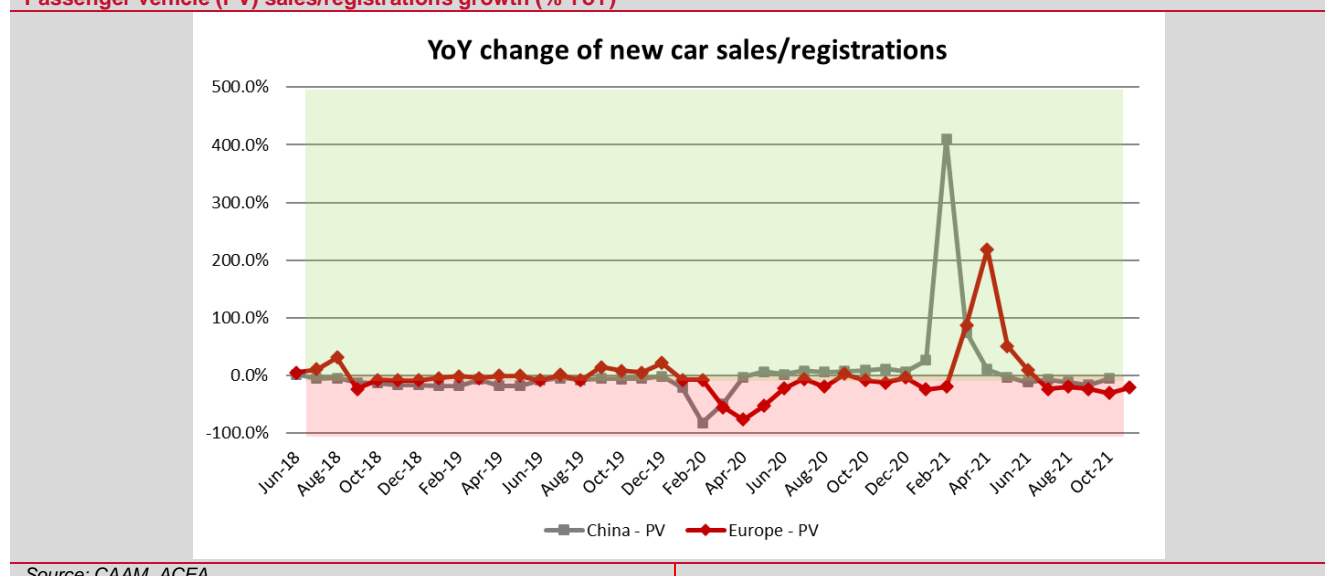
Worldwide Smartphone Sales to End Users by Vendor (m of units)

| Company | Shipments (units) | | | Growth | | Market Share | | |
|--------------|-------------------|--------------|--------------|-------------|--------------|--------------|-------------|-------------|
| | 3Q21 | 2Q21 | 3Q20 | QoQ | YoY | 3Q21 | 2Q21 | 3Q20 |
| Samsung | 69.0 | 57.7 | 80.8 | 19.5% | -14.6% | 20% | 18% | 22% |
| Apple | 48.5 | 49.3 | 40.6 | -1.6% | 19.4% | 14% | 15% | 11% |
| Xiaomi | 44.5 | 51.1 | 44.4 | -12.9% | 0.2% | 13% | 16% | 12% |
| Oppo | 33.6 | 33.6 | 29.9 | 0.0% | 12.6% | 10% | 10% | 8% |
| Others | 146.7 | 137.2 | 170.6 | 7.0% | -14.0% | 43% | 42% | 47% |
| Total | 342.3 | 328.9 | 366.3 | 4.1% | -6.5% | 100% | 100% | 100% |

Source: Gartner

Automotive sales took a breather. Recent automotive statistics have shown slowing sales which at first glance looked like waning demand. Looking deeper, the real reason is due to the on-going chip shortage which hinders production as more car manufactures are looking to integrate more electronics in a vehicle (lane assist, auto braking, proximity sensor etc). Thankfully, automotive demand remains elevated and the pace of decline has also slowed as China reported -11.7%, -16.5% and -5% in car sales growth for Aug-Oct 21 while Europe car sales growth recorded -23.1%, -30.3% and -20.5% for Sep-Nov 21. In our recent engagement with D&O, its management has also indicated strong order momentum going into 2022, coming from exterior LEDs such as rear combination lamps, headlamps, fog lights and daytime running lights.

Passenger vehicle (PV) sales/registrations growth (% YoY)



Source: CAAM, ACEA

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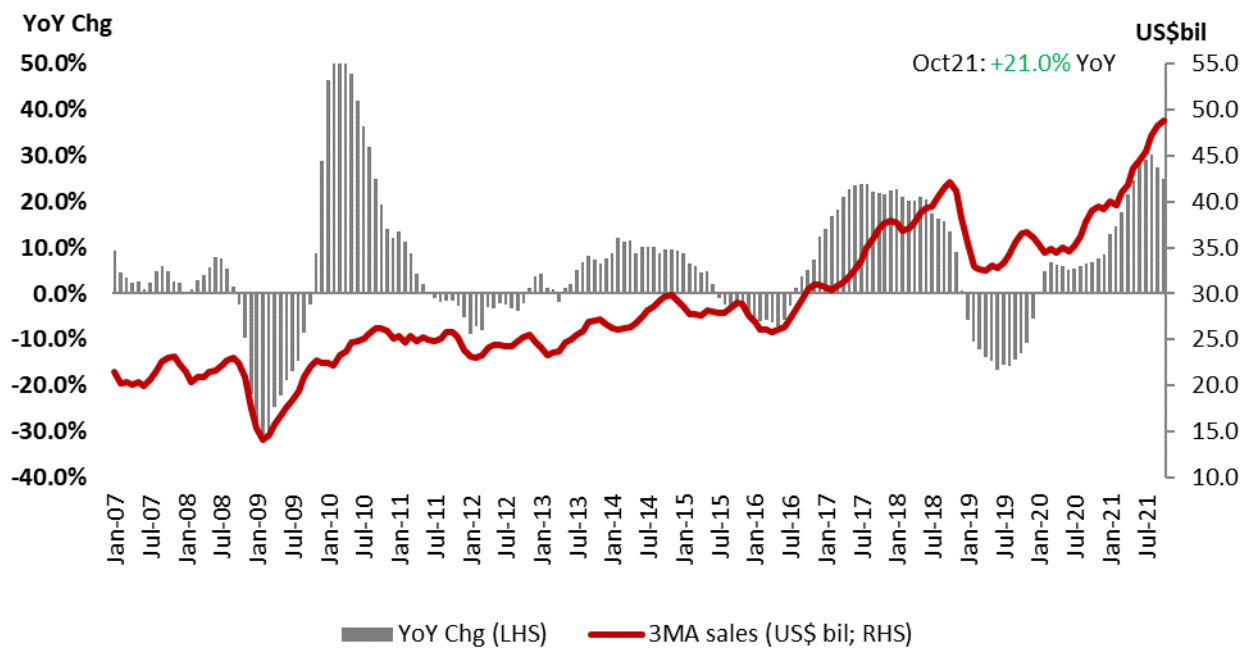
Proxy to spending recovery. With Malaysia's vaccination rate achieving c.77% of total population, daily Covid-19 cases have also fallen to a manageable level of c.5k (vs. >20k in 3QCY21). In addition, the government has recently started to administer booster shots on a voluntary basis. This has facilitated the reopening of the economy where local traveling is back and crossing of states allowed. We learnt that GHL has also seen improving transaction volume for both its e-Pay and TPA segment in the recent months. As the festive season draws nearer, we are positive that this trend will likely continue, thanks to year-end sales as well as strong demand for local travel. This will lead to higher offline-based transactions for credit cards which yield a higher merchant discount rate (MDR). Therefore, we recommend positioning into **GHL Systems (OP; RM2.30)** to ride the return of consumer spending. In addition, the gradual reopening of international travel will be a boon for GHL which has already established a strong presence in the ASEAN region with more than 383k touchpoints.

Maintain OVERWEIGHT stance on the technology sector. Our top picks are:

- (i) **Kelington Group (OUTPERFORM, TP: RM2.50).** Kelington Group ended the year with a bang after securing RM195m (RM85m on 6 Dec and RM110m on 22 Dec) worth of UHP-related jobs in December alone, propelling value of job wins this year to RM1.18b while the current orderbook soared to RM1.23b. The RM85m award was from a customer involved in solid state memory while the RM110m award was from a silicon wafer manufacturer. With the amount of orderbook on hand, we are sanguine for a strong 4QFY21 performance, and followed by a record FY22 as well.
- (ii) **GHL (OUTPERFORM, TP: RM2.30).** GHL has continued to see MoM improvement in its transaction volume and increase in merchant footprint since mid-2021. We believe this trend will likely continue as there is an urgent need for currently cash-based merchants to digitalise their payment acceptance system in order to remain relevant in the current situation where adoption of e-wallet is being accelerated due to the pandemic. With the festive season in the quarter, we are optimistic for QoQ growth in its upcoming 4QFY21 performance, backed by higher consumer spending and interstate travel.
- (iii) **Inari Amertron (OUTPERFORM, TP: RM4.80).** After registering record earnings, Inari's current RF utilisation remains elevated at 88% for 24 SiP lines which could translate into another solid performance in the upcoming 2QFY22 (FYE June). We continue to like Inari owing to its strong position in the 5G space as well as on-going efforts to broaden its exposure in the data centre market (via optical transceiver) and automotive. With its recent inclusion into the FBMKLCI index as well as the MSCI Global Standard index, Inari will likely garner more interest from foreign institutional funds.

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Global Semiconductor Sales and YoY growth



Source: SIA, Kenanga Research

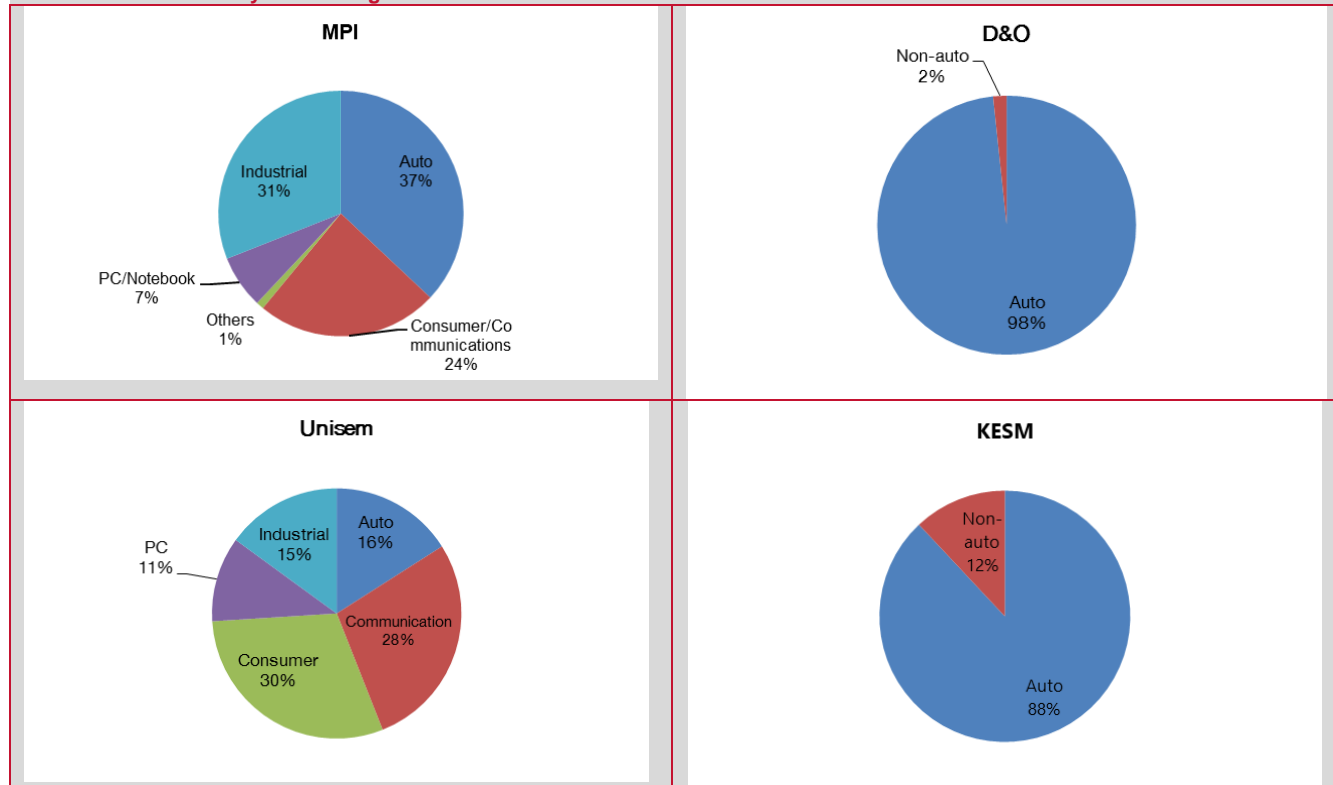
WSTS Semiconductor Sales Forecasts by Product Type (Fall 2021 Q3 Update)

| | US\$ bil | | | | YoY % | | | |
|-------------------------|--------------|--------------|--------------|--------------|--------------|------------|-------------|------------|
| | 2019 | 2020 | 2021F | 2022F | 2019 | 2020 | 2021 | 2022F |
| Discrete Semiconductors | 23.9 | 23.8 | 30.1 | 32.3 | -0.9 | -0.3 | 26.4 | 7.2 |
| Optoelectronics | 41.6 | 40.4 | 43.2 | 46.0 | 9.3 | -2.8 | 7.0 | 6.4 |
| Sensors | 13.5 | 15.0 | 18.8 | 20.9 | 1.2 | 10.7 | 25.6 | 11.3 |
| Integrated Circuits | 333.4 | 361.2 | 460.8 | 502.3 | -15.2 | 8.4 | 27.6 | 9.0 |
| Analog | 53.9 | 55.7 | 72.8 | 79.2 | -8.2 | 3.2 | 30.9 | 8.8 |
| Micro | 66.4 | 69.7 | 79.1 | 84.0 | -1.2 | 4.9 | 13.5 | 6.2 |
| Logic | 106.5 | 118.4 | 150.7 | 167.4 | -2.5 | 11.1 | 27.3 | 11.1 |
| Memory | 106.4 | 117.5 | 158.2 | 171.7 | -32.6 | 10.4 | 34.6 | 8.5 |
| Total | 412.3 | 440.4 | 553.0 | 601.5 | -12.0 | 6.8 | 25.6 | 8.8 |

Source: WSTS

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Revenue breakdown by market segment in 3QCY21



Source: Company, Kenanga Investment Bank Bhd

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Malaysian Technology Peers Comparison

| Name | Last Price @ 17/12/21 (RM) | Market Cap (RM'm) | Shariah Compliant | Current FYE | Revenue Growth | | Core Earnings Growth | | PER (x) - Core Earnings | | | PBV (x) | | ROE (%) | Net Div Yld (%) | Target Price (RM) | Rating |
|-------------------------------------|----------------------------------|----------------------|----------------------|----------------|----------------|---------------|-------------------------|---------------|-------------------------|---------------|---------------|---------|---------------|---------------|--------------------|----------------------|--------|
| | | | | | 1-Yr. Fwd. | 2-Yr. Fwd. | 1-Yr. Fwd. | 2-Yr. Fwd. | Hist. | 1-Yr. Fwd. | 2-Yr. Fwd. | Hist. | 1-Yr. Fwd. | 1-Yr. Fwd. | | | |
| D&O GREEN TECHNOLOGIES BHD | 5.77 | 7,138.3 | Y | 12/2021 | 48.9% | 26.4% | 123% | 34.0% | 141.7 | 63.5 | 47.4 | 17.0 | 13.9 | 21.9% | 0.2% | 6.60 | OP |
| GHL SYSTEMS BHD | 1.79 | 2,043.3 | Y | 12/2021 | 4.3% | 36.3% | -10.5% | 71.6% | 69.5 | 77.6 | 45.2 | 4.5 | 4.2 | 5.4% | 0.0% | 2.30 | OP |
| INARI AMERTRON BHD | 3.73 | 13,794.7 | Y | 06/2022 | 22.5% | 14.6% | 11.3% | 14.7% | 43.4 | 35.9 | 1.3 | 10.4 | 10.2 | 26.4% | 2.5% | 4.80 | OP |
| JHM CONSOLIDATION BHD | 1.73 | 964.6 | Y | 12/2021 | 11.7% | 17.7% | -5.3% | 63.3% | 37.8 | 40.0 | 24.5 | 4.3 | 3.7 | 13.6% | 0.9% | 1.80 | MP |
| KELINGTON GROUP BHD | 1.68 | 1,080.3 | Y | 12/2021 | 25.5% | 40.1% | 84.7% | 45.7% | 61.9 | 33.5 | 23.0 | 6.4 | 5.6 | 16.7% | 0.7% | 2.50 | OP |
| KESM INDUSTRIES BHD | 12.16 | 523.1 | Y | 07/2022 | 4.9% | 6.4% | 4072% | 250% | 131.0 | 37.4 | 25.0 | 1.5 | 1.4 | 3.8% | 0.7% | 11.40 | MP |
| MALAYSIAN PACIFIC INDUSTRIES BHD | 48.80 | 9,706.1 | Y | 06/2022 | 10.0% | 10.0% | 11.3% | 10.0% | 32.2 | 28.8 | 26.2 | 7.1 | 8.0 | 15.6% | 0.6% | 56.20 | OP |
| P.I.E. INDUSTRIAL BHD | 3.74 | 1,436.3 | Y | 12/2021 | 59.9% | 10.6% | 31.0% | 29.9% | 32.3 | 24.7 | 19.0 | 1.3 | 1.5 | 11.5% | 1.8% | 4.30 | OP |
| SKP RESOURCES BHD | 1.65 | 2,577.9 | Y | 03/2022 | 12.3% | 12.4% | 21.7% | 12.4% | 21.6 | 17.7 | 15.8 | 4.1 | 3.7 | 21.0% | 2.8% | 2.60 | OP |
| UNISEM (M) BHD | 4.00 | 6,452.3 | Y | 12/2021 | 20.0% | 15.0% | 47.5% | 21.0% | 46.8 | 31.7 | 26.2 | 3.8 | 3.5 | 11.2% | 1.4% | 4.90 | OP |

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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