Technology

1QCY24 Report Card: Turning the Corner

OVERWEIGHT ↑

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We upgrade our sector recommendation to OVERWEIGHT from NEUTRAL. The sector's earnings delivery (against our forecasts) in the recently concluded 1QCY24 reporting season was satisfactory, having considered 1Q being seasonally weak due to the Chinese New Year break. The good news is players generally guided for stronger quarters ahead, which is consistent with our expectation for a sector-wide recovery in 2HCY24. Our sector top picks are: (i) KGB (OP; TP: RM4.10) for its strong earnings visibility backed by a RM1.3b order book, (ii) INARI (OP; TP: RM4.00) for its growing presence in China's smartphone market and the AI space, and (iii) LGMS (OP; TP: RM1.90) on higher demand for cybersecurity services from corporations locally on the heels of the enactment of Cybersecurity Bill 2024.

The sector's earnings delivery (against our forecasts) in the recently-concluded 1QCY23 reporting season was largely satisfactory with 8%, 62%, and 30% of companies under our coverage coming in above, within and below our forecasts, vs. 23%, 62%, and 15% during the last quarter (see Exhibit 1), respectively. We are unperturbed by earnings misses from **INARI**, **OPPSTAR (OP; TP: RM1.70)**, **KESM (MP; TP: RM7.04)** and **JHM (MP; TP: RM0.61),** as we believe, particularly for **INARI** and **OPPSTAR,** the worst is behind them.

INARI's 3QFY24 (FY Jun) results were weighed down by lingering effects from higher electricity cost and as it took time for production to catch up following power surges in prior quarters. However, it is optimistic for higher utilisation at its radio frequency (RF) segment that typically makes up >60% of group revenue. We are particularly positive on INARI as a laggard play given that it has the largest market cap in the tech space, while its share price has yet to move meaningfully compared to its peers. A near-term tailwind for the group is the upcoming US smartphone launch, which will feature AI functionality. We are positive on this inclusion which will coincide with the next smartphone replacement cycle amongst consumers, given that the previous cycle (2-3 years ago during Covid-19) is much overdue.

OPPSTAR's weaker showing in its reported 4QFY24 (Mar YE) was due to slower project recognition as there was a delay in a turnkey project from a Chinese customer, which led to a lower order book of RM18.2m as at end-Mar 2024 (from RM24m three months ago). Understandably, these fluctuations are typical for a growing company like OPPSTAR. To support its growth, the group aims to increase its headcount to 500 (from 299 at the end of March 2024). Overall, we remain optimistic of the group's long-term prospects based on: (i) its collaboration with Samsung, which is expected to generate a recurring revenue stream throughout the life cycle of the customer's product, (ii) Oppstar Japan, which is now working with nine new Japanese customers to build a track record and bid for more complex projects in the future, and (iii) conducive government policies that promote stronger IC design capabilities in the country.

Improved outlook. We believe investors have looked beyond the seasonally soft 1Q due to the Chinese New Year holidays into better quarters ahead. Players generally guided for stronger outlook ahead, which is consistent with our view of a firmer 2HCY24. **MPI (OP; TP: RM46.84),** for instance, guided for higher utilisation at its Suzhou plant, which already turned profitable for a second consecutive quarter. This is attributed to an overall recovery in the China smartphone market, which recorded a 1.5% YoY sales growth in 1QCY24, according to *Counterpoint Research*. Meanwhile, **KGB** anticipates more job wins in 2HCY24, driven by wafer fabrication plant expansion in Singapore and China by key global semiconductor makers. The group has also started tendering for jobs in new regions, such as Hong Kong and Germany, at the request of existing customers, which is expected to positively contribute to its job replenishment target of at least RM1b in FY24.

Upgrade to OVERWEIGHT from NEUTRAL. This is consistent with our view right from the beginning of the year that 2HCY24 will be a better time to turn more positive on the sector as this is when the recovery in the sector will take shape more firmly. Our sector top picks are:

- **KGB** owing to: (i) it being a proxy to the front-end wafer fab expansion, (ii) its strong earnings visibility underpinned by its robust RM1.3b order book, and (iii) its strong foothold in multiple markets, i.e. Malaysia, Singapore and China.

- **INARI** for an impending ramp-up in orders for its RF products, its ability to defend its top line and superior profit margins via its responsiveness to market demand as evidenced by its adoption of new technologies such as double-sided moulding (DSM) and system-on-module (SOM), cost control.

- **LGMS** for: (i) the high growth prospects of its core cybersecurity business in the under-penetrated local and regional cybersecurity markets, and specifically, higher demand for cybersecurity services from corporations locally on the heels of the enactment of Cybersecurity Bill 2024, (ii) the deep moat around its business given the high barrier to entry created by the tough qualification process as a vendor, and (iii) its new proprietary Star Sentry product.

Quarterly Results Overview

	1QCY24						4QCY23					
	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		1			1		
MPI		1			1				1			1
NATGATE		1			1				1			1
OPPSTAR			1			1		1			1	
PIE		1			1		1			1		
SKP	1			1				1			1	
UNISEM		1			1			1			1	
Total	**1**	**8**	**4**	**1**	**9**	**3**	**3**	**8**	**2**	**3**	**6**	**4**
Total (%)	**8**	**62**	**30**	**8**	**69**	**23**	**23**	**62**	**15**	**23**	**46**	**28**

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	3.86	3.60	-6.7%	4,782.5	Y	12/2024	8.5	12.0	133.7%	41.6%	45.6	32.2	4.8	10.8%	1.4	0.4%
GHL SYSTEMS BHD	AO	1.08	1.08	0.0%	1,232.8	Y	12/2024	2.4	2.8	-3.5%	15.8%	45.2	39.1	2.3	5.2%	0.0	0.0%
INARI AMERTRON BHD	OP	3.80	4.00	5.3%	14,313.4	Y	06/2024	9.4	11.8	8.6%	25.8%	40.4	32.1	5.4	13.4%	8.9	2.3%
JHM CONSOLIDATION BHD	MP	0.680	0.610	-10.3%	412.1	Y	12/2024	3.3	4.1	40.0%	21.7%	20.4	16.7	1.2	6.2%	0.5	0.7%
KELINGTON GROUP BHD	OP	3.58	4.10	14.5%	2,403.3	Y	12/2024	16.1	19.4	1.0%	20.5%	22.2	18.4	5.6	27.7%	4.5	1.3%
KESM INDUSTRIES BHD	MP	7.62	7.04	-7.6%	327.8	Y	07/2024	4.0	8.1	-65.1%	102.8%	190.1	93.7	0.9	0.5%	0.0	0.0%
LGMS BHD	OP	1.55	1.90	22.6%	706.8	Y	12/2024	4.6	6.3	88.4%	37.0%	33.5	24.5	6.8	22.2%	0.9	0.6%
M'SIAN PACIFIC INDUSTRIES BHD	OP	39.90	46.84	17.4%	7,937.3	Y	06/2024	74.5	138.0	141.8%	85.2%	53.5	28.9	3.8	7.2%	35.0	0.9%
NATIONGATE HOLDINGS BHD	OP	2.00	2.06	3.0%	4,147.9	Y	12/2024	6.3	8.3	114.8%	30.8%	31.7	24.2	7.8	27.4%	1.0	0.5%
OPPSTAR BHD	OP	1.44	1.70	18.1%	922.0	Y	03/2024	5.7	6.5	165.0%	15.4%	25.4	22.0	5.2	22.4%	1.4	1.0%
P.I.E. INDUSTRIAL BHD	OP	6.75	6.75	0.0%	2,592.3	Y	12/2024	22.2	28.7	15.7%	29.3%	30.4	23.5	3.9	13.4%	7.0	1.0%
SKP RESOURCES BHD	OP	1.20	1.35	12.5%	1,874.8	Y	03/2024	7.3	8.5	18.5%	15.3%	16.4	14.1	2.0	12.4%	3.7	3.1%
UNISEM (M) BHD	MP	4.37	3.70	-15.3%	7,049.2	Y	12/2024	10.2	12.7	100.1%	24.9%	43.0	34.4	2.9	6.8%	6.0	1.4%
Simple Average										44.1%	32.8%	37.2	28.0	4.1	13.5%		1.0%

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.