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02 May 2018 | Sector Update

Technology Sector

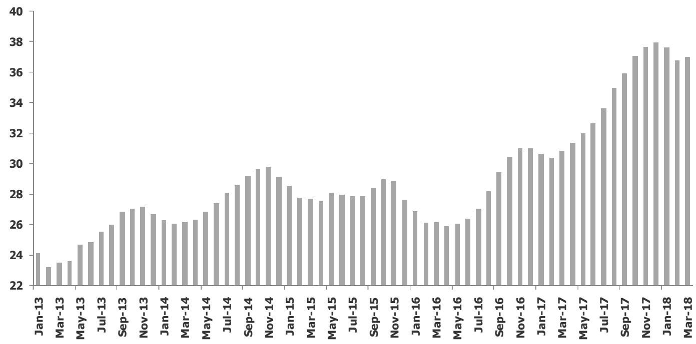
Maintain NEUTRAL

China to step up efforts to grow its domestic chip industry

- **March 2018 sales sustained above USD37b, driven mainly by strong demand of memory products**
- **Capital spending grew at a slower pace on a year-over-year basis, largely due to high base effect**
- **China to accelerate second round of semiconductor funding due to trade tension and US sanctions on ZTE Corp**
- **Maintain NEUTRAL stance on the sector mainly due to: i) expectation of modest sales expansion; ii) slower growth on equipment spending; and iii) uncertainty emanating from the US-China trade tension**

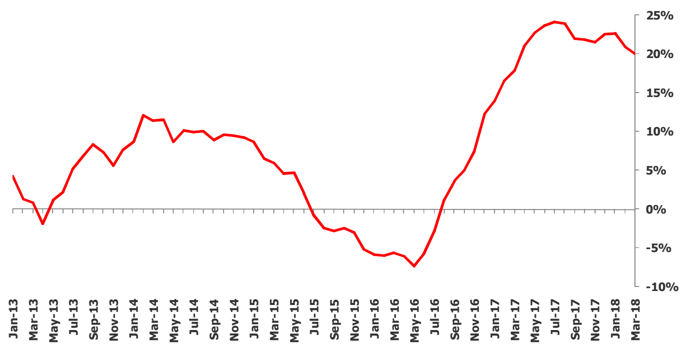
Monthly sales sustained above USD37b. Worldwide sales of semiconductor products advanced by +20.0%yoy to USD37.0b. This represents the 20th consecutive months of year-over-year sales improvement since August 2016. Higher sales were recorded across all major regional markets and all semiconductor product categories, especially for the memory product segment. Meanwhile, on a monthly sequential basis, the global semiconductor sales (GSS) only grew marginally by +0.7%yoy. This is in-line with the typical seasonal market trends. Premised on this, we expect the monthly sales to pick up, on a sequential basis, towards the end of 2Q18 in preparation of various flagship smartphone launches in 3Q18.

Chart 1: Monthly global semiconductor sales (USD billion)



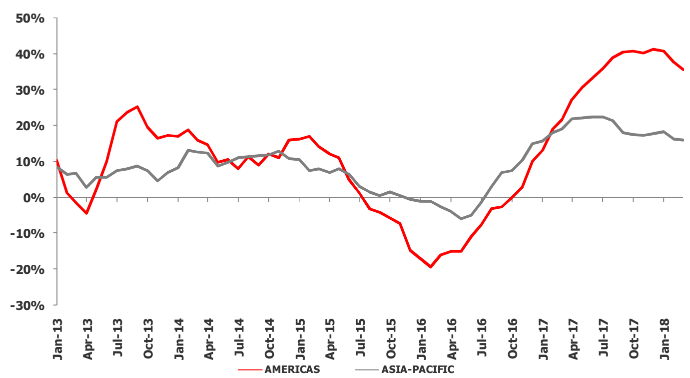
Sources: SIA, MIDFR

Chart 2: Monthly Global semiconductor sales (%yoy)



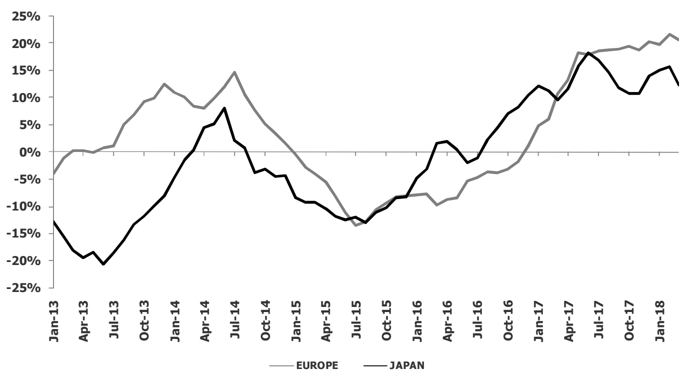
Sources: SIA, MIDFR

Chart 3: Americas and Asia Pacific* sales (%yoy)



Sources: SIA, MIDFR
**Includes China*

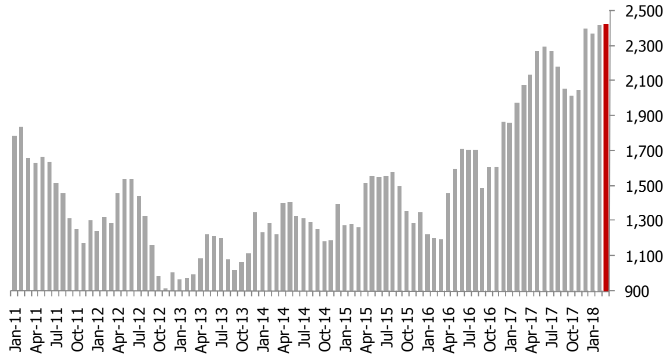
Chart 4: Europe and Japan sales (%yoy)



Sources: SIA, MIDFR

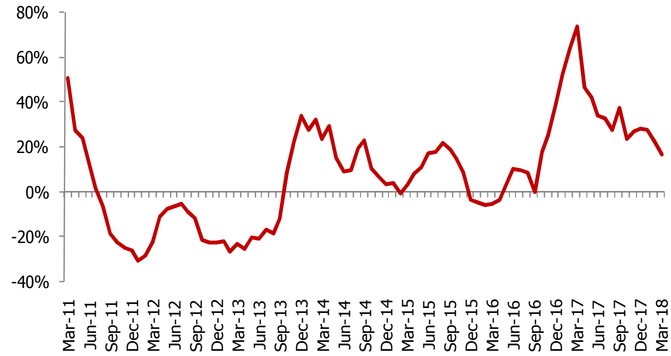
High base effect led to lower spending growth. Billings of semiconductor equipment totalled up to USD2,426.9m for the month of March 2018. This represents a monthly sequential increase of +0.4%mom. On a year-over-year basis, the billings grew at a slower pace of +16.7%yoy, mainly attributable to high base effect. To recall, on March 2017, billings increased by +73.7%yoy. Nonetheless, SEMI is "*seeing sustained strength in the global semiconductor equipment market*". SEMI is expecting the capital spending for full year 2018 to grow by approximately +9.0%yoy. This indicates that the monthly growth rate should taper off towards 2H18.

Chart 5: Billings (USD billion)



Sources: SEMI, MIDFR

Chart 6: Billings (%yoy)



Sources: SEMI, MIDFR

Another round of semiconductor funding. According to newswire, China's state-backed semiconductor fund, known as the National Integrated Circuitry Investment Fund, is near to closing a RMB120b (USD19.0b) investment round for a second fund to boost the local chip production and technologies. This is subsequent to the emergence of US-China trade tension and US sanctions on ZTE Corp. At present, China is still heavily reliant on imported chips. It manufactures only 16% of the semiconductors it uses domestically. The fund is expected to increase the local supply to make up at least 40% of China's semiconductor needs by the middle of the next decade. We expect the move will support the growth in semiconductor equipment spending and ultimately spur the sale of semiconductor products in the long run.

China's smartphone market to stage a comeback. Taiwan Semiconductor Manufacturing Co. Ltd (TSMC) has revised its full-year revenue target lower partially due to soft demand for premium phones. Apple is believed to be the primary reason for this decline in the revenue forecast. On the contrary, Qualcomm issued an optimistic forecast for the current quarter indicating that China's smartphone market is pointing toward a recovery in demand. Qualcomm will stand to benefit because its supplying manufacturers in China are growing by taking market share from Apple. Recall that smartphones shipments in China fell by -21.0%yoy.

Maintain NEUTRAL. The growth rate of monthly worldwide sales of semiconductor has trended lower mainly due to the high base effect. Moving forward, the annual growth rate is expected to taper off to single digit in 2018 according to World Semiconductor Trade Statistic (WSTS). Nonetheless, we expect demand for semiconductor products to remain robust, driven by; i) new smartphone line-up, ii) expected recovery in the tablet market, and iii) stable demand from the automotive industry. Capital spending will continue to growth, albeit at a slower pace.

On another note, the trade tension between the US and China is causing uneasiness among investors. Should the trade tension intensified, it could negatively impact the earnings prospect of semiconductors companies under our coverage. Nonetheless, our channel checks indicate that there is no change to volume order at this juncture. Nevertheless, we do not discount the possibility that future earnings outlook of these companies could be affected. Pending further development on the trade tension, we are maintaining our **NEUTRAL** recommendation on the sector.

Foo Chuan Loong, Martin
martin.foo@midf.com.my
03 - 2173 8354

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STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <-10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.