

Strategy

AI capex expansions to fuel earnings upgrades; pullbacks to offer attractive entry points

Key message

1. AI investment boom is still in an early stage and we think strong cash flows will allow CSPs to keep increasing AI capex.
2. Consensus has revised up 2026F Taix earnings growth to 20% YoY, up from the previous projection of 11% YoY growth made two month ago.
3. AI stocks are our top picks. Any corrections will make a good entry point. In the non-AI space, we recommend defense/ aerospace, financials and food & beverage stocks.

Event

Following the aggressive capex expansion by emerging CSPs, hyperscaler CSPs are also stepping up investment, prompting an upward revision to consensus 2026F Taix earnings growth to 20% YoY, up from the previous 11% YoY. For reference, consensus also anticipates 11% YoY growth for 2025F Taix earnings.

Analysis

AI investment boom still in early stage and far from being overheated. Despite the market hype around AI, some investors are concerned whether market bubbles are forming. However, historical comparisons suggest that the current AI investment cycle is in its early phase and is far from overheating. Looking back on major technological revolutions over the past century, such as the invention of railroad, automobile, electricity, and the internet, the aggregate capex during investment peaks were equivalent to 2-3% of global GDP. In contrast, generative AI investments currently only account for about 0.8% of global GDP, indicating substantial room for further growth.

Moreover, history shows that investment in technology tends to accelerate several years before productivity picks up markedly, and remain elevated even after productivity begins to take off. The curve of investment in AI infrastructure has yet to reach a peak, as seen during the electricity or ICT revolutions, suggesting that AI is still in the early stage of expansion. Over the next few years, AI capex and corporate earnings are likely to keep rising.

Large CSPs continue to raise capex & guide further growth in 2026F. Since 2023, major US CSPs such as Microsoft, Google, and Amazon have consistently revised up their AI capex. At their most recent earnings calls, these CSPs signaled increases in 2025F capex, and guided further growth in 2026F. Instead of showing signs of abatement, the current wave of capex upgrades appears to be accelerating. Based on the latest guidance from the top five CSPs, their 2025F capex is set to grow by 59% YoY, up from the previous forecast of 55% YoY, while 2026F growth is also lifted from 22% to 33% YoY. The updated aggregate capex amounts now stand at US\$386.9bn in 2025F and US\$516.0bn in 2026F.

Abundant operating cash flows & surging compute demand to support CSP capex. Two key factors underpin CSPs' ability to sustain aggressive capex growth: (1) robust operating cash flow; and (2) exponential growth in compute demand. Over the past year, the average ratio of capex to operating cash flow among major CSPs has risen from 61% to 64%, a level that remains manageable. Looking ahead, we expect their operating cash flows to maintain 20-30% YoY growth over the next two years, meaning their capex as a percentage of cash flow is unlikely to reach concerning levels.

As for growing compute demand, it is worth noting that the number of tokens processed by Google's large language model increased from 10tn in May 2024 to 480tn in May 2025, and 1,300tn in October 2025. Given the rise of multimodal applications and longer context requirements, Google's processed token volume may exceed 2,000tn by 2026F.

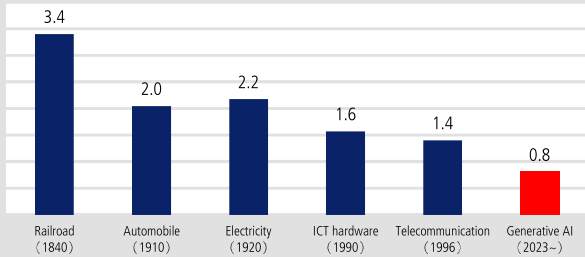
AI supply chains see orders on the rise, which in turn will drive another upgrade in 2026F Taixex earnings. Continued growth in AI capex has markedly boosted the profitability of Taiwan AI suppliers. Over the past two months, consensus has consistently revised up the earnings forecasts for both AI stocks and the broader Taixex market, especially after hyperscaler CSPs followed the steps of emerging CSPs in announcing higher capex plans. Specifically, consensus revised up 2026F Taixex earnings growth to 20% YoY from 11% YoY, which is well above the projected 11% YoY growth for 2025F. For AI stocks, projected 2026 earnings growth has been revised up from 12% to 23% YoY growth. The upward revisions reflect substantive and sustained AI demand, which is by no means mere short-term speculation.

Conclusion & top picks

Overall, we think the AI investment cycle is far from overheating. Instead, it is laying the groundwork for a new wave of global productivity improvement. Abundant cash flows, structural compute demand, and upward capex revisions are driving persistent earnings upgrades for Taixex constituents. Based on the aforementioned consensus 2026F Taixex earnings growth forecast revisions, we think the Taixex may reach 30,000 points in 1Q26F, implying a forward PE of approximately 19x. We suggest investors focus on AI-related subsectors that are riding substantial product spec upgrades, including thermal, networking PCB, power supply, CCL and linear guide makers. Any market correction should be viewed as an opportunity to engage. For non-AI stocks, we recommend sectors with policy support or stable high dividend yields, such as defense/ aerospace, financials, and food & beverage.

Figure 1: AI investments as a percentage of global GDP remain significantly below the levels seen during the introduction of the railroad, automobile, electricity & internet, suggesting the current investment boom is not overheated and still has substantial room for growth

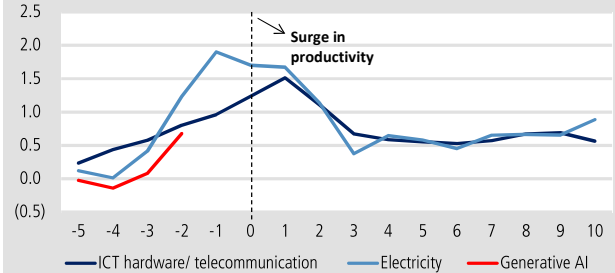
Investment in new technology as a percentage of global GDP at the time of invention, percent



Source: Bloomberg; KGI Research compiled

Figure 2: History suggests the current curve of AI investment has yet to reach the stage of substantial productivity gains, which means there is still substantial upside ahead

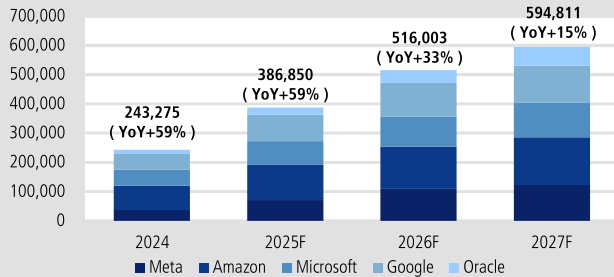
Investment in new technology as a percentage of global GDP at the time of invention, percent



Source: Bloomberg; KGI Research compiled

Figure 3: Large CSPs now guide 2025-26F capex growth of 59% & 33% YoY, up from the previous 55% & 22% YoY

Capex guidance of US top-five CSPs, US\$mn

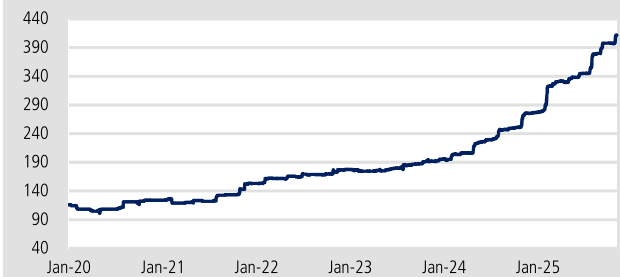


Source: Bloomberg; KGI Research compiled

Note: The top five CSPs are Amazon, Google, Microsoft, Meta and Oracle

Figure 4: Large US CSPs have been increasing AI capex since 2023, reflecting soaring demand for AI computing power

Capex guidance of US top-five CSPs (one-year forward), US\$bn

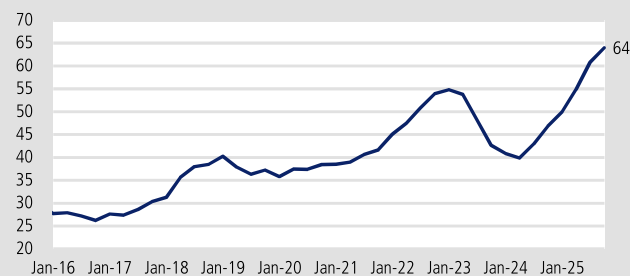


Source: Bloomberg; KGI Research compiled

Note: The top five US CSPs are Amazon, Google, Microsoft, Meta and Oracle

Figure 5: The average ratio of capex to operating cash flow among major CSPs has risen from 61% to 64% over the past year, which remains manageable

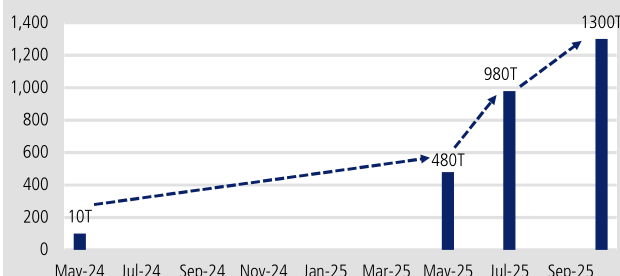
Average ratio of capex to operating cash flow among top-five US CSPs, percent



Source: Bloomberg; KGI Research compiled

Figure 6: Over the past two years, Google's LLM has seen exponential growth in the number of processed tokens every month

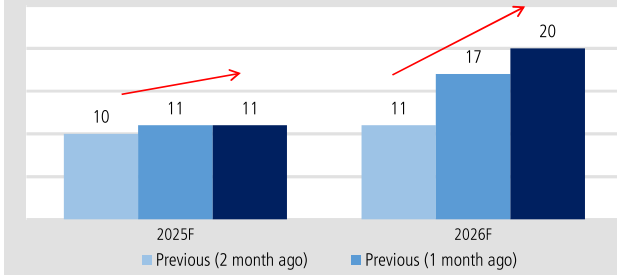
Number of tokens processed by Google's LLM every month, trillion



Source: Google; KGI Research compiled

Figure 7: Consensus has consistently revised up 2025-26F Taichung earnings, with the 2026 forecast raised from 11% YoY growth to 20% in the wake of AI proliferation

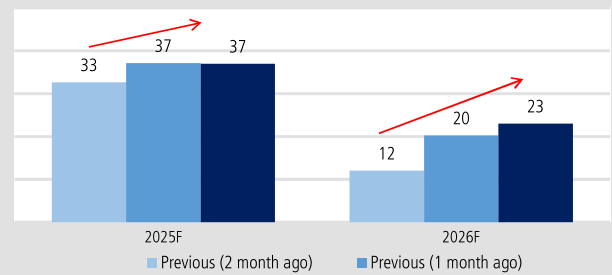
Projected Taichung earnings growth, percent



Source: TEJ; KGI Research compiled

Figure 8: AI-sector earnings have been revised up to 23% YoY growth from 12% over the past two months

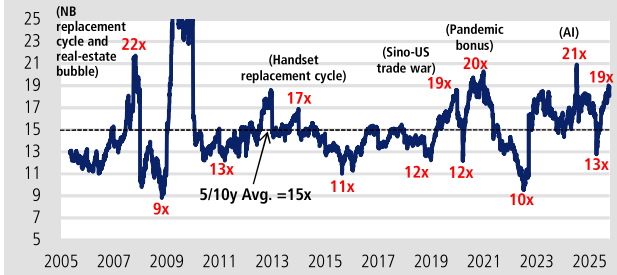
Projected earnings growth for AI suppliers, percent



Source: TEJ; KGI Research compiled

Figure 9: The Taichung index is now valued at 19x one-year forward PE, well above its long-term average of 15x PE

Projected PE (one-year forward), x



Source: TEJ; KGI Research compiled

Figure 10: Taichung index & corresponding valuations

12M forward PE	Equivalent index level (points)	2026F PE	Equivalent index level (points)
15x	22,016	15x	23,407
19x	27,887	19x	29,649
20x	29,355	20x	31,209
21x	30,822	21x	32,769
22x	32,290	22x	34,330
23x	33,758	23x	35,890
24x	35,225	24x	37,451

Source: TEJ; KGI Research compiled

Figure 11: Earnings & valuations of Taichung constituents

Earning (NT\$bn)	2021	2022	2023	2024	2025F	2026F
Taichung	3,917	3,771	2,682	3,780	4,193	5,033
Taichung excl. TSMC	3,320	2,755	1,844	2,607	2,518	3,039
Tech	1,914	2,147	1,698	2,249	2,939	3,600
Tech excl. TSMC	1,317	1,130	860	1,075	1,265	1,607
TSMC	597	1,017	838	1,173	1,674	1,994
EPS growth (%)	2021	2022	2023	2024	2025F	2026F
Taichung	78.1	(3.7)	(28.9)	40.9	10.9	20.0
Taichung excl. TSMC	97.4	(17.0)	(33.1)	41.4	(3.4)	20.7
Tech	51.7	12.2	(20.9)	32.4	30.7	22.5
Tech excl. TSMC	77.1	(14.2)	(23.9)	25.1	17.6	27.0
TSMC	15.2	70.4	(17.5)	39.9	42.7	19.1
P/E (x)	2021	2022	2023	2024	2025F	2026F
Taichung	23.2	24.0	33.8	24.0	21.6	18.0
Taichung excl. TSMC	15.6	18.8	28.0	19.8	20.5	17.0
Tech	36.1	32.2	40.7	30.8	23.5	19.2
Tech excl. TSMC	22.9	26.7	35.1	28.0	23.8	18.8
TSMC	65.4	38.4	46.5	33.3	23.3	19.6

Source: 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	1280.0	81,882	975.0	31.3	23.83	32.79	40.9	29.7	9.7	8.1	25.3	29.7	1.2	1.7
	EMC	2383 TT	Outperform	1425.0	16,992	1470.0	(3.1)	42.22	64.74	34.8	22.7	10.9	8.4	36.8	42.9	1.7	2.6
	TSMC	2330 TT	Outperform	1900.0	1,261,836	1505.0	26.2	64.58	76.89	23.3	19.6	7.5	5.8	35.3	33.6	1.3	1.3
	Accton	2345 TT	Outperform	1180.0	20,863	1150.0	2.6	44.13	47.17	26.1	24.4	13.7	11.4	59.3	51.0	2.2	2.6
	AVC	3017 TT	Outperform	1695.0	18,127	1435.0	18.1	48.71	70.82	29.5	20.3	14.5	10.7	56.3	60.8	1.7	2.5
	Fositek	6805 TT	Outperform	1755.0	3,181	1435.0	22.3	31.06	58.49	46.2	24.5	14.9	11.4	35.0	52.7	1.1	2.0
	Wiwynn	6669 TT	Outperform	4520.0	25,836	4300.0	5.1	252.81	290.34	17.0	14.8	7.3	6.0	47.6	44.4	3.2	3.7
	King Slide	2059 TT	Outperform	4100.0	12,925	4195.0	(2.3)	86.16	136.68	48.7	30.7	15.6	12.4	35.0	44.9	1.1	1.7
policy characteristics	Teco	1504 TT	Outperform	125.0	8,721	113.5	10.1	2.78	4.93	40.9	23.0	3.2	3.0	7.7	14.5	2.0	2.8
	EGAT	2645 TT	Outperform	186.0	1,865	154.0	20.8	4.88	7.43	31.5	20.7	4.3	4.2	13.7	20.6	2.9	4.3
	CTBC Holding	2891 TT	Outperform	48.0	26,937	42.4	13.2	3.51	3.98	12.1	10.7	1.7	1.4	14.7	14.8	5.1	5.7
	E.S.F.H	2884 TT	Outperform	35.5	15,845	30.3	17.2	1.91	2.00	15.8	15.1	1.9	1.6	12.0	11.5	4.6	4.8
	BAFANG	2753 TT	Outperform	234.0	431	200.0	17.0	11.94	12.99	16.8	15.4	3.5	3.3	21.5	22.0	4.2	4.5

Source: KGI Research

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