

Semiconductor Sector

Underweight

No clear signs of sustainable recovery yet

Market rally on improvement in businesses... The Philadelphia Semiconductor Index had shot up 36.8% since March 2009 amid early optimism of a market recovery. In stark contrast to the negative outlook given just towards the end of 2008, major semicon companies, including foundries like TSMC and UMC, are now citing improvements in orders and better utilization rates. A report released over the weekend by Semiconductor Industry Association (SIA) had also suggested that the semicon demand has stabilized somewhat, with global sales up 3.3% MoM in March vs. 7.6% MoM decline in February.

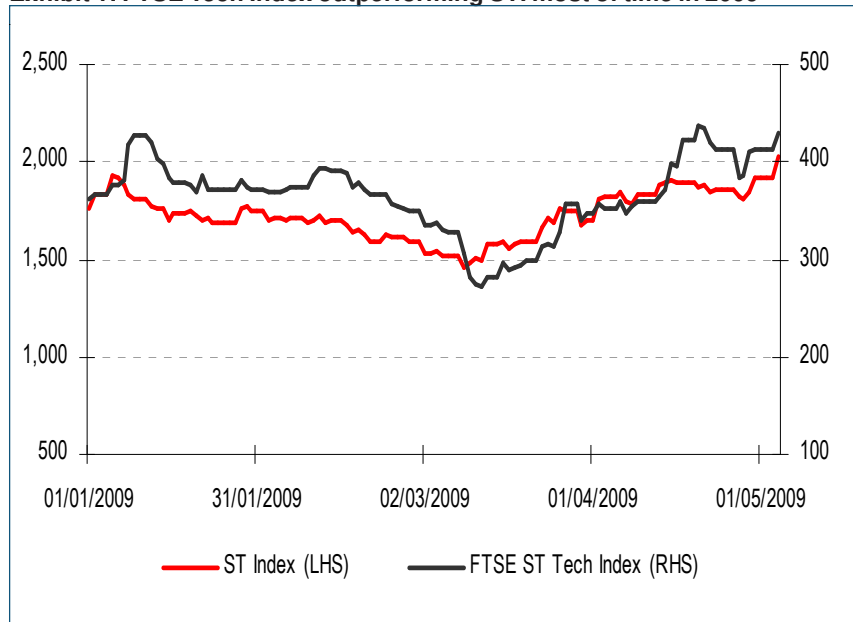
...notwithstanding the losses seen in 1Q09. Under our coverage, Chartered Semiconductor and Micro-Mechanics (MMH) had similarly cited demand pickup during the period, partly buoyed by introduction of new products and/or inventory re-stocking. However, as with many companies, the improved orders were not enough to bring them back to profitability. As such, both Chartered (UMC and SMIC alike) and MMH registered significant losses in 1Q09. For Chartered, it was hit by lower revenue, high fixed costs and lower utilization rates. As for MMH, it was mainly dragged down by low business volumes, high fixed costs at its Custom Machining & Assembly (CMA) plant in US, and to a lesser extent, price pressure. We believe we may see downside earnings surprise for Avi-Tech Electronics (due to report soon) as well.

Maintain UNDERWEIGHT - no clear signs of sustainable recovery. In the near term, we also note that there is scant evidence that points to a sustainable recovery in semicon demand. Nearly all sectors in the electronics industry (key markets for semicon industry) were poised to report dismal performances in 2009, as consumers cut spending in face of the global recession. Moreover, it is likely to continue to be mired by great uncertainty and limited visibility while the crisis plays out. As it is, industry watcher Gartner has recently projected the Asia-Pacific chip market to fall 22.7% to US\$115.2b and global semicon revenue to fall 24.1% to US\$194.5b in 2009. Until we see clearer signs of a firming up in the semicon demand, backed by leading indicators and economic data, we maintain our **UNDERWEIGHT** rating for the semicon industry. Additionally, we keep our **HOLD** rating on Avi-Tech (Fair Value: S\$0.11) and MMH (FV: S\$0.19), and **SELL** rating on Chartered (FV: S\$0.08 before share consolidation), as the latter may not be able to return to profitability in FY10 and its re-financing issues continue to be a concern.

Kevin Tan
(65) 6531 9809
e-mail: KevinTan@ocbc-research.com

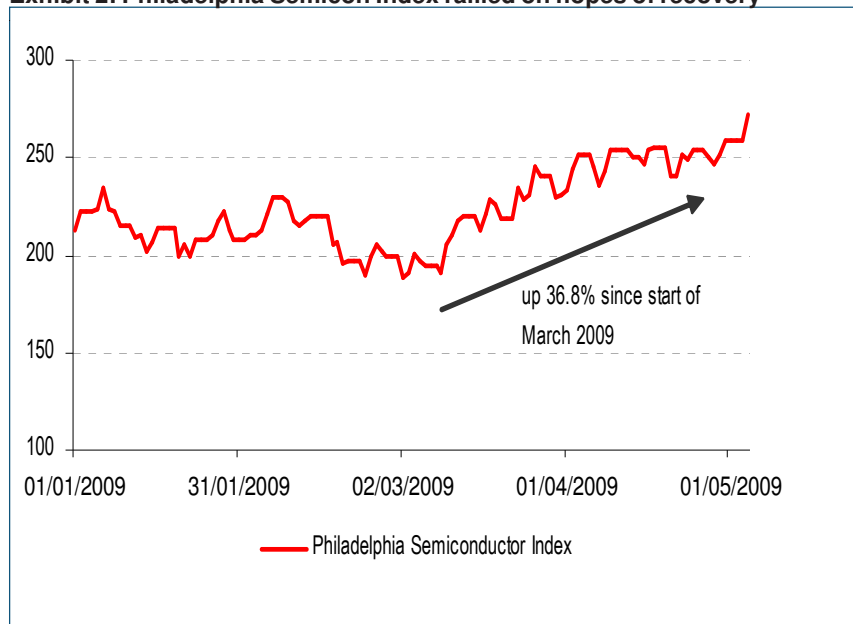
	Price (\$)	Rating	Fair value (\$)	Valuation
Avi-Tech Electronics	0.105	HOLD	0.11	6x FY10F EPS
Chartered Semicon	0.165	SELL	0.08	0.4x FY09F NTA
Micro-Mechanics	0.21	HOLD	0.19	0.8x FY10F NTA

Exhibit 1: FTSE Tech Index outperforming STI most of time in 2009



Source: Bloomberg

Exhibit 2: Philadelphia Semicon Index rallied on hopes of recovery



Source: Bloomberg

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Carmen Lee
Head of Research

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