

Malaysia

ADD (no change)

Consensus ratings*: Buy 10 Hold 1 Sell 1

Current price:	RM0.99
Target price:	RM1.33
Previous target:	RM1.33
Up/downside:	33.9%
CGS-CIMB / Consensus:	1.7%

Reuters:	VSID.KL
Bloomberg:	VSI MK
Market cap:	US\$898.9m
	RM3,779m
Average daily turnover:	US\$2.81m
	RM11.80m
Current shares o/s:	3,812m
Free float:	60.3%

*Source: Bloomberg

Key changes in this note

➤ No change.



Source: Bloomberg

Price performance	1M	3M	12M
Absolute (%)	-13.9	-25.6	-30
Relative (%)	-12.3	-28.2	-28.4

Major shareholders	% held
Beh/Gan Family	28.1
KWAP	11.4

Analyst(s)



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VS Industry Bhd

May be stormy now but it can't rain forever

- We view the margin inefficiencies impacting VSI as transitory and anticipate a much stronger FY23F from alleviation of its supply chain disruptions.
- Share price correction of 26% YTD likely prices in most of the negatives surrounding the EMS industry and provides an attractive entry point.
- Reiterate Add with a TP of RM1.33 (15.7x CY23F P/E, 5-year mean).

2Q continues to be affected by the same culprits

To recap, VS Industry's (VSI) 2QFY22 core net profit fell 32.2% yoy despite a 1.5% yoy revenue increase. At its recent analyst briefing, the company shared that the main reasons for this drop were the same as in 1Q: i) semiconductor shortages, which led to a surge in material costs for printed circuit board assembly (PCBA) operations, resulting in losses at this division, ii) supply chain disruptions from labour shortages, which led to operational inefficiencies as well as higher labour costs, and iii) suboptimal production levels for its newest US-based key customer, which started production in 1QFY22, ultimately leading to continued losses for this line as it was unable to offset depreciation costs associated with the new facilities set up for this customer. However, on a qoq basis, core net profit rose 13% on stronger qoq sales momentum for 2QFY22.

Production hindrances unlikely to affect its longer-term prospects

VSI said that its higher raw material costs in the 2Q are partially a result of a time lag in passing on the cost to customers, and does not foresee any obstacles in passing on the higher costs to customers in the coming quarters. VSI further shared that it remains cautiously hopeful that labour shortages will ease in the next 2-3 months. VSI has a foreign worker quota of 3.7k and should not face any major hurdles in bringing in workers and assimilating them into their operations once the government approves foreign worker recruitment. All in all, the group anticipates a much stronger qoq improvement in 4QFY22F revenue and profits owing to a i) ramp-up of box-built assembly for its newest customer, Customer Y, which should lead to profits for this line, ii) alleviation of labour shortages leading to better operating margins as well as iii) a higher fulfillment rate for its other key customers.

Negatives mostly priced in, VSI offers 34% upside to our TP

We remain positive on VSI's FY23-24F earnings growth prospects, which are mainly driven by its robust order flows outlook as well as a gradual replenishment of its workforce going into FY23F (page 2). Moreover, we have not factored in any earnings potential from new customers so far, for which VSI is actively in discussions. We conservatively estimate potential FY23F core EPS accretion of 11-18% should the group be successful in securing a new customer, based on average new contract wins of RM500m-800m. While we see a weak FY22F owing to margin compression from supply chain disruptions, we believe most of the negatives surrounding the stock have been baked into the share price (-26% YTD), providing an attractive entry at this juncture. The stock trades at an appealing FY23-24F P/E of 9-13x vs. 5-year mean of 15.7x.

Financial Summary	Jul-20A	Jul-21A	Jul-22F	Jul-23F	Jul-24F
Revenue (RMm)	3,243	4,002	4,437	5,322	6,252
Net Profit (RMm)	116.5	245.5	182.2	287.9	405.2
Normalised EPS (RM)	0.04	0.07	0.05	0.08	0.11
Normalised EPS Growth	(31%)	100%	(33%)	58%	41%
FD Normalised P/E (x)	28.02	13.98	20.72	13.11	9.31
Price To Sales (x)	1.16	0.94	0.85	0.71	0.60
DPS (RM)	0.026	0.042	0.016	0.025	0.036
Dividend Yield	2.63%	4.24%	1.62%	2.55%	3.59%
EV/EBITDA (x)	13.69	8.45	10.40	7.29	5.32
P/FCFE (x)	35.9	123.6	21.1	18.5	11.8
Net Gearing	(8.1%)	0.1%	(2.9%)	(5.8%)	(10.6%)
P/BV (x)	2.21	1.85	1.76	1.62	1.47
ROE	8.1%	14.4%	8.7%	12.9%	16.6%
Normalised EPS/consensus EPS (x)			0.82	0.91	1.16

SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS



May be stormy now but it can't rain forever

Other key highlights from the briefing ►

- VSI has a c.3,700 foreign worker quota (leftover quota since before the movement control orders, MCO, in Mar 2020) that it is able to utilise to recruit foreign workers. The group remains hopeful about the labour situation given the recent news that the Malaysian government is signing MOUs with Indonesia and Bangladesh and believes it can recruit foreign workers going into 3QFY22.
- VSI shared that it has been actively recruiting local workers to replace the loss of their foreign workers, but face production inefficiencies as a result of the high attrition rate among local workers.
- As for component shortages, VSI has been actively managing and planning inventory requirements and maintains a higher buffer of finished goods inventory.
- VSI clarified that the negative operating cashflow of RM68m was a result of delays in deliveries to customers owing to a shortage of shipping containers.
- We gather that total all-in recruitment costs for foreign workers average c.RM10k per worker. Assuming it brings in all 3,700 foreign workers in FY22F, this could amount to a total one-off recruitment cost of RM37m, which we have yet to factor into our forecasts.
- VSI expects its PCBA operations to still be affected by semiconductor chip shortages in 3QFY22F but believes the situation will ease slightly going into 4Q.
- As for the new contract wins (3 new models) it secured from Customer X in 1HFY22, the group shared that it does not anticipate high start-up or learning curve costs as they are essentially existing models in the market that were transferred over from other contract manufacturers.
- VSI projects minimal RM1m-2m impact from the Cukai Makmur tax in FY22F.

Outlook and valuations►

We believe FY22F core EPS will decline 33% yoy, mainly given continued disruptions to its production from labour and component shortages for the rest of FY22F. We only anticipate a gradual replenishment of its workforce going into FY23F onwards and we estimate that the component shortages, semiconductor components in particular, are likely to continue to plague the industry well into 1HFY23F. This underpins our weaker EBITDA margins of 8.3%/9.7% in FY22/23F, relative to its FY21 EBITDA margin of 11.6%.

Nevertheless, we remain positive on VSI's FY23-24F earnings growth prospects, which are mainly driven by its robust order flows outlook as well as a gradual replenishment of its workforce going into FY23F, with a full replenishment possibly by end of 1HFY23F. We are aware that there are concerns in the investing community over the potential pull-out or deceleration of order flows by VSI's key customers owing to the group's inability to deliver goods on time but we are not too worried on this front as we gather that its key customers are cognisant of the production hindrances, the labour shortages in particular, that are plaguing the entire EMS industry.

Despite the near-term uncertainties faced by the group, we reiterate our Add call as we believe that most of the negatives surrounding the stock have been baked into the share price (-26% YTD), providing an attractive entry point at this juncture. Our TP of RM1.33 for VSI is based on 15.7x CY23F P/E, in line with its historical 5-year mean P/E. We continue to like VSI for its diversified customer base, robust order flow outlook as well as undemanding valuations. VSI trades at an attractive 12M FWD P/E of 12x, which is close to 1 s.d. below its 5-year mean.

The securing of new clients, especially for its China operations as well as the signing of the MOU between the Malaysian and Indonesia government on foreign worker recruitment are key potential re-rating catalysts. Downside risks include lower-than-expected end-demand for its products and higher learning curve costs for production works for its new customers.

Figure 1: VSI trades at 12M forward P/E of 1 s.d. below its 5-year mean of 15.7x



ESG in a nutshell

[DBL-Click to DEL Table](#)



VSI is one of the largest electronic manufacturing services (EMS) players in South East Asia and is involved in the manufacturing, assembly and sale of plastic mould components and parts. It also has an electronic product business division. VSI aims to deliver sustainable shared value via five pillars: Environment, Welfare of Employees, Community, Marketplace and Suppliers. VSI has been included in the FTSE4Good Bursa Malaysia Index since Jun 2018.

Keep your eye on

VSI recently worked with migrant worker rights specialist Andy Hall to address any potential gaps it faced in its labour practices. They had both identified potential labour issues that could be present among VSI's workers hired through the Recalibrated Worker programme. Pursuant to that, VSI hired PwC to conduct an independent social compliance audit (based on the 11 International Labour Organization (ILO) indicators of forced labour), which will encompass all of VSI's workers, both local and foreign.

Implications

We believe the audit findings will remain a key focus area among investors. We believe any potential issues raised in the audit will allow VSI to address these gaps, which could potentially serve as an unwritten certification that VSI's operations have zero elements of forced labour. This will not only reduce the risk of loss of key customers but could also serve as a strong re-rating catalyst for the stock, in our view. We have lowered our P/E valuations to partially reflect the ESG risks present in this development.

ESG highlights

On the environmental front, VSI allocates resources to waste management, particularly the handling of non-scheduled waste. The volume of recycled waste at VSI increased by 26.7% in FY20 (vs. FY19). Noise pollution and air emissions are less of an issue for VSI compared with other manufacturing companies.

Implications

We believe that VSI's focus on maintaining its competitiveness as a manufacturing partner requires it to continuously improve its manufacturing practices. This includes the implementation of a lean manufacturing programme, which targets to reduce wasteful processes, materials and defects in its production.

Trends

Given the increasing attention on forced labour practices in Malaysia and South East Asia, VSI's treatment and sourcing of labour will be a key trend to watch. Changes in government policies regarding labour, including sourcing requirements and minimum wages, will impact VSI.

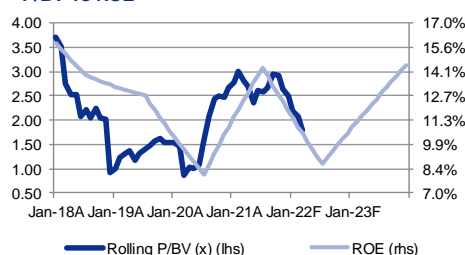
Implications

In addition to adhering to stringent labour standards, VSI invested in new machines and equipment to increase automation and boost the productivity of its workforce. A portion of the RM64m capital expenditure it spent in FY20 was utilised for investments in new technology and initiatives to boost productivity. Additionally, VSI is investing in the construction of new hostels, which cost approximately RM30m for FY23F. The hostels comply with the Workers' Minimum Standards of Housing and Amenities Act, 1990 (No. 446).

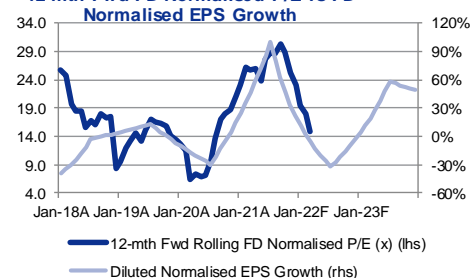
SOURCES: CGS-CIMB RESEARCH, REFINITIV

BY THE NUMBERS

P/BV vs ROE



12-mth Fwd FD Normalised P/E vs FD Normalised EPS Growth



Profit & Loss

(RMm)	Jul-20A	Jul-21A	Jul-22F	Jul-23F	Jul-24F
Total Net Revenues	3,243	4,002	4,437	5,322	6,252
Gross Profit	321	527	399	532	625
Operating EBITDA	271	463	370	517	680
Depreciation And Amortisation	-92	-101	-119	-126	-130
Operating EBIT	179	362	251	391	550
Financial Income/(Expense)	-10	-7	-6	-2	-1
Pretax Income/(Loss) from Assoc.	2	-1	0	2	2
Non-Operating Income/(Expense)	0	0	0	0	0
Profit Before Tax (pre-EI)	171	354	245	390	551
Exceptional Items	-18	-24	0	0	0
Pre-tax Profit	153	329	245	390	551
Taxation	-49	-88	-66	-105	-149
Exceptional Income - post-tax					
Profit After Tax	104	242	179	285	402
Minority Interests	12	4	3	3	3
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax					
Preference Dividends (Australia)					
Net Profit	116	246	182	288	405
Normalised Net Profit	122	266	179	285	402
Fully Diluted Normalised Profit	134	270	182	288	405

Cash Flow

(RMm)	Jul-20A	Jul-21A	Jul-22F	Jul-23F	Jul-24F
EBITDA	270.9	463.1	369.7	516.7	679.8
Cash Flow from Inv. & Assoc.					
Change In Working Capital	71.2	(270.8)	19.5	(156.4)	(160.5)
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense	57.8	11.3	11.3	11.3	11.3
Other Operating Cashflow					
Net Interest (Paid)/Received	(10.2)	(7.3)	(5.7)	(2.3)	(0.9)
Tax Paid	(49.2)	(100.7)	(66.3)	(105.4)	(148.8)
Cashflow From Operations	340.4	95.6	328.6	263.9	381.0
Capex	(115.6)	(233.6)	(150.0)	(60.0)	(60.0)
Disposals Of FAs/subsidiaries	13.4	10.5	0.0	0.0	0.0
Acq. Of Subsidiaries/investments	(9.5)	3.8	0.0	0.0	0.0
Other Investing Cashflow	2.9	6.1	0.0	0.0	0.0
Cash Flow From Investing	(108.9)	(213.2)	(150.0)	(60.0)	(60.0)
Debt Raised/(repaid)	(126.8)	148.1	0.0	0.0	0.0
Proceeds From Issue Of Shares	20.5	49.2	0.0	0.0	0.0
Shares Repurchased	0.0	0.0	0.0	0.0	0.0
Dividends Paid	(48.1)	(105.7)	(72.9)	(115.2)	(162.1)
Preferred Dividends					
Other Financing Cashflow	(15.2)	(0.1)	(11.3)	(11.3)	(11.3)
Cash Flow From Financing	(169.5)	91.6	(84.1)	(126.4)	(173.4)
Total Cash Generated	62.0	(26.1)	94.4	77.4	147.6
Free Cashflow To Equity	104.8	30.5	178.6	203.9	321.0
Free Cashflow To Firm	248.8	(106.3)	189.9	215.2	332.2

SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

BY THE NUMBERS... cont'd

Balance Sheet

(RMm)	Jul-20A	Jul-21A	Jul-22F	Jul-23F	Jul-24F
Total Cash And Equivalents	405	402	471	548	696
Total Debtors	884	992	1,094	1,312	1,542
Inventories	332	637	664	787	925
Total Other Current Assets	106	201	201	201	201
Total Current Assets	1,727	2,232	2,430	2,849	3,364
Fixed Assets	847	990	1,052	991	926
Total Investments	152	267	267	267	267
Intangible Assets	0	0	0	0	0
Total Other Non-Current Assets	107	109	109	109	109
Total Non-current Assets	1,107	1,366	1,428	1,367	1,302
Short-term Debt	224	316	316	316	316
Current Portion of Long-Term Debt					
Total Creditors	576	847	996	1,181	1,387
Other Current Liabilities	39	37	37	37	37
Total Current Liabilities	839	1,200	1,349	1,534	1,740
Total Long-term Debt	28	89	89	89	89
Hybrid Debt - Debt Component					
Total Other Non-Current Liabilities	24	24	24	24	24
Total Non-current Liabilities	52	112	112	112	112
Total Provisions	66	68	68	68	68
Total Liabilities	957	1,381	1,529	1,715	1,921
Shareholders' Equity	1,709	2,041	2,150	2,323	2,566
Minority Interests	168	177	177	177	177
Total Equity	1,877	2,218	2,327	2,500	2,743

Key Ratios

	Jul-20A	Jul-21A	Jul-22F	Jul-23F	Jul-24F
Revenue Growth	(18.5%)	23.4%	10.9%	19.9%	17.5%
Operating EBITDA Growth	(18.1%)	70.9%	(20.2%)	39.7%	31.6%
Operating EBITDA Margin	8.4%	11.6%	8.3%	9.7%	10.9%
Net Cash Per Share (RM)	0.040	(0.001)	0.017	0.038	0.076
BVPS (RM)	0.45	0.54	0.56	0.61	0.67
Gross Interest Cover	10.37	32.04	22.24	34.61	48.72
Effective Tax Rate	31.9%	26.6%	27.0%	27.0%	27.0%
Net Dividend Payout Ratio	35.8%	39.2%	40.0%	40.0%	40.0%
Accounts Receivables Days	106.0	85.6	85.8	82.5	83.5
Inventory Days	44.05	50.85	58.77	55.29	55.69
Accounts Payables Days	80.41	74.73	83.28	82.94	83.53
ROIC (%)	7.7%	16.5%	9.3%	14.2%	19.1%
ROCE (%)	8.3%	15.0%	9.4%	13.8%	18.1%
Return On Average Assets	4.43%	8.45%	4.92%	7.10%	9.07%

Key Drivers

	Jul-20A	Jul-21A	Jul-22F	Jul-23F	Jul-24F
Customer X (RM m)	1,300.0	1,275.6	1,403.2	1,613.7	1,855.7
Coffee Brewer Customer (RM m)	715.0	717.5	717.5	753.4	791.1
Pool Cleaner Customer (RM m)	227.0	358.8	394.6	453.8	521.9
US-Based customer (RM m)	162.0	797.3	956.7	1,052.4	1,157.6
Customer Y (US-Based) (RM m)	-	-	150.0	550.0	900.0
Others (RM m)	164.3	318.9	334.8	351.6	386.7
Blended EBITDA margin (%)	8.4%	11.6%	8.3%	9.7%	10.9%

SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

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Score Range:	90 - 100	80 - 89	70 - 79	Below 70	No Survey Result
Description:	Excellent	Very Good	Good	N/A	N/A

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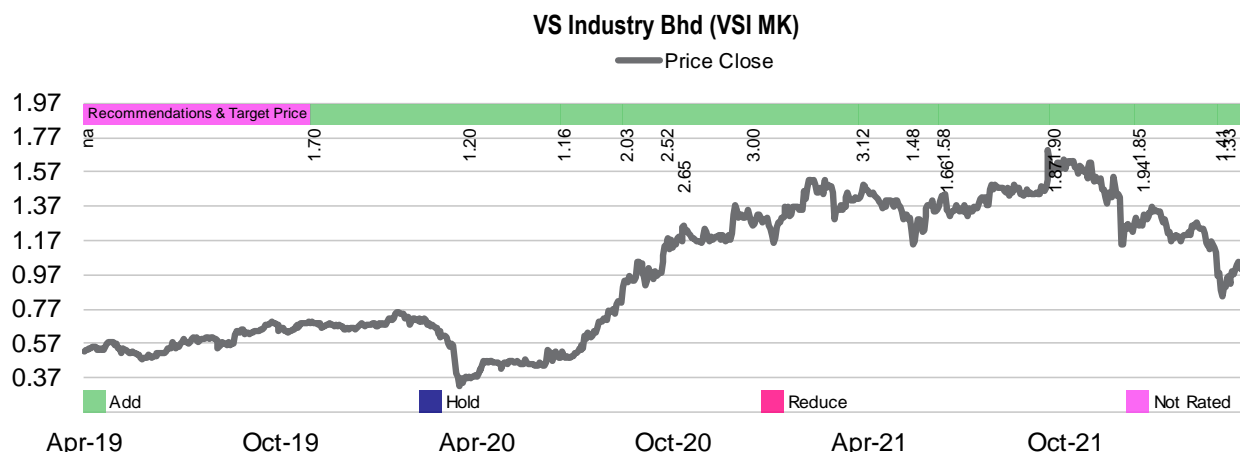
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619 companies under coverage for quarter ended on 31 December 2021		
	Rating Distribution (%)	Investment Banking clients (%)
Add	71.1%	1.5%
Hold	21.8%	0.0%
Reduce	7.1%	0.0%

Spitzer Chart for stock being researched (2 year data)



Corporate Governance Report of Thai Listed Companies (CGR). CG Rating by the Thai Institute of Directors Association (Thai IOD) in 2021, Anti-Corruption 2021

ADVANC – Excellent, Certified, **AMATA** – Excellent, Certified, **ANAN** – Excellent, n/a, **AOT** – Excellent, n/a, **AP** – Excellent, Certified, **ASP** – Excellent, n/a, **AWC** – Excellent, Declared, **AU** – Good, n/a, **BAM** – Very Good, Certified, **BAY** – Excellent, Certified, **BBL** – Excellent, Certified, **BCH** – Very Good, Certified, **BCP** – Excellent, Certified, **BCPG** – Excellent, Certified, **BDMS** – Excellent, n/a, **BEAUTY** – Good, n/a, **BEM** – Excellent, n/a, **BH** – Good, n/a, **BJC** – Very Good, n/a, **BLA** – Very Good, Certified, **BTS** – Excellent, Certified, **CBG** – Very Good, n/a, **CCET** – n/a, n/a, **CENTEL** – Excellent, Certified, **CHAYO** – Very Good, n/a, **CHG** – Very Good, n/a, **CK** – Excellent, n/a, **COM7** – Excellent, Certified, **CPALL** – Excellent, Certified, **CPF** – Excellent, Certified, **CPN** – Excellent, Certified, **CPNREIT** – n/a, n/a, **CRC** – Excellent, Declared, **DELTA** – Excellent, Certified, **DDD** – Excellent, n/a, **DIF** – n/a, n/a, **DOHOME** – Very Good, Declared, **DREIT** – n/a, n/a, **DTAC** – Excellent, Certified, **ECL** – Excellent, Certified, **EGCO** – Excellent, Certified, **EPG** – Excellent, Certified, **ERW** – Very Good, Certified, **GFPT** – Excellent, Certified, **GGC** – Excellent, Certified, **GLOBAL** – Excellent, n/a, **HANA** – Excellent, Certified, **HMPRO** – Excellent, Certified, **HUMAN** – Good, n/a, **ICHI** – Excellent, Certified, **III** – Excellent, Declared, **INTUCH** – Excellent, Certified, **IRPC** – Excellent, Certified, **ITD** – Very Good, n/a, **IVL** – Excellent, Certified, **JASIF** – n/a, n/a, **JKN** – n/a, Certified, **JMT** – Very Good, n/a, **KBANK** – Excellent, Certified, **KCE** – Excellent, Certified, **KEX** – Very Good, Declared, **KKP** – Excellent, Certified, **KSL** – Excellent, Certified, **KTB** – Excellent, Certified, **KTC** – Excellent, Certified, **LH** – Excellent, n/a, **LPN** – Excellent, Certified, **M** – Very Good, Certified, **MAKRO** – Excellent, Certified, **MC** – Excellent, Certified, **MEGA** – Very Good, n/a, **MINT** – Excellent, Certified, **MTC** – Excellent, Certified, **NETBAY** – Very Good, n/a, **NRF** – Very Good, Declared, **OR** – Excellent, n/a, **ORI** – Excellent, Certified, **OSP** – Excellent, n/a, **PLANB** – Excellent, Certified, **PRINC** – Very Good, Certified, **PR9** – Excellent, Declared, **PSH** – Excellent, Certified, **PTT** – Excellent, Certified, **PTTEP** – Excellent, n/a, **PTTGC** – Excellent, Certified, **QH** – Excellent, Certified, **RAM** – n/a, n/a, **RBF** – Very Good, n/a, **RS** – Excellent, Declared, **RSP** – Good, n/a, **S** – Excellent, n/a, **SAK** – Very Good, Declared, **SAPPE** – Very Good, Certified, **SAWAD** – Very Good, n/a, **SCB** – Excellent, Certified, **SCC** – Excellent, Certified, **SCGP** – Excellent, Declared, **SECURE** – n/a, n/a, **SHR** – Excellent, n/a, **SIRI** – Excellent, Certified, **SPA** – Very Good, n/a, **SPALI** – Excellent, Certified, **SPRC** – Excellent, Certified, **SSP** – Good, Certified, **STEC** – Excellent, n/a, **SVI** – Excellent, Certified, **SYNEX** – Very Good, Certified, **TCAP** – Excellent, Certified, **THANI** – Excellent, Certified, **TIDLOR** – n/a, Certified, **TISCO** – Excellent, Certified, **TKN** – Very Good, n/a, **TOP** – Excellent, Certified, **TRUE** – Excellent, Certified, **TTB** – Excellent, Certified, **TU** – Excellent, Certified, **TVO** – Excellent, Certified, **VGI** – Excellent, Certified, **WHA** – Excellent, Certified, **WHART** – n/a, n/a, **WICE** – Excellent, Certified, **WORK** – Good, n/a.

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Definition:

- Add** The stock's total return is expected to exceed 10% over the next 12 months.
- Hold** The stock's total return is expected to be between 0% and positive 10% over the next 12 months.
- Reduce** The stock's total return is expected to fall below 0% or more over the next 12 months.

The total expected return of a stock is defined as the sum of the: (i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.

Sector Ratings

Definition:

- Overweight** An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation.
- Neutral** A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
- Underweight** An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

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Definition:

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