Strategy

Earnings upgrades & accelerated growth fuel bullish momentum; volatility offers entry points

Key message

1. Strong AI demand has reversed the earnings downcycle, putting the Taiex back on an upward track. Mid-sized CSPs are emerging as key drivers of AI order upgrades.
2. Consensus earnings upgrades & accelerated growth are reinforcing the bullish trend, while market volatility presents attractive entry opportunities.
3. AI stocks are our top pick, though investors may consider waiting for share corrections before entering the market; for non-AI stocks, focus on defense/ aerospace, financials and food services.

Event

A substantial consensus upgrade to earnings forecasts for the Taiwan AI supply chain has reversed the downcycle of the Taiex over the past few months. Strong AI-related demand has stabilized the market and laid a structural foundation for accelerated earnings growth over the next two years.

Analysis

Strong AI demand reverses earnings downcycle, putting Taiex back on an upward track. After a brief earnings slump since April due to tariff parity and NT dollar appreciation, the Taiex outlook is finally starting to turn positive. Over the past month, we have significantly revised up our earnings forecasts for Taiwan's AI supply chain. We estimate market consensus for earnings growth of AI-related companies in 2025F has been raised from 33% to 37% YoY. Even more encouraging, the 2026F consensus forecast has jumped from 12% to 20% growth, signaling that AI demand is not a short-lived boom but a sustainable and growing long-term trend.

AI-related companies now account for over 60% of Taiwan stock market aggregate earnings. This substantial share means that upward revisions of AI earnings are strong enough to shift the overall market trajectory. Driven by AI stocks, the earnings outlook for Taiex for both this year and next has consequently been adjusted upward. KGI estimates earnings outlook for 2025F has been revised up from 10% to 11% YoY growth, and from 11% to 17% for 2026F. This acceleration highlights a robust upcycle in Taiwan's tech industry, providing solid fundamental support for the stock market.

Importantly, this wave of earnings upgrades ends a four-month downgrade streak since April, suggesting the market has digested the impact of tariffs and forex losses and is now refocusing on long-term growth opportunities in AI. This shift from negative to positive is often a key signal for the continuation of a bullish market trend.

Mid-sized CSPs emerge as key drivers of AI order upgrades. Beyond hyperscalers like Amazon (US), mid-sized cloud service providers (CSP) such as Oracle (US), CoreWeave (US), and Nebius (NL) are playing an increasingly vital role in driving upward revisions in AI supply chain earnings. Their rise is injecting fresh momentum into AI infrastructure expansion and diversifying order sources for Taiwan's supply chain.

From a capex perspective, the influence of these mid-sized CSPs is growing rapidly. Their share of total CSP capex is projected to rise from 7% in 2024 to 12% in 2025F, and further to 14% in 2026F, signaling aggressive investment in AI infrastructure that directly benefits Taiwan's AI supply chain.

More importantly, these CSPs have recently signed long-term contracts with AI giants like OpenAI (US), Meta (US), and Microsoft (US). The market views these agreements as clear signals of rising demand certainty. These contracts not only ensure revenue visibility for the coming years but also boost confidence for further capex expansion. For Taiwan's AI supply chain, this translates into greater order stability and predictability, reducing uncertainty in future earnings forecasts.

Earnings upgrades & accelerated growth reinforce bullish momentum; volatility presents entry opportunities. In the medium to long term, stock market trends are ultimately driven by corporate profitability. When earnings are not only revised upward but also show signs of accelerating growth, it signals stronger future cash flows and shareholder returns, supporting a sustained bull market.

Looking at the Taiex's recent earnings trajectory, 2Q25 saw a decline due to forex losses and tariff concerns, which dampened market sentiment. However, with strong AI demand, easing tariff pressures, and a stabilizing NT dollar, earnings momentum is expected to strengthen from 3Q25F onward and continue through 4Q26F and beyond. This sustained earnings growth provides a solid foundation for a long-term bullish outlook. Taiwan's 2Q25 earnings declined by 7% YoY, but are projected to rebound with over 8% YoY growth in 3Q-4Q25F, and exceed 10% YoY growth starting 1Q26F.

Additionally, upward consensus earnings revisions tend to attract foreign investors and active funds, which reallocate capital toward sectors with clear profit growth, especially those with the largest upgrades. This shift in capital flows adds depth and durability to the bull market, distinguishing it from short-term speculative rallies.

From a valuation perspective, the Taiex's 2026F forward PE ratio stands at approximately 17.9x, still less than one standard deviation above the long-term average of 15x. In the context of accelerating earnings growth, moderate PE expansion is justified and reflects positive market expectations rather than signs of a bubble. This valuation level increases market acceptance of further price gains and boosts investor confidence. Looking ahead, if the Taiex trades at one standard deviation above average, the PE could reach 18x, corresponding to an index level of 27,400 points. At two standard deviations, a PE of 21x would imply an index level of 32,000 points.

That said, short-term volatility may still occur despite ongoing earnings upgrades. Potential risks include uncertainty from Trump's policy stance, shifts in US Fed rate policy, and technical corrections following recent price gains. However, as long as the upward earnings trend remains intact, such volatility is likely to be a healthy pullback rather than a signal of trend reversal.

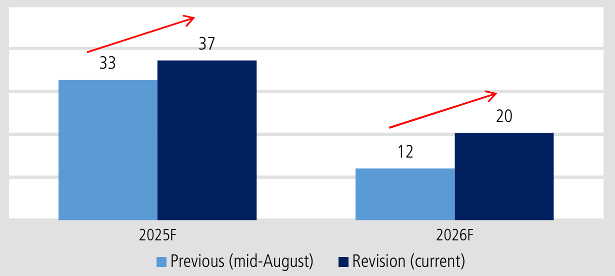
Conclusion & top picks

With consensus earnings forecasts for the AI supply chain significantly revised upward, the Taiex has not only reversed its recent downcycle but also laid the foundation for accelerated growth over the next two years. From a valuation perspective, the Taiex's 2026F forward PE ratio is estimated at 17.9x, less than one standard deviation above the long-term average of 15x. In the context of sustained and accelerating earnings growth, moderate PE expansion is reasonable. If the market trades at one standard deviation above average, the PE could reach 18x, corresponding to an index level of 27,400 points; at two standard deviations, a PE of 21x would imply 32,000 points.

We recommend investors focus on AI-related sectors with significant specification upgrades, including thermal solutions, networking PCB, power supply, CCL, and linear guide, building positions during market corrections. Given the relatively weak fundamentals of non-AI stocks, we advise caution on stock selection. Industries with policy support, such as defense/ aerospace, financials, and food services, may offer more resilient opportunities.

Figure 1: As major cloud providers intensify the AI arms race, we have significantly revised up our earnings forecasts for Taiwan's AI supply chain over the past month

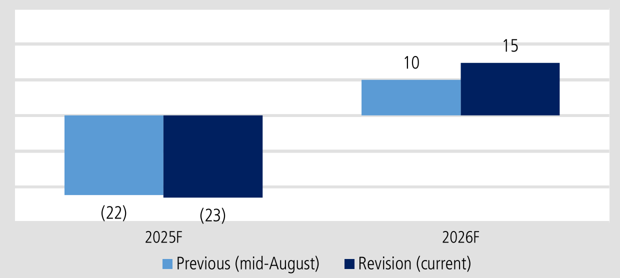
Earnings of Taiwan AI stocks YoY, percent



Source: TEJ; Compiled and forecasted by KGI Research

Figure 2: Our earnings forecasts for non-AI sectors more conservative over the past month

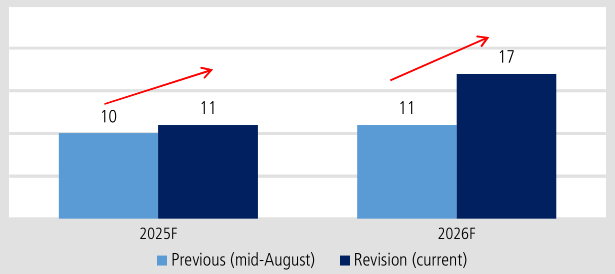
Earnings of Taiwan non-AI stocks YoY, percent



Source: TEJ; Compiled and forecasted by KGI Research

Figure 3: Driven by AI stocks, we have revised up Taiex 2025-26F earnings; notably, 2026F earnings growth is raised from 11% to 17%

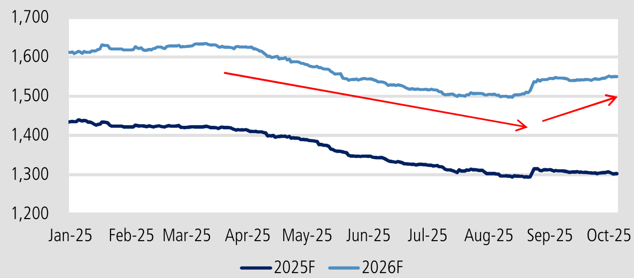
Taiex earnings YoY, percent



Source: TEJ; Compiled and forecasted by KGI Research

Figure 4: Robust AI demand has reversed a four-month streak of Taiex consensus earnings downgrades, returning to an upward revision trend in late-August

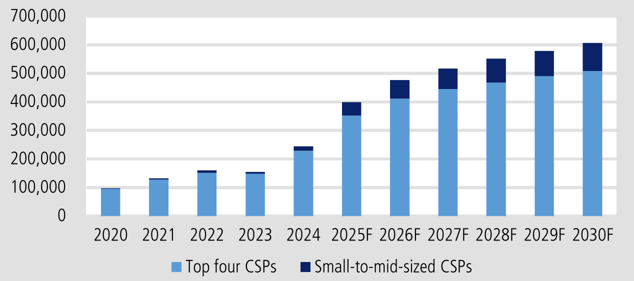
Taiex consensus EPS, NT$



Source: Bloomberg; Compiled by KGI Research

Figure 5: Emerging small-to-mid-sized CSPs (e.g. Oracle, CoreWeave, Nebius) have become key drivers of recent upward revisions in Taiwan AI-related orders

Annual capex breakdown of global top-four CSPs & small-to-mid-sized CSPs, US$mn

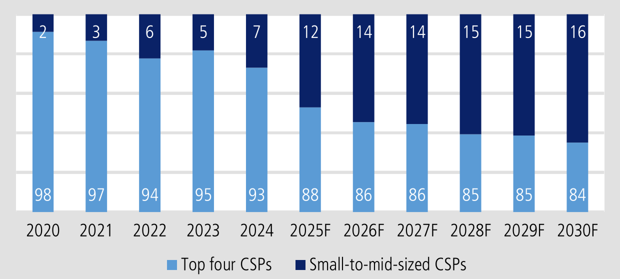


Source: Bloomberg; Compiled by KGI Research

Note: The four major CSPs are Amazon, Google, Microsoft, and Meta; smaller-scale CSPs include Oracle, CoreWeave and Nebius.

Figure 6: AI capex share of small-to-mid-sized CSPs to rise significantly from 7% in 2024 to 12% in 2025F, and further to 14% in 2026F

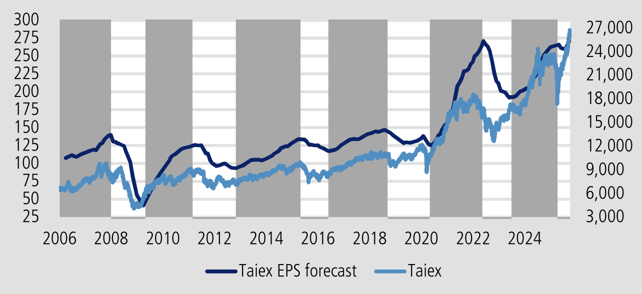
Annual capex breakdown of global top-four CSPs & small-to-mid-sized CSPs, percent



Source: Bloomberg; Compiled by KGI Research

Figure 7: Ongoing consensus earnings upward revisions to strengthen Taiex bullish momentum

Taiex consensus EPS, NT$ (LHS); Taiex, points (RHS)

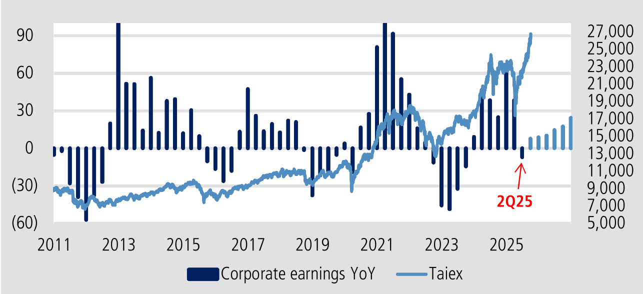


Source: TEJ; Compiled by KGI Research

Note: EPS estimates are based on an index value of 100 as of January 1, 2006; the shaded areas represent periods of corporate earnings upgrades.

Figure 8: Accelerating earnings growth will reinforce the bullish trend in Taiwan's stock market

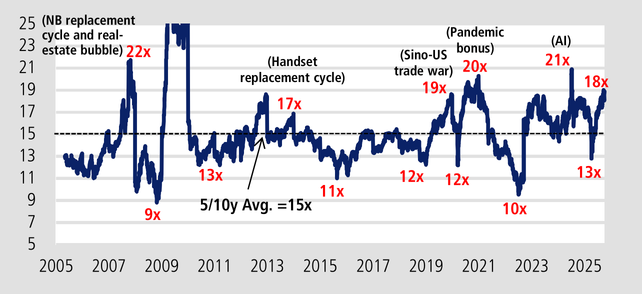
Taiex sector quarterly earnings YoY, percent (LHS); Taiex, points (RHS)



Source: TEJ; Compiled by KGI Research

Figure 9: Taiex consensus 2026F PE ratio around 17.9x, slightly above long-term historical average of 15x (less than one standard deviation higher)

Taiex consensus PE ratio (forward one year), x



Source: TEJ; Compiled by KGI Research

Figure 10: If the Taiex trades at one standard deviation above the average, PE could reach 18x; at two standard deviations above average, PE could reach 21x

Taiex classification & valuation reference table

12M forward PE	Equivalent index level (points)	2026F PE (x)	Equivalent index level (points)
15x	20,027	15x	21,363
16X	21,362	16X	22,787
17x	22,697	17x	24,211
18X	24,032	18X	25,635
19X	25,367	19X	27,060
20X	26,702	20X	28,484
21X	28,037	21X	29,908

Source: TEJ; Compiled & forecasted by KGI Research

Figure 11: Taiex projected earnings & valuations

Earning (NT$bn)	2021	2022	2023	2024	2025F	2026F
Taiex	3,917	3,771	2,682	3,780	4,193	4,891
Taiex excl. TSMC	3,320	2,755	1,844	2,607	2,573	2,948
Tech	1,914	2,147	1,698	2,249	2,768	3,247
Tech excl. TSMC	1,317	1,130	860	1,075	1,148	1,303
TSMC	597	1,017	838	1,173	1,620	1,944
EPS growth (%)						
Taiex	78.1	(3.7)	(28.9)	40.9	10.9	16.7
Taiex excl. TSMC	97.4	(17.0)	(33.1)	41.4	(1.3)	14.6
Tech	51.7	12.2	(20.9)	32.4	23.1	17.3
Tech excl. TSMC	77.1	(14.2)	(23.9)	25.1	6.8	13.5
TSMC	15.2	70.4	(17.5)	39.9	38.1	20.0
P/E (x)						
Taiex	22.3	23.2	32.6	23.1	20.9	17.9
Taiex excl. TSMC	15.1	18.3	27.3	19.3	19.5	17.1
Tech	34.6	30.8	38.9	29.4	23.9	20.4
Tech excl. TSMC	21.9	25.6	33.6	26.9	25.2	22.2
TSMC	62.4	36.6	44.4	31.7	23.0	19.1

Source: Compiled & forecasted by KGI Research

Figure 12: Our top picks

Sector/ theme	Company	Code	Investment rating	Target price (NT$)	Mkt cap (US$mn)	Share price (NT$)	Change +/- (%)	EPS (NT$)		PE (x)		P/B (x)		ROE (%)		Cash yield (%)	
								2025F	2026F	2025F	2026F	2025F	2026F	2025F	2026F	2025F	2026F
AI supply chain	DELTA	2308 TT	Outperform	1075.0	84,058	987.0	8.9	22.33	28.86	44.2	34.2	10.4	8.8	24.4	27.9	1.2	1.5
	TSMC	2330 TT	Outperform	1500.0	1,220,108	1435.0	4.5	62.48	74.96	23.0	19.1	7.2	5.7	34.4	33.2	1.4	1.4
	Accton	2345 TT	Outperform	1180.0	18,857	1025.0	15.1	44.13	47.17	23.2	21.7	12.2	10.1	59.3	51.0	2.4	2.9
	AVC	3017 TT	Outperform	1570.0	14,732	1150.0	36.5	48.85	71.35	23.5	16.1	11.6	8.6	56.4	61.2	2.1	3.1
	Fositek	6805 TT	Outperform	1400.0	2,517	1120.0	25.0	30.10	53.72	37.2	20.8	11.7	9.1	34.0	49.1	1.3	2.4
policy characteristics	GCE	2368 TT	Outperform	475.0	7,138	431.0	10.2	18.42	26.40	23.4	16.3	8.7	6.7	39.6	46.4	2.1	3.1
	Hon Hai	2317 TT	Outperform	245.0	104,617	228.5	7.2	13.24	15.32	17.3	14.9	1.8	1.7	10.9	11.9	3.1	3.5
	King Slide	2059 TT	Outperform	4100.0	10,842	3470.0	18.2	86.16	136.68	40.3	25.4	12.9	10.2	35.0	44.9	1.3	2.0
	EGAT	2645 TT	Outperform	186.0	1,990	162.0	14.8	4.88	7.43	33.2	21.8	4.5	4.5	13.7	20.6	2.7	4.1
	CTBC Holding	2891 TT	Outperform	48.0	27,220	42.3	13.6	3.51	3.98	12.1	10.6	1.7	1.4	14.7	14.8	5.1	5.7
	E.S.F.H	2884 TT	Outperform	35.5	17,341	32.7	8.6	1.91	2.00	17.1	16.3	2.0	1.8	12.0	11.5	4.3	4.4
	BAFANG	2753 TT	Outperform	234.0	429	196.5	19.1	11.96	13.02	16.4	15.1	3.5	3.3	21.7	22.4	4.6	5.0

Source: KGI Research estimates

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