

21 November 2019

KESM Industries Bhd

Steady Start

1QFY20 CNP of RM4.5m came in within expectations, accounting for 22%/24% of our/consensus' estimates. Lower depreciation and raw material expense led to better margins. Looking ahead, we expect to see a gradual continuation of earnings recovery in the subsequent quarters on the back of improving car sales. We tweaked our FY20E CNP higher by 3.4% to RM21.2m on housekeeping. Maintain OUTPERFORM with a higher Target Price of RM9.30.

Within expectation. 1QFY19 registered CNP of RM4.5m (+98% QoQ; +72% YoY), accounted for 22%/24% of our/consensus' estimates. The improvement mainly stemmed from better operating efficiencies. No dividend declared for the quarter.

Results' highlight. YoY, 1QFY20 revenue dipped 17% due to lower demand for burn-in testing services. However, CNP grew 72% to RM4.5m thanks to: (i) lower depreciation with certain test equipment and machinery fully depreciated, (ii) decline in raw material expense as efforts to optimise its testing lines paid off, and (iii) lower staff cost following a reduction in headcount. QoQ, a similar positive picture was painted. 1QFY19 CNP almost doubled (+98% from a low base) albeit on a modest revenue growth of 2% to RM72.4m. EBIT margin (+5 ppt) and CNP margin (+3.2 ppt) also improved to 9.6% and 6.3%, respectively.

Gradual climb. We expect to see a gradual continuation of earnings recovery in subsequent quarter on the back of improving car sales. The EU market recorded back-to-back increase in passenger car sales for the month of October, advancing 9% YoY. This follows the 14.5% YoY jump in the previous month of September, where Germany was the best performer. We believe the growth will continue in tandem with the on-going strive for lower CO2 emission by regulators, pushing car manufacturers to get on board with electric vehicles in order to meet emission targets. This will in turn benefit KESM due to higher demand for automotive semiconductor in electric vehicles.

Tweaked FY20E CNP higher by 3.4% to RM21.2m on housekeeping, while maintaining a net profit margin of 6.1%. We maintain FY21E CNP of RM24.8m (+17% YoY) with a net profit margin 6.7% to account for better operational efficiencies and higher margin businesses from the automotive space.

Maintain OUTPERFORM with a higher Target Price of RM9.30 (previously RM8.70) based on 18.7x (from 18x) FY20E PER (in line with its 3-year average). We believe that KESM will continue to benefit from the rising semiconductor content per vehicle.

Risks to our call include: (i) later-than-expected recovery in vehicle sales, (ii) slower-than-expected adoption of new semiconductor modules in automobiles, and (iii) delay in the US-China trade truce which could potentially lengthen the industry recovery process.

OUTPERFORM ↔

Price: RM8.39

Target Price: RM9.30 ↑

Expected Capital Gain: +RM0.91 +10.8%

Expected Divd. Yield: +RM0.09 +1.1%

Expected Total Return: +RM1.00 +11.9%

KLCI Index 1,601.14

Stock Information

Bloomberg Ticker	KESM MK Equity
Bursa Code	9334
Listing Market	Main Market
Shariah Compliant	No
Shares Outstanding	43.0
Market Cap (RM m)	360.9
Par value per share (RM)	1.00
52-week range (H)	10.86
52-week range (L)	6.66
Free Float	40%
Beta	1.6
3-mth avg daily vol:	30,432

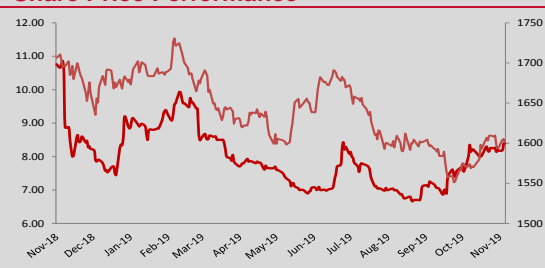
Major Shareholders

Sunright Ltd	48.4%
KWAP	6.7%
Tan Kong Hong Alex	4.8%

Summary Earnings Table

FY July (RM m)	2019A	2020E	2021E
Revenue	307.4	349.8	368.6
EBIT	7.7	19.8	22.1
PBT	9.5	23.0	26.9
Net profit	6.3	21.2	24.8
Core Net Profit	6.3	21.2	24.8
Consensus (NP)	N.A.	18.0	28.3
Earnings Revision	N.A.	+3.4%	0.0%
Core EPS (sen)	14.6	49.3	57.7
Core EPS growth (%)	-84.0	237.6	17.1
DPS (sen)	9.0	9.0	9.0
BV/Share (RM)	8.2	8.6	9.1
Core PER	57.5	17.0	14.6
PBV (x)	1.0	1.0	0.9
Net. Gearing	-0.4	-0.6	-0.6
Div. Yield (%)	1.1	1.1	1.1

Share Price Performance



	1 mth	3 mths	12 mths
Absolute (%)	10.1%	19.2%	-21.3%
Relative (%)	8.2%	19.3%	-14.9%

Adrian Kok

adrian.kok@kenanga.com.my

+603-2172 2653

21 November 2019

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.**

This report has been prepared by Kenanga Investment Bank Berhad pursuant to the Mid and Small Cap Research Scheme ("MidS") administered by Bursa Malaysia Berhad. This report has been produced independent of any influence from Bursa Malaysia Berhad or the subject company. Bursa Malaysia Berhad and its group of companies disclaim any and all liability, howsoever arising, out of or in relation to the administration of MidS and/or this report.

This document has been prepared for general circulation based on information obtained from sources believed to be reliable but we do not make any representations as to its accuracy or completeness. Any recommendation contained in this document does not have regard to the specific investment objectives, financial situation and the particular needs of any specific person who may read this document. This document is for the information of addressees only and is not to be taken in substitution for the exercise of judgement by addressees. Kenanga Investment Bank Berhad accepts no liability whatsoever for any direct or consequential loss arising from any use of this document or any solicitations of an offer to buy or sell any securities. Kenanga Investment Bank Berhad and its associates, their directors, and/or employees may have positions in, and may effect transactions in securities mentioned herein from time to time in the open market or otherwise, and may receive brokerage fees or act as principal or agent in dealings with respect to these companies.

Published and printed by:

KENANGA INVESTMENT BANK BERHAD (15678-H)

Level 17, Kenanga Tower, 237, Jalan Tun Razak, 50400 Kuala Lumpur, Malaysia

Telephone: (603) 2172 0880 Website: www.kenanga.com.my E-mail: research@kenanga.com.my

This report is accessible at www.bursamids.com too.

