

V.S. Industry (VSI MK)

Cyclical recovery or long-awaited rebound?

Results inline; maintain HOLD

VSI's FY23 results came within our forecast but beat the street's estimates at 101%/109% of ours/consensus full year forecasts. We tweak FY24-25E CNP slightly due to housekeeping and introduce FY26E. Our new TP is MYR1.05, based on 19x FY24E PER (5Y mean; previously 14x FY24E PER or -0.55D). The higher PER reflects an improved op. environment due to the end of customers destocking activities, indicating normalisation/potential orders recovery ahead. Maintain HOLD on balanced risk-reward.

Higher QoQ after 3 consecutive qtrs of contractions

VSI's FY23 CNP (ex- one-offs) shrank 5% YoY to MYR195.4m despite higher revenue of +18% YoY. We believe this was largely due to its lower margin product mix, and higher overheads (electricity, labour, financing costs) and taxes. 4QFY23 CNP plunged 39% YoY to MYR53.3m despite revenue rising 16%, also due to lower margins product mix and higher taxes. Positively, 4QFY23 CNP almost doubled QoQ on higher sales and better margins as plant utilisation improved.

Growth mainly driven by MY ops

Geographically, FY23 sales have improved significantly for its MY operations (+25% YoY to MYR3,402m) contributed by its key customers. This brought FY23 MY PBT higher (+7% YoY to MYR251m) despite higher electricity, labour and financing costs. ID's 3Q underperformance (losses due to lower sales orders received during the Aidilfitri festivity) dragged FY23 ID PBT into contraction by 11% YoY to MYR7.5m. China ops continued to be lacklustre (losses still in FY23 at MYR19m) as production was below the optimum level on still challenging operating environment.

Worst is over, but we stay cautious

While we believe the worst could be over for VSI, we remain cautious on its outlook as we expect demand for consumer electronic products to remain muted on prolonged global economic challenges. Upside catalysts include new customer acquisitions/better volume pick up.

FYE Jul (MYR m)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue	3,914	4,600	4,968	5,635	6,249
EBITDA	335	394	487	575	656
Core net profit	206	195	232	298	359
Core FDEPS (sen)	4.9	4.7	5.5	6.9	7.8
Core FDEPS growth(%)	(30.8)	(4.7)	16.9	26.2	12.5
Net DPS (sen)	2.0	1.9	2.4	3.1	3.7
Core FD P/E (x)	20.5	19.0	18.5	14.7	13.0
P/BV (x)	1.8	1.5	1.6	1.5	1.4
Net dividend yield (%)	2.0	2.1	2.4	3.1	3.7
ROAE (%)	8.1	8.2	9.8	11.8	13.2
ROAA (%)	5.4	4.7	5.2	6.4	7.2
EV/EBITDA (x)	13.0	10.1	9.0	7.6	6.5
Net gearing (%) (incl perps)	13.8	15.5	12.1	10.7	7.8
Consensus net profit	-	-	240	290	na
MIBG vs. Consensus (%)	-	-	(3.2)	3.1	na

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HOLD

Share Price	MYR 1.02
12m Price Target	MYR 1.05 (+5%)
Previous Price Target	MYR 0.80

Company Description

VS 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)	1.05/0.77
3m avg turnover (USDm)	1.0
Free float (%)	63.3
Issued shares (m)	3,870
Market capitalisation	MYR3.9B
	USD842M

Major shareholders:

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

Price Performance



	-1M	-3M	-12M
Absolute (%)	8	11	11
Relative to index (%)	8	7	9

Source: FactSet

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 ≥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.

¹**Risk 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. ²**Score 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. ³**Controversy 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/em	1.5	1.0	1.0	34.0
	Lost-time incident rate	p	29.90	15.68	14.27	0.70
	Employee turnover rate	number	-	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?	<i>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.</i>
b) Are the senior management's salaries linked to fulfilling ESG targets?	<i>No.</i>
c) Does the company has human rights violation policies in place?	<i>Yes.</i>
d) Is the company involved in any major adverse controversies relating to labor, corruption and bribery, environmental hazards?	<i>No.</i>
e) Does the company have a mechanism to capture Scope 3 emissions - which parameters are captured?	<i>Yes - it calculates GHG emissions from point-to-point air travel as well as employees' daily commute to work.</i>
f) What are the 2-3 key carbon mitigation/water/waste management strategies adopted by the company?	<i>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.</i>

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

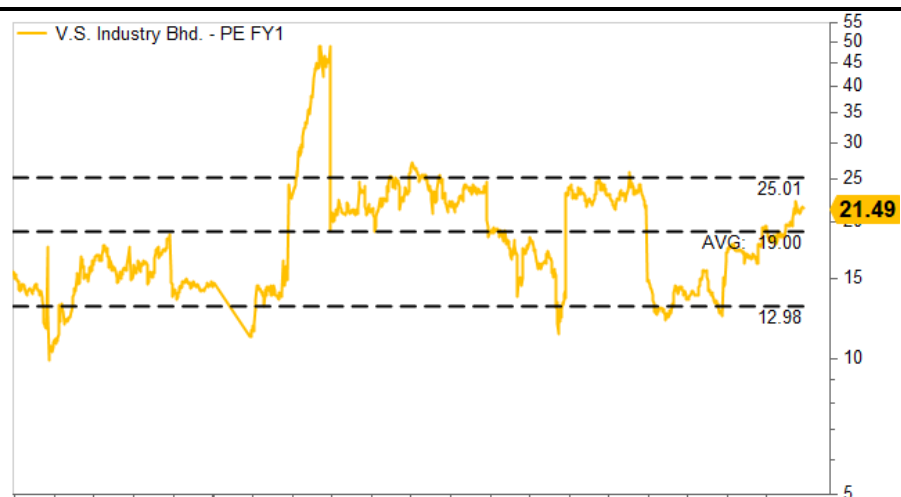
As per our ESG assessment, VSI has an established framework, internal policies, and tangible targets. However, there is still room for improvements on areas such as its commitments towards net zero/carbon emission reduction and Board diversity. VSI's overall ESG score is 56, above its industry's average,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

Figure 1: V.S. Industry results summary

FY Jul (MYR m)	Quarterly results					Cumulative results		
	4Q23	3Q23	%QoQ	4Q22	%YoY	12M23	12M22	%YoY
Turnover	1,161.7	996.8	16.5	1,004.4	15.7	4,599.8	3,914.1	17.5
EBIT	99.3	38.7	>100	41.2	>100	273.8	216.0	26.8
Interest expense	(10.7)	(10.6)	0.5	(3.9)	>100	(40.9)	(12.3)	>100
Interest income	5.2	2.7	92.3	0.4	>100	11.3	2.6	>100
Associate	0.6	0.7	(9.3)	0.8	(20.2)	1.5	(0.5)	NM
Pre-tax profit	94.4	31.5	>100	38.5	>100	245.6	205.8	19.4
Taxation	(29.8)	(8.7)	>100	(15.3)	94.3	(71.2)	(54.4)	30.8
Minority interest	1.4	4.0	(63.5)	12.4	(88.4)	9.5	19.4	(51.2)
Net profit	66.1	26.8	>100	35.6	85.7	183.9	170.8	7.7
One-offs	(12.7)	1.0	NM	51.6	NM	11.5	35.3	(67.4)
Core net profit	53.3	27.8	91.9	87.1	(38.8)	195.4	206.0	(5.1)
	4Q23	3Q23	+/- ppt	4Q22	+/- ppt	12M23	12M22	+/- ppt
Core net profit margin (%)	4.6	2.8	1.8	8.7	(4.1)	4.2	5.3	(1.0)
Tax rate (%)	31.6	27.6	4.0	39.8	(8.3)	29.0	26.5	2.5
	4Q23	3Q23	%QoQ	4Q22	%YoY	12M23	12M22	%YoY
Revenue (MYR m)	1,161.7	996.8	16.5	1,004.4	15.7	4,599.8	3,914.1	17.5
Malaysia	833.4	693.9	20.1	792.4	5.2	3,402.0	2,714.6	25.3
Indonesia	80.7	59.1	36.5	75.4	7.0	340.7	327.8	4.0
China	17.5	8.6	>100	12.4	40.2	49.0	79.7	(38.5)
Others	230.1	235.1	(2.2)	124.1	85.4	808.0	792.0	2.0
	4Q23	3Q23	%QoQ	4Q22	%YoY	12M23	12M22	%YoY
Pretax profit (MYR m)	94.4	31.5	>100	38.5	>100	245.6	205.8	19.4
Malaysia	94.9	38.9	>100	61.9	53.3	251.4	234.0	7.4
Indonesia	0.7	(1.4)	NM	(0.1)	NM	7.5	8.4	(10.6)
China	(3.0)	(8.0)	(62.9)	(21.3)	(86.0)	(19.1)	(36.5)	(47.6)
Others	1.8	2.0	(9.3)	(2.0)	NM	5.9	(0.1)	NM
	4Q23	3Q23	%QoQ	4Q22	%YoY	12M23	12M22	%YoY
Pretax profit margins (%)	8.1	3.2	5.0	3.8	4.3	5.3	5.3	0.1
Malaysia	11.4	5.6	5.8	7.8	3.6	7.4	8.6	(1.2)
Indonesia	0.9	(2.4)	3.3	(0.2)	1.1	2.2	2.6	(0.4)
China	NM	NM	NM	NM	NM	NM	NM	NM
Others	0.8	0.8	(0.1)	(1.6)	2.4	0.7	(0.0)	0.7

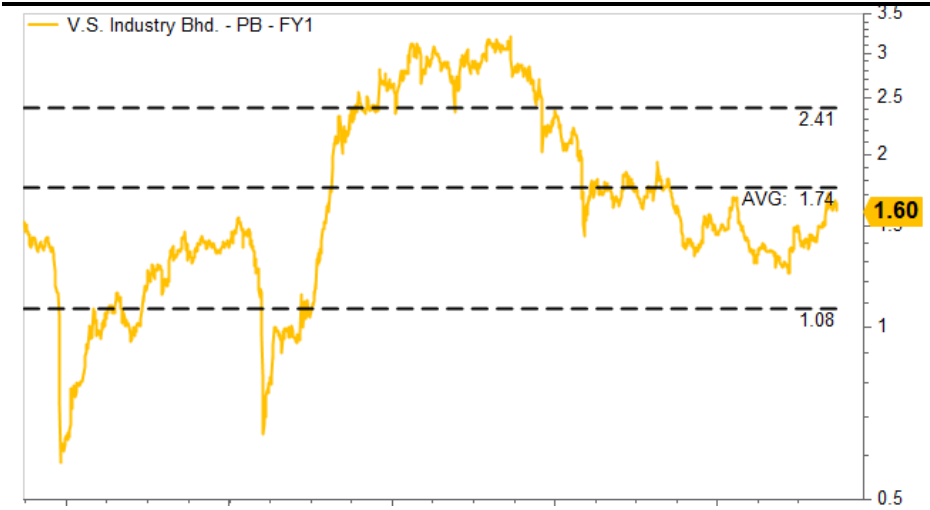
Source: Company, Maybank IBG Research

Figure 2: VSI's one-year rolling forward PER (current PER trading at 21.5x)



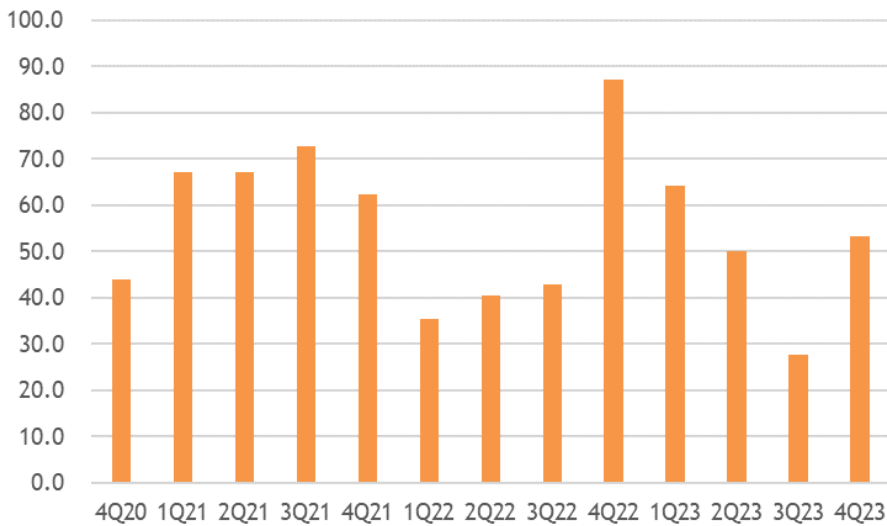
Source: Factset, Maybank IBG Research

Figure 3: VSI’s one-year rolling forward PBV (current PBV trading at 1.6x)



Source: Factset, Maybank IBG Research

Figure 4: VSI’s historical earnings (CNP) - first higher QoQ after 3 consecutive drops



Source: Maybank IBG Research

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.

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.

FYE 31 Jul	FY22A	FY23A	FY24E	FY25E	FY26E
Key Metrics					
P/E (reported) (x)	27.5	18.5	16.9	13.1	10.9
Core P/E (x)	18.7	17.6	16.9	13.1	10.9
Core FD P/E (x)	20.5	19.0	18.5	14.7	13.0
P/BV (x)	1.8	1.5	1.6	1.5	1.4
P/NTA (x)	1.8	1.5	1.6	1.5	1.4
Net dividend yield (%)	2.0	2.1	2.4	3.1	3.7
FCF yield (%)	nm	0.6	4.8	4.2	6.0
EV/EBITDA (x)	13.0	10.1	9.0	7.6	6.5
EV/EBIT (x)	20.2	14.5	12.7	10.0	8.2

INCOME STATEMENT (MYR m)

Revenue	3,914.1	4,599.8	4,968.3	5,635.2	6,248.7
EBITDA	334.7	393.9	487.0	575.0	656.0
Depreciation	(118.7)	(120.1)	(143.3)	(138.1)	(133.4)
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	216.0	273.8	343.7	436.9	522.6
Net interest income / (exp)	(9.7)	(29.7)	(31.7)	(31.5)	(31.3)
Associates & JV	(0.5)	1.5	1.5	1.5	1.5
Other pretax income	0.0	0.0	0.0	0.0	0.0
Pretax profit	205.8	245.6	313.5	407.0	492.8
Income tax	(54.4)	(71.2)	(90.9)	(118.0)	(142.8)
Minorities	19.4	9.5	9.5	9.5	9.5
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	170.8	183.9	232.1	298.5	359.4
Core net profit	206.0	195.4	232.1	298.5	359.4

BALANCE SHEET (MYR m)

Cash & Short Term Investments	278.6	323.8	361.0	378.5	443.6
Accounts receivable	1,092.3	1,283.6	1,386.5	1,572.6	1,743.8
Inventory	925.0	1,096.6	1,175.4	1,326.7	1,466.0
Reinsurance assets	0.0	0.0	0.0	0.0	0.0
Property, Plant & Equip (net)	1,214.5	1,194.4	1,151.1	1,112.0	1,077.5
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	469.8	439.0	437.3	431.6	425.9
Total assets	3,980.2	4,337.4	4,511.3	4,821.3	5,156.8
ST interest bearing debt	478.6	478.6	478.6	478.6	478.6
Accounts payable	860.3	1,019.9	1,093.2	1,233.9	1,363.4
Insurance contract liabilities	0.0	0.0	0.0	0.0	0.0
LT interest bearing debt	125.2	225.2	196.2	196.2	196.2
Other liabilities	155.0	155.0	155.0	155.0	155.0
Total Liabilities	1,619.2	1,878.8	1,923.1	2,063.8	2,193.3
Shareholders Equity	2,190.3	2,297.4	2,436.4	2,615.2	2,830.7
Minority Interest	170.7	161.2	151.7	142.3	132.8
Total shareholder equity	2,361.0	2,458.6	2,588.2	2,757.5	2,963.5
Total liabilities and equity	3,980.2	4,337.4	4,511.3	4,821.3	5,156.8

CASH FLOW (MYR m)

Pretax profit	205.8	245.6	313.5	407.0	492.8
Depreciation & amortisation	118.7	120.1	143.3	138.1	133.4
Adj net interest (income)/exp	9.7	29.7	31.7	31.5	31.3
Change in working capital	(109.2)	(201.4)	(106.3)	(194.4)	(178.6)
Cash taxes paid	(54.4)	(71.2)	(90.9)	(118.0)	(142.8)
Other operating cash flow	0.5	(1.5)	(1.5)	(1.5)	(1.5)
Cash flow from operations	171.0	121.2	289.8	262.7	334.6
Capex	(207.6)	(100.0)	(100.0)	(99.0)	(99.0)
Free cash flow	(36.6)	21.2	189.8	163.7	235.6
Dividends paid	(84.0)	(73.6)	(92.8)	(119.4)	(143.8)
Equity raised / (purchased)	0.0	0.0	0.0	0.0	0.0
Change in Debt	0.0	100.0	(29.0)	0.0	0.0
Other invest/financing cash flow	(8.5)	(32.2)	(30.7)	(26.7)	(26.7)
Effect of exch rate changes	47.1	0.0	0.0	0.0	0.0
Net cash flow	(82.0)	15.5	37.2	17.5	65.1

FYE 31 Jul	FY22A	FY23A	FY24E	FY25E	FY26E
Key Ratios					
Growth ratios (%)					
Revenue growth	(2.2)	17.5	8.0	13.4	10.9
EBITDA growth	(23.7)	17.7	23.6	18.1	14.1
EBIT growth	(35.9)	26.8	25.5	27.1	19.6
Pretax growth	(37.5)	19.4	27.6	29.8	21.1
Reported net profit growth	(30.4)	7.7	26.2	28.6	20.4
Core net profit growth	(23.6)	(5.1)	18.8	28.6	20.4
Profitability ratios (%)					
EBITDA margin	8.6	8.6	9.8	10.2	10.5
EBIT margin	5.5	6.0	6.9	7.8	8.4
Pretax profit margin	5.3	5.3	6.3	7.2	7.9
Payout ratio	44.7	40.0	40.0	40.0	40.0
DuPont analysis					
Net profit margin (%)	4.4	4.0	4.7	5.3	5.8
Revenue/Assets (x)	1.0	1.1	1.1	1.2	1.2
Assets/Equity (x)	1.8	1.9	1.9	1.8	1.8
ROAE (%)	8.1	8.2	9.8	11.8	13.2
ROAA (%)	5.4	4.7	5.2	6.4	7.2
Liquidity & Efficiency					
Cash conversion cycle	88.4	99.1	103.2	100.8	101.9
Days receivable outstanding	95.9	93.0	96.7	94.5	95.5
Days inventory outstanding	80.0	87.5	91.8	89.6	90.5
Days payables outstanding	87.5	81.4	85.4	83.3	84.1
Dividend cover (x)	2.2	2.5	2.5	2.5	2.5
Current ratio (x)	1.8	1.9	1.9	2.0	2.0
Leverage & Expense Analysis					
Asset/Liability (x)	2.5	2.3	2.3	2.3	2.4
Net gearing (%) (incl perps)	13.8	15.5	12.1	10.7	7.8
Net gearing (%) (excl. perps)	13.8	15.5	12.1	10.7	7.8
Net interest cover (x)	22.3	9.2	10.8	13.9	16.7
Debt/EBITDA (x)	1.8	1.8	1.4	1.2	1.0
Capex/revenue (%)	5.3	2.2	2.0	1.8	1.6
Net debt/ (net cash)	325.2	380.0	313.8	296.3	231.1

Source: Company; Maybank IBG Research

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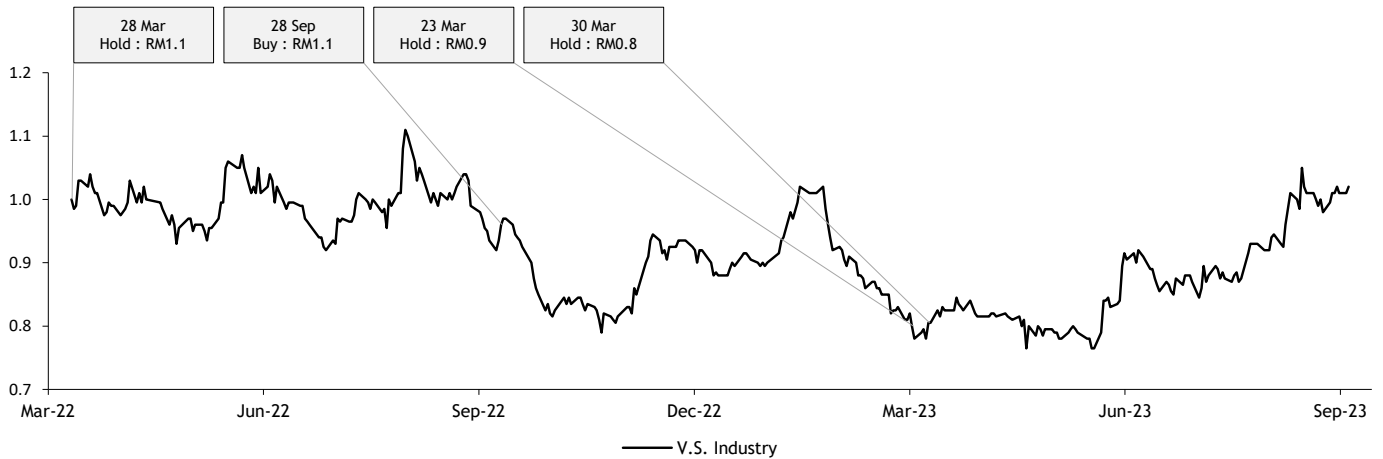
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