

04 April 2018 | Sector Update

Technology Sector

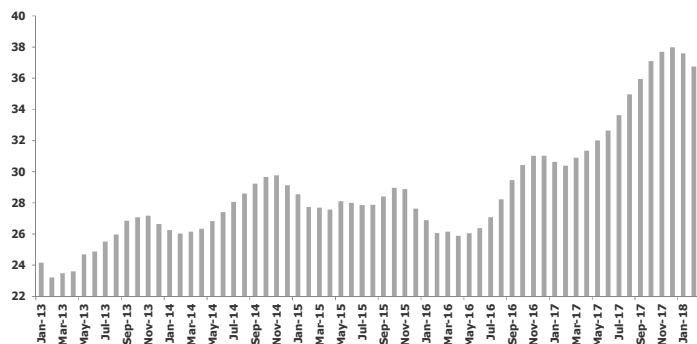
Maintain **NEUTRAL**

Trade war fears linger

- Lower February 2018 sales, in-line with seasonal market trends
- Capital spending on track for third year of spending growth
- Fears in trade wars partially negated by tax exemption for chipmakers in China
- Maintain **NEUTRAL** stance on the sector on: (i) expectation of modest sales growth; (ii) lofty valuation and; (iii) expectation of lower dividend payout

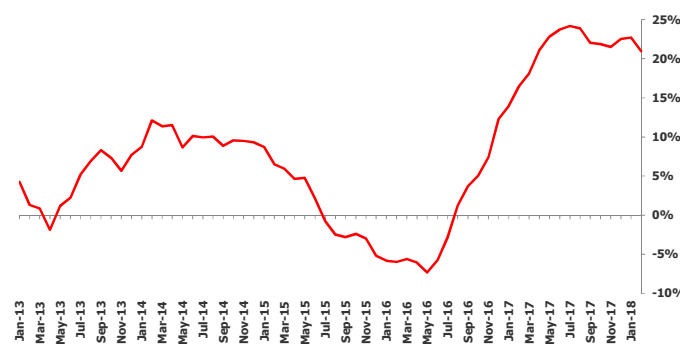
Sales remain resilient. Worldwide sales of semiconductor products rose by +21.0%yoy to USD36.8b. This represents the 19th consecutive month of year-over-year sales improvement since August 2016. Higher sales were recorded across all major regional markets and all semiconductor product categories. On a monthly sequential basis, the global semiconductor sales (GSS) have decreased by -2.2%mom which represent the second consecutive month of decline. 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 smartphones launch in 3Q18.

Chart 1: Monthly global semiconductor sales (USD billion)



Sources: SIA, MIDFR

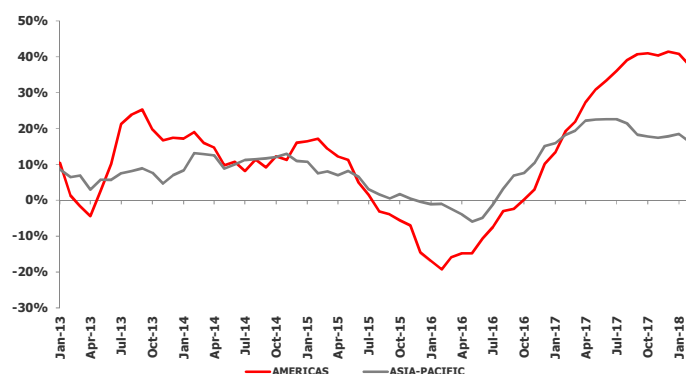
Chart 2: Monthly Global semiconductor sales (%yoy)



Sources: SIA, MIDFR

For the month-in-review, sales from the Americas region grew at the highest pace at +37.7%yoy. The other regional also recorded commendable growth in sales of between +21.7% to +15.5%yoy. However, on a sequential basis, only Europe recorded an increase in year-over-year sales growth of +0.9%yoy while all the other regional markets posted lower sales of between -0.9%yoy to -4.3%yoy.

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



Sources: SIA, MIDFR

*Includes China

Chart 4: Europe and Japan sales (%yoy)



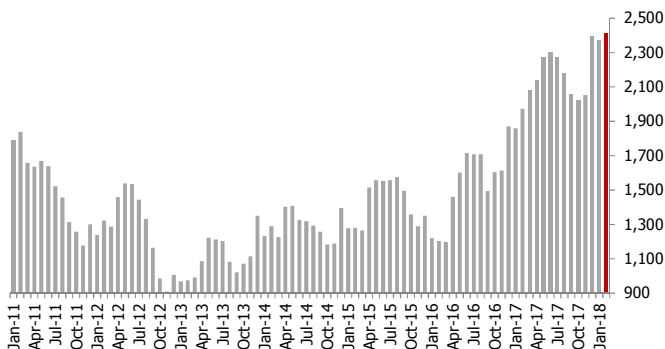
Sources: SIA, MIDFR

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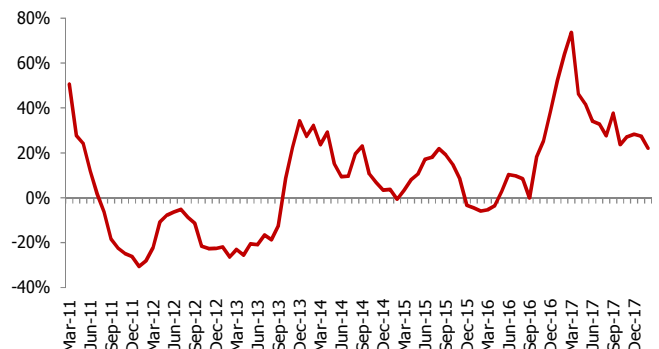
On-track for the third year of spending growth. Billings of semiconductor equipment reached a new height of USD2,411.4m for the month of February 2018. This represents a monthly sequential increase of +1.7%mom after a marginal decline of -1.2%mom recorded for January 2018. On a year-over-year basis, the billings is +22.2%yoy higher as compared to February 2017 billings level of USD1,974.0m. Premised on this, the SEMI expected "2018 to mark the third consecutive year of spending growth, which last occurred in the 1990s." To recall, 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

Tax exemption for chipmakers in China. China has introduced tax breaks for chipmakers made in the country. The move came at a time when the government is seeking to reduce dependency on foreign semiconductors amid trade tensions with the United States over technology transfers. Chipmakers will be exempted from corporate taxes for two to five years followed by partial deductions. The exemptions cover a range of products, from very basic to cutting-edge chips, for use in computers, smartphones and other electronic devices. We view that the move may lead to higher earnings for local semiconductor players which have operations in China. Under our coverage universe, both Inari Amertron Bhd and Unisem (M) Bhd have operations at Kunshan and Chengdu respectively.

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 slower pace. We view that this could negatively impact the dividend payout ratio.

On another note, the trade war between the United States and China has created fear among the investors. Should the trade war 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. Should the trade war intensified, we do not discount the possible that future earnings outlook of these companies could be affected. Pending further development on the trade war, we are maintaining our **NEUTRAL** recommendation on the sector. 

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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 <i>rise</i> 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 <i>fall</i> 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.