

COMPANY UPDATE

VS Industry (VSI MK)

Softness Sufficiently Priced In; Still Seeing Growth In 2023

While we cut FY23 earnings by 19% in view of the prolonged demand softening in the consumer electronics segment, we believe the weak prospects have been sufficiently priced in. Meanwhile, main customers' order rechanneling is cushioning the shortfall while the much-needed drivers are in place to fuel VS' growth in 2H23. VS is still the frontrunner of the US-China trade diversion, with key customers committed to supply chain reconfiguration. Maintain BUY with a lower target price of RM1.20.

WHAT'S NEW

- **Softness could have been sufficiently priced in.** Recall that VS Industry (VS) recorded two consecutive quarters of earnings disappointments (on supply chain disruption and manpower shortages) in 2QFY22 and 3QFY22, followed by concerns of orders slowdown towards 4QFY22. These de-rating catalysts have sent the stock plummeting by 39% from its all-time-high of RM1.675 (in Sep 21). While the group registered a decent set of results in 4QFY22 and 1QFY23, boosted by the order rechanneling from its key customer, the upcoming weak seasons ie 2Q-3QFY23 could also reflect customers' cautious inventory build-up in view of the global economic slowdown. To err on the conservative side, we cut our FY23 earnings by 19%. That said, we are still expecting earnings to improve 26% yoy. Presently, it is trading at 15.6x FY23 ex-cash FD PE (at -0.5SD below its five-year mean) which presents a balanced risk-reward ratio for an entry point.
- **Seeing light at the end of the tunnel.** Beyond the current slowdown, we see better prospects ahead, premised on: a) order rechanneling that would cushion the general weakness, b) a relief in systemic disruption ie labour shortage and supply chain disruption, and c) undemanding valuation with de-rating catalysts being sufficiently priced in. Note that VS is benefitting from the fallout of its peers over the common customer's business engagement, where it has secured three various segments of new models. This would rake in an additional RM800m-1b in revenue, with earnings potential of RM40m-60m (better margins) to cushion off demand softness from other key customers (expect to be slower by about 25% yoy).
- **A laggard to its peers.** While share prices of EMS names have recovered from its trough amid a choppy 2022 (ranging from +28% to +101%) following our sector upgrade in early-Dec 22, VS's share price recovery still lagged at the lower end of the spectrum, only recovering by 28%. In terms of valuation, it presents a decent value proposition with an undemanding PEG ratio of 0.7x, against the backdrop of its improving prospects moving forward. We see room for valuation catch-up in anticipation of a better 2H23.

KEY FINANCIALS

Year to 31 Jul (RMm)	2021	2022	2023F	2024F	2025F
Net turnover	4,002	3,914	4,299	5,002	5,364
EBITDA	439	334	424	532	580
Operating profit	337	212	307	411	454
Net profit (rep./act.)	245	171	217	294	326
Net profit (adj.)	272	205	217	294	326
EPS (sen)	7.1	4.5	4.8	6.5	7.2
PE (x)	14.2	22.3	21.1	15.6	14.1
P/B (x)	1.9	2.1	2.0	1.9	1.7
EV/EBITDA (x)	9.1	11.9	9.4	7.5	6.9
Dividend yield (%)	2.4	1.7	2.1	2.9	3.2
Net margin (%)	6.1	4.4	5.0	5.9	6.1
Net debt/(cash) to equity (%)	1.3	15.8	(3.3)	(5.2)	(9.9)
Interest cover (x)	59.9	34.5	28.2	35.4	38.5
ROE (%)	13.1	8.1	9.6	12.3	12.7
Consensus net profit	-	-	256	305	344
UOBKH/Consensus (x)	-	-	0.85	0.96	0.95

Source: VS Industry, Bloomberg, UOB Kay Hian

BUY

(Maintained)

Share Price	RM1.01
Target Price	RM1.20
Upside	+18.8%
(Previous TP)	RM1.40)

COMPANY DESCRIPTION

VS Industry is involved in the manufacturing of plastic parts and components, contract manufacturing, precision mould making, the sub-assembly of electronic and electrical equipment and other secondary processes. It has plants in Malaysia, China, and Indonesia.

STOCK DATA

GICS sector	Information Technology
Bloomberg ticker:	VSI MK
Shares issued (m):	3,846.2
Market cap (RMm):	3,884.6
Market cap (US\$m):	896.4
3-mth avg daily t'over (US\$m):	0.9

Price Performance (%)

52-week high/low			RM1.28/RM0.790	
1mth	3mth	6mth	1yr	YTD
10.4	27.8	5.8	(20.5)	14.8

Major Shareholders

	%
Kumpulan Wang Persaraan Diperbadankan	8.9
Beh Kim Ling	7.7
Beh Hwee See	7.3
FY23 NAV/Share (RM)	0.51
FY23 Net Cash/Share (RM)	0.02

PRICE CHART



Source: Bloomberg

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STOCK IMPACT

• Clear beneficiary of trade-diversion play; secured five new customers since 2019.

Beyond the acquisition of Ipark Development lands (close to 413,700sf) for customer Y (fifth new order won since early-19) in Oct 20, the group has acquired an additional three parcels of adjacent land in end-Nov 21. These lands, measuring 386,400sf (or 8.9 acres), will be used for future capacity expansion. After the acquisition, VS' land size in Malaysia has now increased to around 2.1m sf (or close to 60 acres) which makes it the largest land size owner among all listed EMS players.

While it is still too early to gauge the potential revenue, it is interesting to note that the total size of these lands is at 89% of iPark facilities' size. Recall that the group racked in RM230m revenue from customer Y on its first year of operations. Meanwhile, max revenue potential (blue-sky) that could be derived from the iPark facilities is around RM1.2b. The recent synergistic move of this customer with an e-commerce giant could also be a door-opening opportunity for the group to venture into the new ecosystem.

• Eyeing new contracts; discussion still in infancy stage.

We understand that VS is still being approached by new MNC customers, with discussions of prospective contracts at the early stages of evaluation. Based on the recent customer acquisition trend, we believe any prospective contracts could carry better margins. We are not assuming any new customer wins for now. Assuming an RM500m contract being secured with full contribution in FY24 on a net margin of 5.9%, the earnings accretion would be 10%.

• Sowing seeds for expansion.

Besides building up inventories to minimise supply chain disruption and facilitating new orders (hence the record-high inventory level), VS had on 8 Jul 22 proposed the establishment of an Islamic Medium Term Notes programme of up to RM1.0b in nominal value based on the shariah principle of Wakalah Bi Al-Istithmar. We take comfort from the announcement, acknowledging that any potential expansion would require additional working capital and capex. Meanwhile, its current net gearing ratio sits comfortably at 0.1x.

EARNINGS REVISION/RISK

- We cut FY23-24 earnings estimates by 5-19% to account for lower sales assumption.

VALUATION/RECOMMENDATION

- **Maintain BUY with a lower SOTP-based target price of RM1.20.** This is after we assume full warrants conversion which resulted in an enlarged share price, alongside cash per share from the warrants conversion. VS is now back to its high-growth cycle again, offering a two-year net profit CAGR of 20% (from FY22-24), notwithstanding the new meaningful contracts pipeline for VS.

ENVIRONMENTAL, SOCIAL, GOVERNANCE (ESG)

• Environmental <ul style="list-style-type: none"> - VS has been certified with the ISO 14001:2015 Environment Management System for assembly services for mechanical and electrical products.
• Social <ul style="list-style-type: none"> - VS held an In-House Vaccination Programme in Aug 21 and achieved a 99.8% vaccination record for the entire workforce. - It is engaging with migrant worker rights specialists and independent auditor proactively for the betterment migrant workers' welfare in Malaysia.
• Governance <ul style="list-style-type: none"> - The company has in place an Anti-Corruption Framework which fulfils the requirements in the Guidelines on Adequate Procedures to Section 17A (5) of the Malaysian Anti-Corruption Commission Act 2009.

SALES ASSUMPTION

Sales (RMm)	FY21	FY22	FY23F	FY24F
Key customer	2,021	1,730	2,380	2,554
Customer Z	370	470	400	439
China	161	80	72	65
Indonesia	350	328	344	327
New key customers	878	1020	850	1350
Others	222	287	254	266
Core net margin (%)	6.8%	5.2%	5.0%	5.9%

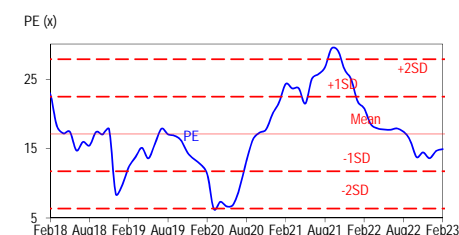
Source: UOB Kay Hian

SOTP TARGET PRICE

Assuming full warrants exercise	
FY23 Net Profit (RMm)	216.7
Weighted average share base (m)	3773.6
Assuming full warrants conversion	761.8
Enlarged share base (m)	4535.4
Fully-diluted EPS (sen)	4.8
TP at 17x FY23 FD PE	0.90
Total cash ex-conversion/share (RM)	0.03
Cash per share from warrants conversion (RM)	0.23
SoP TP	1.20

Source: UOB Kay Hian

FIVE-YEAR FORWARD PE BAND



Source: UOB Kay Hian

PROFIT & LOSS

Year to 31 Jul (RMm)	2022	2023F	2024F	2025F
Net turnover	3,914	4,299	5,002	5,364
EBITDA	334	424	532	580
Deprec. & amort.	121	117	121	126
EBIT	212	307	411	454
Associate contributions	(1)	(1)	(1)	(1)
Net interest income/(expense)	(10)	(15)	(15)	(15)
Pre-tax profit	202	291	395	438
Tax	(52)	(78)	(105)	(117)
Minorities	20	3	4	5
Net profit	171	217	294	326
Net profit (adj.)	205	217	294	326

BALANCE SHEET

Year to 31 Jul (RMm)	2022	2023F	2024F	2025F
Fixed assets	1,215	1,248	1,226	1,201
Other LT assets	299	298	297	296
Cash/ST investment	279	702	752	887
Other current assets	2,189	1,887	2,154	2,292
Total assets	3,981	4,135	4,430	4,676
ST debt	476	476	476	476
Other current liabilities	887	926	1,065	1,137
LT debt	149	149	149	149
Other LT liabilities	105	105	105	105
Shareholders' equity	2,193	2,312	2,473	2,651
Minority interest	171	167	163	158
Total liabilities & equity	3,981	4,135	4,430	4,676

CASH FLOW

Year to 31 Jul (RMm)	2022	2023F	2024F	2025F
Operating	(62)	721	284	382
Pre-tax profit	201	291	395	438
Tax	(85)	(78)	(105)	(117)
Deprec. & amort.	121	117	121	126
Working capital changes	(381)	390	(128)	(66)
Non-cash items	70	0	0	0
Other operating cashflows	12	1	1	1
Investing	(195)	(200)	(100)	(100)
Capex (growth)	(215)	(200)	(100)	(100)
Investments	0	0	0	0
Proceeds from sale of assets	8	0	0	0
Others	13	0	0	0
Financing	115	(98)	(133)	(148)
Dividend payments	(84)	(98)	(133)	(148)
Issue of shares	11	0	0	0
Proceeds from borrowings	n.a.	n.a.	n.a.	n.a.
Loan repayment	188	0	0	0
Others/interest paid	1	0	0	0
Net cash inflow (outflow)	(141)	423	51	134
Beginning cash & cash equivalent	402	279	702	752
Changes due to forex impact	17	0	0	0
Ending cash & cash equivalent	279	702	752	887

KEY METRICS

Year to 31 Jul (%)	2022	2023F	2024F	2025F
Profitability				
EBITDA margin	8.5	9.9	10.6	10.8
Pre-tax margin	5.2	6.8	7.9	8.2
Net margin	4.4	5.0	5.9	6.1
ROA	4.5	5.3	6.9	7.2
ROE	8.1	9.6	12.3	12.7
Growth				
Turnover	(2.2)	9.8	16.3	7.2
EBITDA	(23.9)	27.0	25.5	8.8
Pre-tax profit	(38.6)	44.0	35.7	10.8
Net profit	(30.5)	27.0	35.7	10.8
Net profit (adj.)	(24.7)	5.7	35.7	10.8
EPS	(36.4)	5.7	35.7	10.8
Leverage				
Debt to total capital	20.9	20.1	19.2	18.2
Debt to equity	28.5	27.0	25.3	23.6
Net debt/(cash) to equity	15.8	(3.3)	(5.2)	(9.9)
Interest cover (x)	34.5	28.2	35.4	38.5

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