

24 September 2018

KESM Industries Bhd

Within Expectations

While FY18 results came in line, the generous DPS pay-out of 18.5 sen was a positive surprise. After a brief hiatus in 2H18, earnings should see a stronger comeback in 1H19 with earlier shortfall to be made up by higher utilisation and capacity expansion. Post model updates, we tweaked our FY19E earnings by -2% for house-keeping while introducing our FY20E NP of RM55.6m (+7%). All in, TP lowered to RM18.20 (15.0x FY19E PER). Maintain MP.

Within Expectations. After a soft 3Q18 (which was marred by low utilisation owing to industry-wide wafer shortage), 4Q18 rebounded with a stronger NP of RM11.3m (>100% QoQ, -16% YoY), bringing FY18 NP to RM39.3m (-11%). This made up 96%/98% of our/consensus full-year estimates. That said, the total DPS of 18.5 sen (4Q18 DPS: 6.0 sen) was a positive surprise which beat our/consensus conservative forecast of 11.7 sen/14.3 sen. This represents a total pay-out of c.20%, which is the highest quantum over the past three years.

YoY, FY18 revenue grew 4% on continuous demand for its burn-in and testing services. While EBITDA increased by 7% on better product mix, operational profit dropped by 8% (with EBIT margin shedding 2.6ppt to 16.6%), suggesting the ineffective charge-out of overhead cost on weaker 3Q18 revenue. With a higher ETR of 12.9% (-1.9ppt), NP dropped by a wider 10%.

QoQ, although 4Q18 revenue improved 4% on normalisation from softer 3Q, we believe the wafer shortage issue still prevails, though with milder impact. Recall that sales in 4QFY normally is the seasonally strongest over the past three financial years. With better operational efficiency alongside a tax credit of RM1.34m (on recognition of tax benefits), NP came in much stronger at RM11.3m (+107%).

Growth to resume after a hiatus in 2H18. Though earnings shortfall was observed in 3Q18 with 4Q18 still seeing some sluggishness, we are not overly concerned regarding the lagging sales as we understand that the late delivery was only a timing issue with orders volume still resilient. Note that the group is still at investment phase for customers, where it should plough in a similar quantum of capex as of FY17 (at RM107m) for expansion. Recall that FY17 revenue/CNP saw a jump of 18%/43% during its aggressive expansion period back then. In terms of investment, it is shifting towards upgrading existing plants in Malaysia and China into "smart factories", which should see higher automation; hence, suggesting better operational efficiency. All in, we expect a much better FY19, underpinned by higher utilisation alongside capacity expansion.

Maintain MARKET PERFORM with a lower TP of RM18.20 (from RM18.30). Post model updates, we trimmed our FY19E earnings by 2% for house-keeping and introduced our FY20E NP of RM55.6m (+7% to be supported by continuous capacity expansion on long-term structural growth in higher Automotive semiconductor content). All in, our TP is trimmed to RM18.20, still based on an unchanged 15.0x FY19E PER (which is in line with the Malaysian's OSAT current 2-year Fwd. PER)

Risks to earnings include: (i) lower-than-expected sales and margins, and (ii) longer-than-expected gestation periods.

MARKET PERFORM ↔

Price: RM17.10
Target Price: RM18.20 ↓

Expected Capital Gain: +RM1.10 +6.4%
Expected Divd. Yield: +RM0.24 +1.4%
Expected Total Return: +RM1.34 +7.9%

KLCI Index 1,810.64

Stock Information

Bloomberg Ticker	KESM MK Equity
Bursa Code	9334
Listing Market	Main Market
Shariah Compliant	Yes
Shares Outstanding	43.0
Market Cap (RM m)	735.5
Par value per share (RM)	1.00
52-week range (H)	22.70
52-week range (L)	14.22
Free Float	41%
Beta	1.4
3-mth avg daily vol:	20,335

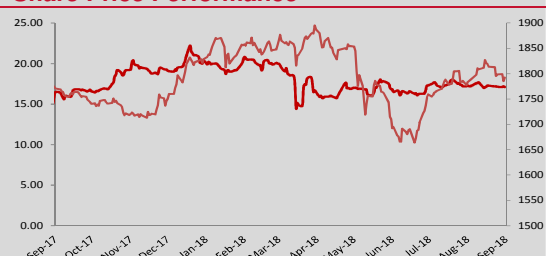
Major Shareholders

Sunright Ltd	48.4%
Kumpulan Wang Persaraan	6.3%
Tan Kong Hong Alex	4.8%

Summary Earnings Table

FY July (RM m)	2018A	2019E	2020E
Revenue	349.8	396.9	418.8
EBIT	44.0	58.0	61.3
PBT	43.7	57.7	61.7
Net profit	39.3	52.0	55.6
Core Net Profit	39.3	52.0	55.6
Consensus (NP)	-	52.3	62.0
Earnings Revision	-	-2%	-
Core EPS (sen)	91.5	120.8	129.2
Core EPS growth (%)	-10.6	32.1	6.9
DPS (sen)	18.5	24.4	26.1
BV/Share (RM)	8.2	9.1	10.1
Core PER	18.7	14.2	13.2
PBV (x)	2.1	1.9	1.7
Net. Gearing	-0.3	-0.3	-0.3
Div. Yield (%)	1.1	1.4	1.5

Share Price Performance



	1 mth	3 mths	12 mths
Absolute (%)	-1.2%	1.7%	3.6%
Relative (%)	-1.9%	-5.3%	1.4%

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Results Highlights

	4Q	3Q	QoQ	4Q	YoY			YoY
FYE July (RM'm)	FY18	FY18	Chg	FY17	Chg	FY18	FY17	Chg
Revenue	85.3	82.3	3.6%	89.8	-5.0%	349.8	338.0	3.5%
EBITDA	29.7	27.0	10.0%	31.5	-5.7%	122.4	114.5	6.9%
EBIT	9.9	7.3	35.6%	13.1	-24.2%	44.0	47.8	-7.8%
PBT	10.0	7.2	37.9%	12.8	-22.2%	43.7	47.8	-8.7%
Taxation	1.3	-1.8	-176.0%	0.6	129.2%	-4.3	-3.8	13.0%
PAT	11.3	5.5	106.9%	13.4	-15.6%	39.3	44.0	-10.6%
Net Profit	11.3	5.5	106.9%	13.4	-15.6%	39.3	44.0	-10.6%
EPS (sen)	26.3	12.7	107.1%	31.2	-15.7%	91.5	102.3	-10.6%
DPS (sen)	6.0	0.0		6.0		18.5	12.5	
EBITDA margin	36.1%	29.5%		37.1%		46.3%	46.1%	
EBIT margin	12.0%	8.0%		15.4%		16.6%	19.2%	
PBT margin	12.1%	7.9%		15.1%		16.5%	19.3%	
PATAMI margin	13.7%	6.0%		15.8%		14.9%	17.7%	
Effective tax rate	18.5%	-13.6%		4.8%		-12.9%	-11.0%	

Source: Company, Kenanga Research



Malaysian Technology Peers Comparison

Name	Last Price (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 BERHAD	0.810	840.5	Y	12/2018	15.8%	16.7%	111%	28%	43.5	29.3	22.9	3.9	3.9	13.2%	0.9%	0.850	OP
KESM INDUSTRIES BERHAD	17.10	735.5	Y	07/2018	13.5%	5.5%	32%	7%	18.7	14.2	13.2	2.1	1.8	13.8%	1.4%	18.20	MP
MALAYSIAN PACIFIC INDUSTRIES BHD	13.20	2625.5	Y	06/2018	5.3%	7.1%	9%	8%	15.4	14.1	13.1	2.3	2.2	12.3%	2.3%	12.20	MP
NOTION VTEC BERHAD	0.655	216.3	Y	09/2018	-12.4%	29.8%	-379%	-142%	18.4	-6.6	15.7	0.6	0.6	-13.6%	0.0%	0.600	UP
P.I.E. INDUSTRIAL BERHAD	1.52	583.7	Y	12/2018	3.6%	19.3%	5%	23%	13.9	13.2	10.7	1.5	1.4	10.5%	4.2%	2.00	OP
SKP RESOURCES BHD	1.35	1687.8	Y	03/2019	5.5%	4.5%	2%	9%	13.1	13.0	11.9	3.0	2.7	20.9%	3.9%	1.45	OP
UNISEM (M) BERHAD	3.10	2268.6	Y	12/2018	-2.2%	9.1%	-28%	31%	14.3	20.0	15.2	1.6	1.5	7.7%	2.9%	3.30	AO

Source: Bloomberg, 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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