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Investing in Local Tech

Edge Markets (27 August 2020)

By Tan Zhai Yun

The local technology sector has been one of the biggest winners on the local bourse since it plummeted in March, thanks to the Covid-19 pandemic. While the Bursa Malaysia Technology Index saw a dip then, it has since recovered to hit a 16-year high on Aug 11, outperforming the FBM KLCI.

This interest in the tech sector follows close on the heels of the global rally in tech stocks. Investors are betting on the accelerated digitalisation trend triggered by the pandemic, which has restricted movement and thus increased the popularity of digital services.

While there are no local equity funds solely focused on the tech sector, several local equity and mixed asset funds have benefited from this trend over the last 12 months. These funds managed to record double-digit returns in the past six months to one year due in part to their large exposure to tech stocks.

"After the World Health Organization declared Covid-19 as a pandemic, we shifted the strategy of the BIMB i Growth fund to focus on sectors that might benefit from the situation. These include the technology, healthcare and consumer-related stocks. This shift in focus improved the fund's performance," says Abd Razak Salimin, head of investment at BIMB Investment Management Bhd.

According to its latest fund factsheet dated June 30, the largest sector allocation for the BIMB i Growth fund was in information technology (45.9%). It recorded a cumulative performance of 16.96% in the past six months and 14.21% in the past one year.

"We were positive on the technology sector for a long time but Covid-19 was a catalyst for the growth of technology stocks, particularly 5G-related counters. Due to the pandemic, everyone experienced the need to have good [mobile internet] connection, so we foresaw 5G-related tech counters would perform well," says Abd Razak. The allocation to tech counters was also a diversification strategy away from the heated glove counters, he adds.

InterPac Dana Safi, which is classified as a mixed asset fund by Lipper, switched its focus to the technology sector last December when Datuk Dr Nazri Khan became the new head of Inter-Pacific Asset Management Sdn Bhd (InterPac).

Nazri says he has always been positive on the technology sector and believes that the 5G trend and Malaysian government's push for digitalisation will benefit local tech counters.

"We think the government will incorporate [incentives for digitalisation and automation] into Budget 2021 and there will be more allocation for e-commerce and 5G technologies going forward. After the pandemic, we are also optimistic that there will be more demand for semiconductors due to pent-up demand in the automotive segment and for things like smart homes and Industry 4.0," he says.

According to its latest factsheet dated June 30, InterPac Dana Safi had a 70.72% allocation to the technology sector. It recorded a return of 13.35% for the past six months and 20.86% for the past year.

Meanwhile, **Kenanga Growth Fund** is overweight on technology as it is one of the few sectors that has continued to deliver superior earnings growth over the last few years. "Besides growth, tech stocks also have strong balance sheets and cash flow, which enable them to weather an economic downturn better than some other cyclicals. The fund's overweight positioning on tech has contributed to its outperformance relative to its benchmark," says Ismitz Matthew De Alwis, CEO of Kenanga Investors Bhd.

The local tech sector will also be a beneficiary of supply chain diversification strategies as a result of US-China trade tensions and the pandemic, he adds. According to its latest factsheet dated June 30, Kenanga Growth Fund has a 20.1% allocation to technology and recorded a return of -8.16% for the past six months and -2.37% for the past one year. The latter beat the benchmark's -10.24%.

"Despite the negative impact in the first quarter, the fund has remained steadfast in its strategy of investing in companies that are backed by solid fundamentals; hence it rebounded strongly compared to the broader market as the second half of 2020 began. As at July 23, the [fund's returns have] increased by 4.6%, outperforming its benchmark that rose by 1.1%, thanks in part to its investments in tech and healthcare (which has a 9% allocation)," says De Alwis.

A quick survey has found that **Kenanga EquityExtra Fund** also has a significant allocation to tech at 18.5% (the second largest allocation after short-term deposit and cash at 36%). According to its fund factsheet, it recorded a return of 7.92% for the past six months and 13.85% for the past one year. The fund will continue to be overweight in tech and export counters owing to decent earnings growth in the sectors, its factsheet states.

PMB Shariah Growth Fund, which recorded a return of 14.11% over the past six months and 24.73% over the past one year, has a 28.89% exposure to technology followed by 19.79% to healthcare, according to its latest factsheet.

"We tried to determine the sectors that will benefit from Covid-19. For example, people have to adapt to the new norm due to the pandemic by working from home, so we believe demand for products and services related to technology will increase. We project these two sectors (tech and healthcare) will contribute to returns of at least 10%," says Isnami Ahmad Mohtar, chief investment officer of PMB.

COMPANY WEBSITES AND BLOOMBERG

Performance of selected local tech counters

NAME	DESCRIPTION	SHARE PRICE IN RINGGIT (AS AT AUG 11)	PRICE GAIN/LOSS OVER 6 MONTHS (%)
Datasonic Group Bhd	Provides solutions such as smart card personalisation and customisation of software and hardware solutions	1.38	-8.58
Dufu Technology Corp Bhd	Manufactures precision machining components for hard disk drive and other products	3.31	45.37
Frontken Corp Bhd	Provider of high-precision cleaning services to global foundries	3.45	39.86
Globetronics Bhd	Provides manufacturing services for semiconductor, LED, sensor and other industries	2.75	17.61
Greatech Technology Bhd	Automation solutions provider	6.09	83.43
JHM Consolidation Bhd	Microelectronics and LED manufacturing company	1.57	3.29
Malaysian Pacific Industries Bhd	Involved in the manufacturing, assembling, testing and sale of integrated circuits, semiconductor devices and other electronic components	13.26	18.14
Pentamaster Corp Bhd	Automation manufacturing and technology solutions provider for semiconductor, computer and other industries	4.22	26.30
Unisem Bhd	Provider of semiconductor assembly and test services	3.28	50.11
ViTrox Bhd	Provider of automated vision inspection system and tester for semiconductor and other industries	11.38	25.67

According to a research article by iFast Capital Sdn Bhd, as at June 30, most of the top 10 performing equity funds — out of 231 funds — on its platform had technology as their top or second highest sector allocation. The rest were focused on China, gold and minerals, as well as healthcare. Among the top 10 were BIMB i Growth fund, PMB Shariah Growth Fund and InterPac Dana Safi.

The funds that were exposed to tech recorded positive returns at a time when more than half of the equity funds under coverage recorded negative returns, according to the article.

These three funds, along with Kenanga EquityExtra Fund, were also ranked in the top five in terms of returns for six months and one year in their respective categories, according to data from Lipper (as at July 31).

While investors can be exposed to the tech sector by investing directly in the counters, the benefit of investing via a fund is that they can rely on experienced fund managers to generate returns while managing downside risks, says Abd Razak.

"The professionals look at the stock market on a daily basis and are able to react to any market movements faster after doing a thorough analysis. Additionally, the collective pool of money in a unit trust can be diversified meaningfully [to many stocks] compared to funds from a single individual," he adds.

Long term or short term?

Fund managers agree that local tech counters will continue to outperform, and will be supported by factors such as the rollout of 5G technology globally and government incentives for automation and digitalisation.

"The upcycle in tech stocks should last multiple years as the earnings outlook [for these counters] are still improving. Some stocks such as Pentamaster Corp Bhd, Unisem (M) Bhd, Frontken Corp Bhd and Malaysian Pacific Industries Bhd have been improving since 2016. The industry is already starting to look at the 6G development potential when 5G hasn't been fully implemented yet. Thus, the sector will always have a meaningful weight in our funds," says BIMB's Abd Razak.

Another factor that will drive the growth of local tech stocks in the medium to long term is the government's emphasis on helping companies digitalise and adopt automation, InterPac's Nazri adds. "We are optimistic that there will be more digital transformation in 2021 and the upcoming budget will be the catalyst that we are waiting for."

He is positive that the planned 5G phone launches this year will support the growth of companies in semiconductor-related industries, and that the local tech sector will benefit from the rally in US tech stocks. Mobile phone manufacturers such as Samsung and Google have announced launches of new phone models in the coming months.

"The tech sector can outperform the others. However, we believe that we are at the late stage of this growth cycle. The tech stocks are overbought now, but I think there is still momentum and the upside could go on for another three months," says Nazri.

A recent boost to local tech stocks came in July when the Semiconductor Equipment Manufacturing Industry (SEMI) forecast was released. Global sales of semiconductor manufacturing equipment by original equipment manufacturers were projected to reach a record high of US$70 billion by 2021.

"In June, Taiwan's export orders grew at their fastest pace in nearly two years. It was cited that the better-than-expected performance was due to strong demand for semiconductors and telecommuting products," says PMB's Isnami.

"We believe that the semiconductor segment has good growth potential, in line with the projections of SEMI and Taiwan's export growth. Thus, we are focusing on the semiconductor segment as there are many companies involved in this segment in Malaysia."

Which stocks are funds holding?

Many of the top tech companies in the US are involved in artificial intelligence (AI), cloud computing and software. In Malaysia, the most popular tech stocks are in semiconductor-related industries or are manufacturers of technology equipment.

According to the fund managers, these companies can still ride the global tech trend as they supply to major tech companies in various industries around the world. Accelerating trends such as 5G, AI, electric vehicles and industrial automation will drive the growth of the local industry.

"Some might argue that there is a lack of high-tech companies in Malaysia, but the local tech ecosystem and its players remain proxies for technological trends. The strong earnings profile of technology counters in recent years is a showcase of not only their capabilities but also the emerging importance of home-grown Malaysian tech companies in the global semiconductor supply chain," says De Alwis.

Among its tech holdings, Kenanga Growth Fund has the largest exposure to Frontken Corp Bhd, Greatech Technology Bhd and Pentamaster Corp Bhd. According to De Alwis, Greatech's clients include global leaders in the solar energy and electric vehicle space. Meanwhile, Frontken's strong track record of meeting the semiconductor industry's stringent requirements and leading-edge technologies create a strong barrier to entry and is testament to the firm's know-how and capabilities, he adds.

As long as the local tech companies stay competitive and relevant to the global smartphone, automotive and aerospace supply chain, their earnings growth prospects will sustain, says Abd Razak.

He is positive that semiconductor test equipment manufacturers, chip designing houses, wafer cleaning service providers and those involved in assembly and testing services will benefit from 5G-related developments.

Currently, the tech company that BIMB i Growth has the largest exposure to is JHM Consolidation Bhd, a microelectronics and LED manufacturing company.

"We are optimistic about this counter because of its strong capability to serve the top-tier car makers globally and its potential to penetrate into the aerospace industry in the medium-term horizon," says Abd Razak.

InterPac Dana Safi's largest technology holdings are Globetronics Technology Bhd, Dufu Technology Corp Bhd and Datasonic Group Bhd.

"We have also invested in Pentamaster and Greatech, which are part of our 5G play. They deliver strong earnings per share. Greatech has benefited from last year's budget and will continue to benefit from the upcoming budget owing to the government's incentives for automation and e-commerce," says Nazri.

PMB's fund has major exposure to Frontken, ViTrox Corp Bhd and engineering firm UWC Bhd due to their good fundamentals and diverse clients.

"The thematic trends [like 5G and Internet of Things] will spur the growth of the sector. Also, companies that take innovative steps and actively develop applications will contribute to the growth of the sector," says Isnami.

Apart from semiconductor-related firms, some funds also have exposure to companies involved in e-commerce and digital services. For instance, PMB has invested in digital service provider MyEG Services Bhd and e-payment service providers GHL Systems Bhd and Revenue Group Bhd.

The fintech segment shares a similar growth profile to the other tech stocks, observes De Alwis. The migration from paper-based payments to electronic payments, as well as the growing volume of online and mobile payment transactions, bode well for companies in the electronic payment space.

"Companies like Revenue Group, for instance, are proxies for riding the robust domestic e-commerce industry. Unfortunately, there are only a handful of these payment-related companies available in Malaysia. We see more alternatives in markets abroad that we are invested in," he says.

Can the returns be maintained?

While fund managers are optimistic about the opportunities in the tech sector, challenges remain. Equities are expected to remain volatile as subsequent waves of the Covid-19 outbreak could force governments to restrict the movement of their population again.

This may disrupt global tech supply chains, as had happened earlier this year when China imposed lockdowns due to the pandemic. A worsening situation could also dampen consumer demand for electronic products.

"But you see that some of these companies are still earning from exports despite disruptions in production. I hope that there will not be any cancellation of smartphone launches this year. Another challenge for these companies is [a limitation of movement] that will impact labour supply," says Nazri.

So far, however, demand from China has recovered and is reflected in the performance of the local tech counters. "Based on the good results reported by Unisem and Frontken this quarter, we expect most tech stocks to report the same good performance this month due to improving orders from China as well as higher demand for 5G-related products," says Abd Razak.

Can the funds sustain their returns for the rest of the year? Nazri says it could be difficult. "Maybe we can churn out another 10% in returns [in the next few months], but to maintain the kind of returns [beyond that is quite challenging]. But we are optimistic on the local market. We have a rosy outlook for the market in 2021 due to high liquidity, strong retail participation and other factors. But in the near term, investors should expect some volatility."

BIMB i Growth is an actively managed growth fund, hence Abd Razak foresees the team eventually rotating out of its current positions in the tech sector. While he is unable to estimate when that might happen, he believes that there is still room for upside in the sector and some of the tech counters have not been fully valued yet.

"The economic reopening is not complete and the full impact of Covid-19 has yet to be seen, nor has 5G been fully implemented. At the moment, I think we can safely [maintain our exposure] in this sector perhaps throughout the year," he says.

Some of the undervalued sectors he is looking at outside of tech are utility players, which have yet to come out of the pandemic-driven sell-off, as well as property players and construction players, which might benefit from a potential election.

Meanwhile, since InterPac Dana Safi invests in momentum-based stocks, it is possible that the fund will rotate out of the tech sector into other assets like gold when the timing is right, says Nazri. But he also does not foresee a pullback in the local tech sector this year.

Going forward, Isnami expects the local market to go into a consolidation mode in the third quarter. Gloves and selective tech counters will remain investors' top choices, he adds, as new waves of Covid-19 might occur and the work-from-home trend continues.

"We expect the market to record better performance in the fourth quarter after consolidating in the third quarter … Coming from a low base in 2020, corporate earnings are also projected to record better growth in 2021. Another factor that will support the market is high liquidity, as we expect the low interest rate environment will remain until next year. We also expect some recovery play," says Isnami.

Kenanga Investors

Investors will likely shift their attention to the US-China tensions and upcoming US elections in the next few months, according to fund managers.

“We continue to remain selective and prefer sectors that see more resilient growth. Thus, we remain overweight in tech and exporters due to decent earnings growth while looking to add cyclicals and commodity stocks on weakness, to position for a rebound. We maintain a trading bias to take advantage of market volatility in the near term,” says De Alwis.

TECH VERSUS HEALTHCARE

Some parties have observed that the rally in technology counters could be more sustainable than that in healthcare counters, as it is underpinned by the long-term trends of digitalisation and the move to cloud computing.

In fact, Lipper data shows that majority of the top 10 performing funds in the Malaysian equity universe over the last six months and one year have either had healthcare or technology as their biggest allocations.

When asked whether the tech or healthcare sector could provide investors with more returns at this time, the fund managers say it is difficult to tell. Both sectors have the potential to record higher income in the future owing to the new norms established, they say.

However, they agree with the long-term potential for tech and believe that local tech counters will be supported by factors such as the rollout of 5G technology globally and government incentives for automation and digitalisation.

Meanwhile, the healthcare sector’s performance could hinge on the availability of a Covid-19 vaccine in the future.

“The future performance of the healthcare sector will be determined by the path of the pandemic and timing of the availability of a vaccine. If a vaccine is successfully developed and widely available in the next 12 months, it could lead to an underperformance of this sector as investors may take profit and rotate towards previously underperforming sectors such as cyclicals,” says Ismitz Matthew De Alwis, CEO of Kenanga Investors Bhd.

“Despite the recent rally in the tech sector, we believe it still offers long-term growth prospects on the back of drivers such as 5G, artificial intelligence, electric vehicles and industrial automation globally. We like both sectors, but we are carefully monitoring trends in the healthcare sector and may adjust our position tactically on any developments.”

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Photo Mohd Shahrin Yahya/The Edge

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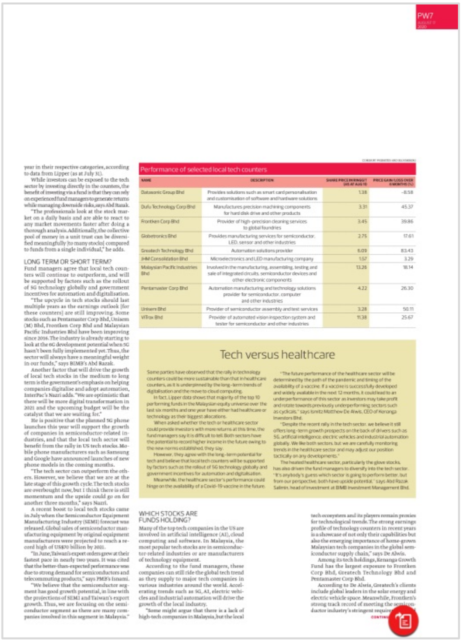
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