

Singapore Company Guide

AEM Holdings Ltd

Version 4 | Bloomberg: AEM SP | Reuters: AEM.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

30 Apr 2020

DBS is supported by the Research Talent Development Grant Scheme which aims to groom research talent to expand research coverage of small-mid cap SGX listed companies

HOLD (Downgrade from BUY)

Last Traded Price (29 Apr 2020): S\$2.37 (STI : 2,574.73)

Price Target 12-mth: S\$2.47 (4% upside) (Prev S\$2.29)

Analyst

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What's New

- Record-high 1Q20; net profit surges 448% to S\$36.1m
- Cloud computing to drive demand for server chips
- Key customer intends to add 20% to capacity in FY20
- Downgrade to HOLD; limited upside to revised TP of S\$2.47

Price Relative



Forecasts and Valuation

FY Dec (\$m)	2018A	2019A	2020F	2021F
Revenue	262	323	379	411
EBITDA	41.6	69.5	81.7	84.6
Pre-tax Profit	40.0	63.7	79.4	82.1
Net Profit	33.5	52.8	65.9	68.2
Net Pft (Pre Ex.)	33.5	52.8	65.9	68.2
Net Pft Gth (Pre-ex) (%)	4.1	57.5	24.9	3.4
EPS (S cts)	12.4	19.6	24.4	25.3
EPS Pre Ex. (S cts)	12.4	19.6	24.4	25.3
EPS Gth Pre Ex (%)	(75)	57	25	3
Diluted EPS (S cts)	12.4	19.6	24.4	25.3
Net DPS (S cts)	3.41	5.10	6.38	6.59
BV Per Share (S cts)	33.3	49.8	67.9	86.5
PE (X)	19.0	12.1	9.7	9.4
PE Pre Ex. (X)	19.0	12.1	9.7	9.4
P/Cash Flow (X)	18.7	9.4	7.0	8.7
EV/EBITDA (X)	13.9	7.7	5.6	4.8
Net Div Yield (%)	1.4	2.2	2.7	2.8
P/Book Value (X)	7.1	4.8	3.5	2.7
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	45.5	47.1	41.5	32.7
Earnings Rev (%):			7	7
Consensus EPS (S cts):			23.0	24.3
Other Broker Recs:		B: 4	S: 0	H: 0

Source of all data on this page: Company, DBS Bank, Bloomberg Finance L.P

Limited upside

Downgrade to HOLD with a revised TP of S\$2.47 on limited upside. We are still overall positive on AEM based on several favourable developments in the industry (spike in demand for server chips and notebooks) and its key customer (improvement in yields in its 10-nm chips and maintaining capacity expansion plan of 20%). However, we are downgrading AEM to HOLD from BUY on the back of a limited upside to our revised TP and the uncertain economic backdrop. AEM's share price has risen by 73% from its trough of S\$1.37 in mid-March 2020.

Record-high 1Q20; net profit surges 448%; maintains sales guidance. AEM's revenue jumped 179% y-o-y to S\$146.8m and net profit surged 448% y-o-y to S\$36.1m. The increase in net profit was attributable to substantially higher sales from its key customer (Intel), and also higher margins. AEM is maintaining its FY20F sales guidance of S\$360-380m and is cautiously optimistic on the outlook.

Where we differ: We are more cautious on the outlook given the uncertainty surrounding the COVID-19 pandemic.

Potential catalysts: Stronger semiconductor equipment billings, increased sales guidance, acquisitions, new revenue streams.

Valuation:

Downgrade to HOLD with a revised TP of S\$2.47. We have revised our FY20F/21F earnings up by 7% each on the back of higher net profit margins. Our TP is still based on 10.0x (+1.5 SD) its historical 12-month rolling forward PE.

Key Risks to Our View:

Single-customer concentration risk, escalation or continued protraction of geopolitical events, and FX risk.

At A Glance

Issued Capital (m shrs)	274
Mkt. Cap (S\$m/US\$m)	649 / 459
Major Shareholders (%)	
Toh Ban Leng	7.6
Morgan Stanley	7.4
Standard Life Aberdeen	6.7
Free Float (%)	78.3
3m Avg. Daily Val (US\$m)	14.4
GIC Industry : Information Technology / Technology Hardware & Equipment	



Live more, Bank less

WHAT'S NEW

Record-high 1Q20

Results Review

AEM reported record-high 1Q20 results despite the COVID-19 pandemic. While the company is maintaining its FY20F revenue guidance of S\$360-380m, it is expecting some 2Q20 revenue to be deferred to 3Q20.

- **1Q20 revenue up 179% y-o-y.** AEM achieved a record-high 1Q20 revenue of S\$146.8m (+179% y-o-y), which is 50% higher than its last high revenue of S\$97.9m in 2Q19. The surge in revenue was mainly due to increased orders from its main customer.
- **1Q20 gross profit margin of 41.1%.** Gross profit margins normalised to c.40% from 49.4% in 4Q19 as it completed its revenue recognition from the development phase of its machines, which command higher margins.
- **1Q20 net profit rose 448% y-o-y.** AEM's net profit surged to S\$36.1m (+448% y-o-y) on the back of higher revenue and margins. Net profit margin increased to 24.6% from 12.5% in 1Q19 mainly due to economies of scale from the higher revenue base, and cost savings from the local sourcing of raw materials.

Our Thoughts: Overall positive for AEM

At this current state of flux, we are still overall positive on AEM based on several affirming developments in its key customer (Intel) and the industry.

- **Demand for cloud computing and notebooks surges on telecommuting; additional infrastructure needed.** Cisco Webex saw a 22-fold increase in network traffic in February while Microsoft Teams suffered some outages as its number of daily active users (DAU) surged by 12 million (40%) to 44 million in the first week of March. Microsoft had to prioritise access to its cloud-based Azure services to cope with demand in the near term and is upgrading its cloud capacity. We are expecting service providers that rely on cloud computing to have to upgrade their infrastructure (expand their bandwidth) to cope with the increased traffic, thereby driving demand for server processors.
- **Intel achieves better yields on its 10-nm chips.** Intel has noted that it is achieving better yields on its 10-

nm chips and has axed its 14-nm Cooper Lake processor to focus on its 10-nm Ice Lake processor.

- **Intel intends to maintain adding 20% capacity in FY20.** Intel is maintaining its plans to increase production capacity by 20% in FY20F.
- **Semiconductor supply chains remain sound.** Semiconductors are classified as essential businesses as they are used in medical equipment, enabling telecommuting, and new technology (5G, AI). Semiconductor companies have been granted approval by governments to continue their operations despite lockdowns in certain countries.

The increase in production volume, chips with smaller nodes, and production capacity all increase test times. This will drive demand for AEM's test handlers, as well as increase the replacement frequency of its parts.

Intel is cautious on 2H20. While Intel had delivered an excellent set of 1Q20 results last week, it came with a cautious tone on 2H20. The company hinted of a possible pushback in capex by six to eight weeks in the near term due to economic growth concerns and regulations.

Earnings and Recommendation

Raise TP to S\$2.47 (previously S\$2.29) on the back of higher earnings driven by higher net profit margins. We are raising our FY20F/21F earnings by 7% each on the back of:

- **Higher gross profit margins** of 40%/40% (previously 39%/38%) in FY20F/21F due to a better product margin mix and lower raw material prices.
- **Lower operating (SG&A) expenses as a percentage of revenue** of 19.4% in FY20F (previously 19.7%) from economies of scale and the Singapore Jobs Support Scheme.

We are now projecting net profit margin of 17.4%/16.6% for FY20F/FY21F, vs 24.6% in 1Q20 and 16% in FY19. Our TP of S\$2.47 is still based on 10.0x its historical 12-month rolling forward PE (+1.5 SD).

Downgrade to HOLD on limited upside to TP. Despite the optimistic developments, we are downgrading our recommendation from BUY to HOLD on:

- **AEM's strong share price performance.** AEM's share price has risen by 73% from its trough of S\$1.37 in mid-March 2020. This outperforms its peer, UMS, whose share price has risen by 38%.
- **The uncertain economic backdrop.**

Quarterly / Interim Income Statement (S\$m)

FY Dec	1Q2019	4Q2019	1Q2020	% chg yoy	% chg qoq
Revenue	52.7	88.7	147	178.5	65.6
Cost of Goods Sold	(32.6)	(44.9)	(86.5)	165.6	92.7
Gross Profit	20.2	43.8	60.4	199.4	37.8
Other Oper. (Exp)/Inc	(12.3)	(24.0)	(16.5)	33.8	(31.1)
Operating Profit	7.82	19.8	43.8	460.8	121.3
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	-	-
Associates & JV Inc	0.09	0.25	0.0	-	-
Net Interest (Exp)/Inc	0.08	0.14	0.0	-	-
Exceptional Gain/(Loss)	0.0	0.0	0.0	-	-
Pre-tax Profit	7.98	20.2	43.8	449.3	117.1
Tax	(1.4)	(3.5)	(7.7)	456.2	123.0
Minority Interest	0.0	0.0	0.0	-	-
Net Profit	6.60	16.7	36.1	447.8	115.8
Net profit bef Except.	6.60	16.7	36.1	447.8	115.8
EBITDA	7.91	20.1	43.8	454.5	118.6
Margins (%)					
Gross Margins	38.2	49.4	41.1		
Opg Profit Margins	14.8	22.3	29.9		
Net Profit Margins	12.5	18.9	24.6		

Source of all data: Company, DBS Bank

CRITICAL DATA POINTS TO WATCH

Critical Factors

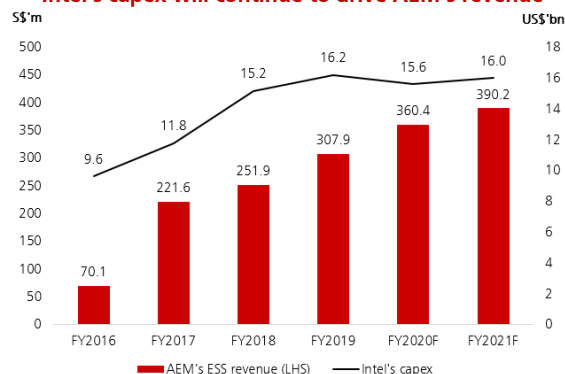
Intel's capital expenditure guidance. More than 90% of its revenue is currently derived from its key customer, Intel, and is captured in Intel's capex. Most of its revenue from Intel is classified under revenue from its Equipment Systems Solutions (ESS). In its 4Q19 earnings presentation, Intel had guided for capex of US\$17bn in FY20F, which will be used to increase the company's fab space and purchase 7-nm and 5-nm equipment. While it has hinted of a possible pushback in capex in the near term due to the economy and regulations, it remains very bullish on the multi-year view of its fast-growing total addressable market (TAM). Working closely as a sticky key supplier to Intel, we believe that AEM's ESS revenue will grow in tandem in FY20F.

US semiconductor equipment billings. AEM's 12-month rolling forward PE correlates closely to the 3-month rolling US semiconductor equipment billings. We remain positive on the industry's recovery and expect equipment billings to trend upwards in the near term on the back of higher demand for server chips, notebooks, medical equipment, and 5G. We believe this will continue to drive a re-rating of AEM's forward PE.

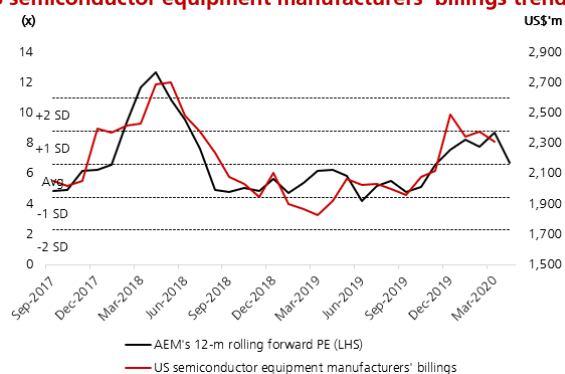
AEM's sales mix. While AEM's Consumables and Services segment generally has slightly higher margins as compared to Tools and Machines, it is shifting to higher-margin machines. Intel has guided that it will be increasing the production capacities of its 14-nm and 10-nm chips by 25% each in 2020. We are expecting gross profit margins to improve slightly due to marginally higher revenue mix from higher-margin products in its Tools and Machines in FY20F/21F.

Inventory levels of top chip makers as well as equipment suppliers in the US. Inventory levels of chip makers and equipment suppliers are a function of anticipated and current demand. Chip makers and equipment suppliers have built up their inventory levels ahead of the anticipated recovery in the semiconductor cycle. As the US-China trade situation improved from aggressive tariffs to a trade-deal standstill, inventory levels fell from 3Q19. This is likely due to an overall recovery in the sector as well as an uplift in business activity following the slight easing of the US-China trade war. We believe inventory levels will decline slightly or remain at the same level as demand for server chips picks up in FY20F.

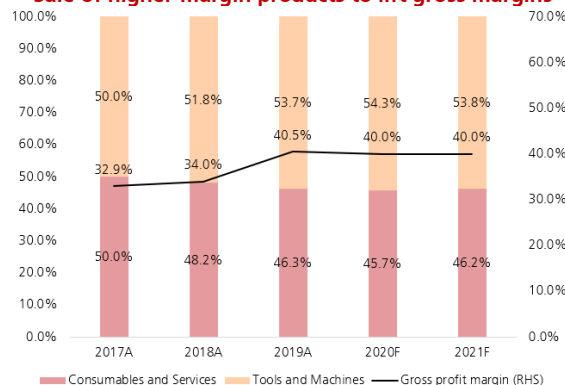
Intel's capex will continue to drive AEM's revenue



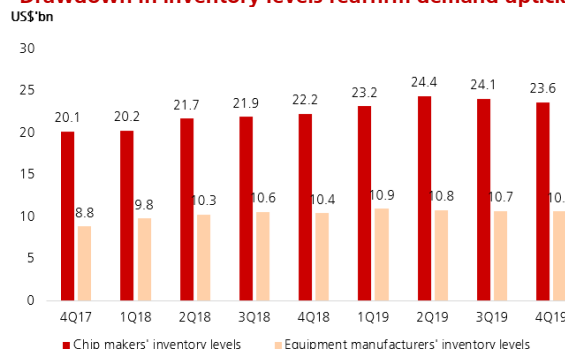
US semiconductor equipment manufacturers' billings trend up



Sale of higher-margin products to lift gross margins



Drawdown in inventory levels reaffirm demand uptick



Source: Company, DBS Bank

AEM Holdings Ltd

Balance Sheet:

Net cash position with minimal debt. As of 1Q20, AEM had a cash balance of S\$100.2m and minimal debt. In the last five years, AEM had close to negligible debt levels and had been financing its operations and acquisitions through its own cashflow. It is currently on the lookout for potential acquisitions that could create synergies with its existing business.

Share Price Drivers:

US 3-month semiconductor billings. AEM's share price and forward PE correlate closely to the US 3-month semiconductor billings. We believe that the recovery and end-demand driven by server chips in the near term will drive semiconductor billings and re-rate AEM's forward PE.

Order book and sales guidance. Management provides guidance on its revenue which is estimated from its order book. In FY19, AEM raised its sales guidance four times, which resulted in its share price increasing by an average of 4.0% on each announcement day.

Key Risks:

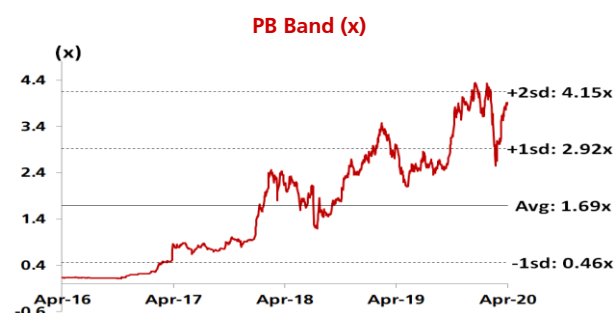
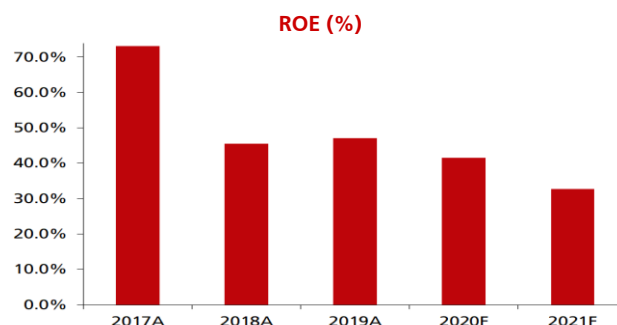
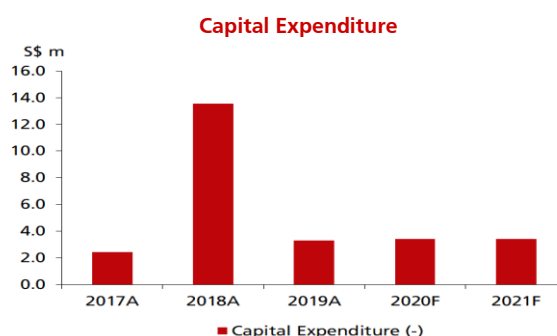
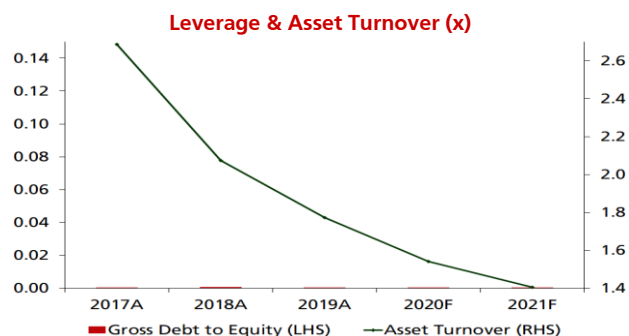
Single-customer concentration risk. Around 90% of AEM's revenue is derived from Intel. Out of this, c.50% is from sales of equipment, which is lumpy in nature and dependent on Intel's need to replace existing machines or increase its production capacity.

Prolonged COVID-19 situation. The COVID-19 pandemic has disrupted global supply chains in China and dampened the economic outlook. If the outbreak escalates and is prolonged, it may weigh on the recovery of the semiconductor cycle.

Re-escalation of the US-China trade war. The US-China trade war weighed heavily on the global manufacturing cycle, reducing the demand for semiconductor end-products as well as disrupting the supply chain. A re-escalation of the trade war could hamper the recovery of the semiconductor industry.

Company Background

AEM is a solutions provider for the back-end testing of the semiconductor manufacturing process. It works closely with its key customer, Intel, to design, engineer, and manufacture the test handlers. AEM then provides field support and post-sales replacements.



Source: Company, DBS Bank

Income Statement (\$\$m)

FY Dec	2017A	2018A	2019A	2020F	2021F
Revenue	222	262	323	379	411
Cost of Goods Sold	(149)	(173)	(192)	(227)	(247)
Gross Profit	73.0	89.1	131	151	164
Other Opng (Exp)/Inc	(35.4)	(49.4)	(67.9)	(72.6)	(82.9)
Operating Profit	37.6	39.8	62.9	78.8	81.5
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	(0.1)	0.0	0.46	0.0	0.0
Net Interest (Exp)/Inc	0.04	0.26	0.36	0.60	0.60
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	37.5	40.0	63.7	79.4	82.1
Tax	(5.4)	(6.5)	(11.0)	(13.5)	(14.0)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	32.2	33.5	52.8	65.9	68.2
Net Profit before Except.	32.2	33.5	52.8	65.9	68.2
EBITDA	38.2	41.6	69.5	81.7	84.6
Growth					
Revenue Gth (%)	216.0	18.4	23.2	17.1	8.6
EBITDA Gth (%)	449.5	8.9	67.0	17.6	3.5
Opg Profit Gth (%)	474.5	5.7	58.3	25.3	3.4
Net Profit Gth (Pre-ex) (%)	575.3	4.1	57.5	24.9	3.4
Margins & Ratio					
Gross Margins (%)	32.9	34.0	40.5	40.0	40.0
Opg Profit Margin (%)	17.0	15.2	19.5	20.8	19.8
Net Profit Margin (%)	14.5	12.8	16.3	17.4	16.6
ROAE (%)	73.1	45.5	47.1	41.5	32.7
ROA (%)	39.0	26.5	29.0	26.8	23.3
ROCE (%)	72.4	44.7	46.3	41.3	32.6
Div Payout Ratio (%)	24.9	27.4	26.1	26.1	26.1
Net Interest Cover (x)	NM	NM	NM	NM	NM

Source: Company, DBS Bank

Quarterly / Interim Income Statement (\$\$m)

FY Dec	1Q2019	2Q2019	3Q2019	4Q2019	1Q2020
Revenue	52.7	97.9	83.9	88.7	147
Cost of Goods Sold	(32.6)	(62.8)	(52.2)	(44.9)	(86.5)
Gross Profit	20.2	35.2	31.7	43.8	60.4
Other Oper. (Exp)/Inc	(12.3)	(16.3)	(15.3)	(24.0)	(16.5)
Operating Profit	7.82	18.9	16.4	19.8	43.8
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	0.09	0.05	0.08	0.25	0.0
Net Interest (Exp)/Inc	0.08	0.07	0.07	0.14	0.0
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	7.98	19.0	16.6	20.2	43.8
Tax	(1.4)	(3.3)	(2.9)	(3.5)	(7.7)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Net Profit	6.60	15.7	13.7	16.7	36.1
Net profit bef Except.	6.60	15.7	13.7	16.7	36.1
EBITDA	7.91	18.9	16.5	20.1	43.8

Growth

Revenue Gth (%)	34.0	85.7	(14.4)	5.7	65.6
EBITDA Gth (%)	72.1	139.3	(12.8)	21.5	118.6
Opg Profit Gth (%)	79.8	141.4	(13.0)	20.6	121.3
Net Profit Gth (Pre-ex) (%)	50.2	138.1	(12.7)	22.0	115.8

Margins

Gross Margins (%)	38.2	35.9	37.8	49.4	41.1
Opg Profit Margins (%)	14.8	19.3	19.6	22.3	29.9
Net Profit Margins (%)	12.5	16.0	16.4	18.9	24.6

Net profit margin surges on the back of higher revenue base and lower raw material cost from local sourcing

Balance Sheet (\$\$m)

FY Dec	2017A	2018A	2019A	2020F	2021F
Net Fixed Assets	3.62	5.73	6.27	8.48	10.5
Invt in Associates & JVs	4.13	4.15	4.57	4.57	4.57
Other LT Assets	3.45	17.8	19.1	17.5	15.8
Cash & ST Invt	46.1	58.9	108	178	231
Inventory	35.8	27.4	57.5	25.2	27.3
Debtors	23.6	18.0	28.0	24.9	28.1
Other Current Assets	0.0	4.49	4.86	4.86	4.86
Total Assets	117	136	228	263	322
ST Debt	0.01	0.0	0.0	0.0	0.0
Creditor	52.2	33.1	73.1	57.9	65.4
Other Current Liab	6.04	10.6	18.2	20.0	20.5
LT Debt	0.0	0.05	0.05	0.05	0.05
Other LT Liabilities	0.59	3.21	2.30	2.30	2.30
Shareholder's Equity	57.8	89.5	134	183	233
Minority Interests	0.0	0.0	0.0	0.0	0.0
Total Cap. & Liab.	117	136	228	263	322
Non-Cash Wkg. Capital	1.10	6.22	(1.0)	(23.0)	(25.7)
Net Cash/(Debt)	46.1	58.8	108	178	231
Debtors Turn (avg days)	34.0	28.9	25.9	25.5	23.5
Creditors Turn (avg days)	85.1	90.9	104.1	106.7	92.4
Inventory Turn (avg days)	65.7	67.4	83.2	67.3	39.3
Asset Turnover (x)	2.7	2.1	1.8	1.5	1.4
Current Ratio (x)	1.8	2.5	2.2	3.0	3.4
Quick Ratio (x)	1.2	1.8	1.5	2.6	3.0
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	34,971.4	27,632.7	6,751.0	6,975.5	6,975.5

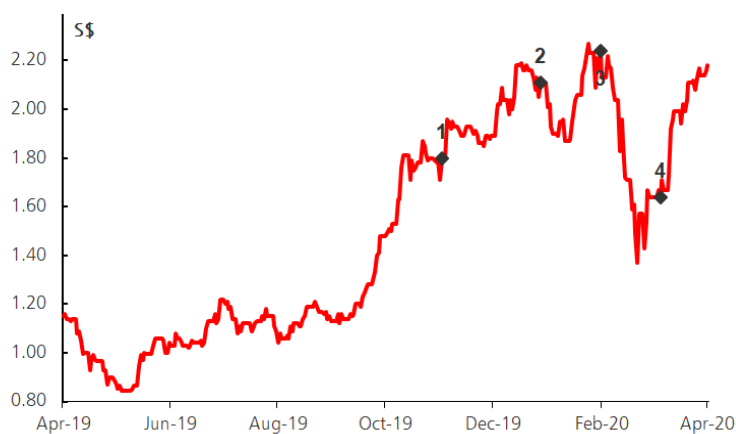
Source: Company, DBS Bank

Cash Flow Statement (\$m)

FY Dec	2017A	2018A	2019A	2020F	2021F
Pre-Tax Profit	37.5	40.0	63.7	79.4	82.1
Dep. & Amort.	0.70	1.87	6.08	2.89	3.08
Tax Paid	(0.3)	(5.2)	(6.7)	(11.6)	(13.5)
Assoc. & JV Inc/(loss)	0.11	0.04	(0.5)	0.0	0.0
Chg in Wkg.Cap.	10.1	(4.7)	(2.2)	20.1	2.21
Other Operating CF	1.74	2.02	7.20	0.0	0.0
Net Operating CF	49.9	34.1	67.7	90.8	73.9
Capital Exp.(net)	(2.5)	(13.5)	(3.3)	(3.4)	(3.4)
Other Invt.(net)	0.0	0.0	0.0	0.0	0.0
Invt in Assoc. & JV	0.0	0.0	0.0	0.0	0.0
Div from Assoc & JV	0.0	0.0	0.0	0.0	0.0
Other Investing CF	0.07	0.30	0.52	0.0	0.0
Net Investing CF	(2.4)	(13.2)	(2.8)	(3.4)	(3.4)
Div Paid	(4.5)	(8.4)	(10.5)	(17.2)	(17.8)
Chg in Gross Debt	(0.1)	(0.3)	(0.2)	0.0	0.0
Capital Issues	0.15	0.0	0.0	0.0	0.0
Other Financing CF	(2.0)	(0.6)	(4.5)	0.0	0.0
Net Financing CF	(6.4)	(9.2)	(15.2)	(17.2)	(17.8)
Currency Adjustments	(1.4)	1.17	(0.9)	0.0	0.0
Chg in Cash	39.8	12.8	48.8	70.2	52.7
Opg CFPS (\$ cts)	60.7	14.4	25.9	26.2	26.6
Free CFPS (\$ cts)	72.4	7.64	23.9	32.4	26.1

Source: Company, DBS Bank

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	29 Nov 19	1.80	2.38	BUY
2:	24 Jan 20	2.11	2.38	BUY
3:	27 Feb 20	2.24	2.52	BUY
4:	01 Apr 20	1.64	2.29	BUY

Note: Share price and Target price are adjusted for corporate actions.

Source: DBS Bank

Analyst: Lee Keng LING

Singapore Research Team

DBS Bank recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

**Share price appreciation + dividends*

Completed Date: 30 Apr 2020 08:06:58 (SGT)

Dissemination Date: 30 Apr 2020 08:21:04 (SGT)

Sources for all charts and tables are DBS Bank unless otherwise specified.

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