Technology

Tech Still Rules

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OVERWEIGHT

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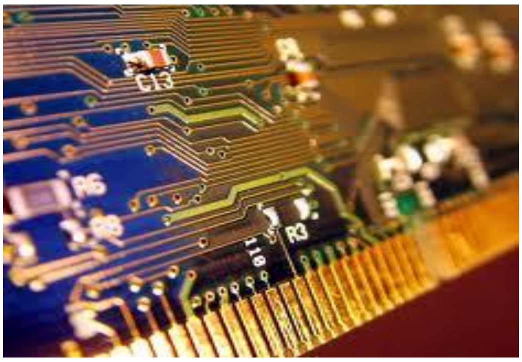
We keep our OVERWEIGHT call on the technology sector moving into 1QCY21 as we anticipate demand for semiconductor components to remain robust with the dawning of the 5G era. We gathered that the 8-inch wafer capacity squeeze is tightening as consumer demand bounced back from the coronavirus crisis. This is led by growing demand for electronic gadgets like 5G smartphones, 5G base stations, laptops, gaming consoles, wireless earphones and automotive. Besides the Apple iPhone 12 series which is still being sold out for some of its Pro models, the Nintendo Switch and Sony Play Station 5 have also been facing global shortage. The top 5 laptop brands recorded all-time high sales in Oct and Nov and Digitimes forecast a strong 1H 2021 owing to ramp-up in laptop orders. Wafer fabrication plants have reported utilisation rates close to 100% as the recovery in consumer demand outpaced production capacity due to under-investment amid the global pandemic. With the expectation for demand to remain elevated going into 2021, significant expansion plans are slated to take place to meet the surging demand for front-end capacity. We have identified **Kelington Group (OP; RM2.30)** as a key beneficiary of SMIC's fab expansion plan. We are also optimistic for **INARI (OP; RM3.14)** and **MPI (OP; RM29.00)** to ride the 5G adoption in smartphones and data centre expansion, with the latter further benefiting from the rapid adoption of electric vehicles.



Demand surged as firms ride out the pandemic. We maintain our OVERWEIGHT call on the technology sector going into 1QCY21 as we anticipate demand for semiconductor components to remain robust with the dawning of the 5G era. Building on our previous 4QCY20 sector outlook (report dated 05 Oct 2020) where we highlighted early signs of 8-inch wafer foundries experiencing orders beyond capacity, we gathered that the capacity squeeze is tightening as consumer demand bounced back from the coronavirus crisis. This is led by growing demand for components such as small-panel display IC (SSDI), contact image sensor (CIS), radio frequency front-end (RFFE), WiFi 6, TWS chips, power management IC (PMIC), MEMS sensor, MOSFET and IGBT which are used in gadgets such as 5G smartphones and base stations, laptops, gaming consoles, wireless earphones and automotive.

Recovery in consumer demand outpaced production capacity. Besides the Apple iPhone 12 series which is still being sold out for some of its Pro models, Nintendo Switch and recently launched Sony Play Station 5 have also been facing global shortage to the extent that consumers are paying a premium in the secondary market. The top-5 laptop brands (HP, Lenovo, Acer, Dell and Asus) saw combined shipment reaching its highest monthly sales in October followed by its second highest in November as the work-from-home (WFH) practice continues. According to Digitimes, the top-3 laptop ODMs (Compal, Quanta and LCFC) are poised to enjoy a strong 1HCY21 on the back of continued ramp-up in orders. We believe **MPI (OP; RM29.00)** will continue to see a strong quarter ahead owing to the WFH practice which translates into higher demand for MPI's power management chip packaging in laptops and servers.

Expansion to follow. The pandemic in 2020 has caused firms to take a cautious approach towards capex budgeting which led to under-investment among the front-end wafer fabrication houses, particularly the 8-inch wafer manufacturing plants. As a result, wafer fabrication houses like TSMC, SMIC, UMC and Samsung have reported utilisation rates close to 100% and expects demand to remain elevated going into 2021. Therefore, significant expansion plans are slated to take place in 2021 to meet the surging demand for front-end capacity. China in particular is well positioned for another growth phase in semiconductor output for 2021, driven by its continuous effort to be technologically self-sufficient. We have identified **Kelington Group (OP; RM2.30)** as a key beneficiary of SMIC's capacity expansion plan. In our recently meeting with Kelington Group, we noted that SMIC is still rushing the group to speed up on the delivery and hinted of more UHP-related jobs to be awarded in 2021.

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

	Shipments (units)			Growth		Market Share		
Company	3Q20	2Q20	3Q19	QoQ	YoY	3Q20	2Q20	3Q19
Samsung	80.8	54.8	79.1	47.6%	2.2%	22%	19%	20%
Huaw ei	51.8	54.1	65.8	-4.2%	-21.3%	14%	18%	17%
Apple	40.6	38.4	40.8	5.8%	-0.6%	11%	13%	11%
Xiaomi	44.4	26.1	32.9	70.2%	34.9%	12%	9%	9%
Oppo	29.9	23.6	30.6	26.6%	-2.3%	8%	8%	8%
Others	119.1	97.7	139.6	21.9%	-14.7%	33%	33%	36%
Total	**366.7**	**294.7**	**388.8**	**24.4%**	**-5.7%**	**100%**	**100%**	**100%**

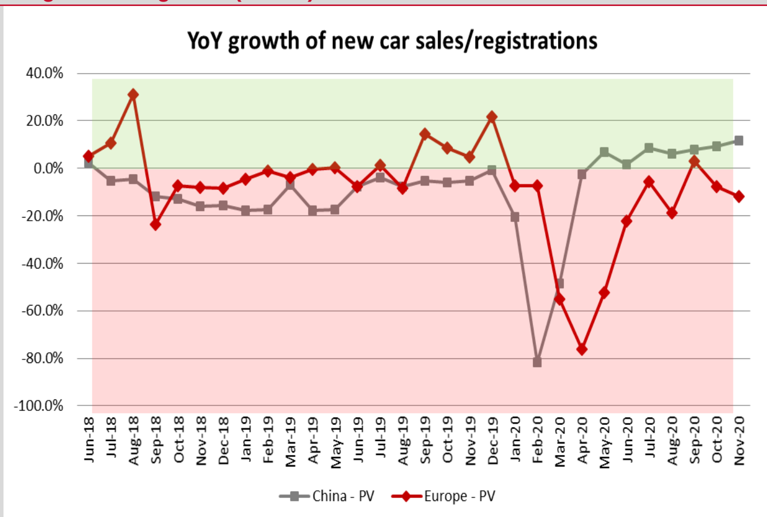
Source: Gartner

China car sales extends growth streak. Favourable government policy coupled with robust demand continued to bolster China's automotive sales recovery from the Covid-19 pandemic. China's car sales have logged seven months of consecutive growth from May till November 2020, thanks to the easing of purchase quota and increase in subsidies provided by the Chinese government. Car sales growth continued to be driven by the premium segment where consumer purchases are largely centred on sport utility vehicles (SUV) and crossovers.

Europe car sales still on a W-shaped recovery. Europe car sales came off its low of -76.3% YoY decline in April to reach a 3.1% YoY growth in September. However, the second wave of Covid-19 outbreak has caused sales to dip back into the red as government re-imposed lockdown restrictions, shutting down car showrooms across Europe. This led to car sales recording a decline of 7.8% YoY and 12% YoY for the month October and November, respectively. With the availability of Covid-19 vaccines being rolled out gradually, we are optimistic for car sales recovery in Europe to resume in 2021.

Electrification will be the focus. Based on our observations of both regions, we noticed a big shift in customer's preference. There is a huge increase in purchase of electric vehicles (EV) this year. China's EVs sales growth have skyrocketed from a strong double-digit since July 2020 (+29% YoY) to a triple-digit growth for the month of October (+113% YoY) and November (+137% YoY). While government's environmental policy has played a part to push for more EVs, the recent jump in numbers can also be tied to the c.USD4,300 Hongguang Mini, built by the General Motors-SAIC-Wuling joint venture. While the Hongguang Mini has a top speed of only 62 mph (or 100km/h), it has zoomed passed Tesla Model 3 as the top selling EV model in China. From Sep to Oct, the Hongguang Mini sold 55,781 units compared with the Tesla Model 3 sale of 35,283 units.

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



Source: CAAM, ACEA

Europe on the other hand saw its EV market share hitting a record 9.9% in 3QCY20, an improvement from 7.2% in 2QCY20. Compared to a year ago, the market share of electric vehicle was merely 3.0% and 2.4% in 3Q19 and 2Q19, respectively. We believe the EV market will continue to grow strongly on the back of incentives from regulators which are aimed towards reducing carbon emission. This has translated into greater interest for EVs among consumers and has further motivated car manufacturers to adopt electrification as the future. Hence, we favour local player such as **MPI (OP; TP: RM29.00)** whose long-term goal is to be automotive-centric. The group is currently involved in automotive sensor packaging and is taking on silicon carbide (SiC) power modules which are gradually replacing common silicon due to higher efficiency. Adoption is still at its infancy but increasing rapidly, thanks to the growing preference for EVs.

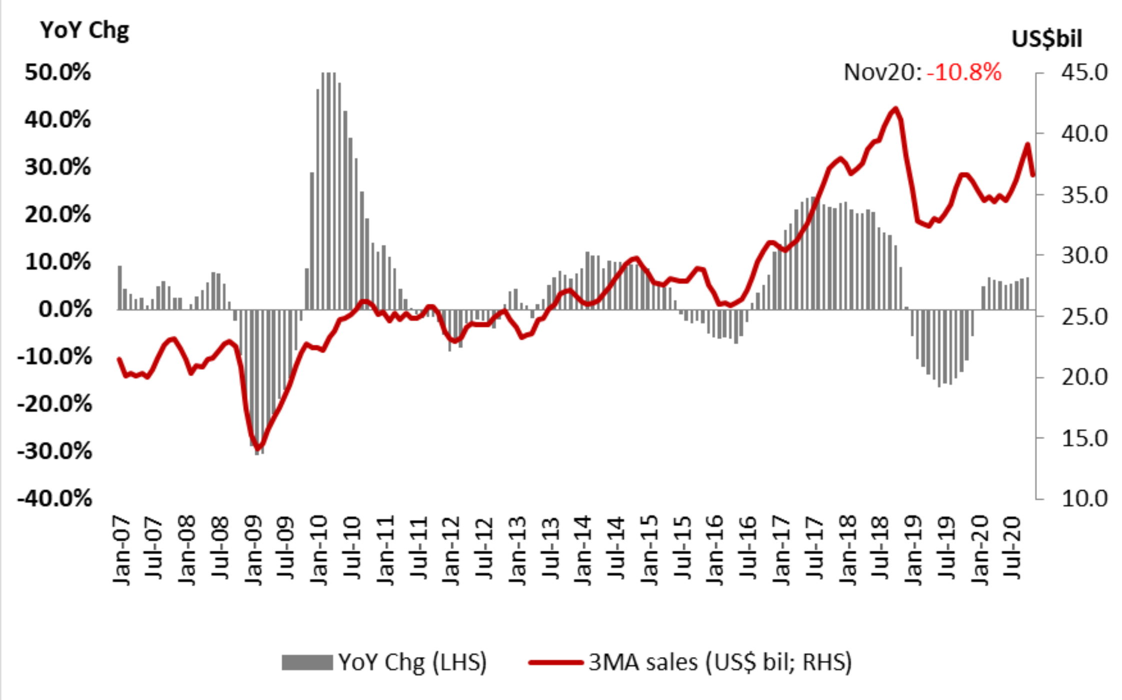
Maintain OVERWEIGHT stance on the technology sector. Our top picks are:-

(i) **MPI (OUTPERFORM, TP: RM29.00).** We remain upbeat on its upcoming quarters as the group is poised to benefit from: (i) surge in laptop sales as the work-from-home practice continues, (ii) expansion in data centre due to higher web computing usage, (iii) increased demand for radio frequency front-end packaging owing to the implementation of 5G in smartphones, and (iv) rising adoption of silicon carbide (SiC) power modules in tandem with the shift in customer's preference towards electric vehicles. The group's diverse yet relevant portfolio has led the group to hit record earnings despite the global pandemic. Its strong net cash position of RM943m (RM4.70/share) allows the group to take on further expansion if needed and even meaningful M&A in the near future.

(ii) **INARI (OUTPERFORM, TP: RM3.14).** Current radio frequency (RF) orders from key customer remain robust, pointing to a sustained momentum going into 2QFY21 and 3QFY21 (FYE June), bucking the typical seasonal trend. We attribute this to the latest US 5G smartphone that enjoyed a 2.5x increase in pre-orders compared to its predecessor, with some models still experiencing shortages. Current utilisation rate is at 90% which is expected to stretch further to 95% with addition of five more SiP lines in its P34 plant to a total of 22 lines by end-2020. Inari is currently doing the back-end test for a HK-based customer who specialises in optical receivers and expects to qualify for full-line assembly in January 2021. In addition, the group has been working with a Swiss-based company on sub-module assembly for the impedance matching network equipment. We gather that the end-user for this product is Lam Research in Penang. Besides that, the JV with PCL has started its first shipment in June and is expected to break even in 2QFY21.

(iii) **KGB (OUTPERFORM, TP: RM2.30).** Kelington Group's order-book reached a new high of RM370m as SMIC's expansion hit full speed, with no signs of slowing. Job replenishment remains healthy as more UHP-related jobs are in the pipeline from SMIC, Micron and Lam Research. The group expects order-book level to remain elevated even after factoring a stronger 4Q ahead. KGB is currently tendering for RM900m worth of jobs, spread equally across Malaysia, Singapore and China. Being regarded as a preferred vendor among large MNCs, the group is in a favourable position to benefit from various on-going expansions by WD Penang (announced RM2.3b investment), Micron SG (new fab construction), along with Lam Research, Bosch, and B Braun. In addition, KGB has been in touch with Pfizer to understand the use of dry ice to store vaccines. We believe the scarcity of deep freezer, especially in rural areas, makes dry ice a timely and more efficient option for vaccine distribution should the need arises. Positive prospects are juxtaposed with an attractive Fwd. PER of 16.7x vs peers' average of 30-58x.

Global Semiconductor Sales and YoY growth



Source: SIA, Kenanga Research

WSTS Semiconductor Sales Forecasts by Product Type (Autumn 2020)

	US$ bil				YoY %			
	2018	2019	2020F	2021F	2018	2019	2020F	2021F
Discrete Semiconductors	**24.1**	**23.9**	**23.6**	**25.3**	*11.3*	*-0.9*	*-1.2*	*7.2*
Optoelectronics	**38.0**	**41.6**	**40.5**	**44.6**	*9.2*	*9.3*	*-2.6*	*10.2*
Sensors	**13.4**	**13.5**	**14.5**	**15.6**	*6.2*	*1.2*	*7.4*	*7.8*
Integrated Circuits	**393.3**	**333.4**	**354.6**	**383.8**	*14.6*	*-15.2*	*6.4*	*8.3*
Analog	58.8	53.9	54.0	58.6	*10.8*	*-8.2*	*0.0*	*8.6*
Micro	67.2	66.4	67.7	68.4	*5.2*	*-1.2*	*2.0*	*1.0*
Logic	109.3	106.5	113.4	121.5	*6.9*	*-2.5*	*6.5*	*7.1*
Memory	158.0	106.4	119.4	135.3	*27.4*	*-32.6*	*12.2*	*13.3*
Total	**468.8**	**412.3**	**433.1**	**469.4**	***13.7***	***-12.0***	***5.1***	***8.4***

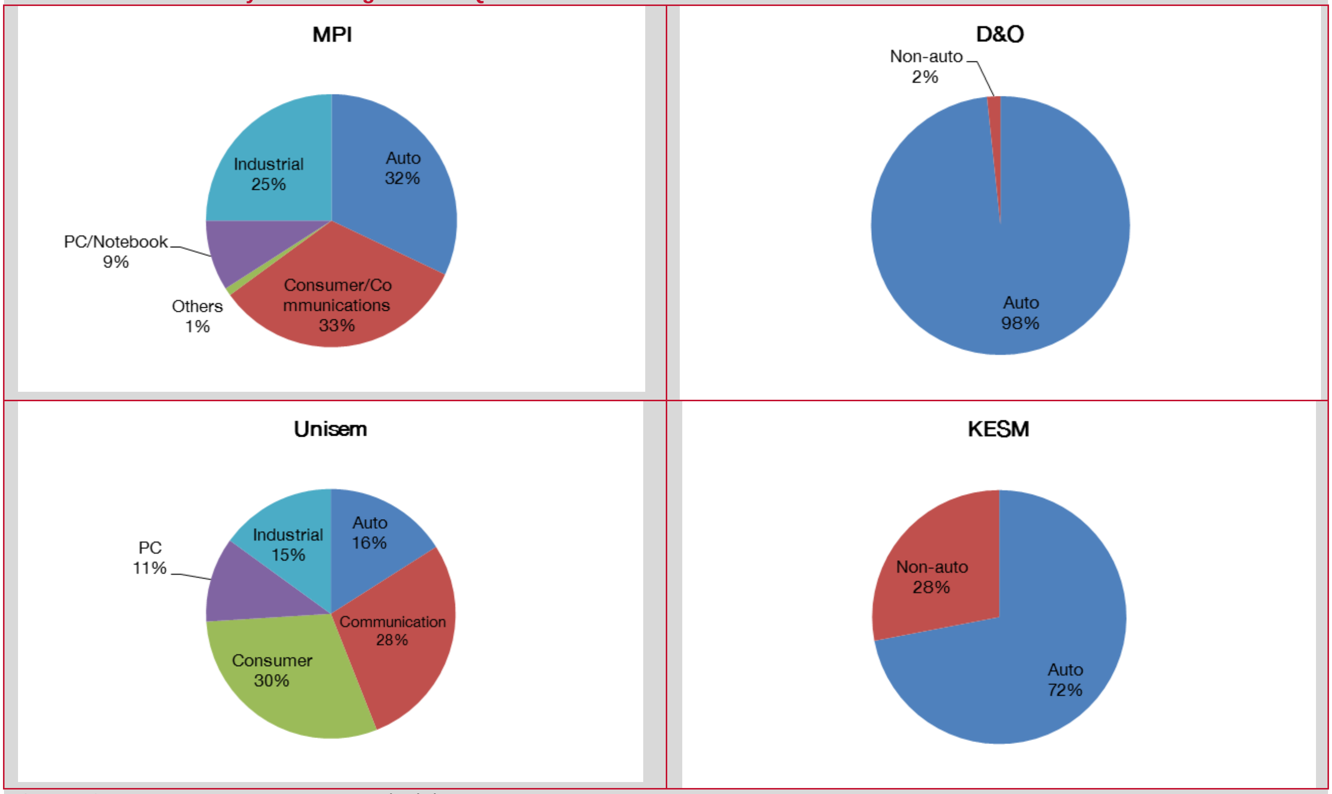
Source: WSTS

Worldwide Device Shipments by Device type (Millions of Units)

Device Type	Shipments (million of units)		YoY growth	
	2019	2020F	2019	2020F
Traditional PCs (Desk-Based and Notebook)	193	170	-4%	-12%
Ultramobile (Premium)	70	66	4%	-6%
PC Market	**263**	**235**	**-2%**	**-10%**
Ultramobiles (Tablets and Clamshells)	144	133	-6%	-7%
Computing Devices Market	**407**	**368**	**-3%**	**-9%**
Mobile Phones	1,754	1,496	-4%	-15%
Total Devices Market	**2,161**	**1,864**	**-4%**	**-14%**

Source: Gartner

Revenue breakdown by market segment in 3QCY20



Source: Company, Kenanga Investment Bank Bhd

Malaysian Technology Peers Comparison

Name	Last Price @ 24/12/20 (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.	1-Yr. Fwd.		
D&O GREEN TECHNOLOGIES BHD	1.88	2,169.4	Y	12/2019	9.2%	15.7	7.7%	69.9%	51.6	48.9	28.8	4.8	4.3	15.0%	1.3%	2.00	OP
INARI AMERTRON BHD	2.63	8,680.5	Y	06/2020	37.4%	24.9%	66.7%	25.1%	55.0	33.5	26.8	7.1	7.2	21.6%	2.7%	3.14	OP
JHM CONSOLIDATION BHD	1.78	992.5	Y	12/2020	-7.8%	42.9%	-21.1%	107%	34.3	38.4	21.0	5.2	4.4	11.5	0.8%	2.00	MP
KELINGTON GROUP BHD	1.61	517.5	Y	12/2020	-8.2%	22.3%	-44.7%	130%	20.8	43.1	18.7	3.3	3.3	8.1%	0.6%	2.30	OP
KESM INDUSTRIES BHD	12.44	535.1	Y	07/2020	14.6%	5.3%	19158%	34.2%	3768	24.5	18.2	1.0	1.0	5.0%	1.1%	10.60	MP
MALAYSIAN PACIFIC INDUSTRIES BHD	24.02	4,777.4	Y	06/2020	9.0%	9.0%	24.0%	12.0%	29.3	23.6	21.1	3.9	3.7	12.6%	1.2%	29.00	OP
P.I.E. INDUSTRIAL BHD	2.37	910.2	Y	12/2020	-6.0%	76.0%	-46.0%	185%	22.5	41.8	14.7	1.8	1.8	4.0%	1.4%	2.32	MP
SKP RESOURCES BHD	2.13	2,662.2	Y	03/2020	23.7%	9.7%	67.3%	20.7%	27.5	19.2	15.9	3.3	3.0	18.0%	3.0%	1.83	MP
UNISEM (M) BHD	6.01	4,680.2	Y	12/2020	9.0%	17.6%	71.9%	47.7%	49.7	28.9	19.6	2.4	2.2	7.8%	1.4%	5.15	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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