

Industry Focus

Malaysia Technology



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AllianceDBS Research, Malaysia Equity

13 Sep 2018

Stay on the sidelines

- Strong rebound in tech stocks since 2Q18 with 43-71% gains from April lows
- 2H18 earnings recovery story priced in; expect profit-taking activities in 4Q18
- Potential US-China trade war blow-up is a lingering risk
- We are Neutral on the sector; stay on the sidelines for now and revisit in early 2019 for new catalysts

Strong rebound. The Malaysian tech sector reached its bottom in April as investors digested the weak 1Q18 earnings and tepid 2Q18 guidance. Amid improving sentiment and expectation of strong earnings recovery in 2H18, Malaysian semi stocks have staged a strong rebound since early 2Q18 and are up by 43-71% from their April lows. Forex has also turned into a tailwind, with the USD strengthening against the Ringgit by 7.5% since April.

Expect profit-taking activities in 4Q18. Without much of a surprise, Apple announced three new iPhone models in an event last evening. Considering the lack of major design changes and feature upgrades, we believe that shipment volume for the next iPhone cycle will likely be only incremental (0-5% growth). In the absence of strong volume growth to drive further upside, we expect iPhone suppliers to underperform in 4Q18 as investors take profit off the table.

Potential US-China trade war blow-up is a lingering risk. Given the complex and intertwined semiconductor supply chain that spans across many countries, we do not think that the potential escalation in US-China trade war will lead to any major changes in supply chain arrangement. Instead, the fear is more towards the negative impact on end-demand for electronic products and components (mostly assembled in China), and this will have a knock-on effect on the whole supply chain.

Stay on the sidelines for now. Sector valuation is now at about +1.5 SD above mean after the strong rebound since early 2Q18, which we believe has priced in the 2H18 earnings recovery story. On balance, the weakening Ringgit is a tailwind for the sector but threat of escalation in US-China trade war could still be a drag on sentiment in the near term. We would advise investors to stay on the sidelines for now, and revisit in early 2019 when there is more visibility on new catalysts for **Inari** (new plant in Batu Kawan), **Globetronics** (new sensor products and/or new business), and **Unisem** (WLCSP expansion in Ipoh site). We close our BUY calls on Globetronics and Unisem, and downgrade both companies to HOLD.

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Analyst

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STOCKS

	Price RM	Mkt Cap US\$m	12-mth		Performance (%)		Rating
			Target Price RM		3 mth	12 mth	
Globetronics	2.60	419	2.80		17.7	(6.1)	HOLD
Inari Amertron Bhd	2.21	1,681	2.00		(0.4)	32.4	FULLY VALUED
Malaysian Pacific	12.28	589	10.40		17.7	(11.1)	HOLD
Unisem	2.97	521	3.30		N.A	N.A	HOLD

Source: AllianceDBS, Bloomberg Finance L.P.

Closing price as of 12 Sep 2018

Globetronics Technology Bhd : Electronics manufacturing & services provider.

Inari Amertron Bhd : Inari is principally involved in back-end semiconductor packaging, which comprises back-end wafer processing, package assembly and RF final testing.

Malaysian Pacific industries : Back-end semiconductor company providing assembly and test services.

Unisem : Back-end semiconductor company providing assembly and test services.

Apple iPhone quarterly sales (in m units)



Source: Apple, Bloomberg Finance L.P

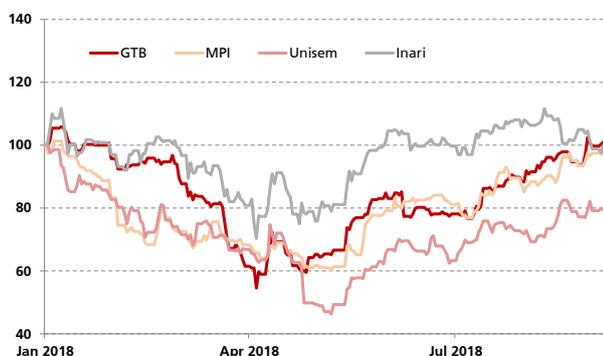


Strong rebound since early 2Q18

Strong rebound since 2Q18. 1Q18 saw a sharp pullback in the share prices of Malaysian semi companies given inventory adjustment in the smartphone supply chain as well as the strengthening Ringgit. As what we have predicted, the sector reached its bottom in April as investors digested the weak 1Q18 earnings and tepid 2Q18 guidance. Amid improving sentiment and expectation of strong earnings recovery in 2H18, Malaysian semi stocks have staged a strong rebound since early 2Q18 and are up by 43-71% from their April lows. Forex has also turned into a tailwind for the sector, with the Ringgit weakening by 7.5% against the USD since April.

Except for Unisem (-20% YTD), the share prices of other Malaysian semi stocks are flat YTD, slightly underperforming the benchmark Philadelphia Semiconductor Index (SOX) and TWSE Semiconductor Index (TWSESCI) which are both up by about 7% YTD.

YTD Performance of Malaysian semi stocks



Sources: Bloomberg Finance L.P

Philadelphia Semiconductor Index (SOX)



Sources: Bloomberg, AllianceDBS

TWSE Semiconductor Index, TWSESCI



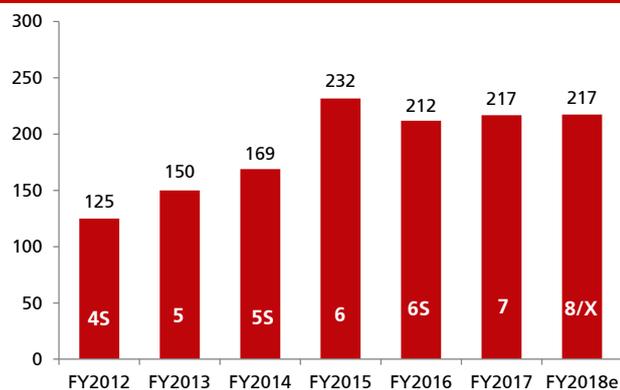
Sources: Bloomberg, AllianceDBS

No surprises in the latest iPhone models

Apple has unveiled its new iPhone line-ups. Without much of a surprise, Apple announced three new iPhone models at an event last evening – 6.1-inch LCD (iPhone Xr), 5.8-inch OLED (iPhone Xs), and 6.5-inch OLED (iPhone Xs Max). The new line-ups have almost a similar form factor to last year's iPhone X (particularly True Tone and Face ID with TrueDepth front camera), but with segmentation in terms of display technology (LCD vs. OLED) and rear camera (single vs. dual-cam).

Considering the lack of major design changes and feature upgrades, we believe that shipment volume for the next iPhone cycle will likely be only incremental (0-5% growth). As such, we are relatively Neutral on Apple component suppliers, except for those which can gain new contents to offset the flattish shipment volume. On this front, we remain positive on 1) RF suppliers given more complex RF architecture and filter requirements to enable faster LTE speed; and 2) Sensor suppliers due to the adoption of 3D sensing across all three models in 2018.

Apple iPhone yearly sales, m units (FYE Sep)



Sources: Apple, Bloomberg Finance L.P

Regardless, iPhone supply chain tends to underperform in 4Q post new model releases. Like clockwork, iPhone suppliers tend to underperform the market in 4Q after the launch of new models every year in September (see Chart below). Generally, investors would have already built in their expectations leading up to that, driving up share price performance. In the absence of strong volume growth to drive further upside, profit-taking activities would generally occur, especially after product reviews and preliminary assessment on sales data are available. As seen in the Chart above, yearly iPhone volume has been flat since the iPhone 6S cycle. We do not expect the current cycle to be any different.

Historical performance trends around Oct-Dec



Sources: Bloomberg Finance L.P, AllianceDBS

Potential escalation in US-China trade war is a lingering risk.

Given the complex and intertwined semiconductor supply chain that spans across many countries, we do not think that the potential escalation in US-China trade war will lead to any major changes in the supply chain arrangement. Instead, the fear is

more towards the negative impact on end-demand for electronic products and components (mostly assembled in China), and this will have a knock-on effect on the whole supply chain. For example, under the latest proposed tariffs on US\$200bn worth of Chinese goods, audio products such as Apple AirPods could be subjected to a 25% import duty into the US. The decline in AirPod sales will surely affect component suppliers such as AMS/GTB which sell optical sensors to Apple.

Near-term key drivers for Malaysian companies

Inari Amertron – Due to the market share loss of Broadcom and slowing smartphone sales, growth for Inari's RF division could slow in FY19 (ending June) before rebounding strongly in FY20 when 5G technology starts to emerge in new smartphone models. In the meantime, growth would be supported by contribution from potential new businesses from Osram in health sensors, 2D facial recognition components, and mini LED packaging. Inari is also constructing a new plant in Batu Kawan, where the first block (Block A with 240,000 sqft of floor space) will be ready by end-September and will mainly cater for Osram.

Globetronics - Production of light sensors was weak in the March-May period at about 15-18m units/month, down from its month peak of 30-31m units. Volume in June saw some recovery to close to 20m units, and this has scaled up to 36-37m units by August/September. Production of gesture sensors was also higher at 16m units/month in August, up from 11m units/month before. Although we take comfort that there is decent visibility for these sensor components up to mid-December, things could still change drastically if the sales of new smartphone models disappoint.

Unisem - Being an OSAT (Outsourced Assembly & Test) player, Unisem's revenue base is more diverse and spread across different customers. By market segment, its revenues are from communication and consumer (52%), PC (13%), industrial (18%), and automotive (17%). The company has completed the construction of its building extension at its Ipoh site and will start to progressively install new WCLSP and bumping capacity in 2H18. Qualification by new customers will likely take place in 1H19.

MPI - Sales contributions are derived from consumer and communication (35%), automotive (30%), industrial (25%) and PC segments (10%). While MPI has an ambitious target to grow the contribution from automotive segment to 50% within 3-4 years, there is still not much visibility from management on how this can be achieved. In the meantime, MPI is trying to transform its overall portfolio by discontinuing legacy products with weak

margins and use the freed-up capacity for high-margin products.

Valuation and recommendation

Stay on the sidelines for now. Sector valuation is now at about +1.5 SD above mean after the strong rebound since early 2Q18, which we believe has priced in the 2H18 earnings recovery story. On balance, the weakening Ringgit is a tailwind for the sector but threat of escalation in US-China trade war could still be a drag on sentiment in the near term. We would advise investors to stay on the sidelines for now, and revisit in early 2019 when there is more visibility on new catalysts for **Inari** (new plant in Batu Kawan), **Globetronics** (new sensor products and/or new business), and **Unisem** (WLCSP expansion in Ipoh site). We close our BUY calls on Globetronics and Unisem, and downgrade both companies to HOLD.

Inari Amertron (Fully Valued; TP: RM2.00). Despite near-term challenges in the RF segment (market share loss of Broadcom and slowing smartphone sales), we remain positive on the company given continued strong earnings growth in FY19-20, underpinned by rising Radio Frequency (RF) content in smartphones (faster LTE speed and 5G), as well as new contribution from other business segments. The stock offers a decent dividend yield of 3% and is backed by a healthy net cash position of RM506m.

Globetronics (Downgrade to HOLD; TP: RM2.80) GTB's share price has rebounded by 69% from its April low, which is likely to have priced in the recovery of light sensor volume in 2H18 after the production cut during March-May. Despite expecting stronger 2H18 earnings, we believe near-term sentiment on the stock would be weighed by potential escalation in US-China trade war that might affect the end-demand of some of its sensor products. Coupled with the limited upside now, we downgrade our recommendation to HOLD with an unchanged TP of RM2.80. An attractive net yield of 4-5% backed by its strong net cash position should help to support GTB's share price, in our view.

Unisem (Downgrade to HOLD; TP: RM3.30). Since our BUY call upgrade in early April, Unisem share price has rebounded by 72% from its low given improving sentiment for the sector, recovery in its 2Q18 earnings and a reversal in the forex direction (i.e. strengthening USD). A more positive surprise is the conditional take-over offer from Tianshui Huatian Technology Co Ltd (TSHT) at RM3.30/share, implying valuation of 1.6x BV and 18.5x FY19 PE (+1 SD above 5-year mean) for Unisem. In conjunction with our sector report, we believe this represents a good opportunity for investors to take profit on the stock. We close our BUY call and downgrade our recommendation to HOLD with RM3.30 TP based on the offer price by TSHT.

MPI (HOLD; TP: RM10.40). Valuation for MPI is relatively fair at 1.5 FY18 B/V, which is in line with Taiwanese peers. Net dividend yield is decent at 3%.

EXHIBIT: Malaysian peer comparison (as at 12 Sep 2018)

	Call	Target Price	Current Price	Market Cap (USD)	P/E (FD)		EPS (FD) Growth (YoY)		Dividend Yield		Price/ BVPS		ROAE	
					CY2018	CY2019	CY2018	CY2019	CY2018	CY2019	CY2018	CY2019	CY2018	CY2019
Inari Amertron	FV	2.00	2.25	1,711.1	26.6x	23.0x	(10%)	16%	2.9%	3.3%	6.3x	5.9x	26%	27%
Vitrox Corporation	NR	NR	7.99	906.7	36.3x	-	24%	-	0.7%	-	9.3x	-	27%	-
Malaysian Pacific Industries	HOLD	10.40	12.36	593.1	17.1x	16.2x	(10%)	5%	2.4%	2.6%	2.0x	1.9x	12%	12%
Unisem	HOLD	2.80	2.97	521.0	20.9x	16.6x	(35%)	26%	3.7%	4.0%	1.5x	1.4x	7%	9%
Globetronics Technology	HOLD	2.80	2.60	419.1	19.2x	15.0x	(25%)	28%	4.2%	5.4%	5.8x	5.4x	31%	37%
Uchi Technologies	NR	NR	3.03	327.8	36.3x	17.3x	24%	9%	0.7%	5.8%	9.3x	4.4x	27%	26%
Average					26.7x	16.3x	(5%)	13%	2.4%	3.0%	6.0x	3.5x	23%	18%

Sources: AllianceDBS, Bloomberg Finance L.P

EXHIBIT: Global peer comparison (as at 12 Sep 2018)

	Call	Local Currency	Target Price	Current Price	Market Cap (USD)	P/E (FD)		EPS (FD) Growth (YoY)		Dividend Yield		P/B		ROAE	
						CY2018	CY2019	CY2018	CY2019	CY2018	CY2019	CY2018	CY2019	CY2018	CY2019
Advanced Semiconductor	NR	TWD	NR	70.60	9,895.1	13.1x	11.4x	11%	15%	3.3%	4.2%	1.5x	1.4x	12%	13%
JCET	NR	CNY	NR	14.20	3,313.9	35.9x	21.5x	41%	67%	0.3%	0.4%	2.0x	1.8x	6%	9%
Powertech Technology	NR	TWD	NR	84.20	2,128.8	9.7x	8.6x	15%	13%	6.1%	6.8%	1.6x	1.5x	16%	17%
Amkor Technologies	NR	USD	NR	7.62	1,825.3	13.6x	9.3x	(39%)	46%	n/a	n/a	1.0x	0.9x	8%	11%
Inari Amertron	FV	MYR	2.00	2.25	1,711.1	26.6x	23.0x	(10%)	16%	2.9%	3.3%	6.3x	5.9x	26%	27%
Nantong Fujitsu	NR	CNY	NR	9.19	1,543.7	25.3x	21.3x	179%	19%	-	-	1.7x	1.6x	n/a	n/a
Chipbond	NR	TWD	NR	65.20	1,373.7	10.4x	12.8x	80%	(18%)	5.7%	5.4%	1.6x	1.5x	15%	12%
King Yuan Electronics	NR	TWD	NR	19.95	791.6	9.3x	7.4x	14%	25%	8.6%	10.2%	1.0x	0.9x	11%	13%
Malaysian Pacific Industries	HOLD	MYR	10.40	12.36	593.1	17.1x	16.2x	(10%)	5%	2.4%	2.6%	2.0x	1.9x	12%	12%
ChipMOS	NR	TWD	NR	20.00	575.0	18.4x	10.8x	(70%)	70%	2.0%	4.0%	1.0x	0.9x	5%	n/a
Unisem	HOLD	MYR	2.80	2.97	521.0	20.9x	16.6x	(35%)	26%	3.7%	4.0%	1.5x	1.4x	7%	9%
Globetronics Technology	HOLD	MYR	2.80	2.60	419.1	19.2x	15.0x	(25%)	28%	4.2%	5.4%	5.8x	5.4x	31%	37%
Average						17.8x	14.0x	21%	24%	2.9%	3.5%	1.9x	1.8x	11%	13%

Sources: AllianceDBS, Bloomberg Finance L.P

DISCLOSURE

Stock rating definitions

STRONG BUY	-	> 20% total return over the next 3 months, with identifiable share price catalysts within this time frame
BUY	-	> 15% total return over the next 12 months for small caps, >10% for large caps
HOLD	-	-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps
FULLY VALUED	-	negative total return > -10% over the next 12 months
SELL	-	negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame

Commonly used abbreviations

Adex = advertising expenditure	EPS = earnings per share	PBT = profit before tax
bn = billion	EV = enterprise value	P/B = price / book ratio
BV = book value	FCF = free cash flow	P/E = price / earnings ratio
CF = cash flow	FV = fair value	PEG = P/E ratio to growth ratio
CAGR = compounded annual growth rate	FY = financial year	q-o-q = quarter-on-quarter
Capex = capital expenditure	m = million	RM = Ringgit
CY = calendar year	M-o-m = month-on-month	ROA = return on assets
Div yld = dividend yield	NAV = net assets value	ROE = return on equity
DCF = discounted cash flow	NM = not meaningful	TP = target price
DDM = dividend discount model	NTA = net tangible assets	trn = trillion
DPS = dividend per share	NR = not rated	WACC = weighted average cost of capital
EBIT = earnings before interest & tax	p.a. = per annum	y-o-y = year-on-year
EBITDA = EBIT before depreciation and amortisation	PAT = profit after tax	YTD = year-to-date

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