Technology

NEUTRAL ↓

3QCY22 Results Review: Largely Disappointing

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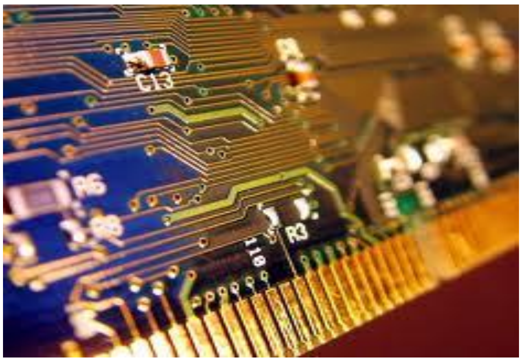
We downgrade our call on the technology sector to NEUTRAL from OVERWEIGHT as the overall 3QCY22 results for companies under our universe disappointed due to the on-going inventory correction amidst growing concern of economic uncertainty. We learnt that the automotive sector is beginning to show early signs of softening as customers are lowering orders in favour of clearing off their existing built-up inventory. This is expected to disrupt D&O's upcoming 4Q which is typically the group's bumper period. In addition, the supply chain disruption caused by China's zero-Covid policy is expected to worsen as the US smartphone maker warned of longer-than-expected delivery times moving forward which will likely weigh down on INARI's FY23 outlook. As such, we advocate cherry-picking for names that can weather through this challenging period such as: (i) KGB (OP; TP: RM1.80) for having a strong order book of >RM1b and resilient utilisation rate of its LCO2 plant, and (ii) LGMS (OP; TP: RM1.50) for its unique exposure to the growing cybersecurity business that is expected to remain stable even in an economy downcycle.



3QCY22 results season disappointed. Out of all the companies under our coverage, the overall results disappointed sequentially; with 9%, 27%, and 64% coming in above, within and below our forecasts vs. 0%, 70%, and 30% for the preceding quarter, respectively (see Exhibit 1).

Earnings were below expectations for most of the companies under our coverage due to the on-going inventory adjustment that is likely to continue into 2023 as a result of growing economic uncertainty. For instance, we learnt that automotive manufacturers are beginning to lower their order forecast and prioritise selling off current inventory built up over the past few quarters. As such, D&O may not see its seasonally strongest 4Q materialising and expects this softening to extend into 1HCY23. Another concern is the worsening zero-Covid policy in China that is causing supply chain challenges. MPI's Suzhou plant has experienced utilisation rate falling to 40% (vs. c.90% two quarters ago) which resulted in its China operation recording a net loss in 3QCY22. MPI also anticipates the situation to worsen in the next two quarters before seeing any signs of rebound. This situation will likely play out negatively for INARI given that the US smartphone manufacturer also indicated longer-than-expected delivery times for the latest smartphone owing to the worsening supply chain situation in China.

On the other hand, KGB was the only company that exceeded expectations thanks to its strong order book and timeliness in project deliveries. The group saw its 9MFY22 revenue more than doubled YoY coming from all regions and bucked the trend to record revenue growth even from China despite the unconducive situation there. The group continued to receive resilient demand for its liquid carbon dioxide (LCO2) gasses and is now operating above 80% utilisation rate. To cater for future demand, it has decided to build a second plant which will be operational in 2024.

Downgrade to NEUTRAL from OVERWEIGHT. We turned neutral on the sector as even the automotive semiconductor segment has joined the consumer electronics segment to exhibit signs of softening on fears of reduced consumer appetite for large ticket item purchases. This coupled with the declining demand in the smartphone and PC market will likely dampen growth for the sector as a whole. That said, we advocate cherry-picking for names that are able to weather through the current turbulence. We like **KGB (OP; TP: RM1.80)** for: (i) it being a direct proxy to the front-end wafer fab expansion, (ii) its strong earnings visibility underpinned by robust order book and tender book exceeding RM1b, and (iii) its strong foothold in multiple markets, i.e. Malaysia, Singapore and China. We also favour **LGMS (OP; TP: RM1.50)** for: (i) its unique exposure to the growing cybersecurity business, (ii) the deep moat around its business given the high barrier to entry created by the tough qualification process as a vendor, and (iii) new proprietary certification software which is expected to be the next earnings driver.

Exhibit 1: Quarterly Results Overview

	3QCY22						2QCY22					
	KENANGA			CONSENSUS			KENANGA			CONSENSUS		
	Above	Within	Below	Above	Within	Below	Above	Within	Below	Above	Within	Below
D&O			1			1		1			1	
GHLSYS		1			1				1			1
INARI			1			1		1			1	
JHM			1			1		1				1
KGB	1				1			1			1	
KESM			1			1			1			1
LGMS*		1			1			0			0	
MPI			1			1		1			1	
PIE			1			1			1			1
SKP		1			1			1			1	
UNISEM			1			1		1			1	
Total	**1**	**3**	**7**	**0**	**4**	**7**	**0**	**7**	**3**	**0**	**6**	**4**
Total (%)	**9**	**27**	**64**	**0**	**36**	**64**	**0**	**70**	**30**	**0**	**60**	**40**

** New coverage*
Source: Kenanga Research

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	4.40	3.51	-20.2%	5,443.9	Y	12/2022	8.8	11.3	-1.9%	28.5%	50.2	39.1	6.2	12.8%	1.5	0.3%
GHL SYSTEMS BHD	MP	0.860	0.800	-7.0%	981.7	Y	12/2022	2.1	2.7	-16.4%	30.2%	41.7	32.1	1.8	4.5%	0.0	0.0%
INARI AMERTRON BHD	MP	2.81	2.85	1.4%	10,489.2	Y	06/2023	10.2	11.5	-3.2%	12.7%	27.5	24.4	4.1	15.0%	9.7	3.5%
JHM CONSOLIDATION BHD	MP	0.74	0.90	21.6%	412.6	Y	12/2022	3.1	6.7	-37.7%	118.8%	24.3	11.1	1.4	9.8%	0.5	0.7%
KELINGTON GROUP BHD	OP	1.49	1.80	20.8%	958.1	Y	12/2022	7.8	8.1	57.9%	4.0%	19.1	18.4	4.1	23.4%	2.0	1.2%
KESM INDUSTRIES BHD	MP	7.20	6.60	-8.3%	309.7	Y	07/2023	2.8	8.6	500.0%	208.3%	258.3	84.6	0.9	0.3%	7.5	1.0%
LGMS BHD	OP	1.33	1.50	12.8%	606.5	Y	12/2022	2.7	3.5	20.4%	29.0%	48.9	37.8	7.2	22.0%	0.0	0.0%
MALAYSIAN PACIFIC INDUSTRIES BHD	MP	30.20	25.00	-17.2%	6,006.7	Y	06/2023	118.5	146.4	-28.7%	23.5%	25.5	20.6	2.8	11.3%	35.0	1.2%
P.I.E. INDUSTRIAL BHD	OP	2.69	3.15	17.1%	1,033.1	Y	12/2022	16.6	19.7	6.0%	18.5%	16.2	13.7	1.8	11.6%	7.0	2.6%
SKP RESOURCES BHD	OP	1.69	2.10	24.3%	2,640.4	Y	03/2024	11.6	12.4	6.3%	7.7%	14.6	13.6	2.9	21.1%	5.8	3.4%
UNISEM (M) BHD	MP	2.90	2.75	-5.2%	4,677.9	Y	12/2022	14.4	15.3	17.7%	6.2%	20.1	18.9	2.0	10.4%	6.0	2.1%
Simple Average								18.0	22.4	47.3%	44.3%	49.7	28.6	3.2	12.9%		1.5%

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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