



Strategy

Bulls to return after digesting slowing earnings & rate hike negatives

Key message

We predict a Taie x rally by the end of 2023, despite the negatives of slowing earnings and interest rate hikes, because the manufacturing sector will start restocking and policy support expectations will shore up market sentiment. We recommend accumulating plays that will benefit from strong restocking demand and policy support.

Earnings and rate hike negatives to depress Taie x further

The Taie x has been correcting since August, primarily due to high AI share valuations and a lack of catalysts, as well as soaring US Treasury yields, which have depressed risk appetite. We don't expect this round of correction to end until mid-October, before or after earnings season starts, as the market needs to digest the following negatives: (1) 3Q23F AI supply chain earnings will cool significantly; (2) consumer electronics will face a lukewarm peak season in 4Q23F; and (3) US dollar strength will prompt FINI to further sell-off Taie x shares.

While long-term AI supply chain business is being driven by the global AI arms race, the 3Q23 earnings outlook is not very promising. We predict the server assembly, power supply, and thermal dissipation subsectors will all see earnings contract YoY in 3Q23, versus YoY growth in 2Q23, due to a high base and tight GPU supply. We forecast server assemblers' earnings will reverse course from 27% YoY growth in 2Q23 to a 20% YoY decline in 3Q23, while power supply makers will turn from 7% YoY growth to a 6% YoY decline, and thermal dissipation solution manufacturers will reverse from 2% YoY growth to a 14% decline. The NT dollar depreciated nearly 7% against the US dollar in 3Q22, with forex gains contributing 14% of Taie x earnings in the quarter. By contrast, NT dollar depreciation in 3Q23 has been just 2-3%. In July-August, the sales achievement ratios for the server assembly, power supply, and thermal dissipation subsectors were a respective 65%, 64%, and 68%, slightly missing consensus on tight GPU supply.

The market has recently begun to expect PC, handset, and other consumer electronics demand to recover from 4Q23. However, panel sector pricing, a leading tech sector demand indicator, has experienced resistance of late in its pricing uptrend, suggesting that demand for PC, handsets, and other consumer electronics will not recover markedly in 4Q23-1H24. The panel sector pricing uptrend that began in March, following the trough in September 2022, is primarily being driven by panel production cuts. However, demand for TVs and PCs remains sluggish, and panel price quotes for November could begin to fall. All this points to a muted 4Q23 peak season for the broader consumer electronics sector.

The US Dollar Index has rallied a hefty 4% since August due to declining risk appetite amid the Chinese housing sector crisis and market anticipation of higher-for-longer US interest rates, the latter bolstered by unexpectedly stubborn US inflation. US Dollar Index strength has led to FINI sell-off pressure on the Taie x and other Asian stock indices. Looking forward, recent surprisingly hawkish guidance from the Fed bodes ill for the likelihood of FINI returning to be net buyers of TWSE-listed stocks due to the strengthening US dollar. Nonetheless, this negative could be digested before the next FOMC meeting on November 1.

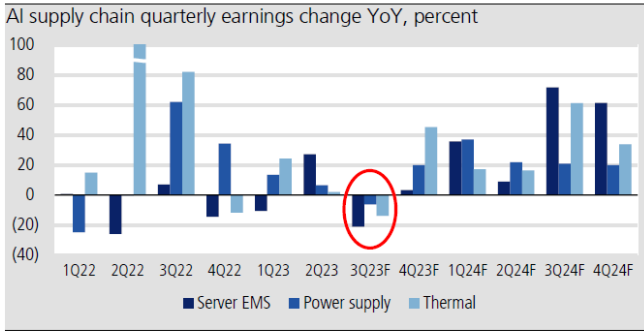
Taie x to rally by end-2023F

The demand recovery outlook for PC, handsets, and other consumer electronics remains unclear. However, we believe smooth inventory digestion progress and the relatively stable global economy will usher in a new wave of restocking by end-2023F, similar to the supply-driven restocking cycle experienced by the panel sector over the past year. Furthermore, policy support prompted by the upcoming Taiwanese presidential election will shore up risk appetite within the market, especially for the green energy and military engineering/aerospace sectors.

Valuation & Action

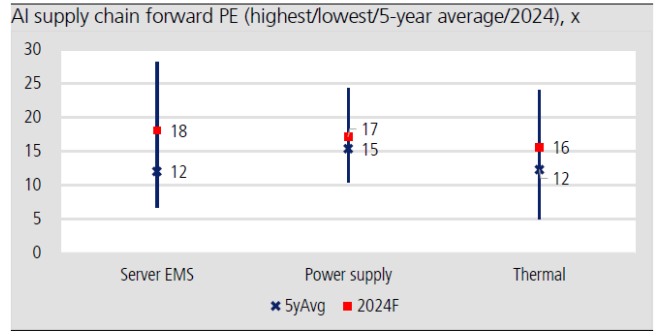
We predict a Taie x rally by end-2023, despite the negatives of slowing earnings and interest rate hikes, as the manufacturing sector will see restocking demand resume and policy support expectations will shore up market sentiment. We recommend plays that will benefit from strong restocking demand and policy support. Our top picks are Compeq (2313 TT), MSI (2377 TT), Auras (3324 TT), Nanya Technology (2408 TT), Media Tek (2454 TT), Novatek (3034 TT), Unimicron (3037 TT), Simplo (6121 TT), AIDC (2634 TT), and Chung-Hsin Electric (1513 TT).

Figure 1: 3Q23F earnings of AI suppliers to fall YoY, with worse performance than in 2Q23



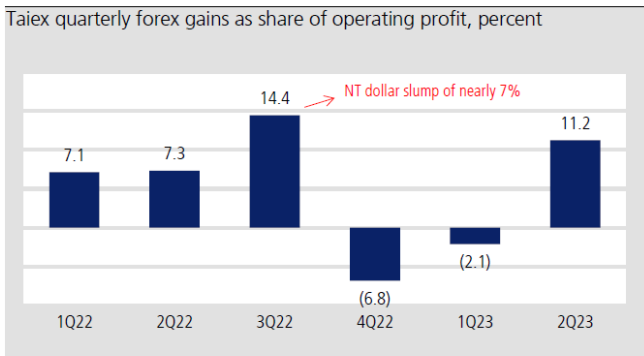
Source: TEJ; KGI Research

Figure 2: AI share rally hurt by poor 3Q23F earnings & overly high valuations (5-year average)



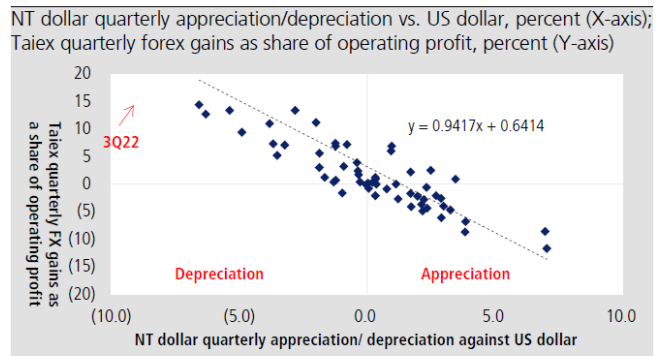
Source: TEJ; KGI Research

Figure 3: Forex gains accounted for 14% of 3Q22 Taixex earnings



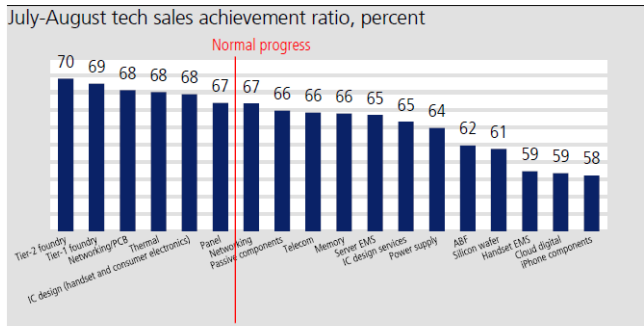
Source: TEJ; KGI Research

Figure 4: NT dollar trend affecting Taixex earnings markedly



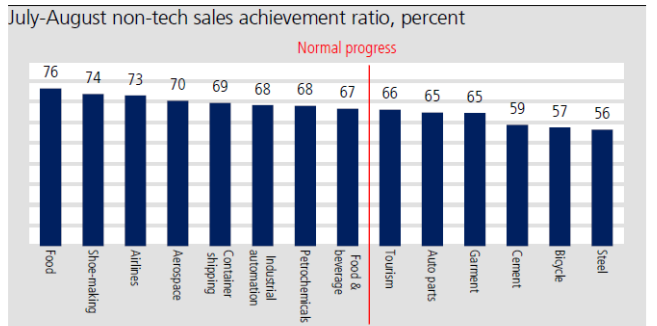
Source: TEJ; KGI Research

Figure 5: Over 60% of 3Q23F tech sales to miss consensus



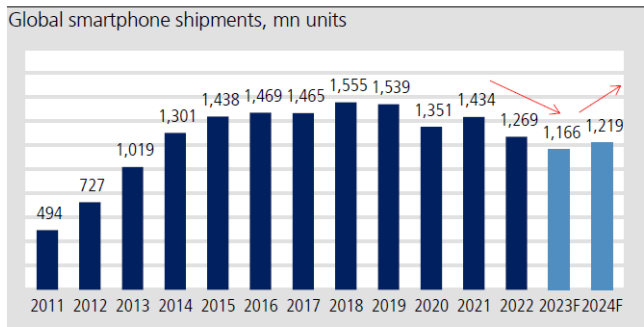
Note: Ratio refers to July-August sales relative to 3Q23F sales
Source: TEJ; KGI Research

Figure 6: Over 40% of 3Q23F non-tech sales to miss consensus



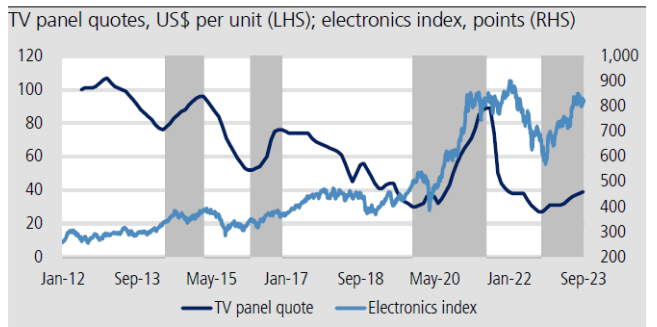
Note: Ratio refers to July-August sales relative to 3Q23F sales
Source: TEJ; KGI Research

Figure 7: Market expects handset demand to recover significantly from 4Q23-2024



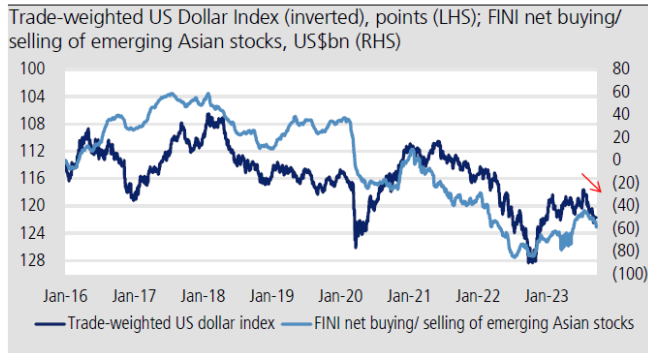
Source: KGI Research

Figure 8: Panel rally end suggests muted consumer electronics demand



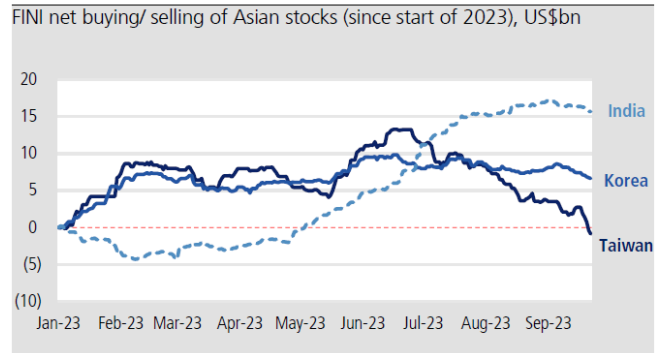
Note: Shaded areas are 32" open cell TV price upcycle
Source: Omdia; KGI Research

Figure 9: Strong US dollar to drive FINI sell-off of Asian stocks



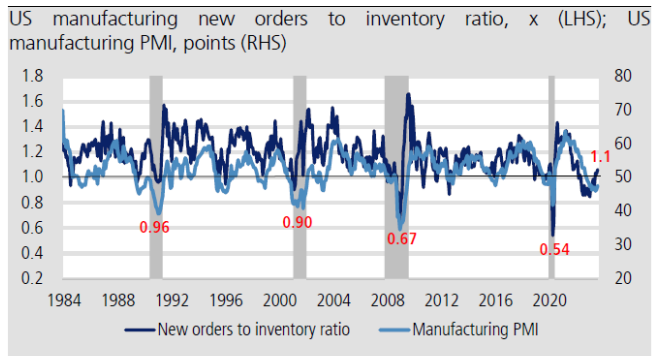
Note: January 2016 as start
Source: Bloomberg; KGI Research

Figure 10: FINI offloading Taiex YTD



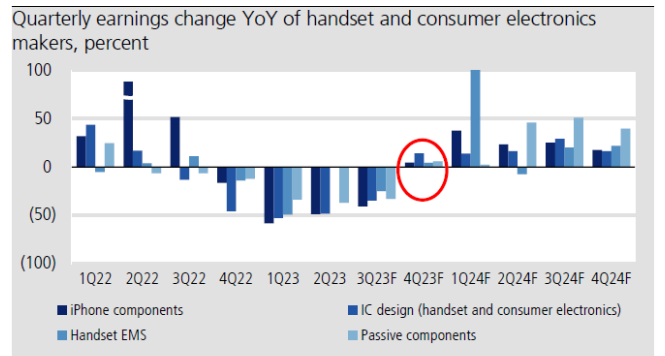
Note: January 2023 as start
Source: Bloomberg; KGI Research

Figure 11: Manufacturing new orders to inventory ratio rebound to prompt restocking demand



Note: Shaded areas are US recessions
Source: Bloomberg; KGI Research

Figure 12: Restocking demand to drive consumer electronics earnings recovery from 4Q23F



Source: TEJ; KGI Research

Figure 13: Cumulative return by index before past Taiwanese presidential elections

| Taiwanese presidential election day | Return in 12 months before election (%) | | | | Return in 6 months before election (%) | | | | Return in 3 months before election (%) | | | |
|-------------------------------------|---|------------|-----------|---------|--|------------|-----------|---------|--|------------|-----------|---------|
| | Taiex | Taiwan OTC | Global DM | Asia EM | Taiex | Taiwan OTC | Global DM | Asia EM | Taiex | Taiwan OTC | Global DM | Asia EM |
| 1996.3.23 | (21.3) | - | 21.4 | 10.1 | 1.5 | - | 8.6 | 4.3 | (1.9) | - | 3.9 | 8.7 |
| 2000.3.18 | 27.1 | 46.1 | 16.7 | 52.4 | 9.3 | 36.7 | 12.5 | 9.9 | 12.4 | 26.4 | 2.7 | 4.9 |
| 2004.3.20 | 48.2 | 65.2 | 35.4 | 65.1 | 18.4 | 34.6 | 10.8 | 23.1 | 18.3 | 32.3 | 3.5 | 11.1 |
| 2008.3.22 | 9.0 | (18.2) | (7.7) | 12.1 | (6.4) | (26.2) | (12.8) | (15.4) | 7.3 | 0.4 | (11.0) | (16.5) |
| 2012.1.14 | (20.0) | (35.4) | (8.2) | (16.8) | (15.3) | (26.5) | (8.4) | (16.1) | (2.4) | (10.9) | 1.2 | 2.3 |
| 2016.1.16 | (15.1) | (14.1) | (9.2) | (21.4) | (14.2) | (9.7) | (14.6) | (20.3) | (9.8) | (3.8) | (9.7) | (15.1) |
| 2020.1.11 | 23.2 | 16.8 | 21.5 | 16.5 | 10.9 | 4.3 | 7.8 | 10.6 | 5.2 | 3.3 | 4.9 | 8.4 |

Source: Bloomberg; KGI Research

Figure 14: Comparison – Taiex valuations

| | Forward PB(X) | | | | | | | | Forward PE(X) | | | | | | | |
|------------------|----------------|------|------|----------------|-----------------|-----------------|-----------|-------------|----------------|-------|-------|----------------|-----------------|-----------------|-----------|-------------|
| | Forward 1-year | 2023 | 2024 | 5-year average | 10-year average | 20-year average | 2007 peak | 2008 bottom | Forward 1-year | 2023 | 2024 | 5-year average | 10-year average | 20-year average | 2007 peak | 2008 bottom |
| Taiex | 1.72 | 1.81 | 1.62 | 1.70 | 1.60 | 1.61 | 2.28 | 0.95 | 17.36 | 19.30 | 15.72 | 14.92 | 14.84 | 17.14 | 21.73 | 8.80 |
| Taiex excl. TSMC | 1.43 | 1.49 | 1.34 | 1.39 | 1.38 | 1.46 | 2.22 | 0.89 | 17.16 | 19.91 | 16.36 | 14.45 | 14.77 | 15.98 | 22.71 | 8.06 |

Source: KGI Research

Figure 15: Our top picks

| Company | Code | Investment rating | Target price (NT\$) | Mkt cap (US\$m) | Share price (NT\$) | Change +/- (%) | EPS (NT\$) | | PE (x) | | P/B (x) | | ROE (%) | | Cash yield (%) | |
|-----------|---------|-------------------|---------------------|-----------------|--------------------|----------------|------------|-------|--------|-------|---------|-------|---------|-------|----------------|-------|
| | | | | | | | 2023F | 2024F | 2023F | 2024F | 2023F | 2024F | 2023F | 2024F | 2023F | 2024F |
| Compeq | 2313 TT | Outperform | 70.0 | 2,014 | 54.30 | 28.9 | 3.52 | 5.81 | 15.4 | 9.4 | 1.6 | 1.4 | 10.5 | 16.0 | 2.6 | 4.2 |
| MSI | 2377 TT | Outperform | 210.0 | 4,431 | 168.50 | 24.6 | 11.54 | 13.99 | 14.6 | 12.0 | 2.7 | 2.5 | 19.3 | 21.4 | 3.8 | 4.6 |
| AURAS | 3324 TT | Outperform | 400.0 | 868 | 315.50 | 26.8 | 13.61 | 18.42 | 23.2 | 17.1 | 4.5 | 3.9 | 19.9 | 23.8 | 1.9 | 2.5 |
| NTC | 2408 TT | Outperform | 85.0 | 6,779 | 70.30 | 20.9 | (1.75) | 2.81 | (40.2) | 25.0 | 1.3 | 1.2 | (3.1) | 5.0 | 0.4 | 1.8 |
| MTK | 2454 TT | Outperform | 805.0 | 36,691 | 737.00 | 9.2 | 44.06 | 53.60 | 16.7 | 13.8 | 4.4 | 4.4 | 19.7 | 31.6 | 7.0 | 8.0 |
| Novatek | 3034 TT | Outperform | 510.0 | 8,087 | 427.00 | 19.4 | 37.45 | 39.26 | 11.4 | 10.9 | 3.9 | 3.6 | 34.5 | 34.5 | 7.1 | 7.4 |
| Unimicron | 3037 TT | Outperform | 225.0 | 8,354 | 176.00 | 27.8 | 9.48 | 14.72 | 18.6 | 12.0 | 2.8 | 2.5 | 16.1 | 22.2 | 2.2 | 3.4 |
| SMP | 6121 TT | Outperform | 360.0 | 1,931 | 335.50 | 7.3 | 27.85 | 32.69 | 12.0 | 10.3 | 1.8 | 1.7 | 15.2 | 17.1 | 6.1 | 7.1 |
| AIDC | 2634 TT | Outperform | 70.6 | 1,601 | 54.60 | 29.3 | 3.00 | 3.53 | 18.2 | 15.5 | 3.0 | 2.8 | 17.2 | 18.9 | 3.3 | 3.9 |
| CHEM | 1513 TT | Outperform | 133.0 | 1,668 | 106.50 | 24.9 | 3.83 | 8.31 | 27.8 | 12.8 | 3.1 | 2.7 | 12.5 | 22.4 | 2.3 | 5.1 |

Source: KGI Research

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