

V.S. Industry (VSI MK)

Earnings bottoming out but headwinds remain

Feeling neutral post briefing

We came away from VSI's analyst briefing feeling neutral. We maintain our forecasts and TP of MYR0.80, based on 14.4x FY24E PER (-0.5SD of 5Y average, with the -0.5SD peg to reflect unabated economic risks globally). HOLD. VSI expects earnings to bottom out in 3Q and recover seasonally in 4Q. For FY24E, growth will be driven by upcoming model launches and potential new customers, with one already in late-stage negotiations.

Key customers updates

VSI anticipates volume recovery for certain slower models from Customer X, with >30% expected growth from the low point as the customer builds up stock ahead of the year-end festive season. Efforts to improve margins through vertical integration are ongoing (including bringing parts sourcing and manufacturing activities in-house), potentially generating c.MYR100m p.a. in sales. Several new models are scheduled for launch for a US-based customer (3 models) and Coffee Brewer (2 models), contributing as early as 4QFY23E. However, contributions from the Pool Cleaning customer and Customer Y are expected to remain weak in the near term.

Long-awaited breakthrough on prospective customer

Regarding the 3 prospective customers discussed in VSI's last results briefing, negotiations are still ongoing. One of them is likely to start contributing from 1QFY24E. VSI plans to initially enter this new US-based customer's supply chain by supplying components (potential revenue of MYR100m p.a.). The company's long-term goal is to move up the value chain. If successful, this customer has the potential to become one of VSI's top customers in the medium term and enable geographical diversification of end-consumer exposure, particularly in the APAC region.

Still lack of rerating catalysts

While we anticipate a gradual recovery for VSI in the near term, volume from new customers is expected to take time to grow and materialize. Given the prolonged global economic challenges, demand for consumer electronic products is likely to remain muted, putting pressure on margins due to suboptimal utilization and efficiency.

FYE Jul (MYR m)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue	4,002	3,914	4,295	4,559	5,075
EBITDA	439	333	410	458	531
Core net profit	270	201	193	236	296
Core FDEPS (sen)	7.1	4.8	4.7	5.6	6.9
Core FDEPS growth(%)	156.7	(32.2)	(3.5)	19.8	23.2
Net DPS (sen)	4.2	2.0	2.0	2.5	3.1
Core FD P/E (x)	19.4	20.9	17.9	14.9	12.1
P/BV (x)	2.6	1.8	1.4	1.3	1.2
Net dividend yield (%)	3.0	2.0	2.4	2.9	3.7
ROAE (%)	13.1	8.0	8.6	9.9	11.7
ROAA (%)	8.4	5.3	4.7	5.5	6.5
EV/EBITDA (x)	12.2	13.1	8.8	7.7	6.5
Net gearing (%) (incl perps)	1.2	13.8	10.6	6.6	4.4
Consensus net profit	-	-	194	251	291
MIBG vs. Consensus (%)	-	-	(0.3)	(6.0)	1.5

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HOLD

Share Price MYR 0.84
12m Price Target MYR 0.80 (-1%)
Previous Price Target MYR 0.80

Company Description

V.S. Industry Bhd is the 26th largest EMS provider in the world by revenue, ranked according to Manufacturing Market Insider in 2020.

Statistics

52w high/low (MYR)	1.11/0.77
3m avg turnover (USDm)	0.7
Free float (%)	63.9
Issued shares (m)	3,859
Market capitalisation	MYR3.2B USD696M

Major shareholders:

Kumpulan Wang Persaraan	9.0%
BEH KIM LING	7.6%
BEH HWEE SZE	7.3%

Price Performance



	-1M	-3M	-12M
Absolute (%)	5	1	(17)
Relative to index (%)	8	2	(13)

Source: FactSet

ESG@MAYBANK IBG
Tear Sheet Insert

Risk Rating & Score ¹	9.5
Score Momentum ²	-3.8
Last Updated	17 May 2022
Controversy Score ³ (Updated: 01 Jan 2000)	0

Business Model & Industry Issues

- VSI is Malaysia's leading integrated electronics manufacturing services (EMS) provider (ranked Global Top 50 for the past 15 years) with a proven track-record of manufacturing office and household electrical & electronic products for established global brand names.
- VSI's ESG rating has improved to the highest 4-star (representing the top 25% ESG ratings amongst PLCs in the FBM Emas Index) from 3-star in the recent F4GBM Index semi-annual review in June 2022. VSI is also a member of Responsible Business Alliance (RBA) since Dec 2018, having most of its facilities being RBA-compliant.
- In Feb 2022, VSI appointed PwC to conduct an independent third-party review of its labour practices. The review was completed in June 2022 with no evidence of systemic forced labour practices identified. Having said that, gaps and areas for improvement were highlighted to VSI, primarily relating to recruitment fees, overtime, accommodation and effective communication. VSI has acknowledged these matters and taken immediate remedial actions to rectify the issues.

Material E issues

- Most operational processes are ISO 14001:2015 certified - the global industry standard benchmark for environmental management measures. VSI has also been a F4GBM index constituent since Jun 2018.
- Waste management: VSI handles all hazardous waste in accordance with Environmental Quality (Scheduled Wastes) Regulations 2005 and other relevant environmental-related legislation in the Environmental Quality Act 1974 (EQA 1974). The volume of recycled waste was up by 3.9% YoY in FY22 at 1,714 tonnes (vs. 1,650 tonnes in FY21).
- Air pollution: Chimney emission testing are done regularly. In FY22, periodic tests showed its emissions complied with the Environmental Quality (Clean Air) Regulations 1978 and Environmental Quality (Clean Air) Regulations 2014.
- Water pollution: VSI has set targets (above regulatory requirements) at each plant to minimise resource use. All plants have achieved targets in total consumption per unit produced in FY22.

Material S issues

- Sustainable supply chain: Has an established Supplier Code of Conduct in place, covering areas such as human rights, labour conditions, environmental impacts, anti-corruptions, etc. In FY22, 63% of its procurement was from local suppliers (FY21: 57%).
- Occupational safety & health (OSH): VSI strives to minimise work-related accidents and injuries for its 9,805 strong workforce. In FY22, its employees Lost-Time Incident Rate (LTIR) improved to 14.27 from 15.68 in FY21, with zero fatality rate recorded during the year.
- Employee diversity: In FY22, VSI employed more women (52%) than men (48%), with 70% of its workforce under the age of 30. Also, estd total hours employees spent on training improved sharply to 1,400 hrs/yr from 475 hrs/yr in FY21.

Key G metrics and issues

- Independent Directors currently make up 45% of the Board (5 out of 11). Although the composition is in compliant with Bursa's Main Market Listing requirements, it fell short of the Malaysian Code on Corporate Governance (MCCG) practise of having $\geq 50\%$ of the Board comprising of Independent members.
- Female representation on the Board is currently lacking at only 9% or 1 of the 11 Board members (vs. 30% as recommended by MCCG).
- None of the group's Independent Board members have served a consecutive term of 9 years.
- The positions of Chairman and Managing Director are held by different individuals. All 3 Board committees (Audit & Risk, Nomination, Remuneration) are chaired by and comprise solely of Independent Directors.
- Directors' remuneration is relatively high at 21.8% of FY22 net profit.
- KPMG has been the external auditor for more than 24 years since VSI was listed on the Main Market of Bursa Malaysia in 1998.
- The group has a 43.3% stake in a Hong Kong-listed subsidiary, V.S. International Group (1002 HK, Not Rated; listed on Main Board of HKSE in 2002). In 2017, VSI subscribed to its entire allotted portion of 200 million rights issue shares (totalling HKD46 million) with proceeds intended for debt repayment, to increase manufacturing capacity and for working capital.
- Related-party transaction: In Apr 2023, VSI purchased two parcels of land (including factory and office) for MYR6m from a company owned by two of its Executive Directors cum substantial shareholder. The property was valued by a registered professional valuer and was deemed to be fair and reasonable to the group.

¹Risk Rating & Score - derived by Sustainalytics and assesses the company's exposure to unmanaged ESG risks. Scores range between 0 - 50 in order of increasing severity with low/high scores & ratings representing negligible/significant risk to the company's enterprise value, respectively, from ESG-driven financial impacts. ²Score Momentum - indicates changes to the company's score since the last update - a **negative** integer indicates a company's improving risk score; a **positive** integer indicates a deterioration. ³Controversy Score - reported periodically by Sustainalytics in the event of material ESG-related incident(s), with the impact severity scores of these events ranging from Category 0-5 (0 - no reports; 1 - negligible risks; ...; 5 - poses serious risks & indicative of potential structural deficiencies at the company).

Quantitative Parameters (Score: 37)						
	Particulars	Unit	FY20	FY21	FY22	VMS (FY21)
E	Scope 1 emissions	tCO2e	442	447	455	68,061
	Scope 2 emissions	tCO2e	29,895	24,835	27,321	65,952
	Total	tCO2e	30,337	25,282	27,776	134,013
	Scope 3 emissions	tCO2e	N/A	N/A	17,549	N/A
	Total	tCO2e	-	-	45,325	-
	Emissions Intensity	kg CO2e/kg/unit	0.075	0.048	0.079	28.4
	Electricity consumption intensity	MWh	51,103	42,453	46,703	115,676
	Total Hazardous Waste Disposal	tonnes	1089	585	692	121
	Total water consumption	m3	245,752	216,091	349,613	685
	Cases of environmental non-compliance	number	N/A	N/A	2	0

S	% of women in workforce	%	57.0%	52.0%	52.0%	55.1%
	% of women in the mgmt role	%	N/A	N/A	N/A	N/A
	Total training hours	hrs/yr/emp	1.5	1.0	1.0	34.0
	Lost-time incident rate	number	29.90	15.68	14.27	0.70
	Employee turnover rate	%	-	54%	41%	N/A
	Local suppliers	%	57%	57%	63%	N/A
	Investment in CSR initiatives	MYR '000	106	79	232	29

G	BOD's remuneration as % of reported net profit	%	24.6%	14.8%	21.8%	0.3%
	Independent directors (tenure <10 years)	%	33.3%	40.0%	45.0%	75.0%
	Women directors as a % of the board	%	11.1%	10.0%	9.1%	38.0%
	% of profits returned to shareholders	%	40.6%	45.4%	45.8%	70.0%
	Total corruption and bribery cases	number	0	0	0	0

Qualitative Parameters (Score: 67)

- a) Is there an ESG policy in place and whether there is a standalone ESG committee or is it part of Risk committee?
Yes - it has an established sustainability framework. The Board oversees the development and adoption of sustainability strategies which is executed by a sustainability working group led by the Operations Director.
- b) Are the senior management's salaries linked to fulfilling ESG targets?
No.
- c) Does the company has human rights violation policies in place?
Yes.
- d) Is the company involved in any major adverse controversies relating to labor, corruption and bribery, environmental hazards?
No.
- e) Does the company have a mechanism to capture Scope 3 emissions - which parameters are captured?
Yes - it calculates GHG emissions from point-to-point air travel as well as employees' daily commute to work.
- f) What are the 2-3 key carbon mitigation/water/waste management strategies adopted by the company?
VSI launched a resource-efficiency pilot program at one of its plants in FY22. The program monitors daily lighting energy usage and switches off lights when there is no production. Heavy machinery is operated or replaced at night to avoid peak demand. Air conditioning is set to 25°C except in specific areas, such as the Clean Room. Energy efficiency targets have been established for the plant.

Target (Score: 83)

Particulars	Target	Achieved
Electricity consumption/unit	<7.09 kW/unit/mth	Yes
Water consumption/unit	<0.03 m3/unit/mth	No
Scheduled waste/unit	<0.0033 kg/unit/mth	Yes
Hazardous waste disposal	<2,842 kg	Yes
Net zero/carbon emission reduction targets	N/A	N/A
Cases of corruption and fines for unethical practices	N/A	Yes
Impact		
N/A		
Overall Score: 56		
As per our ESG matrix, VSI has an overall score of 56		

ESG score	Weights	Scores	Final Score
Quantitative	50%	37	18
Qualitative	25%	67	17
Target	25%	83	21
Total			56

As per our ESG assessment, VSI has an established framework, internal policies, and tangible targets. However, there is still room for improvements on areas such as its commitments towards net zero/carbon emission reduction and Board diversity. VSI's overall ESG score is 56, above its industry's average, in our view (average ESG rating = 50; refer to App I for our ESG Assessment Scoring).

Appendix I

Methodology of our proprietary ESG scoring methodology. We evaluate the ESG ratings based on quantitative, qualitative and ESG targets. We assign a score for each of these three parameters. The overall rating is based on the weighted average of the scores: quantitative (50%), qualitative (25%) and ESG target (25%). For the quantitative, qualitative and ESG target, the sub-parameters are assigned a score - '0' for data not available, '+1' for improving trajectory, positive change, 'Yes', better than peers or a positive number if historical is not available and '-1' for declining trajectory, negative change, 'No', lower than peers or a negative number. The total of the scores of all the sub-parameters is divided by the total number of sub-parameters is the score of each of the three parameters. The sub-parameters may be different for different industries depending on the key areas to monitor for each industry. A company should achieve a minimum score of 50 for an average ESG rating.

Risk statement

There are several risk factors that may impact our earnings estimates, target price and rating for VSI. Key risks include: (i) weaker-than-expected consumer demand for VSI's assembled products (due to a weakening economic outlook); (ii) lower-than-expected margins (resulting from decreased productivity/efficiencies and costs inflation); and (iii) persistent operational disruptions from labour issues and/or components shortage. Positive catalysts include: (i) new customer acquisition; (ii) new models win from existing customers, leading to increased production volume and utilisation rates; (iii) successful vertical integration/service expansion to enhance margins; and (iv) successful costs savings or higher-than-expected costs past through.

FYE 31 Jul	FY21A	FY22A	FY23E	FY24E	FY25E
Key Metrics					
P/E (reported) (x)	19.1	27.6	16.6	13.6	10.8
Core P/E (x)	19.1	19.2	16.6	13.6	10.8
Core FD P/E (x)	19.4	20.9	17.9	14.9	12.1
P/BV (x)	2.6	1.8	1.4	1.3	1.2
P/NTA (x)	2.6	1.8	1.4	1.3	1.2
Net dividend yield (%)	3.0	2.0	2.4	2.9	3.7
FCF yield (%)	nm	nm	4.5	6.7	6.1
EV/EBITDA (x)	12.2	13.1	8.8	7.7	6.5
EV/EBIT (x)	15.8	20.5	13.8	11.1	8.7

INCOME STATEMENT (MYR m)

Revenue	4,002.3	3,914.1	4,295.2	4,559.0	5,074.9
EBITDA	438.6	333.1	409.8	458.0	531.2
Depreciation	(99.1)	(118.7)	(145.7)	(140.3)	(135.4)
Amortisation	(2.3)	(2.3)	(2.3)	(2.3)	(2.3)
EBIT	337.1	212.0	261.7	315.4	393.5
Net interest income / (exp)	(7.3)	(9.7)	(33.2)	(30.9)	(30.6)
Associates & JV	(0.7)	(0.5)	0.0	0.0	0.0
Other pretax income	0.0	0.0	0.0	0.0	0.0
Pretax profit	329.1	201.8	228.5	284.5	362.9
Income tax	(87.5)	(51.5)	(54.8)	(68.3)	(87.1)
Minorities	3.7	19.8	19.8	19.8	19.8
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	245.3	170.1	193.5	236.0	295.7
Core net profit	269.7	201.2	193.5	236.0	295.7

BALANCE SHEET (MYR m)

Cash & Short Term Investments	402.4	278.6	443.1	503.9	555.2
Accounts receivable	992.1	1,092.3	1,198.6	1,272.2	1,416.2
Inventory	633.8	925.0	1,012.6	1,068.0	1,183.4
Reinsurance assets	0.0	0.0	0.0	0.0	0.0
Property, Plant & Equip (net)	989.5	1,214.5	1,168.8	1,128.5	1,092.1
Intangible assets	0.0	0.0	0.0	0.0	0.0
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	577.8	469.8	434.8	429.3	419.7
Total assets	3,595.6	3,980.2	4,257.9	4,402.0	4,666.6
ST interest bearing debt	318.8	478.6	478.6	478.6	478.6
Accounts payable	844.2	860.3	941.8	993.3	1,100.6
Insurance contract liabilities	0.0	0.0	0.0	0.0	0.0
LT interest bearing debt	109.4	125.2	225.2	196.2	196.2
Other liabilities	106.0	155.0	155.0	155.0	155.0
Total Liabilities	1,378.1	1,619.2	1,800.7	1,823.2	1,930.5
Shareholders Equity	2,040.5	2,190.3	2,306.4	2,447.8	2,625.0
Minority Interest	177.0	170.7	150.8	131.0	111.1
Total shareholder equity	2,217.5	2,361.0	2,457.2	2,578.8	2,736.1
Total liabilities and equity	3,595.6	3,980.2	4,257.9	4,402.0	4,666.6

CASH FLOW (MYR m)

Pretax profit	329.1	201.8	228.5	284.5	362.9
Depreciation & amortisation	101.5	121.1	148.1	142.6	137.7
Adj net interest (income)/exp	7.3	9.7	33.2	30.9	30.6
Change in working capital	(266.9)	(109.2)	(110.5)	(74.7)	(148.9)
Cash taxes paid	(87.5)	(44.3)	(54.8)	(68.3)	(87.1)
Other operating cash flow	(167.1)	0.5	0.0	0.0	0.0
Cash flow from operations	(83.6)	179.5	244.4	315.0	295.3
Capex	(227.3)	(207.6)	(100.0)	(100.0)	(99.0)
Free cash flow	(310.9)	(28.1)	144.4	215.0	196.3
Dividends paid	(105.7)	(84.0)	(77.4)	(94.4)	(118.3)
Equity raised / (purchased)	0.0	0.0	0.0	0.0	0.0
Change in Debt	19.2	0.0	100.0	(29.0)	0.0
Other invest/financing cash flow	(0.6)	(8.5)	(32.2)	(30.7)	(26.7)
Effect of exch rate changes	19.1	47.1	0.0	0.0	0.0
Net cash flow	(378.9)	(73.5)	134.8	60.9	51.3

FYE 31 Jul	FY21A	FY22A	FY23E	FY24E	FY25E
Key Ratios					
Growth ratios (%)					
Revenue growth	23.4	(2.2)	9.7	6.1	11.3
EBITDA growth	93.5	(24.1)	23.0	11.8	16.0
EBIT growth	149.9	(37.1)	23.5	20.5	24.8
Pretax growth	159.3	(38.7)	13.2	24.5	27.6
Reported net profit growth	172.5	(30.7)	13.7	22.0	25.3
Core net profit growth	157.8	(25.4)	(3.8)	22.0	25.3
Profitability ratios (%)					
EBITDA margin	11.0	8.5	9.5	10.0	10.5
EBIT margin	8.4	5.4	6.1	6.9	7.8
Pretax profit margin	8.2	5.2	5.3	6.2	7.2
Payout ratio	63.7	44.9	40.0	40.0	40.0
DuPont analysis					
Net profit margin (%)	6.1	4.3	4.5	5.2	5.8
Revenue/Assets (x)	1.1	1.0	1.0	1.0	1.1
Assets/Equity (x)	1.8	1.8	1.8	1.8	1.8
ROAE (%)	13.1	8.0	8.6	9.9	11.7
ROAA (%)	8.4	5.3	4.7	5.5	6.5
Liquidity & Efficiency					
Cash conversion cycle	60.5	88.4	102.4	104.0	101.7
Days receivable outstanding	84.1	95.9	96.0	97.6	95.4
Days inventory outstanding	50.0	80.0	90.8	92.4	90.3
Days payables outstanding	73.6	87.4	84.4	86.0	83.9
Dividend cover (x)	1.6	2.2	2.5	2.5	2.5
Current ratio (x)	1.9	1.8	1.9	2.0	2.0
Leverage & Expense Analysis					
Asset/Liability (x)	2.6	2.5	2.4	2.4	2.4
Net gearing (%) (incl perps)	1.2	13.8	10.6	6.6	4.4
Net gearing (%) (excl. perps)	1.2	13.8	10.6	6.6	4.4
Net interest cover (x)	46.0	21.9	7.9	10.2	12.9
Debt/EBITDA (x)	1.0	1.8	1.7	1.5	1.3
Capex/revenue (%)	5.7	5.3	2.3	2.2	2.0
Net debt/ (net cash)	25.8	325.2	260.7	170.8	119.6

Source: Company; Maybank IBG Research

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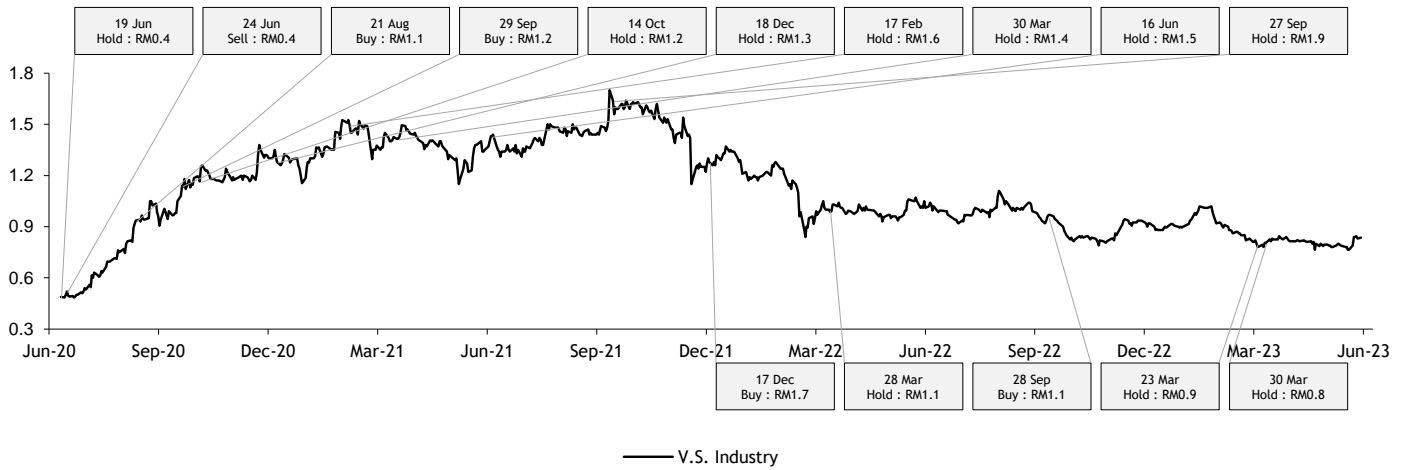
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