# AEM Holdings (AEM SP)

# 5G beneficiary

# Key beneficiary of rising SLT trend; BUY

System level test is gaining traction, due to rising complexity of chips, and the need to test mission-critical devices reliably. We continue to see AEM as a key beneficiary of this trend, on the back of its strong knowhow and track record in this area. We also see FY21E as a growth year, driven by new products across several customers. Maintain BUY and TP of SGD5.05 (14x FY21E P/E).

## Increasingly complex testing needs boon for SLT

The rollout of 5G enables increased complexity in mission-critical applications - in turn creating unprecedented challenges in chip testing. As semiconductor nodes decrease and heterogeneous packaging becomes mainstream, the need for system level test (SLT) is likely to increase. We see AEM as a beneficiary of this given their first-mover advantage and strong track record serving Intel. VLSI Research projects SLT to grow at a 4.4x faster pace than wafer sort and functional test in 2020-24, driven by the need to increase test coverage reliably in chips where design-for-test techniques leave hundreds of millions of transistors untested.

### New products are FY21E drivers

We project FY21E to be a growth year, driven by continued momentum for new products introduced in 2020 - including for Intel (hybrid project), Huawei (TMS) and the memory customer (AMPS). This is offset by our own assumption of reduced HDMT equipment shipments due to potential high-base effects in 2020. AEM will announce FY21 guidance in Jan-21.

## Valuation and risks

As normalising seasonality patterns may create difficult YoY comparisons in 4Q20 and 1Q21, we see risks of near-term share price volatility. We believe these are opportunities to BUY on dips, given AEM's favourable long-term growth prospects. As SLT gains traction, we also see AEM as an M&A candidate. AEM is trading at 5.2x FY21E EV/EBITDA, which compares favourably to the 7.8x that peer Cohu bought Xcerra for in 2018. Key risk to our view is if Intel loses more market share than expected, which may result in lower demand for AEM's equipment.

FYE Dec (SGD m)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue	262	323	512	517	545
EBITDA	42	70	116	126	134
Core net profit	33	53	91	99	106
Core FDEPS (cts)	12.3	19.4	33.0	36.0	38.7
Core FDEPS growth(%)	3.4	58.3	69.8	9.2	7.5
Net DPS (cts)	3.4	5.1	8.2	9.0	9.7
Core FD P/E (x)	6.7	10.4	9.8	9.0	8.4
P/BV (x)	2.5	4.1	4.4	3.2	2.5
Net dividend yield (%)	4.1	2.5	2.5	2.8	3.0
ROAE (%)	45.5	47.3	53.8	41.3	33.6
ROAA (%)	26.6	29.1	33.3	28.6	25.0
EV/EBITDA (x)	4.0	6.3	6.4	5.2	4.4
Net gearing (%) (incl perps)	net cash				
Consensus net profit	-	-	92	102	105
MKE vs. Consensus (%)	-	-	(1.3)	(2.8)	0.9

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# BUY

Share Price	SGD 3.24
12m Price Target	SGD 5.05 (+58%)
Previous Price Target	SGD 5.05

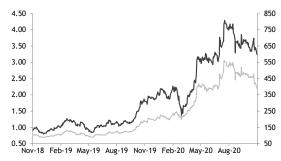
#### **Company Description**

AEM manufactures equipment used in the semiconductor back-end process

#### Statistics

52w high/low (SGD)	4.29/1.37
3m avg turnover (USDm)	14.0
Free float (%)	76.9
Issued shares (m)	276
Market capitalisation	SGD895.7M
	USD667M
Major shareholders:	
Toh Ban Leng James	5.0%
Aberdeen Standard Investments (Asia) Ltd	5.0%
UBS Group AG	4.9%

#### Price Performance



AEM Holdings - (LHS, SGD) AEM Holdings / Straits Times Index - (RHS, %)

	-1M	-3M	-12M
Absolute (%)	(10)	(19)	78
Relative to index (%)	(20)	(27)	104
Source: FactSet			

#### Link to sector note:

ASEAN Technology - Riding a new wave; U/G to POSITIVE



# Value Proposition

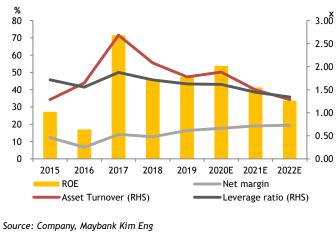
- Back-end test-equipment manufacturer that has codeveloped the HDMT handler for a market-leading chipmaker with a market cap of USD210b.
- Leading-edge HDMT technology has helped its core customer achieve 2x savings in chip-testing costs.
- AEM provides strong synergies like field-service capabilities and manufacturing scale for the high-tech companies that it acquires.
- High single-customer and product risks.

#### Share of new revenue sources progressively growing SGDm % 600 25 500 20 400 15 300 10 200 5 100 ٥ ٥ 2017 2018 2019 2020E 2021E 2022E 2015 2016 Precision components Kits Spares Services (ESS) Tools/ Machine (ESS) Afore (MEMS) Hybrid project TMS - Net margin (RHS) SLTI Source: Company, Maybank Kim Eng

# **Financial Metrics**

- We expect 70% YoY earnings growth in 2020E, driven by sustained sales to Intel and contributions from new initiatives and customers.
- AEM is not a capex-intensive company. Improved cashflow from 2016 levels has allowed AEM to pursue highly synergistic acquisitions.
- Training a batch of engineers during pre-production ramp up could take 5-6 months. During such time, staff costs could be elevated and profitability could temporarily decline.
- Adopted 25% dividend payout ratio policy in 2017.

### DuPont ROE



# **Price Drivers**

#### Historical share price trend



Source: Company, FactSet, Maybank Kim Eng

- 1. Announced favourable 1Q17 net profit as HDMT handlers delivery pick up momentum. There were also insider purchases.
- Announced 2018 guidance for SGD255m in revenue and SGD42m PBT.
- 3. Announced accretive acquisition of Afore, Finnish-based MEMS test-solutions provider.
- 4. Novo Tellus distributes AEM shares in-specie to investors; Core customer announces 10nm delay.
- 5. AEM's core customer denies rumours from tech-blog SemiAccurate that its 10nm process was cancelled.

# **Swing Factors**

# Upside

- Revenue expansion from securing new customers or wallet expansion/increased orders from existing customers.
- Synergistic and accretive acquisitions.
- Positive customer-related news flow that could catalyse improved orders for AEM, such as capacity expansion or launch of new chips.

# Downside

- Order cancellation, delays and earnings misses.
- Emerging technology from rivals that could erode AEM's competitive position with customer(s).
- Erosion in the competitive advantages of the core customer as a result of company specific or industry related developments.

# ESG

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## **Business Model & Industry Issues**

- As an equipment maker, AEM is inherently exposed to environmental, workplace safety, and socio-economic risks. AEM has
  had zero incidences of environmental non-compliance, as well as zero substantiated cases of corruption and legal
  compliance issues in 2019.
- From an environmental and social perspective, AEM screens all of its suppliers. AEM constantly strives to be more efficient with electricity usage, and ensures employees are well trained and remunerated fairly.
- AEM is recognised for good transparency with shareholders, while still being able to balance business requirements (e.g. respecting non-disclosure agreements).
- AEM has several new products in the pipeline and it is engaging customers for more. In our view, this is the key for economic sustainability, as well as for development of its own employees.

# Material E issues

- AEM's environmental exposure is through energy, water and inputs (fabricated parts and electronics).
- AEM adheres to all National Environment Agency laws and regulations and has not had incidences of environmental non-compliance over the past 10 years.
- Further, AEM's constant energy-saving initiatives have resulted in energy consumption rising by only 7.5% (in kWh) in 2019 despite a 23% increase in revenue.
- AEM screens suppliers for negative environmental and social impacts, including pollutions, biodiversity loss, global warming, incidences of child labour, breaches of customer privacy, and more. All eight key fabrication suppliers and 23 key standard part suppliers were found to have no negative environmental or social impacts.

# **Material S issues**

- AEM values talent retention. One approach is through wages. In Malaysia, where around a-third of production takes place, AEM's entry wage for production workers have been higher than the minimum wage at least since 2017, to retain employees. Entry wages are also higher than minimum wages in the US and China.
- Workforce diversity. AEM is an equal-opportunities employer. Management are hired from local communities and consists of various nationalities. 86% of management are local across AEM's footprint globally.
- Workplace safety. AEM trains its employees on health and safety work practices. In 2018, there was 1 minor injury.
- In 2019, average training per employee was 15.7 hours, or 7,590 hours in total, to equip staff with skills across technical, project management and software domains.
- Females comprise 22-23% of the total work force, and 19-23% of new hires since 2017.
- Turnover rate per month ranged from 1.1-2.1% in FY17-19.
   2020 target is to maintain turnover rate at below 1.5% a month.

# Key G metrics and issues

- The board has seven directors, of which one is the executive chairman, four are independent directors (57%), and two are non-independent, non-executive. All the directors are male.
- The audit & risk management, remuneration, and nominating committees are chaired by independent directors. The strategy committee, which works with management on long-term strategic planning, is chaired by the executive chairman.
- Executive chairman Mr. Loke Wai San plans to return to a non-executive chairman role from 1 Jan-21.
- Key management compensation (comprising the Board and senior management) accounted for 27% of staff costs in 2019 (2018:17%). FY19 profit was 58% higher YoY.
- In 2019, AEM won "Most Transparent Company Award, Technology" and was runner up for the "Singapore Corporate Governance Award" by SIAS. AEM regularly updates on its sales guidance and orders received and it's active in engaging with the investment community.
- Zero substantiated cases of corruption or legal compliance issues in 2019, to be maintained in 2020.
- AEM was granted two patents in 2019, and the staff involved were rewarded. AEM views its considerable engineering development revenue as a positive sign of customer satisfaction and relationship.

FYE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Key Metrics					
P/E (reported) (x)	9.2	6.2	9.8	9.0	8.4
Core P/E (x)	6.7	10.3	9.8	9.0	8.4
Core FD P/E (x)	6.7	10.4	9.8	9.0	8.4
P/BV (x)	2.5	4.1	4.4	3.2	2.5
P/NTA (x)	2.5	4.1	4.4	3.2	2.5
Net dividend yield (%)	4.1	2.5	2.5	2.8	3.0
FCF yield (%)	12.2	11.1	7.3	12.9	10.6
EV/EBITDA (x)	4.0	6.3	6.4	5.2	4.4
EV/EBIT (x)	4.1	6.9	6.9	5.6	4.7
INCOME STATEMENT (SGD m)					
Revenue	262.3	323.1	512.3	517.3	545.4
Gross profit	89.1	130.8	202.9	210.5	224.7
EBITDA	41.9	69.5	115.7	125.7	134.4
Depreciation	(1.9)	(4.4)	(4.8)	(4.8)	(4.6
Amortisation	0.0	(1.5)	(3.6)	(3.6)	(3.6
EBIT	40.0	63.6	107.3	117.3	126.2
Net interest income /(exp)	(0.0)	(0.2)	0.8	0.8	0.8
Associates & JV	(0.0)	0.5	1.0	1.0	1.0
Exceptionals	0.0	0.0	0.0	0.0	0.0
Other pretax income	0.0	0.0	0.0	0.0	0.0
Pretax profit	40.0	63.9	109.1	119.1	128.0
Income tax	(6.5)	(11.0)	(18.5)	(20.3)	(21.8)
Minorities	0.0	0.0	0.0	0.0	0.0
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	33.5	52.9	90.6	98.9	106.2
Core net profit	33.5	52.9	90.6	98.9	106.2
	55.5	52.7	,0.0	,0.,	100.1
BALANCE SHEET (SGD m)					
Cash & Short Term Investments	58.8	107.7	146.7	233.2	297.2
Accounts receivable	21.7	28.0	53.4	42.9	52.7
Inventory	28.2	57.5	79.9	63.0	86.4
Property, Plant & Equip (net)	5.7	6.4	6.6	5.9	5.3
Intangible assets	16.8	19.0	19.0	19.0	19.0
Investment in Associates & JVs	4.2	4.6	5.6	6.6	7.
Other assets	0.2	4.9	4.9	4.9	4.9
Total assets	135.5	228.0	316.0	375.4	473.0
ST interest bearing debt	0.2	0.0	0.0	0.0	0.0
Accounts payable	36.6	73.1	99.8	85.1	103.0
LT interest bearing debt	0.0	0.0	0.0	0.0	0.0
Other liabilities	9.0	20.0	14.0	14.0	14.0
Total Liabilities	46.0	93.6	113.8	99.0	116.9
Shareholders Equity	89.5	134.3	202.3	276.4	356.
Minority Interest	0.0	0.0	0.0	0.0	0.0
Total shareholder equity	89.5	134.3	202.3	276.4	356.1
Total liabilities and equity	135.5	228.0	316.0	375.4	473.0
CASH FLOW (SGD m)	40.0	62.0	100 1	110 1	170 /
Pretax profit	40.0	63.9	109.1	119.1	128.0
Depreciation & amortisation	1.9	5.9	8.4	8.4	8.3
Adj net interest (income)/exp	0.0	0.0	0.0	0.0	0.0
Change in working capital	(6.2)	2.3	(27.7)	12.6	(15.2
Cash taxes paid	(4.2)	(5.8)	(18.5)	(20.3)	(21.8
Other operating cash flow	0.0	0.0	0.0	0.0	0.
Cash flow from operations	31.5	65.8	70.3	118.8	98.
Capex	(4.0)	(5.1)	(5.0)	(4.0)	(4.0
Free cash flow	27.5	60.7	65.3	114.8	94.
Dividends paid	(8.4)	(10.5)	(22.6)	(24.7)	(26.6
Equity raised / (purchased)	6.0	0.0	0.0	0.0	0.
Change in Debt	0.3	(0.3)	0.0	0.0	0.
Other invest/financing cash flow	(1.7)	(1.3)	(3.6)	(3.6)	(3.6
Effect of exch rate changes	(11.0)	0.2	0.0	0.0	0.
Net cash flow	12.7	48.9	39.0	86.5	64.0

FYE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Key Ratios					
Growth ratios (%)					
Revenue growth	18.4	23.2	58.6	1.0	5.4
EBITDA growth	11.3	65.8	66.4	8.6	6.9
EBIT growth	8.3	58.8	68.7	9.3	7.6
Pretax growth	8.5	59.9	70.7	9.2	7.5
Reported net profit growth	6.4	58.1	71.0	9.2	7.5
Core net profit growth	6.4	58.1	71.0	9.2	7.5
Profitability ratios (%)					
EBITDA margin	16.0	21.5	22.6	24.3	24.6
EBIT margin	15.3	19.7	20.9	22.7	23.1
Pretax profit margin	15.2	19.8	21.3	23.0	23.5
Payout ratio	27.6	26.0	25.0	25.0	25.0
DuPont analysis					
Net profit margin (%)	12.8	16.4	17.7	19.1	19.5
Revenue/Assets (x)	1.9	1.4	1.6	1.4	1.2
Assets/Equity (x)	1.5	1.7	1.6	1.4	1.3
ROAE (%)	45.5	47.3	53.8	41.3	33.6
ROAA (%)	26.6	29.1	33.3	28.6	25.0
Liquidity & Efficiency					
Cash conversion cycle	5.2	5.2	7.9	8.9	9.9
Days receivable outstanding	31.0	27.7	28.6	33.5	31.6
Days inventory outstanding	66.5	80.2	79.9	83.8	83.8
Days payables outstanding	92.3	102.7	100.6	108.5	105.5
Dividend cover (x)	3.6	3.8	4.0	4.0	4.0
Current ratio (x)	2.4	2.2	2.6	3.6	3.9
Leverage & Expense Analysis					
Asset/Liability (x)	2.9	2.4	2.8	3.8	4.0
Net gearing (%) (incl perps)	net cash				
Net gearing (%) (excl. perps)	net cash				
Net interest cover (x)	nm	nm	na	na	na
Debt/EBITDA (x)	0.0	0.0	0.0	0.0	0.0
Capex/revenue (%)	1.5	1.6	1.0	0.8	0.7
Net debt/ (net cash)	(58.5)	(107.7)	(146.7)	(233.2)	(297.2)

Source: Company; Maybank

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#### APPENDIX I: TERMS FOR PROVISION OF REPORT, DISCLAIMERS AND DISCLOSURES

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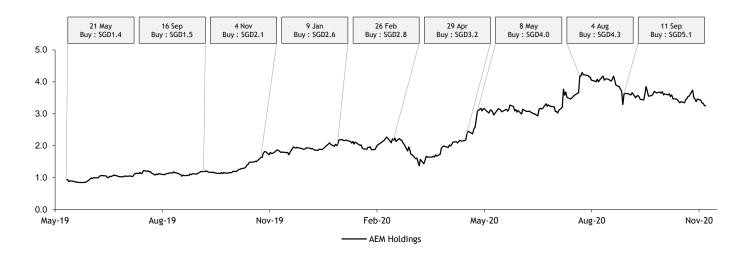
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#### Historical recommendations and target price: AEM Holdings (AEM SP)



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