

V.S. Industry (VSI MK)

Pass (but with room for improvement)

No evidence of systemic forced labour practices

The independent review of VSI's labour practices by PWC has finally concluded, with no evidence of systemic forced labour practices identified. We maintain our earnings assumptions and TP of MYR1.07, derived by pegging its fully-diluted FY23E EPS of 6.4 sen to a PER multiple of 16.7x, in-line with the company's 5Y historical PER mean. We prefer ATECH (BUY, TP: MYR2.03) as our top EMS pick.

To improve on accommodation and communication

To recap, the review was a holistic labour practice assessment carried out jointly by PWC and a labour rights consultant, among others, including to examine any potential forced labour conducts within the group, based on the 11 indicators by the International Labour Organization (ILO). While there are no major red flags identified, some areas for improvement were highlighted, namely, matters relating to recruitment fees, accommodation and effective communication. Remediation plans were carried out to rectify the issues - VSI has fully reimbursed the recruitment fees paid by workers who joined prior to 2017, and its existing workforce no longer has workers hired through third-party subcontractors.

Positive outcome offset by recession fears

The favourable review findings are a positive development for VSI. The outcome of the review will help alleviate investor concerns relating to the group's labour-associated risks. Nevertheless, we are not expecting this to have a substantial impact on the group's valuation at this juncture, as the stock's risk premium has risen on account of growing fears of recession. As a reference, SKP Resources' (VSI's other local peer, non-rated) share price has since moderated and is now trading -3% lower vs. the day before its announcement of a clean review completion, despite a short-term uptick of +6% in share price in the week after the announcement.

Remain neutral given the mixed outlook ahead

VSI is recovering from its labour-related operational disruptions. Apart from the review completion, it has also onboarded c. 1,000 foreign workers recently, with expectation to bring in another 2,700 foreign workers by September. While this can finally ease the labour shortage bottleneck, overhangs remain relating to inflationary pressures and growing fears of recession, which could affect its near-term margins and dampen consumer demand for the consumer electronic products it assembles, respectively.

FYE Jul (MYR m)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue	3,243	4,002	4,356	4,940	5,364
EBITDA	227	439	355	471	552
Core net profit	105	274	182	277	342
Core FDEPS (sen)	2.8	7.3	4.3	6.4	7.8
Core FDEPS growth(%)	(74.5)	161.1	(40.4)	48.0	22.5
Net DPS (sen)	2.6	3.7	2.1	3.1	3.9
Core FD P/E (x)	25.0	19.0	22.4	15.2	12.4
P/BV (x)	1.5	2.6	1.7	1.6	1.5
Net dividend yield (%)	3.7	2.7	2.1	3.2	4.0
ROAE (%)	5.4	13.1	8.7	12.4	14.3
ROAA (%)	3.6	8.5	5.0	7.4	8.7
EV/EBITDA (x)	11.4	12.2	9.7	7.1	5.7
Net gearing (%) (incl perps)	net cash	1.2	net cash	net cash	net cash
Consensus net profit	-	-	185	277	353
MKE vs. Consensus (%)	-	-	(1.9)	0.0	(3.0)

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HOLD

Share Price	MYR 0.97
12m Price Target	MYR 1.07 (+13%)
Previous Price Target	MYR 1.07

Company Description

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

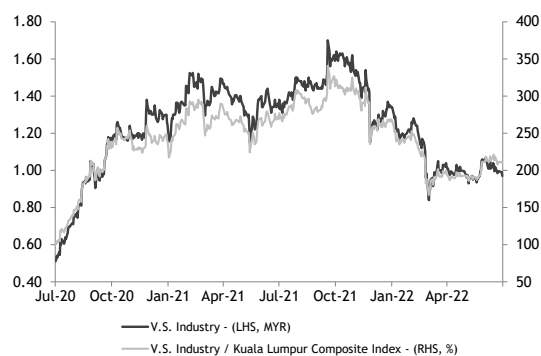
Statistics

52w high/low (MYR)	1.70/0.84
3m avg turnover (USDm)	1.1
Free float (%)	65.5
Issued shares (m)	3,838
Market capitalisation	MYR3.7B
	USD841M

Major shareholders:

Kumpulan Wang Persaraan	8.6%
BEH KIM LING	7.7%
BEH HWEE SZE	7.3%

Price Performance



	-1M	-3M	-12M
Absolute (%)	(8)	(5)	(28)
Relative to index (%)	(2)	6	(23)

Source: FactSet

Risk Rating & Score ¹	9.5 (negligible)
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 6th in ASEAN and consistently in the Global Top 50 for the past 15 years) with a proven track-record of manufacturing office and household E&E products for established global brand names.
- In our view, the company has solid credentials in complying with the many environmental, safety and regulatory standards in the jurisdictions it currently operates in. Although independent and female representation on its Board is relatively low, this is mitigated by its industry-leading fair employment, anti-discrimination and supply-chain sustainability policies.
- With its competent management team and continuous investments in spare production capacity, the company looks well positioned to take advantage of supply-chain relocation opportunities by multinational appliance manufacturers looking to relocate their base of operations to the ASEAN region as a result of the US-China trade war and pandemic induced lockdowns.

Material E issues

- All operational processes are certified ISO 14001:2015 - the global industry standard benchmark for environmental management measures. VSI has also been part of the FTSE4Good index since Jun 2018.
- Waste management: VSI has a set of standardised procedures under their Environmental Policy framework for both scheduled and non-scheduled waste management. Volume of recycled waste was up by 32% YoY in FY21 at 1,650 tonnes (FY20: 1,252 tonnes).
- Noise pollution - VSI uses systems that minimise noise from the onset and implements control techniques to ensure noise attenuation. Its noise levels at 6 of its' sites are all at acceptable level.
- Emissions intensity - VSI's emissions intensity of 0.048 kgCO_{2e}/kg/product has reduced by -36% YoY in FY21 (FY20: 0.075 kgCO_{2e}/kg/product).

Material S issues

- Sustainable supply chain: Has an established Supplier Code of Ethics in place. However, in FY21, the Group's engagement with local suppliers dropped slightly.
- Occupational safety & health (OSH) - the group is compliance with various OSH related acts and code of practices, including OSHA 1994, FMA 1967, EQA 1974, etc. It has a committee in place to regularly review the safety concerns and performances, and it conducts internal and external audits to verify the effective implementation of the related programmes and conformance to standards.
- Lost-time incident rate (LTIR) - the group's LTIR has improved significantly among both employees (FY21: 1; FY20: 9) and contractors (FY21: 0; FY20: 1).
- Employee diversity: In FY21, women's mix in VSI total workforce has increased to 48% (FY20: 43%). 71% of its workforce is under the age of 30. The turnover rate of VSI's full-time staff was 54% in FY21, of which 86% are direct labour.

Key G metrics and issues

- Independent directors currently make up 40% of the Board (4 out of 10). Although the composition is 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. The company acknowledges this shortcoming and will consider to meet the recommended threshold in the near future.
- Female representation on the board is currently lacking at only 10% or 1 of the 10 of the board members (vs. MCCG's recommendation of having at least 30% of women directors).
- VSI has none of its independent directors served a consecutive term of 9 years or more.
- The positions of Chairman and CEO are held by different individuals.
- Director's remuneration as a percentage of the group's total net profit has lowered to 13% (FY20: 25%).
- KPMG has been the external auditor for more than 23 years since the company listed on the Main Market of Bursa Malaysia 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 their entire allotted portion of 200 million rights issue shares (totalling HKD46 million) with proceeds intended for debt repayment, increase manufacturing capacity and working capital.
- Related-party transaction: In Sep 2020, VSI purchased a plot of vacant land for MYR5.07m from one of their executive directors cum substantial shareholder. The land, located close to their primary manufacturing facility, was appraised by an independent third-party and was deemed to be a vital part of the group's expansion plans.

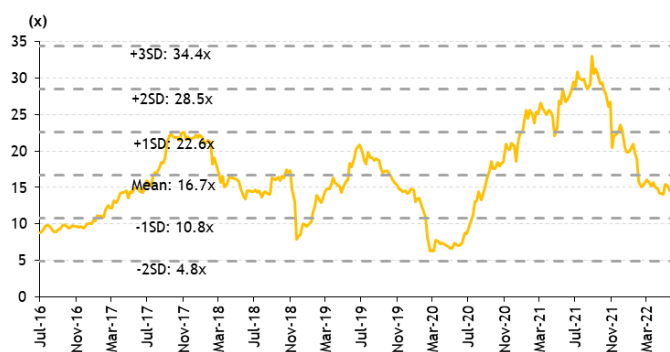
¹**Risk Rating & Score** - derived by Sustainalytics and assesses the company's exposure to unmanaged ESG risks. Scores range between 0 - 50 in order of increasing severity with low/high scores & ratings representing negligible/significant risk to the company's enterprise value, respectively, from ESG-driven 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).

Figure 1: Revenue forecasts for selected key customers

Customer	Revenue forecasts (MYR'm)		
	FY22E	FY23E	FY24E
Customer X	1,407	1,414	1,415
US-based	987	1,050	1,092
Coffeemaker	748	806	868
Pool cleaner	344	468	558
Customer Y (Home appliances)	200	400	500

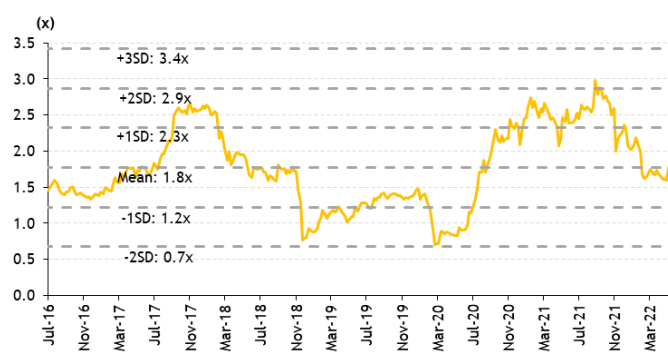
Source: Company, Maybank IBG Research

Figure 2: VSI's 12M forward PER (currently trades at 13.7x)



Source: Bloomberg, Maybank IBG Research

Figure 3: VSI's 12M forward P/BV (currently trades at 1.6x)



Source: Bloomberg, Maybank IBG Research

Risk statement

There are several risk factors for our earnings estimates, target price and rating for VSI. Key risks are: (i) weaker-than-expected consumer demand for VSI assembled products (on weakening economics outlook); (ii) lower-than-expected costs pass through (as the mechanism depends on the company's negotiation with its clients); (iii) persistent operational disruptions from labour issues and components shortage; and (iv) USD/MYR forex volatility (we estimate for every +/- 1% change in USD/MYR, bottom line impact is +/-0.5%). Potential upside includes (i) better-than-expected revenue from ramped up production (as labour and raw material shortage issue ease); (ii) new customer acquisitions; and (iii) improve margins from better efficiencies due to economics of scales.

FYE 31 Jul	FY20A	FY21A	FY22E	FY23E	FY24E
Key Metrics					
P/E (reported) (x)	24.3	19.1	20.3	13.4	10.8
Core P/E (x)	24.6	18.7	20.3	13.4	10.8
Core FD P/E (x)	25.0	19.0	22.4	15.2	12.4
P/BV (x)	1.5	2.6	1.7	1.6	1.5
P/NTA (x)	1.5	2.6	1.7	1.6	1.5
Net dividend yield (%)	3.7	2.7	2.1	3.2	4.0
FCF yield (%)	4.7	4.2	6.2	5.7	9.4
EV/EBITDA (x)	11.4	12.2	9.7	7.1	5.7
EV/EBIT (x)	19.2	15.8	14.7	9.5	7.2

INCOME STATEMENT (MYR m)

Revenue	3,243.2	4,002.3	4,356.2	4,940.4	5,364.1
EBITDA	226.7	438.6	354.9	470.8	552.0
Depreciation	(89.5)	(99.1)	(118.7)	(116.5)	(114.5)
Amortisation	(2.3)	(2.3)	(2.3)	(2.3)	(2.3)
EBIT	134.9	337.1	233.8	352.0	435.2
Net interest income / (exp)	(10.2)	(7.3)	(14.0)	(11.5)	(8.3)
Associates & JV	2.3	(0.7)	(0.7)	(0.7)	(0.7)
Other pretax income	0.0	0.0	0.0	0.0	0.0
Pretax profit	126.9	329.1	219.2	339.8	426.2
Income tax	(48.9)	(87.5)	(48.2)	(81.5)	(102.3)
Minorities	12.0	3.7	10.9	18.5	18.6
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	90.0	245.3	181.8	276.7	342.5
Core net profit	104.6	274.3	181.8	276.7	342.5

BALANCE SHEET (MYR m)

Cash & Short Term Investments	404.5	402.4	863.0	930.4	1,078.4
Accounts receivable	877.6	992.1	895.1	1,015.2	1,053.2
Inventory	331.8	633.8	409.1	453.9	477.0
Reinsurance assets	0.0	0.0	0.0	0.0	0.0
Property, Plant & Equip (net)	846.9	989.5	970.8	954.3	939.8
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	364.7	577.8	473.5	467.5	461.5
Total assets	2,825.5	3,595.6	3,611.4	3,821.2	4,010.0
ST interest bearing debt	215.4	318.8	318.8	318.8	318.8
Accounts payable	576.0	844.2	767.3	838.2	879.6
Insurance contract liabilities	0.0	0.0	0.0	0.0	0.0
LT interest bearing debt	47.0	109.4	109.4	109.4	80.4
Other liabilities	118.0	106.0	106.0	106.0	106.0
Total Liabilities	956.7	1,378.1	1,301.3	1,372.2	1,384.6
Shareholders Equity	1,702.4	2,040.5	2,144.0	2,301.4	2,496.3
Minority Interest	166.4	177.0	166.1	147.7	129.1
Total shareholder equity	1,868.8	2,217.5	2,310.1	2,449.1	2,625.4
Total liabilities and equity	2,825.5	3,595.6	3,611.4	3,821.2	4,010.0

CASH FLOW (MYR m)

Pretax profit	126.9	329.1	219.2	339.8	426.2
Depreciation & amortisation	91.8	101.5	121.1	118.8	116.8
Adj net interest (income)/exp	10.2	7.3	14.0	11.5	8.3
Change in working capital	79.0	(266.9)	23.7	(77.4)	(1.8)
Cash taxes paid	(48.9)	(87.5)	(48.2)	(81.5)	(102.3)
Other operating cash flow	(31.2)	358.5	0.7	0.7	0.7
Cash flow from operations	227.9	442.1	330.4	311.8	447.9
Capex	(107.2)	(227.3)	(100.0)	(100.0)	(100.0)
Free cash flow	120.7	214.8	230.4	211.8	347.9
Dividends paid	(48.1)	(105.7)	(78.4)	(119.3)	(147.6)
Equity raised / (purchased)	0.0	0.0	0.0	0.0	0.0
Change in Debt	5.1	19.2	0.0	0.0	(29.0)
Other invest/financing cash flow	(19.0)	(18.1)	(25.2)	(25.2)	(23.3)
Effect of exch rate changes	21.9	19.1	0.0	0.0	0.0
Net cash flow	80.7	129.2	126.8	67.4	148.1

FYE 31 Jul	FY20A	FY21A	FY22E	FY23E	FY24E
Key Ratios					
Growth ratios (%)					
Revenue growth	(18.5)	23.4	8.8	13.4	8.6
EBITDA growth	(25.0)	93.5	(19.1)	32.7	17.3
EBIT growth	(33.6)	149.9	(30.6)	50.5	23.6
Pretax growth	(30.2)	159.3	(33.4)	55.0	25.4
Reported net profit growth	(45.6)	172.5	(25.9)	52.2	23.8
Core net profit growth	(46.6)	162.2	(33.7)	52.2	23.8
Profitability ratios (%)					
EBITDA margin	7.0	11.0	8.1	9.5	10.3
EBIT margin	4.2	8.4	5.4	7.1	8.1
Pretax profit margin	3.9	8.2	5.0	6.9	7.9
Payout ratio	106.8	56.2	43.1	43.1	43.1
DuPont analysis					
Net profit margin (%)	2.8	6.1	4.2	5.6	6.4
Revenue/Assets (x)	1.1	1.1	1.2	1.3	1.3
Assets/Equity (x)	1.7	1.8	1.7	1.7	1.6
ROAE (%)	5.4	13.1	8.7	12.4	14.3
ROAA (%)	3.6	8.5	5.0	7.4	8.7
Liquidity & Efficiency					
Cash conversion cycle	68.2	60.5	51.9	38.9	39.0
Days receivable outstanding	103.9	84.1	78.0	69.6	69.4
Days inventory outstanding	43.3	50.0	47.8	35.6	35.9
Days payables outstanding	79.1	73.6	73.8	66.3	66.3
Dividend cover (x)	0.9	1.8	2.3	2.3	2.3
Current ratio (x)	2.0	1.9	2.0	2.1	2.2
Leverage & Expense Analysis					
Asset/Liability (x)	3.0	2.6	2.8	2.8	2.9
Net gearing (%) (incl perps)	net cash	1.2	net cash	net cash	net cash
Net gearing (%) (excl. perps)	net cash	1.2	net cash	net cash	net cash
Net interest cover (x)	13.2	46.0	16.7	30.5	52.2
Debt/EBITDA (x)	1.2	1.0	1.2	0.9	0.7
Capex/revenue (%)	3.3	5.7	2.3	2.0	1.9
Net debt/ (net cash)	(142.1)	25.8	(434.8)	(502.2)	(679.3)

Source: Company; Maybank IBG Research

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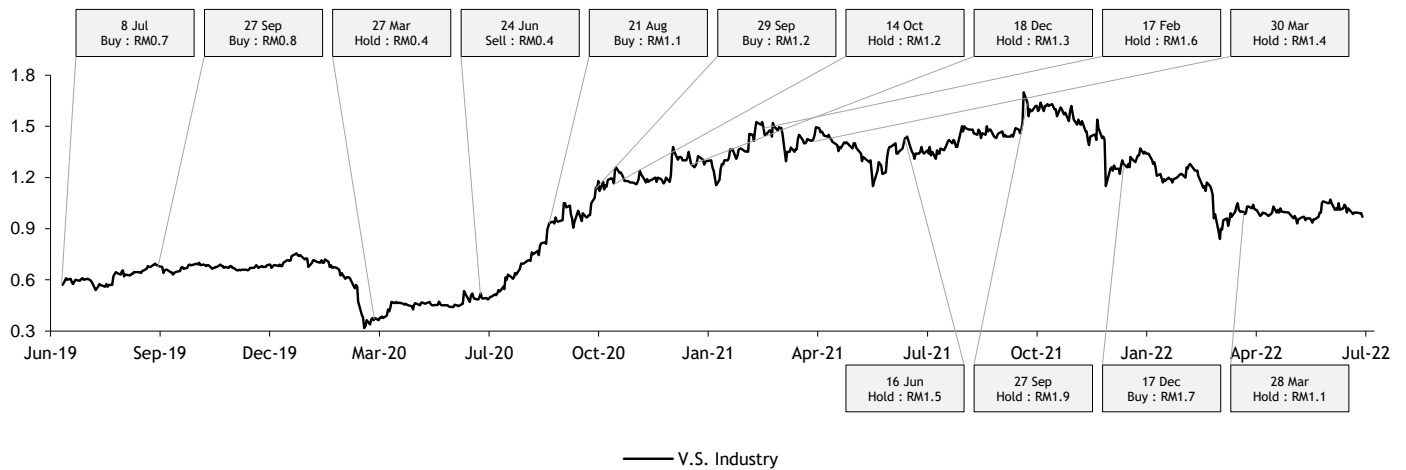
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