

Semiconductor sector set for further boost on growing digital trends

BY ZAVIER ONG |

The semiconductor sector has returned 40.5% this year, based on the average performance of 12 stocks compiled by *The Edge Singapore*. All but two registered double-digit growth in market valuations: **Manufacturing Integration Technology**, which makes equipment used in the front- and back-end processes of integrated circuit assembly, saw its share price dip 7.5% this year. **CDW Holdings**, which makes precision components, closed unchanged at 25 cents on March 30. The best performer was **AEM Holdings**. The provider of systems to semiconductor facilities has seen its stock rise 147.7% this year.

Following this run, the sector has outperformed regional and global benchmarks. The Philadelphia Stock Exchange Semiconductor Index has returned 11.3% this year. The Bloomberg Asia Pacific Semiconductors Index has generated a 19.4% return in Singapore dollar terms. Is it time for investors to cash out?

Terence Wong, CEO of boutique investment firm Azure Capital, points

Semiconductor stars

The local semiconductor sector has rocketed ahead this year

COMPANY	WHAT IT DOES	SHARE PRICE* (\$)	YTD GAIN (%)
AEM Holdings	Manufactures semiconductor manufacturing equipment and high-precision components	2.130	147.7
Ellipsiz	Manufactures probe cards used to test semiconductor wafers; provider of wafer reclaim services, equipment distribution and support services	0.595	70.7
Sunright	Manufactures burn-in equipment and substrates; provider of testing services	0.480	60.0
Avi-Tech Electronics	Manufactures burn-in boards and boards-related products; provider of engineering services	0.425	51.8
UMS Holdings	Manufactures high-precision components and provides final-testing services	0.835	36.9
Advanced Systems Automation	Manufactures automatic moulding machines and other back-end assembly equipment	0.004	33.3
Smartflex Holdings	Assembles and tests smart card modules, manufactures equipment for production of SIM cards	0.195	25.8
Global Testing Corp	Provides wafer-sorting and final-testing services for logic and mixed signal semiconductors and equipment distribution	1.355	23.2
ASTI	Manufactures semiconductor equipment, precision parts, modules and standalone equipment assembly	0.054	22.7
Micro-Mechanics (Holdings)	Designs and manufactures precision tools, parts and consumable products that are critical in the chip assembly and testing process to semiconductor equipment makers	1.045	20.8
CDW Holding	Manufactures precision components, metal and plastic LED frames, LCD backlight units and related components	0.250	0
Manufacturing Integration Technology	Designs, develops and distributes integrated automated equipment that caters to the front- and back-end processes of integrated circuit assembly	0.161	-7.5

*As at March 30

out that the rally started from a very low base. "Many of these companies were trading near their net cash levels, so now they are just catching up with their intrinsic valuations," he says. "When investors look at how much the sector has gained over the past few months, they may get a little

scared. So, there may be a bit of correction before people notice that the stocks are trading cheaply." But a correction would be a good time for investors to evaluate each company on its own merits, Wong adds.

Jarick Seet, head of small- and mid-cap research at RHB Research Institute

Singapore, agrees. While valuations in the sector have picked up, he believes they remain reasonable. "Valuations have not only shot up in the semiconductor sector, but across the board in manufacturing and other sectors because of the bull market," he says. "Moreover, the earnings of the semiconductor players are picking up... [Most] are reporting better results. So, the increases in share prices are validated by earnings growth."

Indeed, analysts and industry observers polled by *The Edge Singapore* remain bullish on the sector. "The general view is that we are into a structural uptick," says Loke Wai San, founder and managing director of private-equity firm Novo Tellus Capital Partners. Loke owns a 0.2% stake in AEM. "This is driven by an uptick in the Internet of Things [IOT] space and in driverless cars, as well as virtual and augmented reality. All that requires computing, memory, sensors and networking. From my perspective, the upcycle will continue into 2018."

The growing power and ubiquity of smartphones could drive growth too, Loke adds. "The macro upcycle is driven by the continuous use of smartphones and... data centres. The industry is expecting the 5G network to come on board in the next two years, which will drive more semiconductor usage."

Evaluating the cycle

Technology research and advisory firm Gartner forecasts a 7.2% y-o-y increase in global semiconductor revenue to US\$364 billion (\$507.8 billion) for 2017, much more than the 1.5% growth experienced last year. Driving the growth, Gartner says, is higher demand in the storage market as well as higher semiconductor content within the growing IOT industry.

Already, the local semiconductor industry is reporting better numbers. In February, Singapore's manufacturing output rose 12.6% y-o-y. The electronics cluster grew 39.8%, thanks mainly to a 63.6% increase in the semiconductor segment.

C K Tan, president of the Singa-

pore Semiconductor Industry Association, thinks the local players are well positioned to ride the wave. "Despite the challenges of the past couple of years, the sector has remained resilient. Manufacturers in Singapore have put in a lot of work to improve their skillsets and make their processes more efficient," says Tan.

Nevertheless, there are challenges for the sector. "If China experiences a hard landing and they are not consuming or buying, it will be an issue for the sector. Moreover, US President Donald Trump is still a wildcard today, with his policies still uncertain. In Europe, Brexit is on the cards. But the predominant problem is the sentiment of protectionism that seems to be on the rise. If countries start protecting their turf, it could affect the dynamics of the market," Tan warns.

RHB's Seet also points out that the semiconductor sector is cyclical. "The drop in demand for its products is very fast and can change very rapidly in a year or even a quarter," he says. He thinks investors need to thoroughly research a stock before entering the market. "If valuations are still below that of peers and growth looks good, they can enter. If not, it's better to wait and see."

Where to find upside

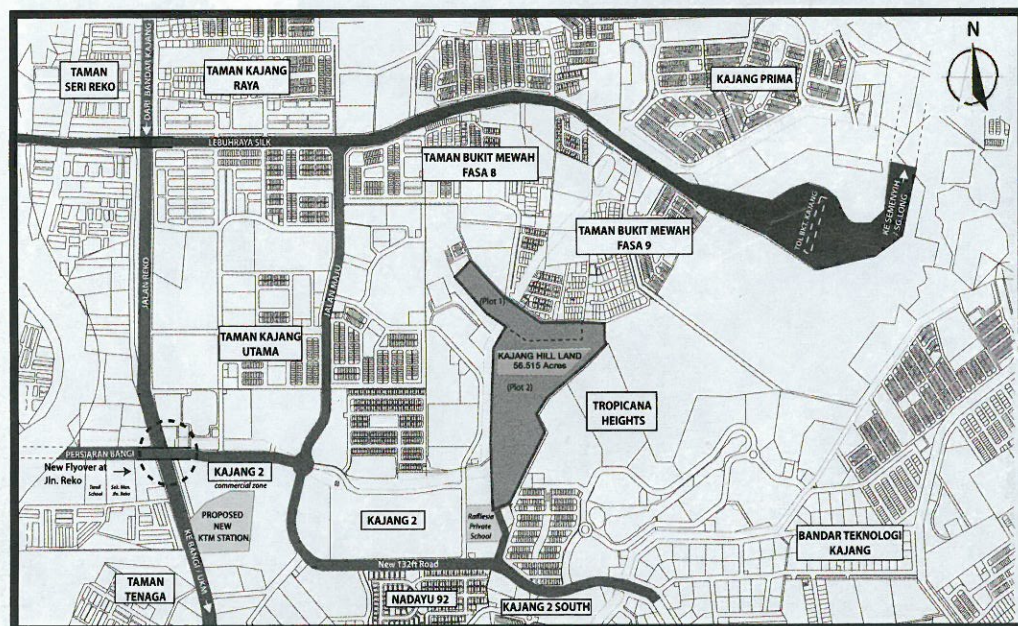
On March 29, Seet initiated coverage of Avi-Tech with a "buy" call and a price target of 52 cents. "Avi-Tech's burn-in services segment is well positioned to benefit from the rising sophistication of vehicles, and ultimately the advent of driverless vehicles," Seet says in his report. Shares in Avi-Tech closed at 42.5 cents on March 30.

Meanwhile, William Tng, director of research at CIMB Research, initiated coverage of AEM on March 8. He notes that the company has returned to profitability, following the completion of a restructuring exercise in FY2014 ended December, which saw the sale of the company's loss-making semiconductor substrate business. He believes AEM is now at the beginning of a new product upcycle, noting that the company is currently the sole supplier of next-generation high-density modular testers to its major customer. As at March 2, AEM had purchase orders worth \$130 million for delivery in FY2017. Tng has an "add" call on the counter, with a price target of \$2.69. Shares in AEM closed at \$2.13 on March 30.

Azure Capital's Wong likes **Micro-Mechanics (Holdings)**. Calling it a "very well run company", Wong says: "They have built up a good balance sheet. And since they are in the consumables part of the semiconductor value chain, they are less susceptible to the booms and busts of the sector. The upturns and the downturns are also less pronounced." Wong also thinks AEM and **UMS Holdings**, which makes equipment modules for the semiconductor equipment manufacturers, are potential privatisation targets.

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