UMS Holdings Limited (SGX:558)

BUY: SGD 1.73 (+28.1%)

A hidden opportunity to ride on Singapore's semiconductor upcycle

Date: 25th March 2024

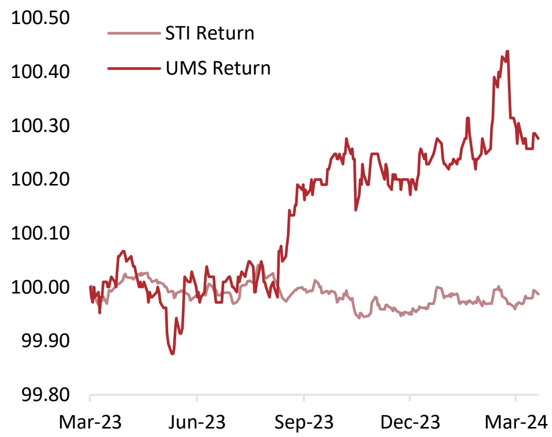
Analyst

Tan Qiuyi Charmaine
Research Analyst
charmaine.tan@fundsupermart.com

Basic Information

Stock name	UMS Holdings Limited
Ticker code	558
Exchange	SGX
Target Price	SGD 1.73
Upside Potential	28.1%
Latest Dividend	SGD 0.056

1-Year Price Performance



Source: Bloomberg Finance L.P.
Data as of 25th Mar 2024.

Company Description

UMS Holdings Limited is a precision engineering group that operates as an integrated original equipment manufacturer specialising in front-end semiconductor equipment, offering a comprehensive range of services such as component manufacturing, sub-assembly and final testing services.

Key Financials

Market Cap	SGD 952m
Fiscal Year End	31st Dec 2023

(SGD mil)	FY23A	FY24E	FY25E	FY26E
Revenue	299.9	327.2	351.9	370.1
Gr Rate (%)	*-19.5*	*9.1*	*7.6*	*5.2*
Net Profit	61.2	84.5	99.0	104.2
Margin (%)	*23.5*	*29.5*	*32.1*	*32.1*
EPS (SGD)	*0.0895*	*0.1167*	*0.1368*	*0.1440*

Key Executives

Andy Luong	Chief Executive Officer
Stanley Loh	Group Financial Controller / Senior Vice President, Operations

We are initiating coverage of **UMS Holdings Limited, ("UMS")** with a BUY rating and a **SGD 1.73** 3Y price target. UMS is well-positioned to ride the upswing in the semiconductor cycle with additional production capacity from its new Penang plant, the acquisition of a new key customer and the successful placement of new shares.

Overview

- UMS is a precision engineering group that operates as an integrated original equipment manufacturer specialising in front-end semiconductor equipment, offering a comprehensive range of services such as component manufacturing, sub-assembly and final testing services.
- In 2023, UMS delivered lower revenue largely attributed to the semiconductor downcycle, along with a decrease in net profit due to higher expenses.
- We expect UMS to benefit from a 35% YoY increase in global semiconductor sales by 2Q24 due to a structural surge in demand driven by increased semiconductor application, higher silicon content in applications, and the rapid adoption of AI.
- With additional production capacity coming online and a new key customer, UMS is estimated to earn an additional revenue of SGD 30 million, which is about 10% of its revenue in 2023. The management has also shared that in three to five years, this amount could increase to SGD 300 million per annum, which is equivalent to its revenue in 2023.
- With stronger expected earnings, we project a 2026 target price of SGD 1.73 based on a fair P/E multiple of 12X. This implies an upside potential of 28.1% relative to its share price of SGD 1.35 as of 25th March 2024.

As highlighted in a previous article, we project a significant 35% YoY increase in global semiconductor sales by 2Q24. This uptrend is fuelled by adjustments in production levels, government incentives, base effects, and rapid adoption of AI. Over the longer term, we also expect a structural surge in chip demand, spurred by the growing trend of digitalisation, leading to increased semiconductor applications and higher silicon content in them. Key beneficiaries of this trend within SGX include UMS Holdings Limited (SGX:558).

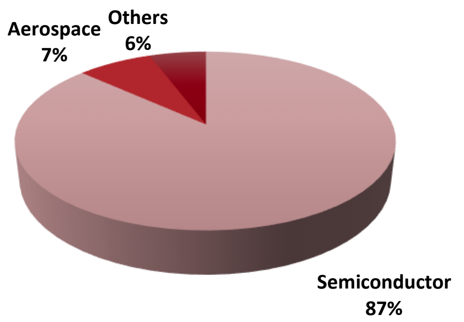
Related article: Chip stocks have soared to record highs. Why share prices still have room to climb.

Related Article: Singapore's GDP to soar by 4% in 2024, here's how to capitalise on this

In this article, we highlight the attributes that underscore its position as a local semiconductor stock deserving of investors' consideration.

View this article on our website:
UMS Holdings: A hidden opportunity to ride on Singapore's semiconductor upcycle

Figure 1: Revenue breakdown by segments for 2023



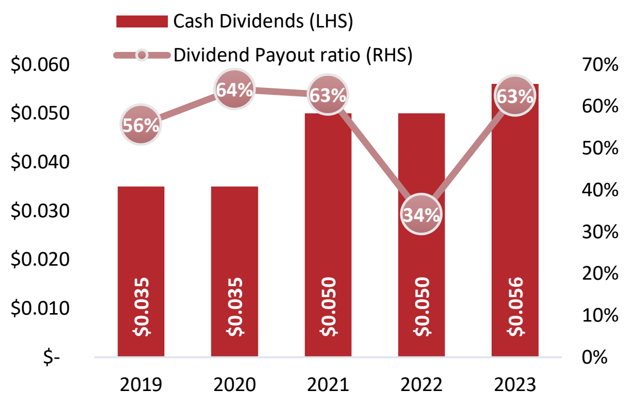
Source: UMS Holdings Limited.
Data as of 31st Dec 2023.

Table 1: Financial highlights of UMS based on its latest performance

UMS Holdings Limited (in SGD thousands unless otherwise stated)	2023	2022	% Change
Revenue	299,907	372,389	-20%
Net Profit	61,186	101,974	-40%
Net Profit Margin (%)	24%	32%	-8%
Earnings per Share (SGD)	0.0895	0.1464	-39%
Dividends per Share (SGD)	0.034	0.030	+13%

Source: UMS Holdings Limited, iFAST Compilations.
Data as of 31st Dec 2023.

Figure 2: Cash Dividends and Dividend Payout Ratio



Source: UMS Holdings Limited.
Data as of 31st Dec 2023.

Note: Bonus shares were given on top of cash dividends in 2019 and 2021. One bonus share for four existing shares

Company Overview

Core business focus on semiconductors: Singapore-based UMS Holdings Limited (UMS) is a precision engineering group that operates as an integrated original equipment manufacturer (OEM) specialising in manufacturing high-precision front-end semiconductor components. It offers a comprehensive range of services, including equipment manufacturing, sub-assembly and final testing services. In 2023, its revenue by business segments consisted of Semiconductors (86.7%), Aerospace (7.6%) and Others (5.7%).

- Semiconductors: This is the core business segment of UMS. The semiconductor business comprises two key segments (i) component parts and (ii) integrated systems.
- Aerospace: The segment provides precision machining services for the aerospace, electronics, and automotive industries.
- Others: Primarily encompasses Starke and JEP Industrades which provide the raw materials and tooling for UMS' component manufacturing operations.

Geographical presence: In terms of geographical regions, Singapore accounted for the majority of revenue (70.3%). Other remaining markets include the US (11.6%), Taiwan (8.7%) and Malaysia (3.0%). The company's largest customer is Applied Materials (AMAT), historically contributing about 90% of UMS' revenue.

FY2023 earnings highlights: UMS' FY2023 financial results were impacted by higher expenses and the semiconductor downcycle. The company reported a 20% YoY decline in revenue and a larger 40% YoY decline in net profit as depreciation expense rose 15% YoY due to fixed asset additions while other expenses rose 13% YoY due to higher maintenance costs and utilities. On a per-share basis, earnings fell 39% YoY while dividends rose 13% YoY.

Dividend policy: UMS adopts a dividend policy to declare dividends quarterly. Over the last five years, the company has declared annual dividends of 34% to 64% of its earnings. Despite the wide range in annual dividend payout ratios, the cash dividends in absolute terms continued to grow over the last five years. Moreover, excluding 2022, the annual dividend payout ratios have been largely stable between 56% to 64%. We also note that despite recording a drop in earnings in 2023, the company declared higher dividends of SGD 0.056 for the year relative to the preceding year, suggesting its commitment to providing returns to shareholders in the form of dividends.

Investment Thesis

Well-positioned to ride on the upswing in Singapore's semiconductor cycle: Despite the poor financial performance for FY2023, we are expecting an improving outlook for UMS as it rides the upswing of Singapore's semiconductor cycle. Our projected 35% YoY growth in global chip sales by 2Q24 will have a significant impact on Singapore, given its crucial role in the global semiconductor industry, particularly in the downstream supply chain involving the testing and packaging of semiconductor products.

There are already signs of a recovery in Singapore's semiconductor industry. In January 2024, industrial output rose by 0.6% YoY. This was attributed to sectors including precision engineering which rose 27.8% YoY, mainly driven by a 33.0% YoY surge in the machinery and systems segment, supported by increased production of front-end semiconductor equipment and process control equipment.

In February, Singapore's industrial output continued to expand and grew by 3.8% YoY. However, precision engineering output declined -19.9% YoY, mainly due to a 20.4% YoY drop in the machinery and systems segment. Despite this, we are of the view that precision engineering output growth will be more stable in the coming months.

As UMS specialises in manufacturing high-precision front-end semiconductor components, we expect the increased output for semiconductors to drive greater growth in UMS' revenue. This is also fuelled by our expectations of the robust recovery of the electronics sector which would drive greater demand for integrated circuits and semiconductors.

All in all, UMS would benefit from the growth in Singapore's semiconductor industry. The company also stands out among its peers like AEM Holdings and Frencken, due to its significantly higher revenue contribution from Singapore. In 2023, UMS' revenue from Singapore accounted for 70%, as compared to AEM Holdings' 22% and Frencken's 9%.

Additional production capacity with the new plant: Heightened geopolitical tensions have resulted in increased US restrictions on exports to China which would further prompt many businesses to adopt the China-Plus One strategy, exploring alternative manufacturing locations to strengthen their supply chains.

Consequently, a popular destination for many semiconductor players is Malaysia due to its cheap labour, proven expertise in the downstream portion of the semiconductor supply chain as well as its English-speaking population. Companies such as Lam Research, Bosch and Ericsson are looking to expand there as well. Hence, it is no surprise that most of UMS' production activity is located in Malaysia, improving operational cost efficiency.

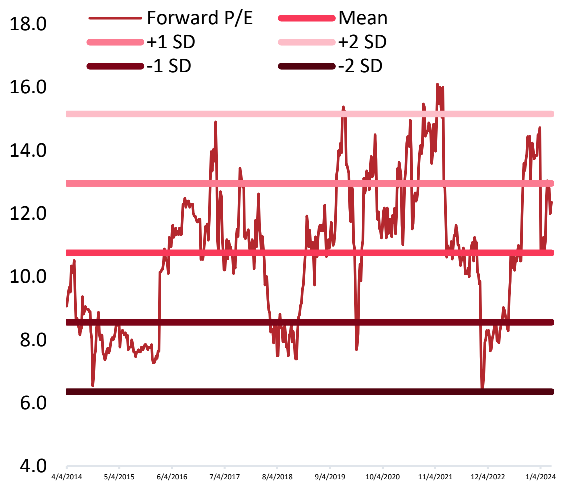
To further meet the increasing chip demand, UMS has expanded its production capacity in Penang by providing an additional 300,000 square feet (sq ft) to its existing 500,000 sq ft of factory space. This expansion has also shed light on UMS' new key customer involving a three-year renewable contract. With the facility coming online this March, UMS has shared that their new key customer could contribute SGD 30 million in revenue this year which is about 10% of its revenue for 2023.

In the long term, UMS expects to grow this new key customer's contribution to be on par with its existing largest customer, AMAT. They also expect a top-line contribution of SGD 300 million per annum for the next three to five years, which is equivalent to its revenue in 2023. Hence, this could potentially result in a lower reliance on AMAT, reducing concentration risk.

We believe this could be the key reason behind UMS' new shares placement as it provides additional funding required to grow the business. On 1st February 2024, UMS completed the successful placement of new shares which made up about 6% of its existing share capital. A total sum of SGD 49.98 million from institutional investors was raised. 60% of the raised funds would be used for capital expenditures (CAPEX) to grow the business, with the remaining split equally between general working capital purposes and future business developments through potential investments, acquisitions, joint ventures, and collaboration.

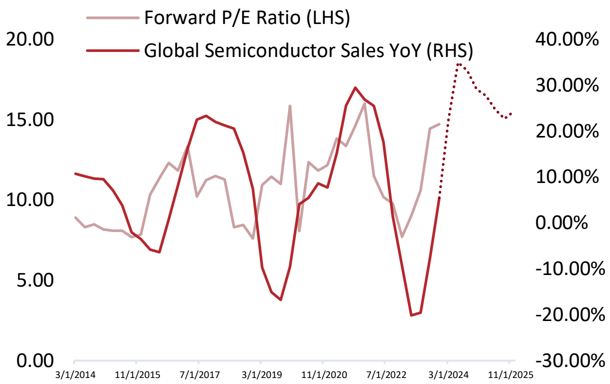
The strategic move to increase production capacity and timely placement of shares would better prepare the company to deliver stronger financial performance in years to come.

Figure 3: UMS 10-year forward P/E ratio (X)



Source: Bloomberg Finance L.P.
Data as of 25th Mar 2024.

Figure 4: UMS forward P/E ratio and Global Semiconductor Sales Growth (X)



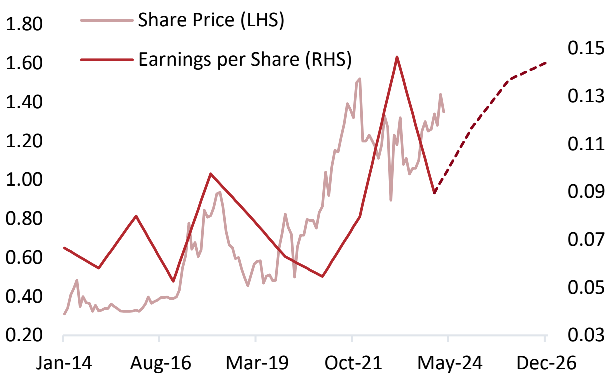
Source: Bloomberg Finance L.P., iFAST Estimates.
Data as of 31st Dec 2023.

Table 2: UMS Earnings

UMS	FY23A	FY24E	FY25E	FY26E
P/E Ratio (x)	10.8	11.6	9.9	9.4
Earnings growth	-40%	30%	17%	5%
EPS (in SGD)	0.0895	0.1167	0.1368	0.1440
Upside Potential	-	3.7%	21.6%	28.1%

Source: Bloomberg Finance L.P., iFAST Estimates. Data as of 25th Mar 2024.

Figure 5: UMS share price vs Earnings per share



Source: Bloomberg Finance L.P., iFAST Estimates. Data as of 25th Mar 2024.

Table 3: Comparison with similar peers

	Market cap (SGD millions)	Forward P/E	Leverage in 2023
UMS	952	12.2	21%
AEM	670	16.6	33%
Frencken	717	14.9	45%
Average	780	14.6	33%

Source: Company Filings, Bloomberg Finance L.P. Data as of 25th Mar 2024.

Valuation

While UMS currently trades at 13X, which is about one standard deviation above its ten-year average forward P/E of 11X and in line with its peers' average P/E, we assess that it is undervalued. This is because we forecast its earnings to grow strongly on the back of Singapore's semiconductor upcycle, additional production capacity, and the acquisition of a new key customer.

We assign a fair P/E multiple of 12X, which is in line with UMS' historical forward P/E multiple during the semiconductor market upcycles over the last decade, as well as its five-year historical average. By applying this to our estimated 2026 earnings, we arrive at a target price of SGD 1.73. This translates to an upside potential of 28.1%, based on the closing price of SGD 1.35 on 25th March 2024.

In summary, we recommend investors to consider UMS as it is a hidden lucrative investment opportunity in the upswing of the Singapore's semiconductor cycle.

Investment risks

Potentially higher financing costs: Higher interest rates have had an adverse impact on UMS' peers like AEM Holdings and Frencken which saw an increase of 160% and 44% in financing costs respectively. Given our view that interest rates will stay higher for longer, there is a potential risk that UMS may face higher financing costs in 2024, which could lower its earnings. However, we note that UMS has a lower leverage of 21%, compared to that of AEM Holdings and Frencken which stood at 33% and 45% respectively.

Prolonged shipping route disruptions: As uncertainties involving the Red Sea and the drought in the Panama Canal continue to weigh on the global supply chain scene, it could potentially lead to delays and a rise in logistics costs. If these uncertainties persist for a long time, it may result in weaker exports and UMS' performance.

Concentration risk on sole key customer: Since UMS' revenue is heavily dependent on AMAT, there is concentration risk. Any news related to AMAT, good or bad, could have an impact on UMS. This risk may be mitigated in the long-term with the acquisition of the new key customer.

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