Technology sector

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Cautiously optimistic on gradually recovery

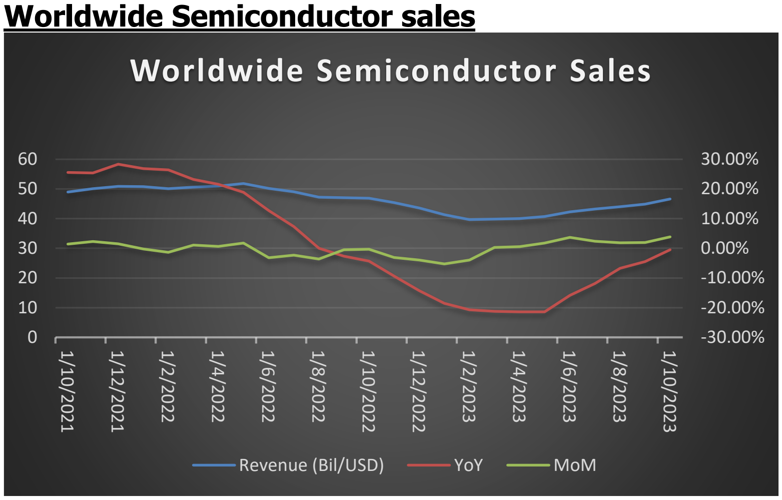
- **Review**. Bursa Malaysia Technology Index displayed an unremarkable performance in 2023, reflecting the broader challenges faced by the global semiconductor sector. The sector experienced sluggish performance and an uncertain outlook, due to excess inventory and weak demand after a period of remarkable growth from 2019 to 2022. Despite the challenges, technology counters recovered from May 2023. The said recovery was supported by positive sentiment spillover from the US tech sector, driven by expectations of less hawkish US Federal Reserve interest rate hikes and growing interest in AI. Data from Semiconductor Industry Association (SIA) indicated 14.3% yoy decline in global semiconductor sales in 2023 YTD. However, there were eight consecutive month-to-month growth in recent months, suggesting a softening rate of decline and indicating a potential stabilisation or bottoming out in the industry cycle.

- Local companies in the outsourced semiconductor assembly and test (OSAT) and electronics manufacturing services (EMS) segments faced challenges, delivering disappointing FY23 results in terms of both revenue and margins. This was attributed to lower demand and weaker economies of scale. However, companies involved in automated test equipment (ATE) and those serving the domestic market showed resilience. The latter benefited from a diverse client portfolio and strong demand from the automotive and medical segments, driven by a robust domestic economy, which helped offset the weak demand from electro-optical and consumer industrial products.

Bursa Malaysia Technology Index

Source: Bloomberg

Worldwide Semiconductor sales



Source: Bloomberg, SIA

- **Outlook**. In anticipation of an uptick in the stock replenishment cycle and a low base effect, earnings of the technology sector are expected to gradually recover in 2024. The Semiconductor Industry Association (SIA) has forecasted a rebound with +13.1% yoy growth in global semiconductor sales in 2024F, following a contraction of -9.4% yoy in 2023. The forecasts highlight growth in Memory (+44.8% yoy), Logic chip (+9.6% yoy), Discrete Semiconductors (+4.2% yoy), and Sensors (+3.7% yoy). However, it's important to note that the rebound will be largely attributed to the low base effect in 2023, and the growth may not be exceptional, due to expectations of modest improvement in consumer electronics, particularly in Western countries.

- Recovery in the industry is anticipated to occur gradually in 2H24 as a relatively subdued start to the year is expected, considering the seasonally slow 1H. While a strong rebound is considered unlikely due to economic uncertainties and ongoing geopolitical conflicts, we are holding a more optimistic view on the semiconductor industry. The projection of improving outlook is based on the anticipation of a rebound from the severe downturn experienced in 2023. Factors such as inventory normalisation, stabilisation of supply-chain costs, and a resurgence in consumer demand, especially in key end-markets like PCs, smartphones, and automotive are contributing to the cautious optimism regarding the industry's recovery in 2024.

- **Valuation & Recommendation**. Bursa Technology index is trading at 32.5x 2023F PER and 25x 2024F PER with EPS anticipate to decrease 25.9% yoy in 2023F, before staging a rebound of 29.2% yoy in 2024F. At present, Bursa Technology index is trading higher than pre-pandemic trailing and forward 1Y PER (refer below) mainly attributed to the spillover sentiment from US tech stocks and pricing in high recovery growth prospects for FY24F. Despite a projected strong growth target % for 2024, we opine the sector's current valuation with 25.1x 2024F PER is less attractive, as the timing of strong recovery remained ambiguous.

- Our top pick would be **Aurelius Technologies Bhd (BUY; FV: RM 3.22)** due to its exposure to IoT, which sees relatively lower impact from the cooling demand, strong profit growth and prospects with massive expansion coupled with margin enhancement expecting with higher margin product mix. Meanwhile, we like **Infoline Tec Group Bhd (BUY; FV: RM 1.15)** for its strong growth prospects driven by large-scale expansions are on the cards, coupled with favourable industry outlook on IT infrastructure and cybersecurity.

Bursa Malaysia Technology Index PER

Source: Bloomberg

- **Key Risk**. Softer seasonal demand and slower-than-expected inventory adjustment. Prolonged high interest rate may keep valuations on the lower end against historical average

- **Summary.** We believe the technology sector will recover on a gradual manner, particularly in 2H24 after a seasonally slower 1H. However, we advised investors to exercise caution due to the relatively high valuation and the uncertainty over the timing of a potential strong recovery. In summary, we maintained a **Neutral** stance on the technology sector and advocate to monitor over the ongoing global economic conditions for any signals that may lead towards a potential substantial recovery.

Top Picks

Company	Price (RM) as at 31Dec23	P/E (x) 2022	2023F	2024F	Dividend Yield (%)	Target Price (RM)	Potental Upside
Infoline Tec Group Bhd	0.76	15.90	13.10	11.80	2.91	1.15	51.3%
QES Group Bhd	0.51	18.80	22.70	17.30	0.98	0.73	42.2%
Kronologi Asia Bhd#	0.40	11.70	28.10	13.30	-	0.53	32.5%
Aurelius Technologies Bhd	2.60	25.90	22.10	16.70	1.54	3.22	23.8%
Frontken Corporation Bhd	3.24	48.90	53.40	34.70	3.28	3.32	2.5%

 # Kronologi Asia Bhd data based on FYE Jan
Source: Apex Securities Bhd, Bloomberg