

TECHNOLOGY & TELECOMMUNICATIONS SECTOR

We are OVERWEIGHT on the Technology sector, specifically the semiconductor plays. We are highlighting these four tech stocks which we believe would benefit from a positive macro outlook on technology. They are:- (i) Avi-Tech (BUY), on the basis of its expected earnings appreciation and attractive dividend yield; (ii) Fu Yu (BUY), for its high dividend yield; (iii) Micro-Mechanics (BUY ON WEAKNESS), which boasts of earnings growth and attractive dividends and; (iv) Venture Corp (BUY ON WEAKNESS), as it is slated to benefit from the realignment of the global tech supply chain.

Expecting worldwide semiconductor growth despite COVID-19. While market research house Gartner Inc is expecting a 0.9% drop in global semiconductor revenue to US\$415.4 billion for 2020 over 2019, this is primarily due to an expected weak 1H20 which is in turn attributed to COVID-19. Nevertheless, in a recent report as seen in Exhibit 4, the WSTS (World Semiconductor Trade Statistics) was more bullish and disclosed that they are expecting the world semiconductor market to be up by 3.3 percent to US\$426 billion in 2020. For 2021, the global semiconductor market is projected to grow by 6.2 percent to US\$452 billion.

Exhibit 1: Key Highlights

Company	Our Recommendation	Market Cap (\$m)	Price as of 19-Feb-20 (\$)	Price as of 22-Jun-20 (\$)	% change from 19-Feb to 22-Jun	Target Price, Bloomberg consensus (\$)	% upside of TP from price on 22-Jun-20	Net cash position (\$m)	Net cash to market cap (%)	Net debt to equity (%)	Current P/B ratio (x)
Avi-Tech	BUY	67.5	0.420	0.385	-8.3%	0.500	29.9%	34.3	50.8%	NA	1.3
Fu Yu	BUY	176.9	0.255	0.235	-7.8%	0.265	12.8%	94.4	53.4%	NA	1.1
Micro Mechanics	BUY ON WEAKNESS	247.5	1.800	1.780	-1.1%	1.820	2.2%	16.1	6.5%	NA	4.5
Venture Corp	BUY ON WEAKNESS	4662	16.860	16.080	-4.6%	17.100	6.3%	852	18.3%	NA	1.8
SingTel	BUY	40823	3.170	2.500	-21.1%	3.220	28.8%	-13172	NA	49	1.6
StarHub	HOLD	2268	1.510	1.310	-13.2%	1.500	14.5%	-829	NA	137	4.4

Source: Bloomberg, Lim & Tan Research

Exhibit 2: Key Statistics

Company	Price as of 22-Jun-20 (\$)	Financial Year end	FY19 net profit (\$m)	FY20F net profit (\$m)	% increase	FY19 P/E (x)	FY20F P/E (x)	FY19 DPS (\$)	FY20F DPS (\$)	% change	FY19 dividend yield (%)	FY20F dividend yield (%)
Avi-Tech	0.385	June	4.65	5.1	9.9	14.5	13.2	0.023	0.023	unchg	6.0	6.0
Fu Yu	0.235	Dec	12.7	10.2	-19.9	13.9	17.4	0.016	0.015	-6.3	6.8	6.4
Micro Mechanics	1.780	June	13	14.4	10.9	19.0	17.2	0.09	0.09	unchg	5.1	5.1
Venture Corp	16.080	Dec	363	327	-10	12.8	14.2	0.70	0.70	unchg	4.4	4.4
SingTel *	2.500	March	2457	2332	-5.1	16.6	17.5	0.1225	0.1225	unchg	4.9	4.9
StarHub	1.310	Dec	186	130	-30.1	12.2	17.4	0.09	0.08	-11.1	6.9	6.1

* depicts underlying net profit which exclude one-off exceptional losses from Bharti Airtel. All numbers for SingTel are for FY20 and FY21 due to FY ended March

Source: Bloomberg, Lim & Tan Research

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Exhibit 3: Percentage Change In Share Price Year-To-Date Of Various Technology Counters



Source: Bloomberg, Lim & Tan Research

Exhibit 4: Expecting Worldwide Semiconductor Growth Despite COVID-19

Spring 2020	Amounts in US\$M			Year on Year Growth in %		
	2019	2020	2021	2019	2020	2021
Americas	78,619	88,694	94,598	-23.7	12.8	6.7
Europe	39,816	38,174	40,381	-7.3	-4.1	5.8
Japan	35,993	34,400	35,547	-9.9	-4.4	3.3
Asia Pacific	257,879	264,697	281,725	-8.8	2.6	6.4
Total World - \$M	412,307	425,966	452,252	-12.0	3.3	6.2
Discrete Semiconductors	23,881	22,309	23,576	-0.9	-6.6	5.7
Optoelectronics	41,561	39,441	41,850	9.3	-5.1	6.1
Sensors	13,511	13,230	13,839	1.2	-2.1	4.6
Integrated Circuits	333,354	350,986	372,987	-15.2	5.3	6.3
Analog	53,939	50,808	53,809	-8.2	-5.8	5.9
Micro	66,440	68,151	69,129	-1.2	2.6	1.4
Logic	106,535	109,668	113,973	-2.5	2.9	3.9
Memory	106,440	122,358	136,076	-32.6	15.0	11.2
Total Products - \$M	412,307	425,966	452,252	-12.0	3.3	6.2

Note: Numbers in the table are rounded to whole millions of dollars, which may cause totals by region and totals by product group to differ slightly.

Source: WSTS (World Semiconductor Trade Statistics) report dated 09-Jun-20

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We are bullish on the tech sector in 2H20 and we note that both Gartner Inc and WSTS are positive as well, which we believe are attributed to several factors driving the market, namely the:- (i) Digital Transformation; (ii) Work from home; (iii) 5G; and (iv) Autonomous driving themes.

Digital Transformation of businesses, which includes support for e-payments and adopting digital solutions, is picking up steam globally, helped in part recently due to COVID-19. For example, in the recent Fortitude Budget of Singapore, more than \$500m was allocated to support the digital transformation of businesses. Meanwhile, for the Work from home theme, more technology hardware/software would be required going forward as more companies encourage working from home due to COVID-19.

For the 5G theme, the 5G mobile network aims to expand the entire mobile ecosystem, where Qualcomm is forecasting 5G to enable up to US\$13.2 trillion worth of goods and services by 2035. In conjunction with the 5G theme, Autonomous driving is yet another growth sector within the broader technology industry. According to Adroit Market Research, the Autonomous driving sector will grow at a CAGR of 35% for 2019 – 2025 and reach US\$13b in 2025.

Appetite for certain tech stocks within the favoured sub-sector is still present. On 03-Apr-20, during the COVID-19 period, printed circuit board manufacturer, Elec & Eltek, announced that it had received a privatisation offer from its parent company. At an offer price of US\$2.33, this equates to a takeover P/E and EV/EBITDA of 14.3x and 6.5x respectively, which also represents a 99% premium over its last done share price of US\$1.17 before it called for a trading halt. Meanwhile, on 28-May-20, loss-making Broadway Industrial announced that it had received a non-binding offer for its hard disk drive business, although no financial terms of the offer were disclosed.

Avi-Tech, which offers earnings appreciation and an attractive dividend yield, saw 1H20 revenue inch up 0.8% to S\$15.6mln while net profit jumped 71.2% to S\$3.1mln. 1H20 gross margins also improved to 38.6% from 28.2% in 1H19, due to higher sales from the burn-in segment as compared to the PCBA and engineering services businesses. The Group had generated free cash flows of S\$4.3mln in 1H20, while 1H20 dividends increased to S\$0.01 (1H19 = S\$0.008).

Avi-Tech provides burn-in services for semiconductor chips, of which its major customers have not turn bearish despite COVID-19. We note that all of Avi-Tech's manufacturing facilities are in Singapore, and they were partially affected by the recent circuit breaker locally. We are expecting a 10% yoy growth in net profit to S\$5.1m for FY20F (as compared to FY19 net profit of S\$4.65m), and annual dividends to remain unchanged at S\$0.023. Given its earnings growth and high dividends, we view the stock as a growth and yield play.

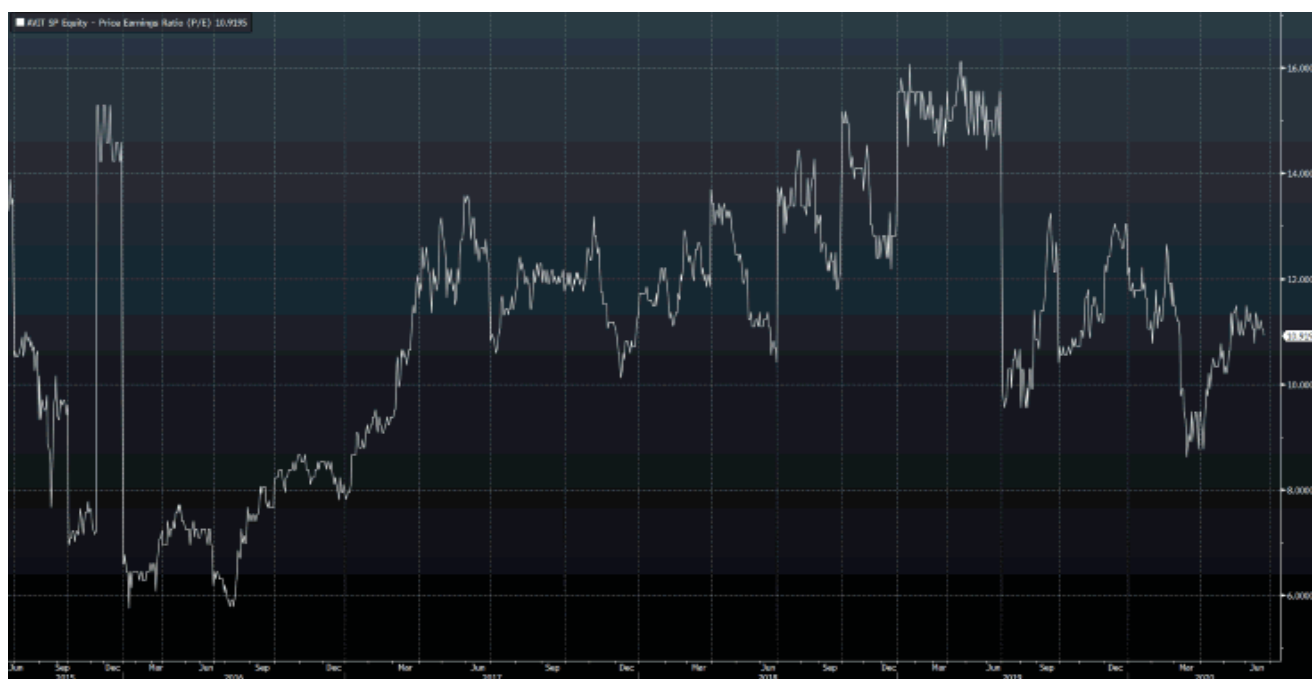
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Exhibit 5: Ten Year Share Price Chart Of Avi-Tech



Source: Bloomberg, Lim & Tan Research

Exhibit 6: Five Year P/E Chart Of Avi-Tech



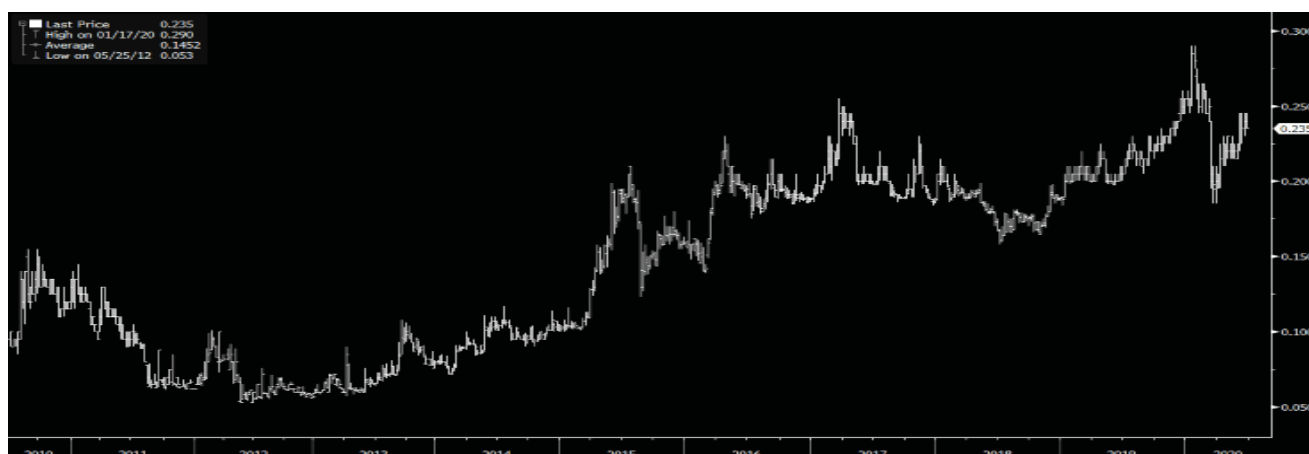
Source: Bloomberg, Lim & Tan Research

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Fu Yu, which most investors like for its high dividend yield, saw 1Q20 revenue move down 25.5% to S\$46.7mln although net profit rose to S\$4.4mln from S\$1.6mln in 1Q19, attributed to FX gains of S\$3.2mln arising from the appreciation of the US dollar. 1Q20 operating profit was down 42% to S\$1.8mln, although gross margins improved to 19.8% from 7.7% in 1Q19 due to better operating efficiencies. No dividend was declared in 1Q20, as Fu Yu usually only declares dividends from 2Q to 4Q.

Fu Yu is expected to remain operationally profitable in 2Q20, unlike its peer Sunningdale Tech which could record a loss in 2Q20. However, Fu Yu's China operations had accounted for 43% of Group revenue, and it may be affected going forward due to the expected realignment of the global tech supply chain out of China. All in, we are expecting a 20% drop in net profit to S\$10.2m in FY20 over FY19 net profit of S\$12.7mln, and FY20 dividends to decrease to S\$0.015 per share (FY19: S\$0.016). We opine that Fu Yu remains a favoured dividend yield play.

Exhibit 7: Ten Year Share Price Chart Of Fu Yu



Source: Bloomberg, Lim & Tan Research

Exhibit 8: Five Year P/E Chart Of Fu Yu



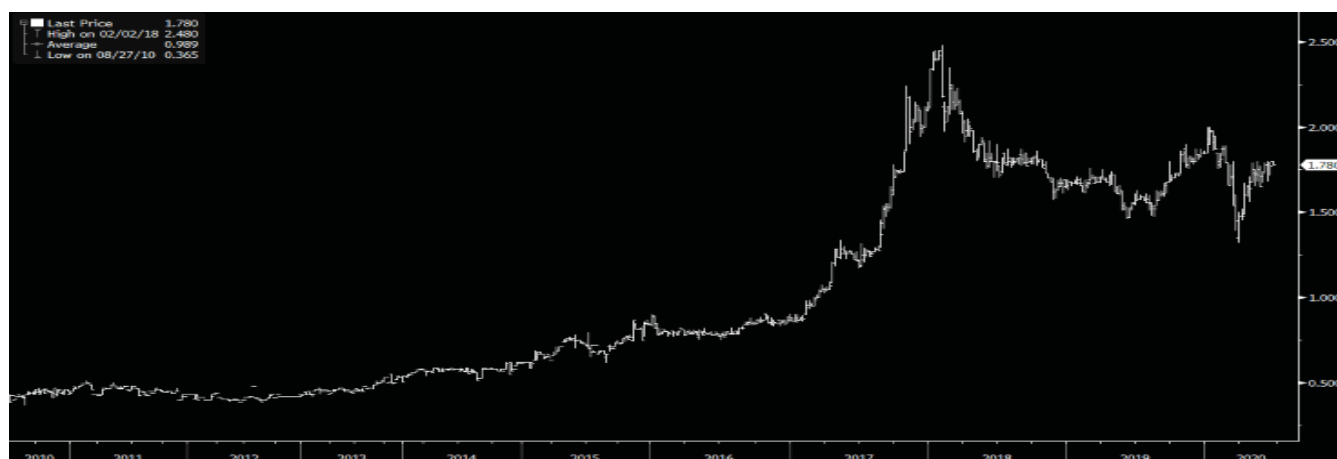
Source: Bloomberg, Lim & Tan Research

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Micro-Mechanics, which offers earnings growth and attractive dividends, is a manufacturer of high precision tools and parts used for the assembly processes of the semiconductor industry. 3Q20 revenue had expanded 12.9% to S\$16.2m while net profit surged 48.1% to S\$3.9m, as gross margins improved to 52% from 49.3% in 3Q19. Meanwhile, 9M20 revenue inched up 3.1% to S\$47.8m while net profit rose 4.6% to S\$10.7m, despite issues over COVID-19.

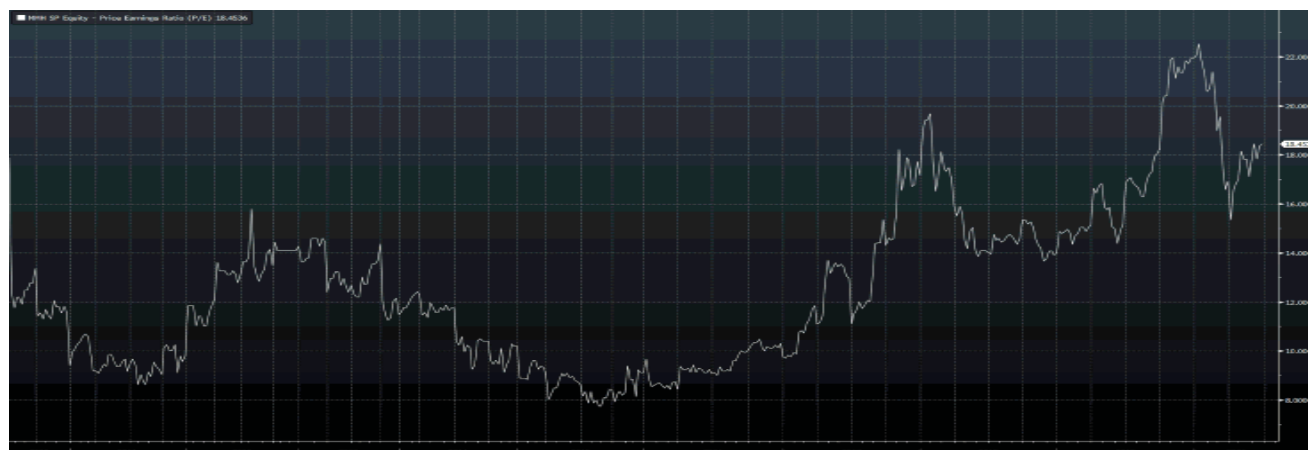
We opine that Micro-Mechanics is slated to ride on the broader semiconductor growth within the industry for calendar year 2H20, and are expecting 11% yoy growth in net profit to S\$14.4m for FY20F as compared to FY19 net profit of S\$13m while dividends to remain unchanged at 9 cts. However, we note that valuations for the stock do not appear to be low. In summary, given its high dividends and expected profitability growth, we view the stock as a yield and growth play.

Exhibit 9: Ten Year Share Price Chart Of Micro-Mechanics



Source: Bloomberg, Lim & Tan Research

Exhibit 10: Ten Year P/E Chart Of Micro-Mechanics



Source: Bloomberg, Lim & Tan Research

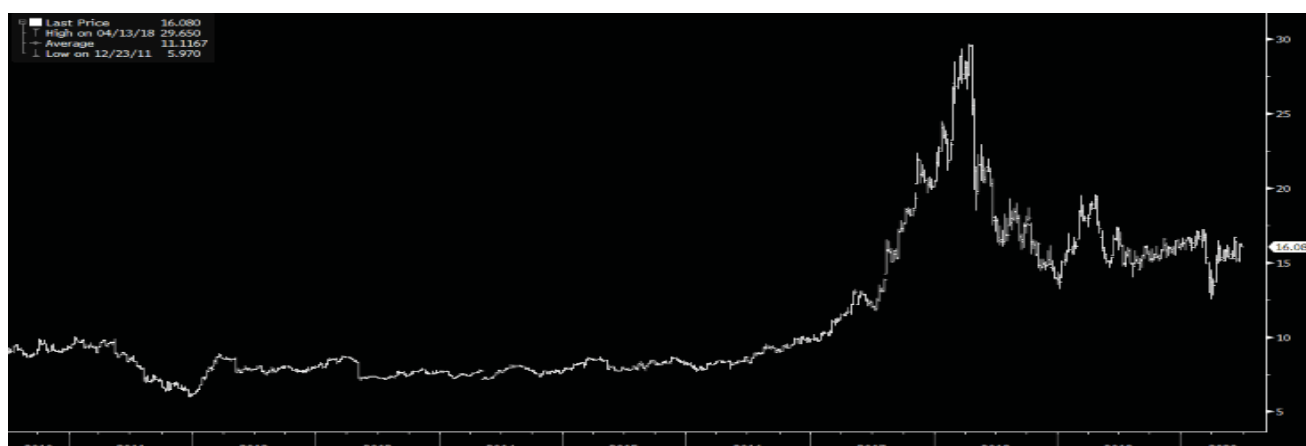
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Venture Corp, which is slated to benefit from the realignment of the global tech supply chain, saw 1Q20 revenue decline 27.5% to S\$673mln while net profit tumbled 33.6% to S\$60.3mln. Lockdowns in the various countries within the global tech supply chain had affected Venture in 1Q20 although going forward, Venture is expecting a stronger 2H20 as compared to 1H20 for the Group.

Realignment of the worldwide tech supply chain presents opportunities for Venture's Singapore and Malaysia factories, as the various global tech giants look to diversify their production requirements out of China. Currently, less than 10% of Venture's total production output are from its China factories, while more than 90% of its total production output are from its various factories outside of China.

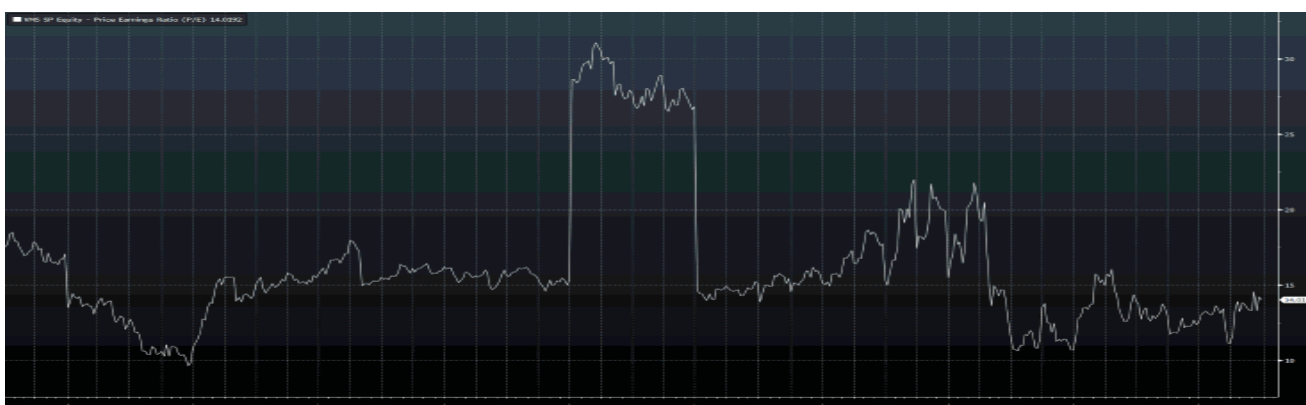
However, due to an expected weak 1H20 for Venture, we are forecasting a 10% yoy decline in net profit to S\$327m for FY20F, as compared to FY19 net profit of S\$363m while dividends to remain unchanged at 70 cts. Also, while dividend yield of Venture is not high comparatively, we nevertheless believe that sentiment in the stock will turn positive in the second half this year with investors looking to Venture as a proxy for SGX-listed tech counters slated to ride on a recovery from post COVID-19.

Exhibit 11: Ten Year Share Price Chart Of Venture Corp



Source: Bloomberg, Lim & Tan Research

Exhibit 12: Ten Year P/E Chart Of Venture Corp



Source: Bloomberg, Lim & Tan Research

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For the Telecommunications sector, SingTel is our top telco pick as compared to StarHub due to dividend uncertainty for the latter as StarHub (HOLD) recently withdrew its FY20 dividend guidance when it released its 1Q20 financials. While SingTel (BUY) also did disappoint the market when it recently disclosed its FY20 results where it had slashed its dividend payout by 30% to 12.25 cents in FY20 from 17.5 cents in FY19, we do note that the market is still expecting SingTel to maintain this 12.25 cents dividend in FY21. For StarHub, however, a bigger question mark arises over whether it is able to sustain its 9 cents dividend in FY20 after having paid this same amount in FY19. Also, we note that as seen in Exhibit 1, SingTel's share price has significantly underperformed StarHub and that based on consensus target price, SingTel has a lot more potential upside at 28.8% as compared to 14.5% for StarHub.

Exhibit 13: Percentage Change In Share Price Year-To-Date Of SingTel & StarHub



Source: Bloomberg, Lim & Tan Research

Meanwhile, the present outlook for the Telecommunications sector in Singapore is mixed, as seen in the exhibit below. For the Consumer market, market competition is intense with 4 MNOs (Mobile Network Operator) and 11 MVNOs (Mobile Virtual Network Operator). Moreover, the TV businesses of SingTel and StarHub have both been hit with the rise of OTTs ("Over the top", refers to Netflix, Amazon, etc) and content providers going direct to consumers. For the broadband segment, there is also lack of differentiation between operators.

On the Enterprise market, however, the growing demand from enterprise customers in data analytics solutions, IoT (Internet of Things), cloud and data centre solutions is a positive. There are also opportunities to expand into the underserved SME/mid-market segments, as adjacent ICT (Info-Communications Technology) business in Managed Services, Cloud, Analytics and IoT are expected to grow at a 9% CAGR over 2018 – 2022F according to various market research firms.

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Exhibit 14: Factors Affecting The Telecommunications Sector In Singapore

CONSUMER

INTENSE MARKET COMPETITION

- Mobile: 4 MNOs, 11 MVNOs
- TV: Rise of OTTs (fragmented market) and content providers going direct to consumers
- Broadband: Lack of differentiation between operators

CHANGING CONSUMER BEHAVIOUR

- Higher data usage
- On-the-go OTT
- Favours flexibility & simple plans (e.g. no contract / SIM-Only)

NEW TECH CYCLE (5G)

- Consumer: Emerging opportunities in IoT / VR
- Enterprise: Tap 5G capabilities (higher speed, lower latency, prioritization, slicing) to enable innovative solutions

ENTERPRISE

ENABLING DIGITAL TRANSFORMATION

- Leverage the rise of Singapore's digital economy that is driven by the Government's Smart Nation push
- Growing demand from enterprise customers in data analytics solutions, IoT, cloud and data centre solutions

GROWING ADDRESSABLE MARKET

- Adjacent ICT business in Managed Services, Cloud, Analytics and IoT growing at 9% CAGR over 2018 – 2022F¹
- Opportunity to expand reach into underserved SME/mid-market customer segments

¹ Source: Analysys Mason, GlobalData, IDC, Frost & Sullivan, Gartner, Arthur D. Little Analysis, August 2019

Source: Starhub

The global Digital Transformation, Work from home, 5G and Autonomous driving themes as mentioned in our technology sector outlook above are also expected to be beneficial for the Telco industry longer-term. Meanwhile, closer to home and as disclosed on 30-Apr-20, SingTel and a joint venture between StarHub and M1 won the rights to build the Republic's two nationwide networks and will have to scale up to provide 5G nationwide coverage by 2025. While the Infocomm Media Development Authority (IMDA) had mentioned that operators of the nationwide 5G network need to each offer at least \$55 million for the scarce 3.5GHz band of airwaves to provide nationwide coverage, we note that SingTel has yet to officially guide on its own required 5G capital expenditure. Nevertheless, we are not expecting capex requirements from SingTel's 5G venture to negatively impact its FY21 dividend payout.

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On the digital banking licences in Singapore that are expected to be awarded by end-2020, industry sources have mentioned that the 40:60 joint venture between SingTel and Grab Holdings is one of the 14 applicants that has been shortlisted on 18-Jun-20. For a digital full banking license, the Monetary Authority of Singapore (MAS) had stated that a minimum paid-up capital of S\$1.5 billion is required. While this could indicate that SingTel would need to fork out at least S\$600 million for its 40% stake for the digital full banking license, we believe that SingTel would still be able to maintain its FY21 dividend at S\$0.1225 (equates to total value of S\$2 billion), as FY20 free cash flow (defined as cash flows from operations minus capital expenditure and minus dividends) came in at S\$925 million even after having accounted for capex and dividend payment.

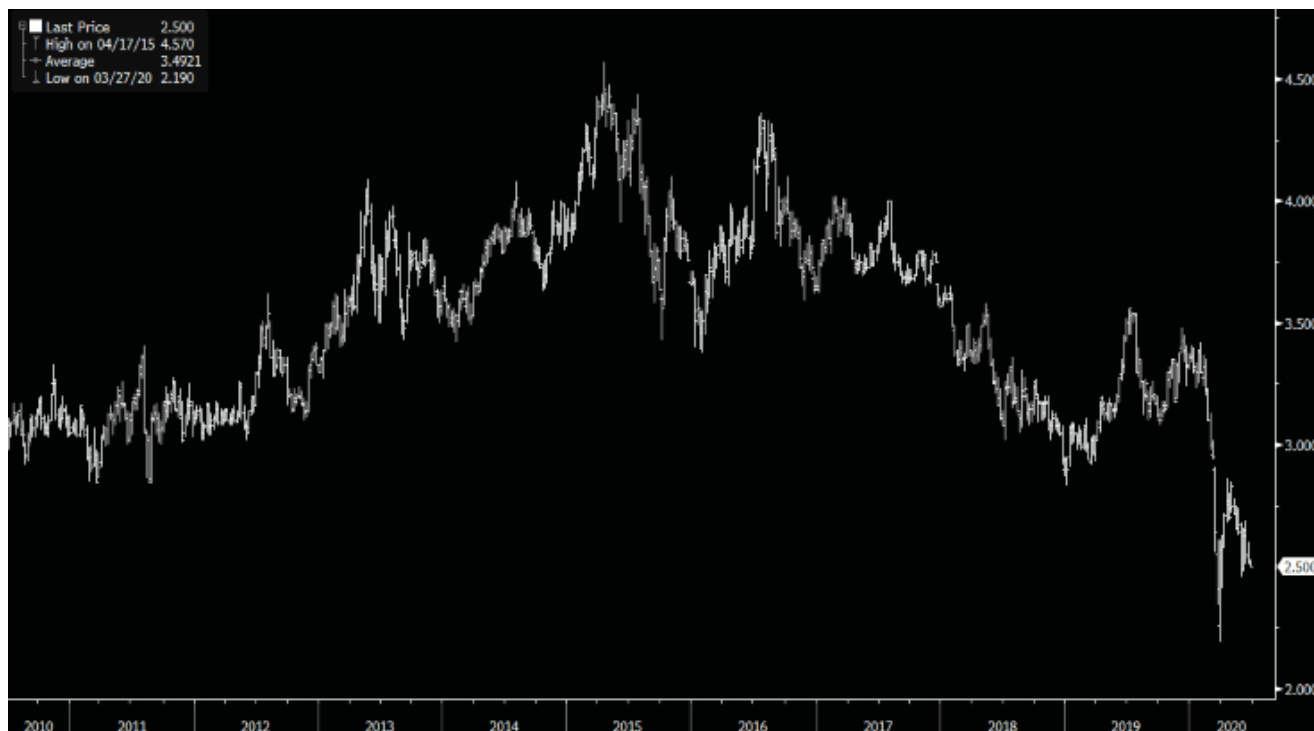
Earnings outlook for both SingTel and StarHub not looking positive. SingTel's operating revenue for the full year FY20 declined 2% in constant currency terms at S\$16.54 billion, a result of lower mobile service revenue and equipment sales, aggravated by the onset of COVID-19 this February. Underlying net profit (excluding one-off exceptional charge from Bharti Airtel) decreased 13% to S\$2.46 billion in FY20, with pronounced fourth quarter weakness in the Australia business due to continuing data price competition and weak consumer sentiment, and the effects of lower equipment sales and margins and low NBN resale margins.

SingTel also saw FY20 net profit plunge 65% yoy to S\$1.08 billion due to Airtel's exceptional charges for regulatory costs, including the adjusted gross revenue matter and a one-time spectrum charge. Management noted that this has been a challenging year, given structural shifts in the industry, already soft economic conditions, adverse regulatory outcomes in India and the onset of COVID-19 in the fourth quarter. Travel and movement restrictions have also led to significant reductions in roaming and prepaid revenues and slowing economic growth has impacted business spending.

Earnings dip for SingTel in FY21 may be forthcoming. Management noted that the COVID-19 pandemic has created unprecedented disruptions to the global business environment as well as in the countries that the Group operates. Given the uncertainty of the impact on economic activity and the Group's business, the Group will not provide guidance for FY21. Nevertheless, we note that according to Bloomberg consensus, analysts are on average forecasting FY21 underlying net profit (exclude losses from Bharti Airtel) to drop 5.1% yoy to S\$2,332 million, although dividend payout is anticipated to remain unchanged at 12.25 cents. While this dividend yield is not as high as some of our highlighted technology stocks, we do regard SingTel as a defensive play where investors can seek refuge in during times of uncertainty which still offers a palatable dividend yield.

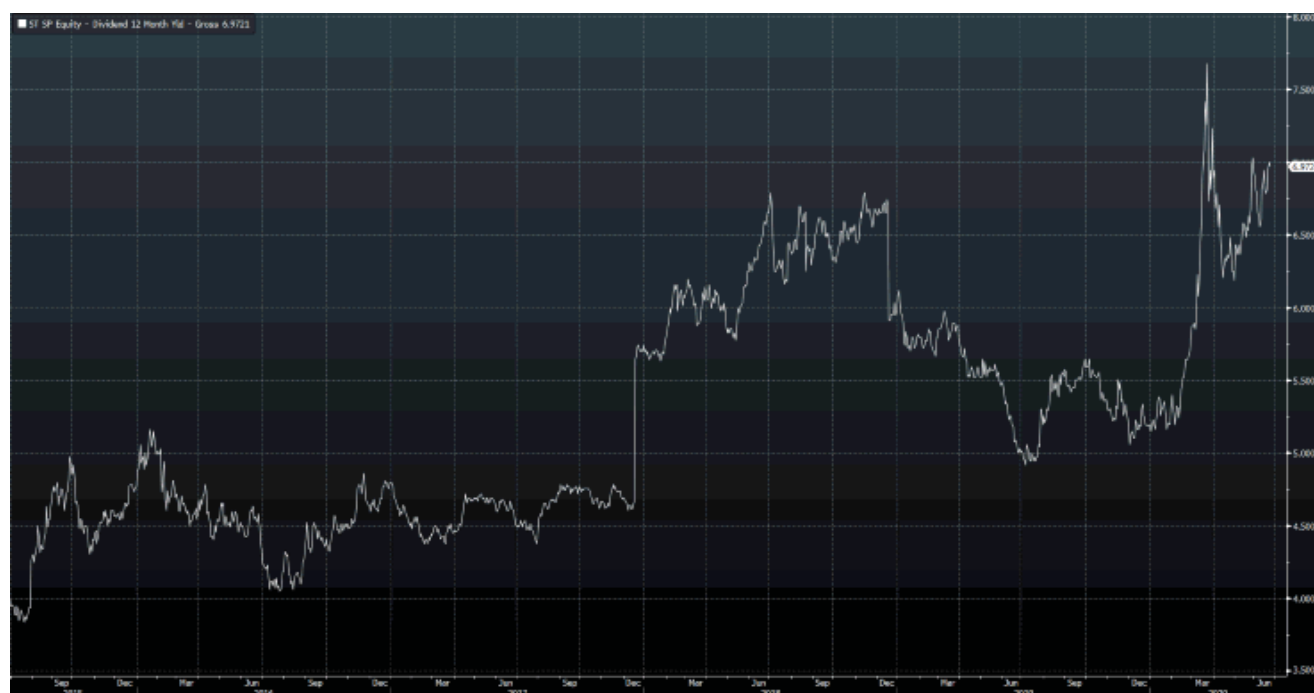
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Exhibit 15: Ten Year Share Price Chart Of SingTel



Source: Bloomberg, Lim & Tan Research

Exhibit 16: Five Year Dividend Yield Chart Of SingTel



Source: Bloomberg, Lim & Tan Research

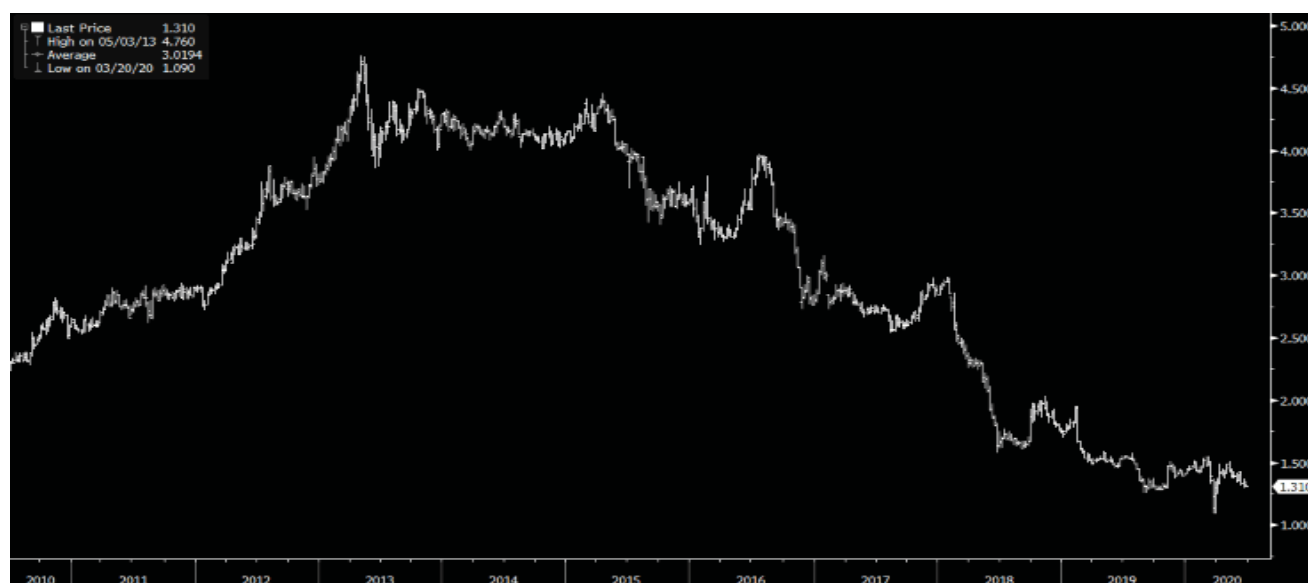
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The latest results release of StarHub saw a 15.2% yoy decline in total revenue to S\$506.2mln and 25.7% decrease in net profit to S\$40.2mln for 1Q20. Management noted that their 1Q2020 results reflected the impact of COVID-19 and the early softening of the economic environment. With border controls and movement restrictions, roaming, IDD and prepaid revenues have been significantly reduced. Also, its Enterprise business has also experienced some project and tender delays, coupled with longer sales cycles.

StarHub also provided a negative guidance where they mentioned that the COVID-19 crisis is expected to have a material impact on the Group's revenue and profitability for the year, with expectations for revenue declines for most business segments at varying degrees. StarHub noted that they will provide more information in 2H20 when there is greater clarity on both the relevant Government measures and the economic situation.

In view of the uncertainty, StarHub is withdrawing all guidance for 2020 and will update shareholders once there is greater visibility to the aggregate nature of the COVID-19 impact. We also note that according to Bloomberg consensus, analysts are on average forecasting its FY20 net profit to drop 30.1% yoy to S\$130 million, while dividend payout is expected to decrease 11.1% to 8 cts in FY20 from 9 cts in FY19. Additionally, given StarHub's higher gearing levels with net gearing at 137% as compared to SingTel at 49% (see Exhibit 1), we thus prefer SingTel over StarHub.

Exhibit 17: Ten Year Share Price Chart Of StarHub



Source: Bloomberg, Lim & Tan Research

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Exhibit 18: Five Year Dividend Yield Chart Of StarHub



Source: Bloomberg, Lim & Tan Research

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2. The research analysts do hold *interests in SingTel as recommended in this report as at the close of 23/06/2020.

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