

Gemtek (4906.TW/4906 TT)

Direct sales bearing fruit

Outperform · Upgraded

Price as of July 1 (NT\$)	36.95
12M target price (NT\$)	45.00
Previous target price (NT\$)	35.00
Revised up (%)	28.6
Upside (%)	21.8

Key message

- 1Q24 gross margin beat on higher direct-sale weighting.
- Higher 2024F direct-sale weighting.
- 2025F sales drivers to be Wi-Fi 7 & 25GPON.

Trading data

Mkt cap (NT\$bn/US\$mn)	15.27 / 471.0
Outstanding shares (mn)	413.3
Foreign ownership (mn)	76.55
3M avg. daily trading (mn)	5.95
52-week trading range (NT\$)	31.35 –39.50

Performance	3M	6M	12M
Absolute (%)	6.9	7.1	11.8
Relative (%)	-7.1	-21.5	-24.5

Quarterly EPS

NT\$	1Q	2Q	3Q	4Q
2022	0.17A	0.14A	0.57A	0.82A
2023	0.16A	0.79A	0.90A	(0.30)A
2024	0.18A	0.49F	0.51F	0.54F

Share price chart



Source: TEJ

Event

We predict profitability will rise in 2H24-25F on Gemtek Technology's transition to a direct-sale business model.

Impact

1Q24 gross margin beat on higher direct-sale weighting. Gemtek posted sales of NT\$5.76bn in 1Q24, down 2.4% QoQ and 18.4% YoY, due to continued inventory adjustments by clients. The company has been transforming its business model from pure OEM to direct shipping to end-clients since 2H23. Consequently, the weighting of direct sales rose from close to 20% in 4Q23 to 30-40% in 1Q24, widening gross margin from 10.5% to 12%. In 1Q24, EPS grew 12.7% YoY to NT\$0.18, beating our forecast.

Higher 2024F direct-sale weighting. We are upbeat on Gemtek's business model transition, expecting the direct-sale weighting will rise QoQ in 2024F, to 40-50% by the end of the year. In addition, we expect a new US telco customer's 10GPON products will ramp up in 2H24F. Gross margin will rise as a result. While operating expenses will increase due to higher customer service requirements, Gemtek's overall profitability will be higher than that of a purely OEM operation. We adjust our 2024F sales forecast to NT\$28.1bn, generating gross margin of 12.1% and EPS of NT\$1.71.

2025F sales drivers to be Wi-Fi 7 & 25GPON. We expect Gemtek's sales will resume growth in 2025F, as customer inventory adjustments peter out in 2H24F. European and US customers will begin adopting Wi-Fi 7 and 25GPON, lifting product unit prices. The module business will benefit from growing demand for 5G modules. Gemtek's continually increasing the firm's direct-sale weighting will help to boost profitability. All told, we adjust 2024F and 2025F sales to NT\$28.1bn and NT\$30.6bn, for gross margin of 12.1% and 13.2%, and EPS of NT\$1.71 and NT\$2.96, respectively.

Valuation & Action

We predict Gemtek will benefit from the firm's rising direct-sale weighting, which will improve gross margin over the long term. We upgrade the company to Outperform, with a target price of NT\$45, on 15x our 2025F EPS forecast. Due to clear growth trends for Gemtek's earnings in 2024-25F, we adjust our valuation method from PB to PE.

Risks

Gross margin expansion weaker than expected; deferral of new orders.

Key financials and valuations

	Dec-21A	Dec-22A	Dec-23A	Dec-24F	Dec-25F
Revenue (NT\$mn)	22,913	27,900	26,136	28,056	30,605
Gross profit (NT\$mn)	2,061	2,865	2,771	3,403	4,049
Operating profit (NT\$mn)	356	728	464	844	1,406
Net profit (NT\$mn)	680	665	609	688	1,189
EPS (NT\$)	1.89	1.70	1.55	1.71	2.96
Cash DPS (NT\$)	1.50	1.50	1.48	1.50	1.50
EPS growth (%)	(51.0)	(10.3)	(8.9)	10.7	72.7
PE (x)	19.5	21.8	23.9	21.6	12.5
PB (x)	1.2	1.1	1.2	1.2	1.2
EV/EBITDA (x)	12.8	8.7	8.5	5.0	3.7
Net debt to equity (%)	14.2	11.3	Net cash	Net cash	Net cash
Dividend yield (%)	4.1	4.1	4.0	4.1	4.1
Return on average equity (%)	6.5	5.4	4.7	5.4	9.3

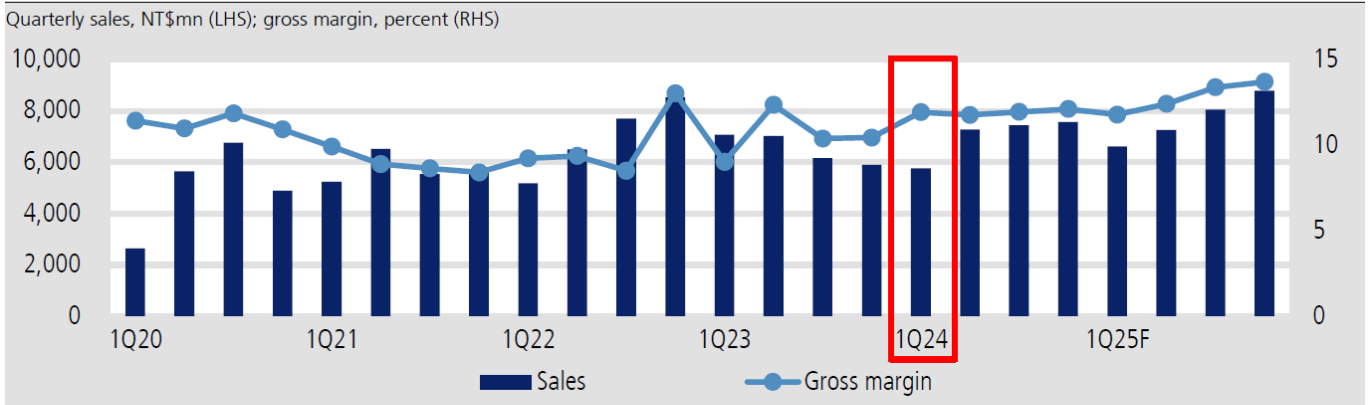
Source: Company data; KGI Research estimates

Gross margin improving on migration to direct sales

As a contract manufacturer of networking equipment for brand names and system integrators, Gemtek operated with gross margin of 9-11%. During the COVID-19 pandemic, Taiwanese firms demonstrated solid capabilities in coordinating component supplies, production capacity allocations, and logistics. Also, in light of US and European clients' concerns about geopolitical risk stemming from the China-US trade war, more Taiwanese networking equipment firms, including leading suppliers like Wistron NeWeb (6285 TT, NT\$157, OP), Arcadyan (3596 TT, NT\$163, OP) and Sercomm (5388 TT, NT\$117.5, OP), are bypassing brand names and system integrators to work directly with telecom operators.

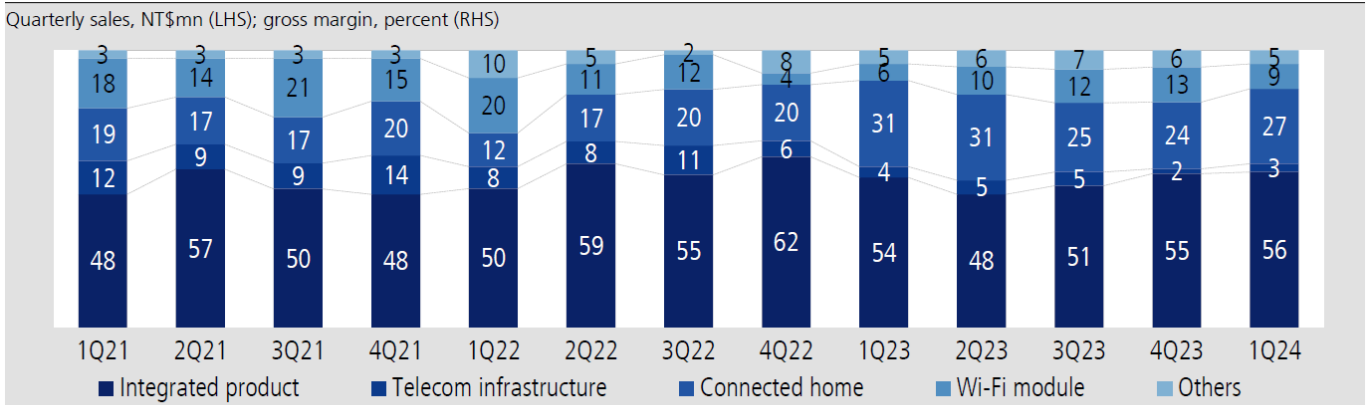
The migration to a direct sales business model will boost gross margin for Gemtek by bypassing brands and system integrators to work directly with telecom operators. However, operating expenses will also increase, as the firm will need to provide system integration and other after-sales services to telecom operators. Direct sales accounted for close to 20% of the firm's 4Q23 sales, but rose to a 30-40% weighting in 1H24. We estimate the weighting will climb further, to 40-50%, in 2H24F. We do not think Gemtek will give up major European clients, which it serves indirectly, in the near future, and so the weighting of indirect sales should remain substantial in 2025F. 1Q24 gross margin arrived at 12% on sales of NT\$5.76bn, and the firm's product mix was similar to that of 4Q22, when sales were NT\$8.53bn and gross margin was at 13.1%. We predict that the weighting of direct sales will rise to nearly 60% in 2025F, pushing gross margin up to 13.2%.

Figure 1: Projected quarterly sales & gross margin through 2025F



Source: Company data; KGI Research

Figure 2: 2021-1Q24 product mix



Source: Company data; KGI Research

Figure 3: Breakdown of 2Q-3Q24 forecast revisions

NT\$m	2Q24F					3Q24F				
	Revision	Previous	Chg. (%)	QoQ (%)	YoY (%)	Revision	Previous	Chg. (%)	QoQ (%)	YoY (%)
Sales	7,283	6,117	19.1	26.4	3.8	7,443	6,712	10.9	2.2	20.9
Gross profits	872	657	32.7	26.5	0.3	906	769	17.8	3.9	41.0
Operating income	230	99	133.0	95.8	(18.2)	241	193	24.7	4.7	345.3
Pretax Income	245	129	90.4	18.6	(34.6)	256	223	14.6	4.4	(41.2)
Net income	196	103	90.4	176.5	(36.8)	205	179	14.6	4.4	(42.3)
EPS (NT\$)	0.49	0.26	86.2	176.5	(38.3)	0.51	0.45	12.1	4.4	(43.6)
Gross margin (%)	12.0	10.7	1.2 ppts	0.0 ppts	(0.4)ppts	12.2	11.5	0.7 ppts	0.2 ppts	1.7 ppts
OP margin (%)	3.2	1.6	1.5 ppts	1.1 ppts	(0.9)ppts	3.2	2.9	0.4 ppts	0.1 ppts	2.4 ppts
Net margin (%)	2.7	1.7	1.0 ppts	1.5 ppts	(1.7)ppts	2.8	2.7	0.1 ppts	0.1 ppts	(3.0)ppts

Source: Company data; KGI Research

Figure 4: Breakdown of 2024-25 forecast revisions

NT\$m	2024F				2025F	
	Revision	Previous	Chg. (%)	YoY (%)	KGI forecast	YoY (%)
Sales	28,056	26,201	7.1	7.3	30,605	9.1
Gross profit	3,403	2,942	15.7	22.8	4,049	19.0
Operating income	844	698	21.0	82.1	1,406	66.5
Pretax Income	979	813	20.4	24.1	1,486	51.8
Net income	688	650	5.9	13.0	1,189	72.7
EPS (NT\$)	1.71	1.65	3.6	10.7	2.96	72.7
Gross margin (%)	12.1	11.2	0.9 ppts	1.5 ppts	13.2	1.1 ppts
OP margin (%)	3.0	2.7	0.3 ppts	1.2 ppts	4.6	1.6 ppts
Net margin (%)	2.5	2.5	(0.0)ppts	0.1 ppts	3.9	1.4 ppts

Source: Company data; KGI Research

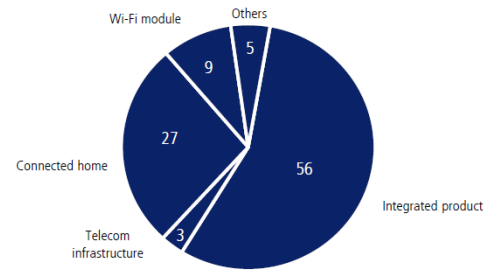
Figure 5: Company profile

Gemtek was established in 1988, and listed in 2003. The firm is mainly engaged in the network equipment OEM, ODM, and JDM business. In 2022, the firm's sales mix was 56% integrated products (VoIP, VDSL, G.fast, & GPON), 3% telecom infrastructure (small cell & CPE), 27% connected home, 9% Wi-Fi module (wireless communications), and 5% others. The company has factories in Taiwan, the Czech Republic, China (Kunshan & Changshu), and Vietnam, with around 1,000 employees in Taiwan and about 4,900 employees worldwide. Gemtek's major competitors are local networking OEMs, and main clients are global telecom operators and retailers.

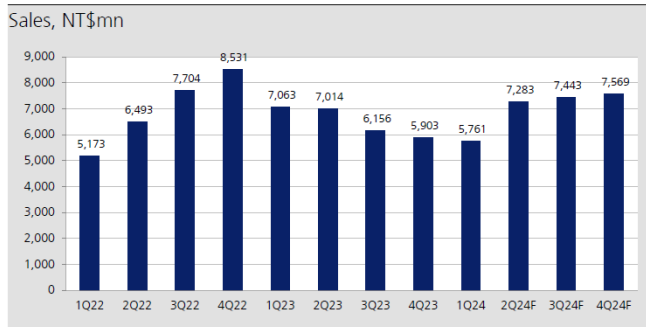
Source: Company data; KGI Research

Figure 6: Sales mix

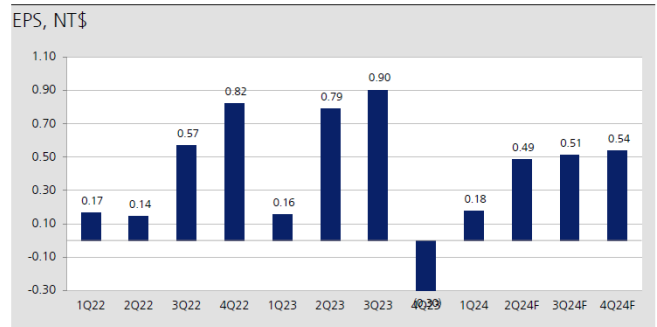
1Q24 sales weighting by product, percent



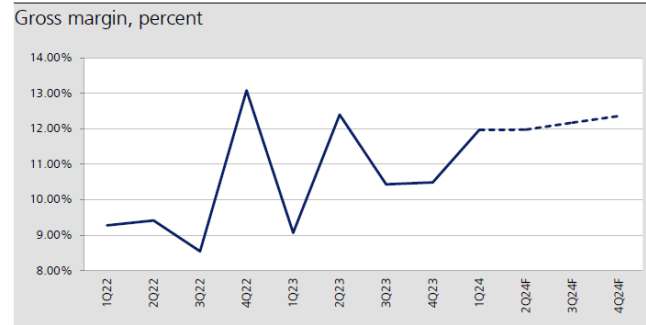
Source: Company data; KGI Research

Figure 7: Sales


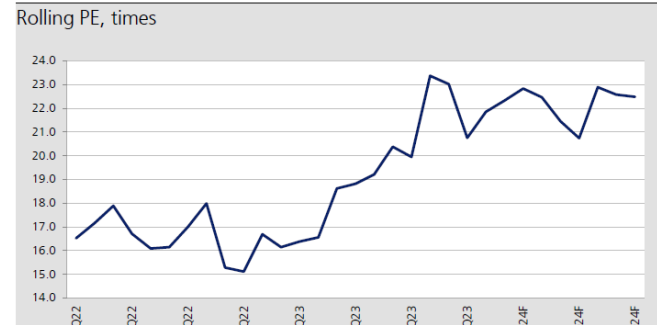
Source: KGI Research

Figure 8: EPS


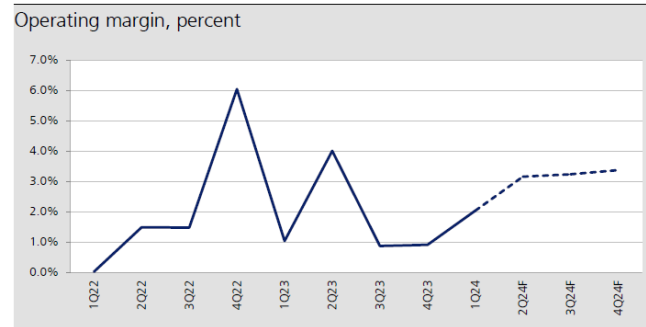
Source: KGI Research

Figure 9: Gross Margin


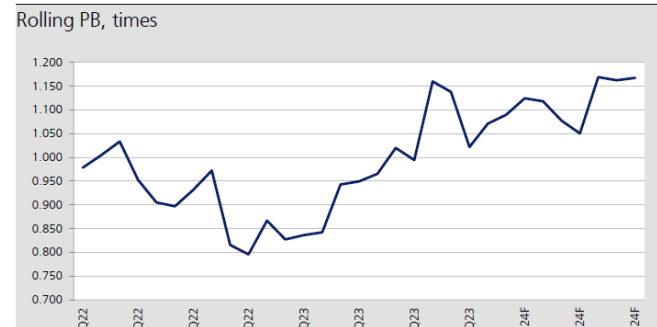
Source: KGI Research

Figure 10: Rolling PE


Source: KGI Research

Figure 11: Operating Margin


Source: KGI Research

Figure 12: Rolling PB


Source: KGI Research

Income statement

	Quarterly								Annually		
	Mar-23A	Jun-23A	Sep-23A	Dec-23A	Mar-24A	Jun-24F	Sep-24F	Dec-24F	Dec-23A	Dec-24F	Dec-25F
Income statement (NT\$m)											
Revenue	7,063	7,014	6,156	5,903	5,761	7,283	7,443	7,569	26,136	28,056	30,605
Cost of goods sold	(6,423)	(6,144)	(5,514)	(5,284)	(5,072)	(6,411)	(6,537)	(6,633)	(23,365)	(24,653)	(26,556)
Gross profit	640	869	642	619	689	872	906	936	2,771	3,403	4,049
Operating expenses	(566)	(588)	(588)	(565)	(572)	(642)	(665)	(680)	(2,308)	(2,559)	(2,643)
Operating profit	74	281	54	54	118	230	241	256	464	844	1,406
Depreciation of fixed assets	(124)	(121)	(120)	(123)	(138)	(241)	(241)	(345)	(489)	(965)	(1,072)
Amortisation of intangible assets	(52)	(39)	(47)	(40)	(57)	(44)	(44)	(31)	(178)	(175)	(175)
EBITDA	250	441	221	217	312	515	526	631	1,130	1,984	2,652
Interest income	9	16	15	16	19	10	10	10	56	49	40
Investment income	8	17	31	6	13	25	25	25	61	88	100
Other non-op income	9	14	24	16	13	-	-	-	63	13	-
Non-operating income	25	47	71	37	45	35	35	35	180	150	140
Interest expense	(29)	(40)	(25)	(20)	(35)	(30)	(30)	(30)	(114)	(125)	(100)
Investment loss	-	-	-	-	-	-	-	-	-	-	-
Other non-op expenses	6	87	336	(170)	79	10	10	10	259	109	40
Non-operating expenses	(22)	47	311	(190)	45	(20)	(20)	(20)	145	(15)	(60)
Pre-tax profit	77	375	436	(99)	207	245	256	271	789	979	1,486
Current taxation	(31)	(71)	(89)	(53)	(132)	(49)	(51)	(54)	(243)	(286)	(297)
Minorities	16	6	8	34	(4)	-	-	-	64	(4)	-
Normalised net profit	62	311	355	(118)	71	196	205	216	609	688	1,189
Extraordinary items	(0)	(0)	0	(0)	0	-	-	-	-	0	-
Net profit	62	311	355	(118)	71	196	205	216	609	688	1,189
EPS (NT\$)	0.16	0.79	0.90	(0.30)	0.18	0.49	0.51	0.54	1.55	1.71	2.96
Margins (%)											
Gross profit margin	9.1	12.4	10.4	10.5	12.0	12.0	12.2	12.4	10.6	12.1	13.2
Operating margin	1.0	4.0	0.9	0.9	2.0	3.2	3.2	3.4	1.8	3.0	4.6
EBITDA margin	3.5	6.3	3.6	3.7	5.4	7.1	7.1	8.3	4.3	7.1	8.7
Pretax profit margin	1.1	5.3	7.1	(1.7)	3.6	3.4	3.4	3.6	3.0	3.5	4.9
Net profit margin	0.9	4.4	5.8	(2.0)	1.2	2.7	2.8	2.9	2.3	2.5	3.9
Sequential growth (%)											
Revenue growth	(17.2)	(0.7)	(12.2)	(4.1)	(2.4)	26.4	2.2	1.7			
Gross profit growth	(42.6)	35.8	(26.1)	(3.6)	11.4	26.5	3.9	3.3			
Operating profit growth	(85.7)	280.6	(80.8)	0.2	116.8	95.8	4.7	6.0			
EBITDA growth	(62.3)	76.5	(49.9)	(1.8)	43.5	65.1	2.1	20.0			
Pretax profit growth	(77.3)	389.5	16.1	(122.6)		18.6	4.4	5.7			
Net profit growth	(80.8)	404.6	14.3	(133.2)		176.5	4.4	5.7			
YoY growth (%)											
Revenue growth	36.5	8.0	(20.1)	(30.8)	(18.4)	3.8	20.9	28.2	(6.3)	7.3	9.1
Gross profit growth	33.4	42.3	(2.4)	(44.5)	7.7	0.3	41.0	51.1	(3.3)	22.8	19.0
Operating profit growth	4539.9	190.0	(52.6)	(89.5)	59.1	(18.2)	345.3	371.1	(36.3)	82.1	66.5
EBITDA growth	89.0	86.2	(15.2)	(67.2)	24.8	16.7	137.6	190.3	(12.6)	75.5	33.7
Pretax profit growth	(48.1)	170.5	47.2	(129.3)	169.9	(34.6)	(41.2)		(14.2)	24.1	51.8
Net profit growth	(3.3)	450.5	59.0	(136.7)	15.3	(36.8)	(42.3)		(8.4)	13.0	72.7

Source: Company data; KGI Research estimates

Balance sheet

NTSmn	Dec-21A	Dec-22A	Dec-23A	Dec-24F	Dec-25F
Total assets	20,217	24,831	21,970	32,298	43,196
Current assets	12,009	15,279	13,526	23,914	34,970
Cash & ST securities	1,556	1,031	3,528	13,277	23,394
Inventory	3,749	4,601	3,009	3,166	3,420
Accounts receivable	6,359	9,368	6,828	7,310	7,996
Other current assets	345	279	160	160	160
Non-current assets	8,208	9,551	8,444	8,384	8,227
LT investments	3,953	4,565	4,045	4,133	4,232
Net fixed assets	3,472	4,043	3,412	3,264	3,007
Other assets	783	944	987	987	987
Total liabilities	8,301	11,452	8,775	19,106	30,016
Current liabilities	8,057	11,213	7,269	8,008	12,116
Accounts payable	3,951	7,104	4,805	5,056	5,462
Interest bearing ST liabilities	2,966	2,526	952	1,361	4,558
Other current liabilities	1,140	1,583	1,511	1,591	2,097
Non-current liabilities	245	239	1,506	11,097	17,900
Long-term debt	-	-	1,227	10,818	17,621
Other L-T liabilities	220	226	273	273	273
Total equity	11,916	13,379	13,196	13,192	13,180
Share capital	3,706	3,946	4,056	4,056	4,056
Retained earnings reserve	697	1,728	1,592	1,584	1,572
Minority interests	226	306	356	360	360
Preferred shareholders funds	-	-	-	-	-

Key ratios

	Dec-21A	Dec-22A	Dec-23A	Dec-24F	Dec-25F
Growth					
Revenue growth	15.0%	21.8%	(6.3%)	7.3%	9.1%
Operating profit growth	(23.9%)	104.5%	(36.3%)	82.1%	66.5%
EBITDA growth	(6.3%)	55.7%	(12.6%)	75.5%	33.7%
Net profit growth	(50.4%)	(2.2%)	(8.4%)	13.0%	72.7%
EPS growth	(51.0%)	(10.3%)	(8.9%)	10.7%	72.7%
Profitability					
Gross profit margin	9.0%	10.3%	10.6%	12.1%	13.2%
Operating margin	1.6%	2.6%	1.8%	3.0%	4.6%
EBITDA margin	3.6%	4.6%	4.3%	7.1%	8.7%
Net profit margin	3.0%	2.4%	2.3%	2.5%	3.9%
Return on average assets	3.5%	3.0%	2.6%	2.5%	3.1%
Return on average equity	6.5%	5.4%	4.7%	5.4%	9.3%
Stability					
Gross debt to equity	24.9%	18.9%	16.5%	92.3%	168.3%
Net debt to equity	14.2%	11.3%	Net cash	Net cash	Net cash
Interest coverage (x)	24.5	12.2	7.9	8.8	15.9
Interest & ST debt coverage (x)	0.2	0.2	0.4	0.4	0.2
Cash flow interest coverage(x)	(18.6)	11.6	22.8	10.8	18.0
Cash flow/int. & ST debt (x)	(0.2)	0.4	2.4	0.9	0.4
Current ratio (x)	1.5	1.4	1.9	3.0	2.9
Quick ratio (x)	1.0	1.0	1.4	2.6	2.6
Net debt (NT\$m)	1,691	1,517	(767)	(516)	(632)
Per share data					
EPS (NT\$)	1.89	1.70	1.55	1.71	2.96
CFPS (NT\$)	(1.60)	2.44	6.62	3.36	4.48
BVPS (NT\$)	31.54	33.13	31.65	31.64	31.61
Adj BVPS (NT\$)	32.55	33.38	32.58	31.90	31.87
SPS (NT\$)	63.80	71.24	66.31	69.75	76.08
EBITDA/share (NT\$)	2.31	3.30	2.87	4.93	6.59
Cash DPS (NT\$)	1.50	1.50	1.48	1.50	1.50
Activity					
Sales / avg assets	1.18	1.24	1.12	1.03	0.81
Days receivable	101.3	122.6	95.4	95.4	95.4
Days inventory	65.6	67.1	47.0	47.0	47.0
Days payable	69.2	103.6	75.1	75.1	75.1
Cash cycle	97.8	86.1	67.3	67.3	67.3

Source: Company data; KGI Research estimates

Profit & loss

NTSmn	Dec-21A	Dec-22A	Dec-23A	Dec-24F	Dec-25F
Revenue	22,913	27,900	26,136	28,056	30,605
Cost of goods sold	(20,852)	(25,035)	(23,365)	(24,653)	(26,556)
Gross profit	2,061	2,865	2,771	3,403	4,049
Operating expenses	(1,704)	(2,137)	(2,308)	(2,559)	(2,643)
Operating profit	356	728	464	844	1,406
Non-operating income	268	251	180	150	140
Interest income	21	36	56	49	40
Investment income	186	140	61	88	100
Other non-op income	61	75	63	13	-
Non-operating expenses	99	(61)	145	(15)	(60)
Interest expense	(31)	(82)	(114)	(125)	(100)
Investment loss	-	-	-	-	-
Other non-op expenses	130	22	259	109	40
Pre-tax profit	723	919	789	979	1,486
Current taxation	(42)	(173)	(243)	(286)	(297)
Minorities	(2)	(81)	64	(4)	-
Extraordinary items	-	(0)	(0)	0	-
Net profit	680	665	609	688	1,189
EBITDA	831	1,294	1,130	1,984	2,652
EPS (NT\$)	1.89	1.70	1.55	1.71	2.96

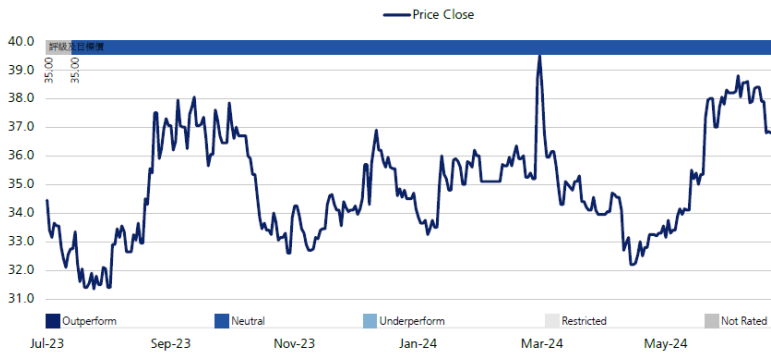
Cash flow

NTSmn	Dec-21A	Dec-22A	Dec-23A	Dec-24F	Dec-25F
Operations cash flow	(573)	956	2,609	1,353	1,801
Net profit	680	665	609	688	1,189
Depreciation & amortisation	475	565	667	1,140	1,246
Decrease in working capital	(1,800)	(901)	1,587	(388)	(534)
Other operating cash flow	72	627	(254)	(88)	(100)
Investing cash flow	(248)	(663)	(83)	(992)	(989)
Sale of ST investment	214	25	(338)	-	-
New investments	-	1	-	0	0
Capital expenditure	(551)	(825)	(811)	(818)	(814)
Others investing cashflow	88	137	1,065	(175)	(175)
Free cash flow	(1,646)	(701)	1,586	357	848
Financing cash flow	309	(704)	(520)	9,388	9,304
Increase in short term debt	1,026	418	(1,574)	-	-
Increase in long term loans	-	(3)	1,552	10,000	10,000
New ordinary shares issued	-	-	-	-	-
Ordinary dividends paid	(715)	(608)	(592)	(616)	(696)
Other financing cashflow	(2)	(204)	94	4	-
Forex effects	(137)	144	(70)		
Total cash generated	(649)	(266)	1,936	9,749	10,116

ROIC

	Dec-21A	Dec-22A	Dec-23A	Dec-24F	Dec-25F
1 - COGS/revenue					
- Operating exp./revenue	7.4%	7.7%	8.8%	9.1%	8.6%
= Operating margin	1.6%	2.6%	1.8%	3.0%	4.6%
1 / (Working capital/revenue	0.2	0.2	0.1	0.1	0.1
+ Net PPE/revenue	0.2	0.1	0.1	0.1	0.1
+ Other assets/revenue)	0.0	0.0	0.0	0.0	0.0
= Capital turnover	2.5	2.9	3.5	3.7	4.2
Operating margin	1.6%	2.6%	1.8%	3.0%	4.6%
x Capital turnover	2.5	2.9	3.5	3.7	4.2
x (1 - tax rate)	94.2%	81.2%	69.2%	70.8%	80.0%
= After-tax ROIC	3.7%	6.0%	4.4%	7.9%	15.4%

Source: Company data; KGI Research estimates

Gemtek – Recommendation & target price history


Date	Rating	Target	Price
2024-03-14	Neutral	35.00	34.90
2023-07-16	Neutral	35.00	32.75
2022-09-28	Not Rated	N.A.	26.05

Source: TEJ; KGI Research

All the above named KGI analyst(s) is SFC licensed person accredited to KGI Asia Ltd to carry on the relevant regulated activities. Each of them and/or his/her associate(s) does not have any financial interest in the respectively covered stock, issuer and/or new listing applicant.

Disclaimer

All the information contained in this report is not intended for use by persons or entities located in or residing in jurisdictions which restrict the distribution of this information by KGI Asia Limited ("KGI") or an affiliate of KGI. Such information shall not constitute investment advice, or an offer to sell, or an invitation, solicitation or recommendation to subscribe for or invest in any securities or investment products or services nor a distribution of information for any such purpose in any jurisdiction. In particular, the information herein is not for distribution and does not constitute an offer to sell or the solicitation of any offer to buy any securities in the United States of America, or to or for the benefit of United States persons (being residents of the United States of America or partnerships or corporations organised under the laws of the United States of America or any state, territory or possession thereof). All the information contained in this report is for general information and reference purpose only without taking into account of any particular investor's objectives, financial situation or needs. Such information is not intended to provide professional advice and should not be relied upon in that regard.

Some of KGI equity research and earnings estimates are available electronically on www.kgi.com.hk. Please contact your KGI representative for information. The information and opinions in this report are those of KGI internal research activity. KGI does not make any representation or warranty, express or implied, as to the fairness, accuracy, completeness or correctness of the information and opinions contained in this report. The information and opinions contained in this report are subject to change without any notice. No person accepts any liability whatsoever for any loss however arising from any use of this report or its contents. This report is not to be construed as an invitation or offer to buy or sell securities and/or to participate in any investment activity. This report is being supplied solely for informational purposes and may not be redistributed, reproduced or published (in whole or in part) by any means for any purpose without the prior written consent of KGI. Members of the KGI group and their affiliates may provide services to any companies and affiliates of such companies mentioned herein. Members of the KGI group, their affiliates and their directors, officers and employees may from time to time have a position in any securities mentioned herein.