

COMPANY UPDATE

AEM Holdings (AEM SP)

Downgrade To HOLD On Limited Near-term Catalysts And Inventory Write-downs

AEM uncovered a shortfall in its inventories due to human error in transactions in its ERP system during the migration of production to its new Penang facility. The shortfall is expected to have a negative earnings impact of around S\$22m in 4Q23 due to understated cost of sales. As a result, we trim 2023 earnings from S\$14m to a S\$6m loss. We also trim 2024 earnings by 17%. Downgrade to HOLD with a 16% lower target price of S\$3.06.

WHAT'S NEW

- **Uncovered shortfall in inventories during year-end stock-taking exercise.** On 14 Jan 24, AEM Holdings (AEM) announced that a shortfall in the group's inventories had been uncovered during its 2023 year-end internal stock-taking exercise. While the stock-taking exercise is still ongoing, the preliminary estimate suggests that AEM's inventories are anticipated to be 5-7% below the 3Q23 figure of S\$359m. The initial investigation into this issue attributes the shortfall to human error in transactions in the group's Enterprise Resource Planning (ERP) system during the migration of production to the group's Penang facility from Singapore. Management further elaborated that the errors were due to data entry of volume and unit of measurement. These errors were not detected by the existing controls and processes that are in place. As a result of the initial findings, AEM is reviewing its inventory and stock monitoring as well as tracking processes and systems.
- **Expect negative earnings impact in 4Q23.** The accounting adjustment for the inventory shortfall is expected to have negative earnings impact of around S\$22m for 4Q23 as the writing down of inventories will increase the cost of sales. This is expected to drag 2023 earnings into a loss of S\$6m. Previously, we were expecting S\$14m earnings for 2023.
- **Downgrade to HOLD as inventory issue will put a dent in confidence and weak earnings are expected in 4Q23.** We downgraded AEM to HOLD as the inventory issue is likely to put a dent in the stock confidence in the near to medium term. In addition, we think there will be limited positive catalysts in the near term given that ramp-up of production is only expected in late-24 as previously guided by AEM. For the upcoming 4Q23 results, we expect AEM to report a loss of around S\$10m and the new full-year revenue guidance for 2024 is also going to be lacklustre given that recovery is only expected in late-24.

KEY FINANCIALS

Year to 31 Dec (S\$m)	2021	2022	2023F	2024F	2025F
Net turnover	565	870	487	509	560
EBITDA	126	184	16	95	102
Operating profit	112	160	(1)	78	86
Net profit (rep./act.)	92	128	(6)	63	69
Net profit (adj.)	92	128	(6)	63	69
EPS (S\$ cents)	33.5	41.4	(2.0)	20.4	22.5
PE (x)	9.5	7.7	n.m.	15.5	14.1
P/B (x)	2.2	2.0	2.0	1.9	1.7
EV/EBITDA (x)	7.6	5.2	59.1	10.0	9.4
Dividend yield (%)	2.4	3.2	(0.2)	1.6	1.8
Net margin (%)	16.3	14.7	(1.3)	12.4	12.4
Net debt/(cash) to equity (%)	(33.5)	3.2	(2.5)	(6.2)	(5.4)
Interest cover (x)	95.3	140.1	2.5	43.2	55.4
ROE (%)	30.0	28.8	n.a.	12.5	12.5
Consensus net profit	-	-	13	75	106
UOBKH/Consensus (x)	-	-	n.m.	0.84	0.65

Source: AEM, Bloomberg, UOB Kay Hian

HOLD

(Downgraded)

Share Price	S\$3.17
Target Price	S\$3.06
Upside	-3.5%
(Previous TP)	S\$3.63

COMPANY DESCRIPTION

AEM prides itself on being a global leader in test innovation and provides comprehensive test solutions for the semiconductor and electronics industries, spanning test handlers, testers, consumables and data analytics.

STOCK DATA

GICS sector	Semiconductor Equipment
Bloomberg ticker:	AEM SP
Shares issued (m):	308.9
Market cap (S\$m):	979.2
Market cap (US\$m):	730.7
3-mth avg daily t'over (US\$m):	3.9

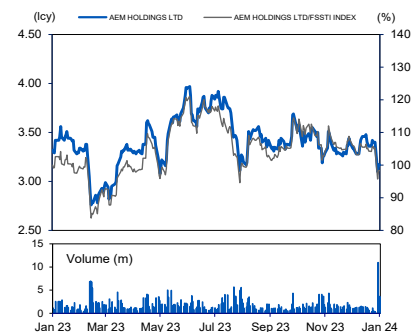
Price Performance (%)

52-week high/low	S\$ 3.97/S\$ 2.76			
1mth	3mth	6mth	1yr	YTD
(6.8)	(11.2)	(18.3)	(2.8)	(8.4)

Major Shareholders

	%
Temasek Hldgs	11.3
EPF	10.1
FY23 NAV/Share (S\$)	1.71
FY23 Net Cash/Share (S\$)	0.11

PRICE CHART



Source: Bloomberg

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STOCK IMPACT

- **We expect ramp-up of product production in late-24** given the current visibility around customer product release schedules. Signs of stabilisation in the smartphone and PC markets have begun to emerge, with experts forecasting 2024 to be a year of growth for PCs and smartphones. Inventory levels are reducing across the board, and the semiconductor industry appears to be passing through the trough of the cycle. PC shipments recovered sequentially in 3Q23 and returned to pre-pandemic levels. Although the overall growth rate for the year remains negative, the percentage decline has moderated.
- **AEM is starting to see the beginnings of AI in the consumer space, with PCs that feature built-in generative AI capabilities powered by AI processors being put up for demonstration.** While the news is positive on the consumer side, analysts are of mixed views in terms of the pace and timing of recovery for the semiconductor test equipment market. Nonetheless, AEM is in a strong position to leverage the strong relationships it has fostered with its customers across a number of new programmes, and is prepared to support these customers' new product releases and subsequent production ramp-ups with its Test 2.0 test solutions in 2024 and beyond.

EARNINGS REVISION/RISK

- We have trimmed our 2023 earnings estimate to a S\$6m loss, from a S\$14m profit previously to account for the adjustment of inventory shortfall of S\$22m, which is expected to increase the cost of sales in 4Q23.
- We have also reduced our 2024 and 2025 revenue by 7% per year to account for a potential delay in recovery of AEM's order. As a result, our earnings estimates for 2024 and 2025 are reduced by 17% as well.

VALUATION/RECOMMENDATION

- **Downgrade to HOLD with a 16% lower target price of S\$3.06.** This is based on 15x 2024F PE, pegged to 1SD above AEM's historical mean. This is to account for the potential recovery in the semiconductor industry in 2024 and better earnings quality from increasing contributions of more new customers.

SHARE PRICE CATALYST

- Positive surprise in future revenue guidance and winning of more new customers.

PEER COMPARISON

Company	Ticker	Trading Curr (lcy)	Price @ 16-Jan-24 (lcy)	Market Cap (US\$m)	PE		P/B		EV/EBITDA		ROE 2023 (%)	Yield 2023 (%)	Net Gearing (%)
					2023 (x)	2024 (x)	2023 (x)	2024 (x)	2023 (x)	2024 (x)			
AEM	AEM SP	SGD	3.17	731	n.a.	15.5	2.0	1.9	59.1	10.0	n.a.	n.a.	(2.5)
SGX-listed peers													
UMS	UMSH SP	SGD	1.3	651	14.6	11.3	2.4	2.2	9.5	7.5	20.1	4.3	(11.3)
Frencken	FRKN SP	SGD	1.3	415	21.6	13.4	1.4	1.3	10.6	7.7	9.9	2.2	4.1
ISDN	ISDN SP	SGD	0.34	113	13.6	9.2	0.7	0.7	5.7	4.8	7.5	2.6	(4.5)
Grand Venture	GVTL SP	SGD	0.52	132	28.9	14.4	1.4	1.3	8.4	6.1	9.4	1.5	31.1
Avi-Tech	AVI SP	SGD	0.255	33	13.4	n.a.	0.8	n.a.	3.0	n.a.	n.a.	n.a.	(61.8)
Average					18.4	12.1	1.4	1.4	7.4	6.5	11.7	2.7	
Others													
Teradyne	TER US	USD	104.81	16,023	36.5	28.3	6.6	6.1	22.8	19.7	22.9	0.4	(29.1)
Advantest	6857 JP	JPY	5110	26,723	59.3	38.2	9.3	8.3	35.9	25.9	22.8	1.0	(1.4)
Cohu	COHU US	USD	32.99	1,567	20.6	18.0	1.7	1.6	10.7	10.3	8.0	0.0	(34.6)
Hirata	6258 JP	JPY	6490	476	14.6	12.5	1.1	1.0	11.5	10.0	8.6	1.6	39.1
Astronics	ATRO US	USD	16.94	578	n.a.	24.0	2.3	2.1	15.2	8.9	n.a.	n.a.	83.7
Average					32.7	24.2	4.2	3.8	19.2	14.9	15.6	0.8	

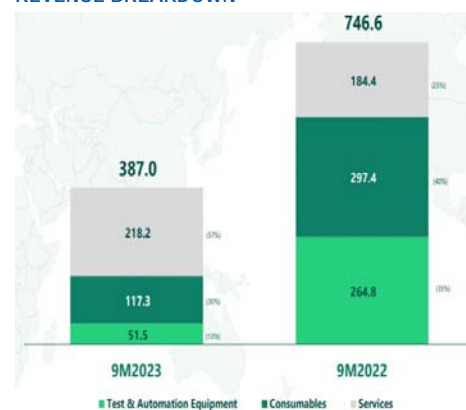
Source: Bloomberg, UOB Kay Hian

HISTORICAL PE RANGE



Source: Bloomberg, UOB Kay Hian

REVENUE BREAKDOWN



Source: AEM, UOB Kay Hian

PROFIT & LOSS

Year to 31 Dec (\$m)	2022	2023F	2024F	2025F
Net turnover	870.5	487.0	508.8	560.4
EBITDA	183.8	16.2	95.3	101.5
Deprec. & amort.	23.5	16.9	16.9	15.8
EBIT	160.3	(0.8)	78.4	85.7
Associate contributions	(0.3)	(0.3)	(0.3)	(0.3)
Net interest income/(expense)	(1.3)	(6.3)	(2.2)	(1.8)
Pre-tax profit	158.7	(7.4)	75.9	83.6
Tax	(31.4)	1.3	(12.9)	(14.2)
Minorities	0.5	0.0	0.0	0.0
Net profit	127.8	(6.1)	63.0	69.4
Net profit (adj.)	127.8	(6.1)	63.0	69.4

BALANCE SHEET

Year to 31 Dec (\$m)	2022	2023F	2024F	2025F
Fixed assets	76.9	70.7	64.5	59.5
Other LT assets	138.1	167.1	196.9	226.3
Cash/ST investment	127.8	141.9	148.6	31.3
Other current assets	462.8	359.5	363.2	399.5
Total assets	805.6	739.2	773.2	716.5
ST debt	13.7	13.7	116.0	0.0
Other current liabilities	154.5	106.4	106.8	114.1
LT debt	129.7	116.0	0.0	0.0
Other LT liabilities	14.3	14.3	14.3	14.3
Shareholders' equity	485.0	480.5	527.7	579.7
Minority interest	8.4	8.4	8.4	8.4
Total liabilities & equity	805.6	739.2	773.2	716.5

CASH FLOW

Year to 31 Dec (\$m)	2022	2023F	2024F	2025F
Operating	(32.1)	72.6	78.4	57.8
Pre-tax profit	127.3	(6.1)	63.0	69.4
Tax	31.4	(1.3)	12.9	14.2
Deprec. & amort.	23.5	16.9	16.9	15.8
Associates	2.8	0.3	0.3	0.3
Working capital changes	(197.6)	55.2	(4.0)	(29.5)
Other operating cashflows	(19.5)	7.6	(10.7)	(12.4)
Investing	(38.4)	(39.2)	(39.1)	(39.0)
Capex (growth)	(4.3)	(40.0)	(40.0)	(40.0)
Investments	(12.8)	0.0	0.0	0.0
Proceeds from sale of assets	0.6	0.0	0.0	0.0
Others	(21.9)	0.8	0.9	1.0
Financing	(18.6)	(19.3)	(32.5)	(136.1)
Dividend payments	(36.2)	1.5	(15.7)	(17.4)
Issue of shares	0.0	0.0	0.0	0.0
Proceeds from borrowings	50.0	0.0	0.0	0.0
Loan repayment	(15.4)	(13.7)	(13.7)	(116.0)
Others/interest paid	(17.1)	(7.2)	(3.1)	(2.8)
Net cash inflow (outflow)	(89.1)	14.1	6.8	(117.4)
Beginning cash & cash equivalent	216.2	127.8	141.9	148.6
Changes due to forex impact	0.7	0.0	0.0	0.0
Ending cash & cash equivalent	127.8	141.9	148.6	31.3

KEY METRICS

Year to 31 Dec (%)	2022	2023F	2024F	2025F
Profitability				
EBITDA margin	21.1	3.3	18.7	18.1
Pre-tax margin	18.2	(1.5)	14.9	14.9
Net margin	14.7	(1.3)	12.4	12.4
ROA	16.9	n.a.	8.3	9.3
ROE	28.8	n.a.	12.5	12.5
Growth				
Turnover	53.9	(44.0)	4.5	10.2
EBITDA	45.5	(91.2)	489.2	6.6
Pre-tax profit	42.8	(104.7)	n.a.	10.2
Net profit	38.6	(104.8)	n.a.	10.2
Net profit (adj.)	38.6	(104.8)	n.a.	10.2
EPS	23.7	(104.8)	n.a.	10.2
Leverage				
Debt to total capital	22.5	21.0	17.8	0.0
Debt to equity	29.5	27.0	22.0	0.0
Net debt/(cash) to equity	3.2	(2.5)	(6.2)	(5.4)
Interest cover (x)	140.1	2.5	43.2	55.4

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