Strategy

3Q24 results imply robust AI demand & continued weakness across non-AI sectors

Key message

1. Taiex 3Q24 earnings and 4Q24 guidance both better than expected on robust AI demand.

2. AI demand is soaring, but non-AI demand remains sluggish.

3. We suggest investors engage upon recent pullbacks triggered by risks stemming from a second term for US President-elect Trump.

Event

Taiex 3Q24 earnings and 4Q24 guidance indicate an ongoing market imbalance, with AI-related firms performing well, while the rest languish, which has been the case since early 2024.

Analysis

3Q24 earnings & 4Q24 guidance both better than expected on robust AI demand. Taiex-listed firms generated total 3Q24 net profit of NT$1.0tn, up 24% YoY, versus our estimate of 13% YoY growth. 4Q24 guidance is also better than expected, with earnings likely to grow 42% YoY, outstripping our forecast of 25% YoY growth. Upbeat earnings and guidance are driven primarily by very strong demand for AI servers, which has not only prompted shipment growth for related suppliers, but also component spec upgrades, consequently pushing up ASP and gross margin. The exponential growth in AI-related data traffic has also helped accelerate upgrades of networking and optical communication interfaces.

AI demand is soaring, but non-AI demand remains sluggish. Taiex 3Q24 earnings and 4Q24 guidance suggest a market imbalance, with strong AI demand, but weakness across non-AI sectors since early 2024. In early 2024, the market had high hopes for replacement demand driven by AI smartphone and PC model launches. However, we note that actual sell-through has been anemic to date due to high product prices and a lack of killer applications. China handset makers saw a temporary uptick in 1H24 shipments after an extended period of inventory digestion, but the recovery did not persist into 2H24. Even the highly anticipated launch of the iPhone 16 series failed to drive replacement demand on a delay in AI feature rollout and an absence of groundbreaking applications. To rub salt into the wound, Apple (US) has had cut orders to suppliers in the wake of poor sell-through. Automotive and industrial applications have also struggled with meaningful demand recovery on economic weakness in China and Europe, despite the fact that inventory adjustments are coming to an end. Within the non-tech sector, financial, food, marine transport, and aviation plays are the only bright spots. Financial stocks have benefitted from solid sales of wealth management products and growing investment returns, while food companies have seen stellar sales of essential consumer goods in China amid a consumption downgrade. Marine transporters have outperformed due to looming geopolitical risks, which have led to reduced shipping capacity and rebounding freight rates. Aviation firms are winners in the face of a surge in outbound travel and robust demand for AI servers.

We revise up 2024-25F Taiex earnings. Despite broad-based weakness in non-AI demand, we believe rapid growth in AI server shipments will contribute substantially to the earnings of related suppliers. To factor in 3Q24 results and the latest 4Q24 guidance, we revise up 2024-25F Taiex earnings to respective 36% and 18% YoY growth from 27% and 17% YoY growth.

Conclusion & top picks

We believe robust AI demand will continue to boost the Taiex in late-2024 and early-2025. Investors are advised to engage related plays upon recent pullbacks due to risks stemming from a second term for US President-elect Trump. We recommend thermal solution provider Asia Vital Components (3017 TT), networking PCB maker Gold Circuit Electronics (2368 TT), optical communication firm Elite Advanced Laser (3450 TT), tier-1 foundry TSMC (2330 TT), server EMS Hon Hai Precision (2317 TT), CCL maker Elite Material (2383 TT), power supplier Delta Electornics (2308 TT), networking play Accton Technology (2345 TT), and back-up battery unit (BBU) maker Advanced Energy Solution Holding (6781 TT).

Figure 1: Taiex net profit up 24% YoY in 3Q24, driven by robust AI demand for tech sector

| Taiex and subsector 3Q24 earnings	3Q24 net profit (NT$bn)	QoQ(%)	YoY(%)
Tech	663	14.4	25.0
Non-tech	297	7.8	13.8
Financial	139	(7.4)	19.5
Taiex	1,011	11.6	23.7
TPEx	57	(12.0)	(0.9)

Source: TEJ; KGI Research

Figure 2: Taiex 3Q24 results & 4Q24 guidance better than expected

YoY growth in quarterly Taiex earnings, percent
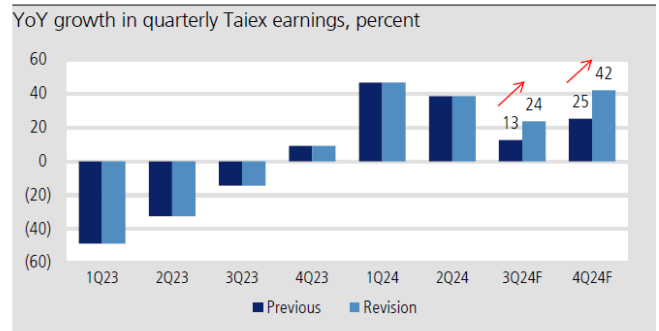
Source: TEJ; KGI Research

Figure 3: AI-related firms have seen earnings upgrades, while earnings of non-AI sectors have been downgraded

2024-25F earnings revisions for Taiex and individual subsectors (before & after 3Q24 results announcement), percent
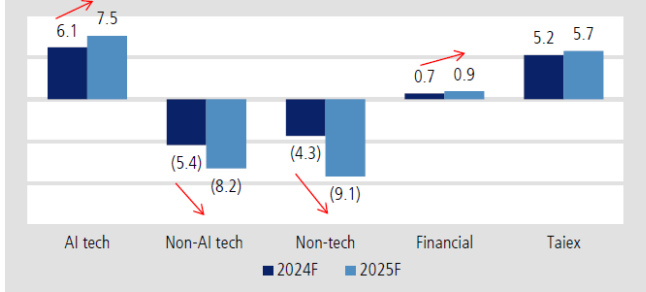
Source: TEJ; KGI Research

Figure 4: AI-related firms set to deliver stellar earnings, while non-AI companies suffer poor earnings outlooks

Latest 2024-25F Taiex and subsector earnings growth YoY, percent
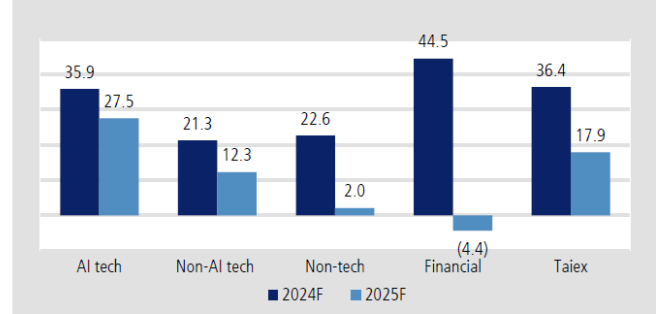
Source: TEJ; KGI Research

Figure 5: We revise up respective 2024-25F Taiex earnings growth to 36% & 18% YoY

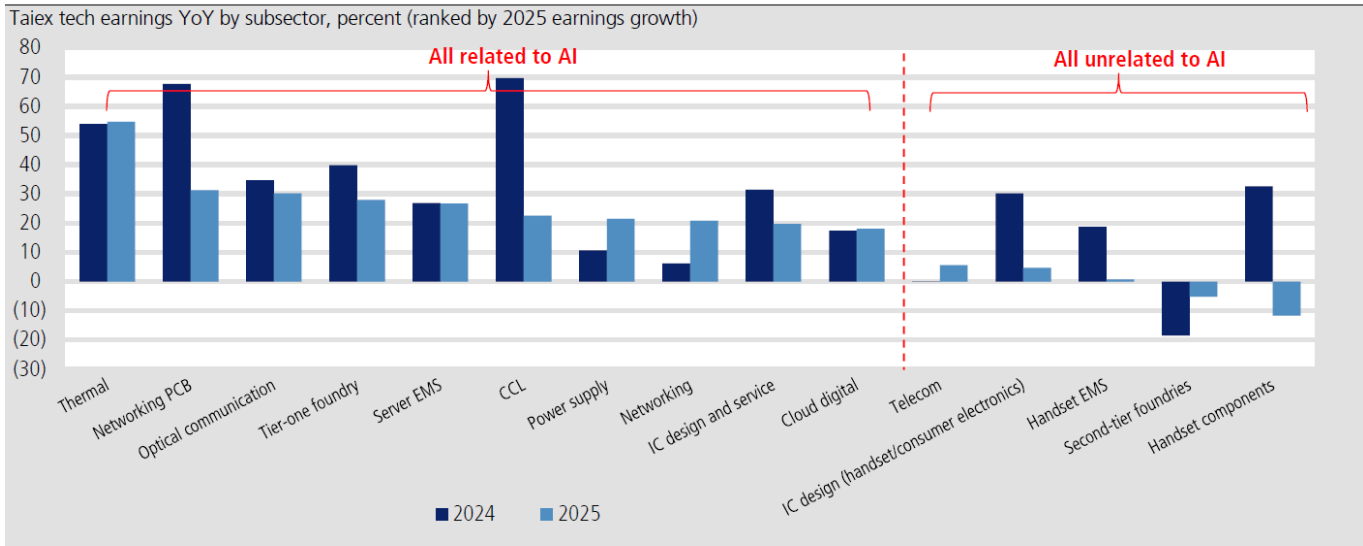| Taiex and subsector earnings YoY (%)	Previous		Revision	
	2024F	2025F	2024F	2025F
Taiex	26.8	17.4	36.4	17.9
Taiex excl. TSMC	26.0	14.5	34.8	13.2
Tech	29.9	23.0	34.8	22.9
Tech excl. TSMC	31.6	22.2	29.8	17.5

Source: TEJ; KGI Research

**Figure 6: Taiex PE at 17.4x, above long-term average of 15x**

Taiex one-year forward PE, x
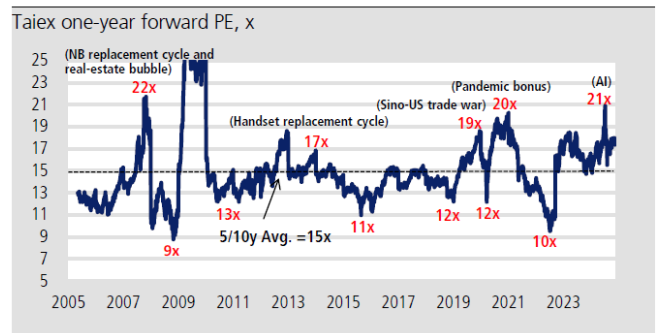
Source: TEJ; KGI Research

Figure 7: AI demand is robust, while non-AI demand remains stagnant

Taiex tech earnings YoY by subsector, percent (ranked by 2025 earnings growth)

Source: TEJ; KGI Research

Figure 8: Non-tech outperformers, in terms of 2025 earnings growth in descending order are green energy, bicycle, restaurants, aerospace, heavy electrical equipment, food, auto parts, & industrial automation

Taiex non-tech earnings YoY by subsector, percent (ranked by 2025 earnings growth)
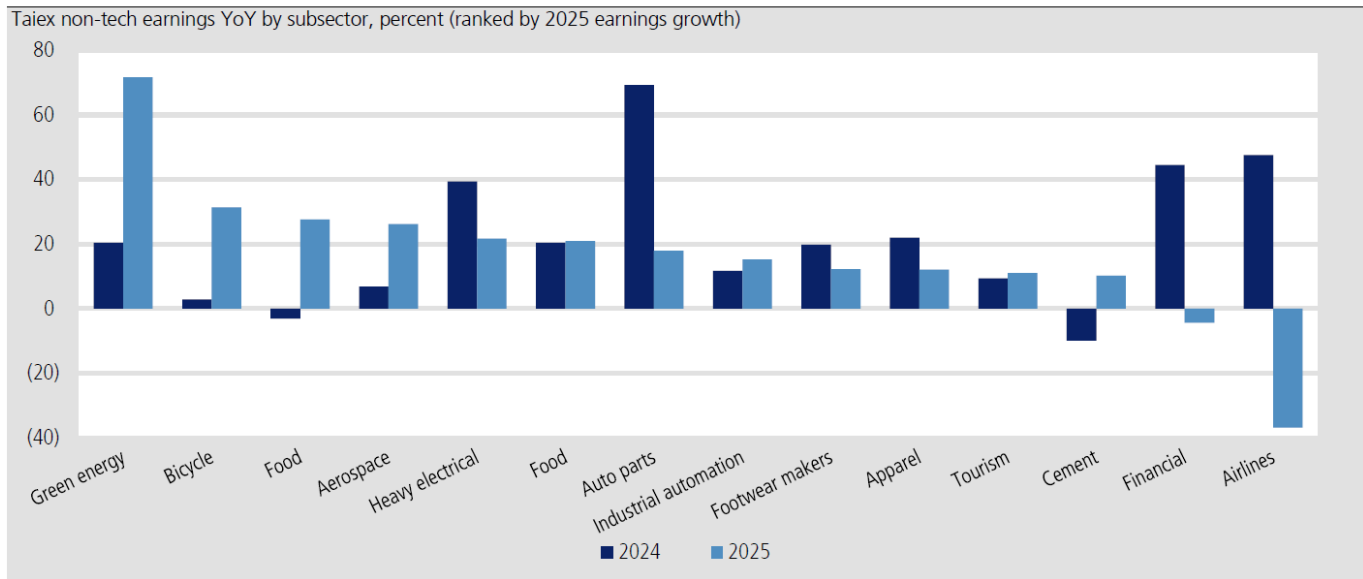
Source: TEJ; KGI Research

Figure 9: Taiex & subsector earnings & valuations

Tech	Earning YoY (%)				Forecast PE (x)		Non-tech	Earning YoY (%)				Forecast PE (x)	
	2022	2023	2024F	2025F	2024F	2025F		2022	2023	2024F	2025F	2024F	2025F
Server EMS	(1.7)	3.7	26.9	26.7	19.3	15.2	Cement	(50.7)	31.4	(9.8)	10.2	20.2	18.0
Thermal	34.5	20.5	53.9	54.6	31.7	19.2	Food	(13.6)	6.8	20.4	20.9	22.1	18.3
Power supply	15.1	2.4	10.7	21.5	21.8	18.0	Apparel	32.1	(11.0)	21.9	12.0	20.3	18.1
ABF	102.5	(68.1)	(58.7)	266.3	292.3	15.1	Footwear makers	100.0	(45.2)	19.8	12.2	22.2	19.8
Optical communication	-	63.4	34.7	30.1	34.5	26.5	Auto parts	52.8	(24.7)	69.3	17.9	15.4	-
IC design service	94.8	5.3	31.4	19.7	43.1	30.6	Industrial automation	5.2	(14.2)	11.7	15.3	28.2	23.2
Networking PCB	56.1	(22.8)	67.7	31.2	15.1	11.5	Bicycle	(12.7)	(44.8)	2.8	31.3	20.4	15.5
Networking	77.3	15.2	6.2	20.8	30.2	15.8	Tourism	(46.5)	176.4	9.4	11.0	14.3	12.6
CCL	(7.7)	8.2	69.7	22.5	16.6	13.5	Food	(2.7)	92.7	(3.1)	27.6	17.9	13.6
Tier-one foundry	70.4	(17.5)	39.9	27.9	22.9	17.9	Aerospace	135.4	21.3	6.8	26.2	21.2	15.4
Second-tier foundries	51.6	(33.3)	(18.5)	(5.2)	19.8	19.8	Airlines	(37.8)	185.5	47.6	(36.8)	9.2	15.7
Handset components	28.4	(36.7)	32.6	12.1	11.4	31.8	Heavy electrical	(1.9)	41.4	39.4	21.7	28.3	21.4
Telecom	2.6	13.7	0.0	5.6	29.3	27.9	Green energy	56.9	90.1	12.8	65.7	26.7	15.8
IC design (handset/consumer electronics)	(2.9)	(32.6)	30.2	4.7	16.6	15.8							
Handset EMS	(26.5)	4.1	18.7	0.7	13.8	13.7							
Cloud digital	16.3	17.1	17.4	18.0	26.5	22.3							

Source: KGI Research

Figure 10: Taiex valuations

	Forward PB(X)								Forward PE(X)							
	Forward 1-year	2024	2025	5-year average	10-year average	20-year average	2007 peak	2008 bottom	Forward 1-year	2024	2025	5-year average	10-year average	20-year average	2007 peak	2008 bottom
Taiex	2.11	2.27	2.10	1.75	1.63	1.63	2.28	0.95	17.39	19.83	16.82	15.10	14.95	17.08	21.73	8.80
Taiex excl. TSMC	1.51	1.63	1.51	1.41	1.39	1.47	2.22	0.89	16.70	18.39	16.25	14.80	14.93	16.00	22.71	8.06

Source: TEJ; KGI Research

Figure 11: Our top picks

Company	Code	Investment rating	Target price (NT$)	Mkt cap (US$mn)	Share price (NT$)	Change +/- (%)	EPS (NT$) 2024F	EPS (NT$) 2025F	PE (x) 2024F	PE (x) 2025F	P/B (x) 2024F	P/B (x) 2025F	ROE (%) 2024F	ROE (%) 2025F	Cash yield (%) 2023	Cash yield (%) 2024F	Cash yield (%) 2025F
TSMC	2330 TT	Outperform	1450.0	823,072	1035.0	40.1	45.23	57.87	22.9	17.9	6.3	5.1	30.4	31.5	1.3	1.5	1.7
Hon Hai	2317 TT	Outperform	290.0	88,177	207.0	40.1	11.50	14.48	18.0	14.3	1.8	1.7	10.4	12.4	2.6	2.9	3.7
AVC	3017 TT	Outperform	885.0	7,703	648.0	36.6	21.40	31.61	30.3	20.5	9.5	7.7	34.1	41.6	1.1	1.7	2.4
DELTA	2308 TT	Outperform	512.0	30,747	386.0	32.6	15.56	18.97	24.8	20.3	4.3	3.9	18.8	20.1	1.7	2.0	2.5
ELASER	3450 TT	Outperform	270.0	1,028	230.0	17.4	3.78	8.97	60.9	25.6	8.2	7.5	14.0	30.5	0.0	0.9	2.6
Accton	2345 TT	Outperform	700.0	10,324	600.0	16.7	19.17	23.33	31.3	25.7	11.7	10.1	39.8	42.3	1.7	2.2	2.5
EMC	2383 TT	Outperform	595.0	4,728	446.5	33.3	27.05	33.14	16.5	13.5	5.1	4.4	32.6	35.2	2.2	3.6	4.5
GCE	2368 TT	Outperform	255.0	2,745	182.0	40.1	12.03	15.79	15.1	11.53	5.2	4.36	34.7	41.07	1.9	3.3	4.12
AES-KY	6781 TT	Outperform	925.0	2,022	772.0	19.8	24.20	31.70	31.9	24.4	4.7	4.3	15.4	18.5	1.5	1.6	2.1

Source: TEJ; KGI Research

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