**MALAYSIA**
**INVESTMENT RESEARCH REPORT**
**KDN PP13226/04/2013 (032022)**

JF APEX SECURITIES BERHAD
(47680-X)

Initiating Coverage

8 July 2016

# V.S. Industry Berhad

***A force to be reckoned with***

***BUY***

**Target Price: RM1.50**

| | |
|---|---|
| **Share Price** | **RM1.18** |
| **Target Price** | **RM1.50** |

**Company Description**

V.S Industry Berhadn and its subsidiary manufacture, assemble, and sell plastic molded parts and electronics parts and components such as speakers and remote controls.

| **Stock Data** | |
|---|---|
| Bursa / Bloomberg code | 6963 / VSI MK |
| Board / Sector | Main / Ind-Prod |
| Syariah Compliant status | Yes |
| Issued shares (m) | 1169.92 |
| Par Value (RM) | 1.00 |
| Market cap. (RM'm) | 1380.51 |
| 52-week price Range | RM0.88-1.69 |
| Beta (against KLCI) | 0.67 |
| 3-m Average Daily Volume | 3.76m |
| 3-m Average Daily Value | RM4.58m |

**Share Performance**

| | 1m | 3m | 12m |
|---|---|---|---|
| Absolute (%) | -4.1 | 0.0 | 31.1 |
| Relative (%-pts) | -4.2 | -1.8 | 36.4 |

| **Major Shareholders** | **%** |
|---|---|
| Beh Kim Ling | 9.77 |
| BNP Paribas Wealth Mngt. | 8.77 |
| Gan Sem Yam | 6.91 |

**Historical Chart**


*Source: Bloomberg*

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## Investment Highlights

- **We initiate coverage on V.S. Industry (VS) with a target price of RM1.50, based on 12.5x FY2017F PE with diluted EPS of 12 sen.** We advise investors to accumulate the stock amid current share price weakness. Our fair value for VS renders 27% potential capital appreciation to investors coupled with its decent dividend yield of 4-5%.

- **Growth remains intact albeit absence of 'forex play'.** Despite share price falling 25% year-to-date due to rebound of MYR against USD and across-the-broad selling pressure on export oriented counters, we believe VS still commands a resilient business model, which is able to provide fully integrated assembly services for Electronics Manufacturing Services (EMS) ranging from plastic injection moulding, production of Printed Circuit Board (PCB), battery packs and sub/full assembly of consumer electronic products. It is a leading global EMS provider, ranked 31$^{st}$ largest in the world, according to the Manufacturing Market Insider, along with other prestigious names like Foxconn and Flextronics.

- **Commendable earnings growth and sturdy balance sheet.** VS is a fundamentally sound company, enjoying 5-year Compounded Annual Growth Rate (CAGR) of 19% for revenue and CAGR of 40% for headline net profit during FY10 till FY15. Going forward, we envisage the Group's core net earnings to grow by 29.9% to RM135.7m for FY16F and 20.6% to RM163.7m for FY17F with key earnings contribution from its three major clients, namely Dyson (vacuum cleaner), Keurig (coffee brewer) and Zodiac (robotic pool cleaner). Besides, VS commands a sturdy balance sheet with current low net gearing of 0.2x, which allows it to have ample flexibility to gear up for future capacity expansion and M&A.

- **Resumption of strong orders from Dyson.** Moving forward, we believe the Group could clinch more orders in respect of box build full assembly for the new model of vacuum cleaner from Dyson. The first Purchase Order (PO) could come in a few months time. We learnt that the Group could bag as much as RM300m new orders per annum from Dyson starting FY17F over a period of 3-5 years. Hence, this shall lift the Group's earnings by 12.6% for FY17F and 10.8% for FY18F. This is on top of existing Dyson models with job scope worth estimated RM650m in FY17F. Our earnings forecast has yet to factor in the potential contract win.

- **Inorganic growth to further expand its business and bottom line.** VS plans to embark on an acquisition strategy to level up its business. The Group may consider taking up a strategic stake in a healthcare and wellness company to reap the synergistic benefits. This could render sub/full assembly works worth RM180m yearly contract for VS under its China operation in addition to the profits from ownership stake in an immediate term. Should the acquisition materialise, it could contribute RM13m yearly net profit to the Group for FY17F onwards. Meanwhile, for the recent acquisition of 12.1% stake in Seeing Machines Ltd (SML), we expect VS to benefit from the R&D collaboration and manufacturing opportunity of the company in the longer run by participating in the Automotive Driver Monitoring System (DMS) and Driver Safety Solution (DSS).

- **Improving margin with profit turnaround in overseas operations.** Historically, VS' net margin of 3-5% was significantly below its peer of 6-9%, mainly dragged down by losses in overseas operations. Going forward, we reckon that the Group's profit margin would improve along with the anticipated profit turnaround in China and Indonesia operations. Indonesian market is expected to be profitable in FY16F (9MFY16: PBT of +RM4.8m vs FY15: PBT of –RM3.6m); whilst Chinese market is envisaged to breakeven in FY16F (9MFY16: PBT of +RM2.8m vs FY15: PBT of –RM7.6m). Thus, overall group's core net margin (excluding forex gain/loss) could improve to 6.5-7.0% for FY16-18F from 5.4% in FY15.
- **Attractive dividend yield.** The Group subscribes to minimum 40% net profit payout as its dividend policy with quarterly dividend declaration. We expect VS to reward shareholders with 4.8 sen/share for FY16F and 6.0 sen/share for FY17F, which translate into decent dividend yield of 4-5% based on current closing price. The Group is currently enjoying average utilisation rate of below 60%, which allows it to continue growing without incurring heavy capex for the coming years.

## Earnings Outlook

- **We estimate the Group's FY2016F, FY2017F and FY2018F core net earnings to trend positively, up 29.9%, 20.6% and 18.1% respectively** on the back of higher revenue achieved (FY16F: +9.1%; FY17F: +11.9% and FY18F: +16.9%). Furthermore, the Group's profit margin is expected to continue expanding in line with the turnaround in overseas operations.

## Valuation/Recommendation

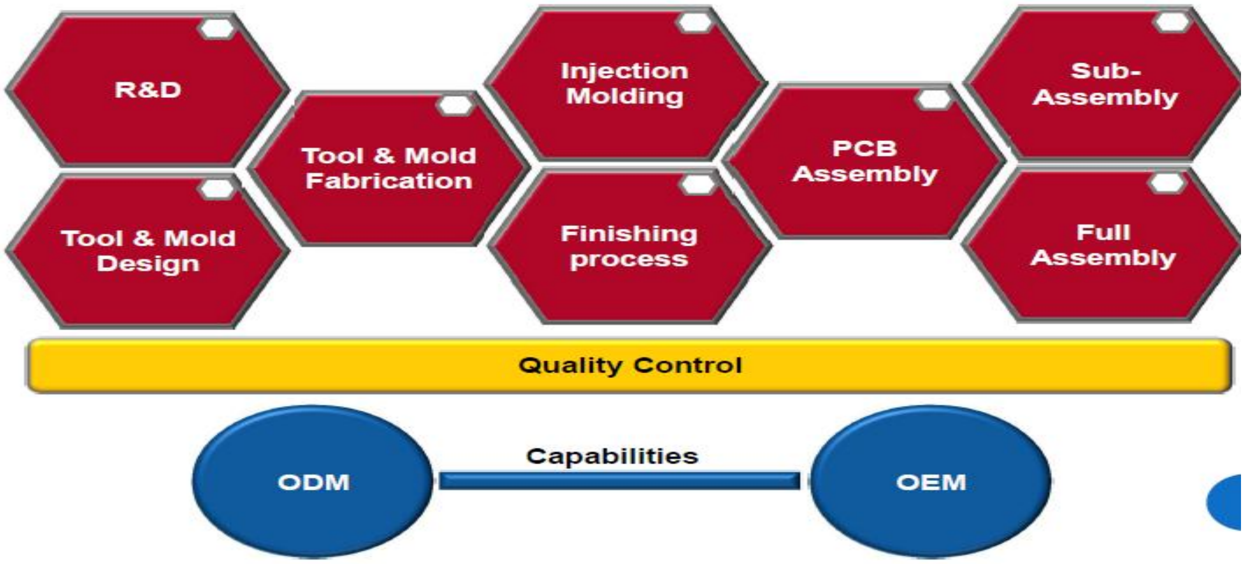
- **We initiate coverage on VS with a target price of RM1.50**, based on 12.5x FY2017F PE with diluted EPS forecast of 12 sen. The PER assigned for valuation of VS is at the sector average PE and +2 standard deviation above mean of historical PE of the Group.
- The target PE is warranted in view of the Group's capability of securing sizeable orders from Dyson and its potential strategic acquisition of a healthcare and wellness company under its China operation to further expand its earnings in FY17F.

## Company Background

VS is a leading global electronics manufacturing services (EMS) provider involved in plastic injection moulding, mould design and fabrication, production of Printed Circuit Board (PCB), sub-assembly and final product assembly of consumer electronic products. It is one of the world's top 50 Integrated EMS providers and top 5 largest EMS providers in ASEAN. VS also serves as original design manufacturer (ODM) & original equipment manufacturer (OEM) to customers who are mainly from the USA, Europe & Japan.

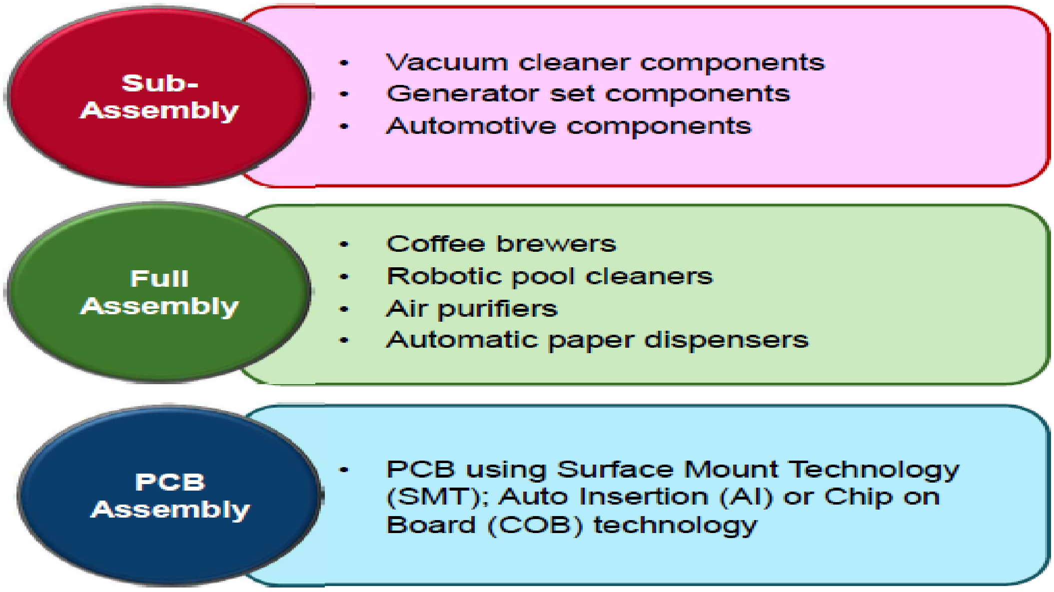
VS has more than 30 years of experience and track record, having established in 1982. Examples of finished and semi-finished products manufactured and/or assembled by the Group include coffee brewers, vacuum cleaners, automatic swimming pool cleaners, automotive plastic components, printed circuit boards, and battery packs etc.

**Figure 1: Integrated EMS Services Provider**




*Source: Company, JF Apex*

**Figure 2: Business Activities**




*Source: Company, JF Apex*

**Figure 3: Key Products**

*Source: Company, JF Apex*

VS' clientele comprises renowned multinational consumer product companies based in the US, Europe and Japan. Top 3 customers of VS contribute about 55% to turnover. No single customer contributes more than 30% to the Group revenue, minimizing risk of overly reliance on any one particular customer.

**Figure 4: Major Customers for Malaysian Operation**

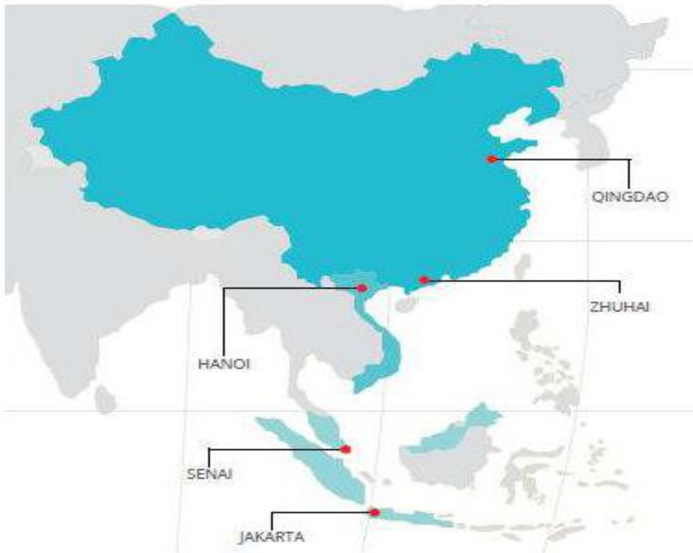

*Source: Company, JF Apex*

**Figure 5: Major Customers for Overseas Operations**


*Source: Company, JF Apex*

The Group has factories in Senai, Johor; Jakarta, Indonesia; Zhuhai and Qingdao, China; as well as Hanoi, Vietnam, with a combined production space in excess of 3m sq ft. The Group has about 10,000 staff, down from 15,000 staff several years ago, despite rising revenue. This was achieved through ongoing initiatives to increase automation as well as improvement in production process flow to increase efficiency.

**Figure 6: Overseas Operations and Production Capacity**



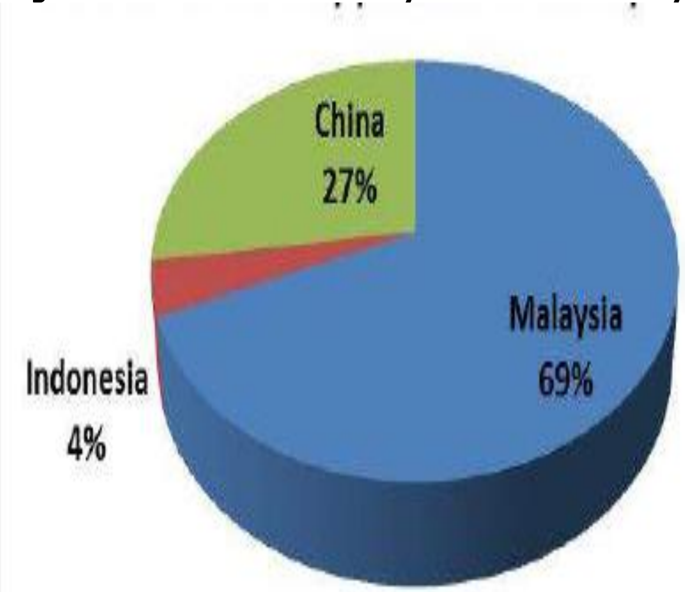

| LOCATION | DESCRIPTION |
|---|---|
| Johor, Malaysia | 8 facilities<br>1.3 mln sq. ft. BU<br>40 acres land |
| Zhuhai, China | 6 factories<br>1.5 mln sq. ft. BU<br>78 acres of land |
| Qingdao, China | 1 factory<br>416k sq. ft. BU<br>13 acres |
| Jakarta, Indonesia | 1 factory<br>247k sq. ft. BU<br>7 acres of land |
| Hanoi, Vietnam | 5 factories<br>463k sq. ft. BU<br>16 acres |

Total combined 3.5 mln sq. ft. built-up space with workforce of 10,000 people*

*Source: Company, JF Apex*

Geographically, Malaysia is the largest earnings contributor to the Group. Malaysian operation contributed close to 70% to the Group's topline with remaining 30% from China and Indonesian operations. Product wise, consumer electronic is the largest contributor to the Group's revenue with more than 90% of VS' output is for consumer products segment. The balance is made up of clients in automotive, medical devices, and machinery.

**Figure 7: FY15 Contribution by Production Country**




FY15 segmental profit mix

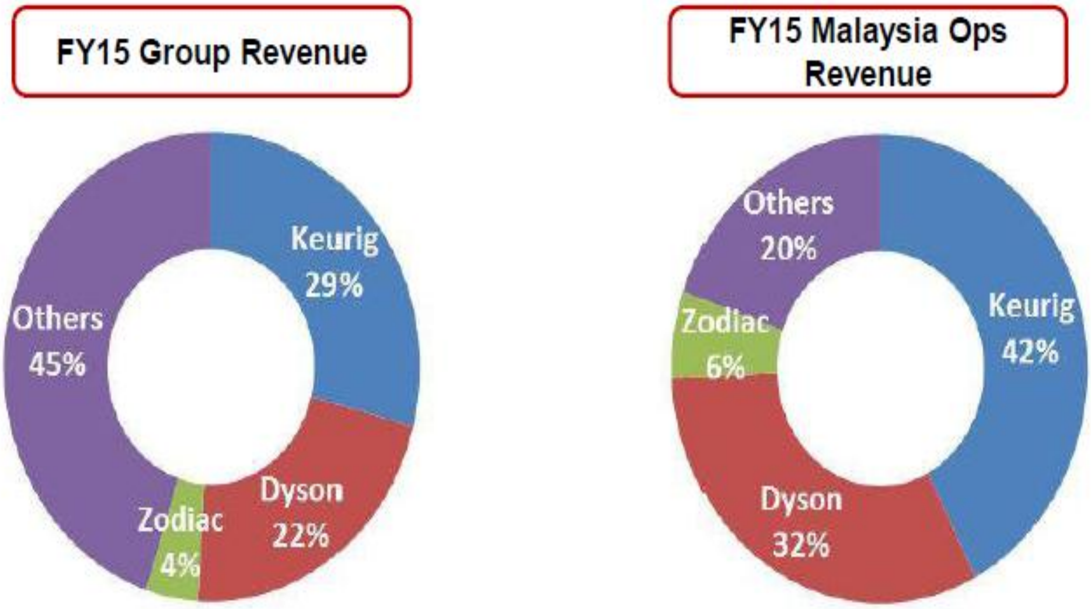
| Country | RM mln |
|---|---|
| Malaysia | 170.3 |
| Indonesia | (3.6) |
| China | (7.6) |

*Note: Vietnam ops is at associate level.*

*Source: Company, JF Apex*

Top 3 customers, namely, Keurig, Dyson and Zodiac contributed 55% of the Group's turnover and 80% of Malaysia's turnover. No single customer contributes more than 30% to the Group revenue, hence minimizing risk of overly reliance on any particular customer.

**Figure 8: Revenue Mix by Clients**




*Source: Company, JF Apex*

## SWOT Analysis

| Strengths | Weaknesses |
|---|---|
| • Leading EMS service provider with proven track record.<br>• Able to offer fully integrated services with OEM and ODM capabilities.<br>• Strong business relationship with Dyson and Keurig.<br>• Experienced management as founding members having over 30 years of experience in the industry.<br>• Ready to take on more orders with ample capacity as current utilisation rate is below 60%.<br>• Ongoing push for higher automation to increase productivity and reduce labour cost. | • Concentration risk with top three customers, Keurig, Dyson and Zodiac contribute 55% of the Group's FY15 revenue.<br>• Forex risk with strengthening of MYR against USD. VS is net beneficiary of appreciation of USD against MYR and vice versa. |
| **Opportunities** | **Threats** |
| • Inorganic growth stemming from potential M&A and organic growth with sizeable contracts to be won from existing clients.<br>• Strengthening of USD against MYR. VS is net beneficiary of appreciation of USD against MYR and vice versa.<br>• Turnaround of overseas operations especially in China and Indonesia. | • The Group's earnings could be affected by downturn in E&E industry.<br>• Intense competition in contract manufacturing may result in drop of profit margin.<br>• Impact of Brexit. |

## Industry Review/Outlook

The worldwide electronics manufacturing services (EMS) market is a determining force in production of electronics products and now accounts for almost 40 percent of all assembly. While the rate of growth for outsourcing is slowing, it still represents the most desired manufacturing model for the assembly of electronics products available to OEM companies. The EMS industry declined approximately 1.7 percent in 2015 as a result of the slowing of sales for PCs (desktop and notebook).

New Venture Research (NVR) estimates that total electronics assembly value was $1.3 trillion in 2015 and will grow to approximately $1.6 trillion in 2020 – a 4.0 percent compounded annual growth rate. Fueled by the demand for EMS services, NVR believes that the contract manufacturing industry will grow from $430 billion in 2015 to $580 billion in 2020 - approximately at a 6.2 percent CAGR.

(Source: New Venture Research Report)

**Figure 9: VS is the only Malaysian company ranked under The Manufacturing Market Insider's Top 50 EMS providers (Based on 2015 Sales)**

| | |
|---|---|
| 1 | Foxconn, Taiwan |
| 2 | Pegatron, Taiwan |
| 3 | Flextronics, Singapore |
| 4 | Jabil, US |
| 5 | Sanmina, US |
| 6 | Celestica, Canada |
| 7 | New Kinpo Group, Taiwan |
| 8 | Wistron, Taiwan |
| 9 | Universal Scientific Industrial Co Ltd, China |
| 10 | Plexus, US |
| 11 | Benchmark Electronics, US |
| 12 | Shenzhen Kaifa, China |
| 13 | Venture, Singapore |
| 14 | Zollner Elektronik Group, Germany |
| 15 | PKC Group, Finland |
| 16 | SIIX, Japan |
| 17 | Asteelflash, France |
| 18 | UMC Electronics, Japan |
| 19 | Sumitronics, Japan |
| 20 | Fabrinet, Thailand |
| 21 | Kimball Electronics Group, US |
| 22 | Integrated Micro-Electronics Inc, Philippines |
| 22 | Global Brands Manufacture, Taiwan |
| 23 | NEO Tech, US |
| 24 | Scanfil EMS, Finland |
| 25 | Enics, Switzerland |
| 26 | Ducommum, US |
| 27 | 3CEMS, China |
| 28 | VIDEOTON Holding, China |
| 29 | VTech Communications, HK |
| 30 | Katolec, Japan |
| **31** | **VS Industry, Malaysia** |
| 32 | WKK Technology Ltd, HK |
| 33 | Neways Electronics International N.V., The Netherlands |
| 34 | Eolane, France |
| 35 | Wong's, HK |
| 36 | Key Tronic, US |
| 37 | Oriental Semiconductor Electronics, Taiwan |
| 38 | Global Brands Manufacturing, Taiwan |
| 39 | Creation Technologies, Canada |
| 40 | Hana Microelectronics, Thailand |
| 41 | Computime Limited, HK |
| 42 | ALL CIRCUITS, France |
| 43 | LACROIX Electronics, France |
| 44 | Kitron, Norway |
| 45 | Topscom, China |
| 46 | SVI, Thailand |
| 47 | Valuetronics Holding, HK |
| 48 | Di-Nikko Engineering, Japan |
| 49 | Nippon Manufacturing Service, Japan |
| 50 | TT Electronics, UK |

*Source: Manufacturing Market Insider*

## Financial Review & Outlook

**VS is a fundamentally sound company,** enjoying 5-year Compounded Annual Growth Rate (CAGR) of 19% for revenue and CAGR of 40% for headline net profit during FY10 till FY15. Going forward, we envisage the Group's core net earnings to grow by 29.9% to RM135.7m for FY16F and 20.6% to RM163.7m for FY17F with key earnings contribution from its three major clients, namely Dyson (vacuum cleaner), Keurig (coffee brewer) and Zodiac (robotic pool cleaner). Besides, VS commands a sturdy balance sheet with current low net gearing of 0.2x, which allows it to have ample flexibility to gear up for future capacity expansion and M&A.

**Figure 10: Growing Topline**

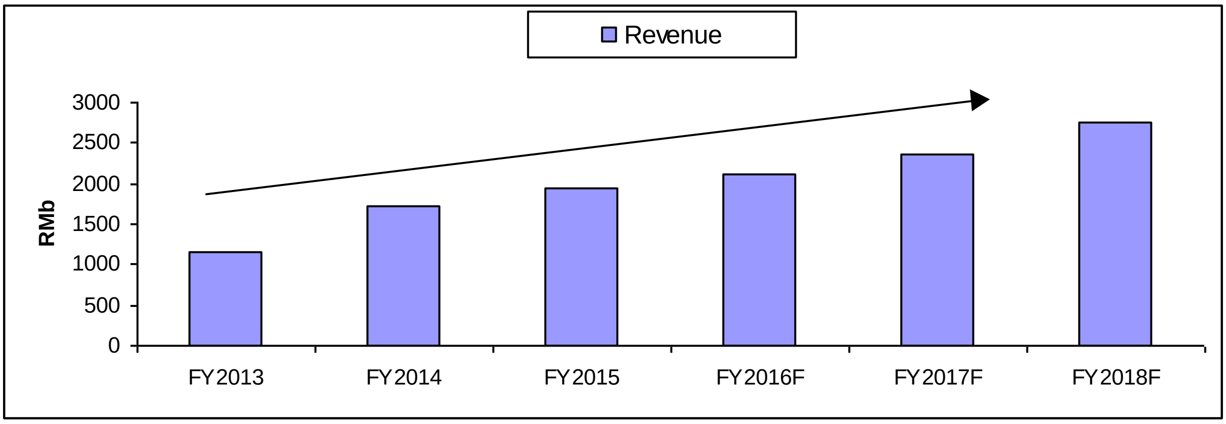



**Figure 11: Accelerating Bottomline**

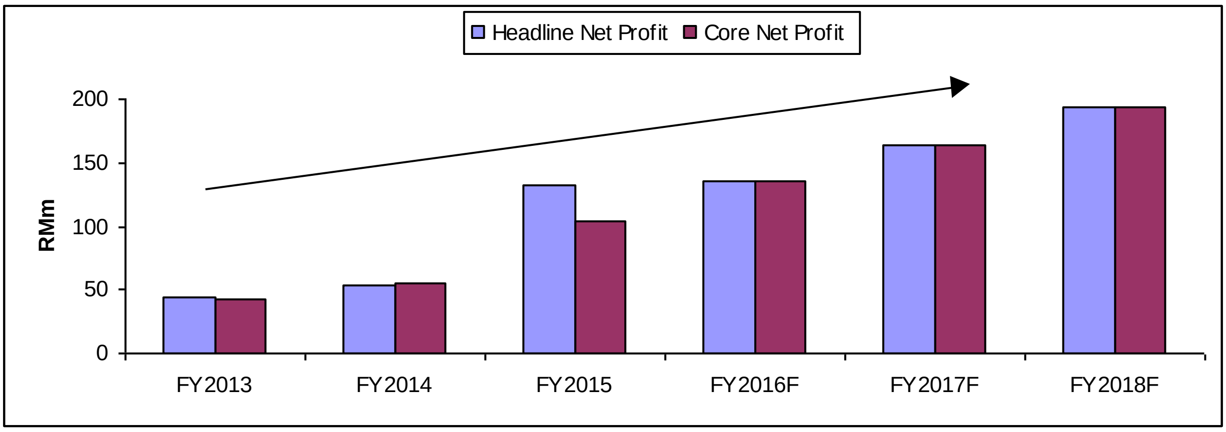
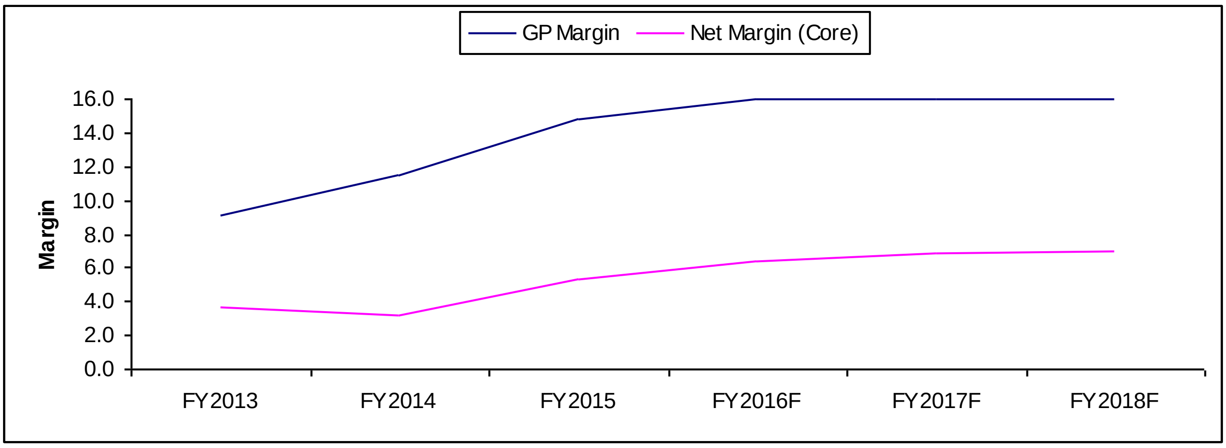



**Figure 12: Improving Gross Profit and Net Margins**




*Source: Company, JF Apex*

**For 9MFY16, revenue of VS increased 13.4% yoy to RM1.6b, while core net earnings soared by 45.0% YoY to RM101.7m** (excluding RM7.1m forex gain). The strong surge in core net profit was due to higher sales volume, improved gross profit margin, lower net interest expense and lower effective tax rate pursuant to utilization of export-related tax incentives.

Meanwhile, the Group achieved headline net profit of RM19.3m for its 3QFY16, down 27.2% yoy and 29.8% qoq amid higher revenue recorded, RM507.8m (+20.9% yoy and +1.3% qoq). This was mainly due to lower gross profit margin resulting from weakening of USD against MYR during the period as the USDMYR exchange rate used in the revenue recognition was less favourable as compared to the USDMYR exchange rate used to book the raw materials cost coupled with forex loss. Excluding the forex gain or loss, VS registered 3QFY16 core net profit of RM23.7m, up 15.4% yoy on the back of healthy orders from all key customers, but still down 18.0% qoq as affected by unfavourable forex.

**Figure 13: Quarterly Financials**

| Year to 31 July (RMm) | 3QFY16 | 2QFY16 | 3QFY15 | qoq % | yoy % | 9MFY16 | 9MFY15 | yoy % |
|---|---|---|---|---|---|---|---|---|
| Revenue | 507.8 | 501.1 | 420.1 | 1.3 | 20.9 | 1621.4 | 1430 | 13.4 |
| Gross Profit | 70.7 | 85.9 | 66.1 | -17.7 | 7.0 | 263.3 | 214.9 | 22.5 |
| EBIT | 26.6 | 39.7 | 38.3 | -33.0 | -30.5 | 145.4 | 115.7 | 25.7 |
| PBT | 22.3 | 35.8 | 34.5 | -37.7 | -35.4 | 133 | 102.6 | 29.6 |
| Net Profit | 19.3 | 27.5 | 26.5 | -29.8 | -27.2 | 107 | 80 | 33.8 |
| Core Net Profit | 23.7 | 28.9 | 20.5 | -18.0 | 15.4 | 101.7 | 70.1 | 45.0 |
| Gross margin (%) / ppt | 13.9 | 17.1 | 15.7 | -3.2 | -1.8 | 16.2 | 15.0 | 1.2 |
| EBIT margin (%) / ppt | 5.2 | 7.9 | 9.1 | -2.7 | -3.9 | 9.0 | 8.1 | 0.9 |
| PBT margin (%) / ppt | 4.4 | 7.1 | 8.2 | -2.8 | -3.8 | 8.2 | 7.2 | 1.0 |
| Net margin (%) / ppt | 3.8 | 5.5 | 6.3 | -1.7 | -2.5 | 6.6 | 5.6 | 1.0 |

*Source: Company, JF Apex*

**Improved overseas operations**. Indonesia operations continued to be profitable in 3QFY16 with PBT of RM1.0m, against pre-tax loss of RM2.6m a year ago and climbed 42.9% qoq thanks to higher orders secured from existing customers and higher margin as benefited from economies of scale following increase in production. The Group expects performance to continue improving going forward with current 9MFY16 PBT of RM4.8m, successfully returning into the black from a year ago.

For China operations, it registered marginal loss of RM1.1m in 3QFY16 due to seasonal factors. However, 9MFY16 remained profitable at RM2.8m. Management expects full year performance to be satisfactory or at least breakeven. Earnings shall pick up in tandem with better sales volume given depreciation and fixed overheads are already factored in.

**Figure 14: Geographical Breakdown**

| Year to 31 July (RMm) | 3QFY16 | 2QFY16 | 3QFY15 | qoq % | yoy % | 9MFY16 | 9MFY15 | yoy % |
|---|---|---|---|---|---|---|---|---|
| **Revenue** | | | | | | | | |
| Malaysia | 356.3 | 311.7 | 284.1 | 14.3 | 25.4 | 1098.2 | 989.3 | 11.0 |
| Indonesia | 26.3 | 25.2 | 18.7 | 4.4 | 40.6 | 82.4 | 58 | 42.1 |
| China | 124.6 | 163.8 | 116.7 | -23.9 | 6.8 | 439 | 381.2 | 15.2 |
| **PBT** | | | | | | | | |
| Malaysia | 23.4 | 31.8 | 40.2 | -26.4 | -41.8 | 127.9 | 112 | 14.2 |
| Indonesia | 1 | 0.7 | -2.6 | 42.9 | n.a. | 4.8 | -3.3 | n.a. |
| China | -1.1 | 4.8 | -3 | n.a. | n.a. | 2.8 | -4.5 | n.a. |
| **PBT margin (%) / ppt** | | | | | | | | |
| Malaysia | 6.6 | 10.2 | 14.1 | -3.6 | -7.6 | 11.6 | 11.3 | 0.3 |
| Indonesia | 3.8 | 2.8 | n.a. | 1.0 | n.a. | 5.8 | n.a. | n.a. |
| China | n.a. | 2.9 | n.a. | n.a. | n.a. | 0.6 | n.a. | n.a. |

*Source: Company, JF Apex*

**Moving into 4QFY16, we envisage VS to chalk up better core net earnings of RM34.0m, up 43.5% qoq** and flat or slip marginally yoy. Historically, 1Q and 4Q are the stronger quarters whilst 2Q and 3Q are the weaker seasons. Thus, this bring VS' forecasted core net earnings for FY16F to RM135.7m, up 29.9% yoy (against FY15: core net earnings of RM104.4m). This was mainly due to higher sales volume with revenue up 9.1% yoy coupled with better gross margin of 16.0% (against FY15: gross margin of 14.8%) banking on improving overseas operations.

**For FY17F, we envisage the Group's revenue and core net earnings to grow further** by 11.9% yoy to RM2.4b and 20.6% yoy to RM163.7m respectively, driven by consistent sales orders from its three main customers - Dyson, Keurig and Zodiac as well as continued improving sales and operational efficiency from its Indonesia and China operations.

**Potential earnings upside**. We believe the Group could clinch more orders in respect of box build full assembly for the new model of vacuum cleaner from Dyson. The Group could bag as much as RM300m new orders per annum from Dyson starting FY17F over a period of 3-5 years. Hence, this shall lift the Group's earnings by 12.6% for FY17 and 10.8% for FY18F. This is on top of the existing Dyson's model with job scope worth estimated RM650m in FY17F. Our earnings forecast is yet to factor in the potential new contract win.

**VS plans to embark on an acquisition strategy to further enhance its earnings**. The Group may consider taking up a strategic stake in a healthcare and wellness company to reap the synergistic benefits. This could render sub/full assembly works worth RM180m yearly contract for VS under its China operation in addition to the profits from ownership stake in an immediate term. Should the acquisition materialise, it could contribute RM13m yearly net profit to the Group for FY17F onwards.

**Figure 15: Yearly Financial Summary**

| FYE 31 JULY | FY2014 (RMm) | FY2015 (RMm) | FY2016F (RMm) | FY2017F (RMm) | FY2018F (RMm) |
|---|---|---|---|---|---|
| Revenue | 1715.1 | 1936.9 | 2112.8 | 2365.2 | 2764.9 |
| Gross Profit | 197.9 | 287.2 | 338.1 | 378.4 | 442.4 |
| EBIT | 58 | 176.1 | 190.2 | 224.7 | 265.4 |
| PBT | 42 | 159.7 | 169.0 | 203.4 | 240.6 |
| Taxation | 4.7 | -34.2 | -36.3 | -43.7 | -51.7 |
| PAT | 46.7 | 125.5 | 132.7 | 159.7 | 188.8 |
| Reported Net Profit | 53.6 | 132.7 | 135.7 | 163.7 | 193.3 |
| Core Net Profit | 55.7 | 104.425 | 135.7 | 163.7 | 193.3 |
| GP margin (%) | 11.5 | 14.8 | 16.0 | 16.0 | 16.0 |
| PBT margin (%) | 2.4 | 8.2 | 8.0 | 8.6 | 8.7 |
| Net margin (%) | 3.1 | 6.9 | 6.4 | 6.9 | 7.0 |
| Net margin (Core) (%) | 3.2 | 5.4 | 6.4 | 6.9 | 7.0 |
| Revenue growth (%) | 47.4 | 12.9 | 9.1 | 11.9 | 16.9 |
| Gross profit growh (%) | 86.3 | 45.1 | 17.7 | 11.9 | 16.9 |
| EBIT growth (%) | -2.2 | 203.6 | 8.0 | 18.2 | 18.1 |
| PBT growth (%) | -15.0 | 280.2 | 5.8 | 20.3 | 18.3 |
| Net profit growth (%) | 22.1 | 147.6 | 2.3 | 20.6 | 18.1 |
| Core earnings growth (%) | 28.9 | 87.5 | 29.9 | 20.6 | 18.1 |
| EPS (sen) | 4.6 | 11.3 | 11.5 | 13.9 | 16.5 |
| Core EPS (sen) | 4.7 | 8.9 | 11.5 | 13.9 | 16.5 |
| Diluted EPS (sen) | 4.5 | 9.9 | 10.1 | 12.0 | 14.0 |
| Diluted EPS (Core) (sen) | 4.7 | 8.0 | 10.1 | 12.0 | 14.0 |
| P/E (x) | 25.9 | 10.4 | 10.2 | 8.5 | 7.2 |
| P/E (Core) (x) | 24.9 | 13.3 | 10.2 | 8.5 | 7.2 |
| Diluted P/E (x) | 26.1 | 11.9 | 11.7 | 9.8 | 8.4 |
| Diluted P/E (Core) (x) | 25.3 | 14.8 | 11.7 | 9.8 | 8.4 |
| DPS (sen) | 2.3 | 4.8 | 4.8 | 6.0 | 7.0 |
| Dividend payout (%) | 50.4 | 42.5 | 41.6 | 43.1 | 42.5 |
| Dividend Yield (%) | 1.9 | 4.1 | 4.1 | 5.1 | 5.9 |
| Net gearing / (cash) (x) | 57.4 | 24.2 | 17.0 | 13.3 | 12.1 |
| ROE (%) | 10.2 | 17.1 | 14.2 | 14.0 | 13.6 |
| ROA (%) | 3.5 | 7.2 | 6.4 | 6.7 | 6.9 |
| BV/share | 0.5 | 0.8 | 1.0 | 1.2 | 1.4 |
| P/B (x) | 2.2 | 1.4 | 1.2 | 1.0 | 0.8 |

| FYE - July (RMm) | FY2014 | FY2015 | FY2016F | FY2017F | FY2018F |
|---|---|---|---|---|---|
| **Cash Flow** | | | | | |
| Cash flow from operations | 46.4 | 11.4 | 14.8 | 19.3 | 25.0 |
| Cash flow from investing | -51 | -64 | -83.2 | -108.2 | -140.6 |
| Cash flow from financing | 39.3 | 128.5 | 134.9 | 141.7 | 148.8 |
| Cash generated | 30.8 | 102.9 | 66.5 | 52.8 | 33.2 |
| Cash at beginning | 77.8 | 107.6 | 224.2 | 290.7 | 343.5 |
| **Cash at end of period** | **107.6** | **224.2** | **290.7** | **343.5** | **376.7** |

| FYE - July (RMm) | FY2014 | FY2015 | FY2016F | FY2017F | FY2018F |
|---|---|---|---|---|---|
| **Balance Sheet** | | | | | |
| *Cash* | 107.6 | 224.2 | 290.7 | 343.5 | 376.7 |
| Current assets | 842.7 | 1019.4 | 1172.3 | 1348.2 | 1550.4 |
| Non-current assets | 709 | 836.3 | 961.7 | 1106.0 | 1271.9 |
| **Total assets** | **1551.7** | **1855.7** | **2134.1** | **2454.2** | **2822.3** |
| | | | | | |
| *Short term debt* | 269.8 | 289.2 | 318.1 | 349.9 | 384.9 |
| Current liabilities | 721 | 697.9 | 767.7 | 844.5 | 928.9 |
| *Long term debt* | 140 | 123 | 135.3 | 148.8 | 163.7 |
| Non-current liabilities | 189.7 | 178.1 | 195.9 | 215.5 | 237.1 |
| **Total liabilities** | 910.7 | 876 | 963.6 | 1060.0 | 1166.0 |
| | | | | | |
| *Shareholders' equity* | 526.2 | 777.1 | 957.7 | 1170.8 | 1421.8 |
| MI | 114.8 | 202.6 | 212.7 | 223.4 | 234.5 |
| **Total equity** | 641 | 979.7 | 1170.5 | 1394.2 | 1656.3 |
| | | | | | |
| **Total liabilities & equity** | **1551.7** | **1855.7** | **2134.1** | **2454.2** | **2822.3** |

*Source: Company, JF Apex*

## Assessing Current Headwinds

### *Impact of Forex*

**VS is net beneficiary of USD's appreciation against MYR** as 90% of the Group's sales proceeds and 63% cost of sales are in USD. The strengthening of USD against MYR will benefit VS as the Group's sales proceeds are denominated in USD whilst revenue recognition is in MYR and vice versa.

However, with the current rebound of MYR, this may work against the Group. Having said that, we believe VS could overcome the headwinds as sales volume growth is more than offset the weaker ASP in MYR term, and hence topline could still grow positively in near future. For bottomline, the Group's gross profit margin may slide marginally or stay flat in view of rising cost of material coupled with recognition of limited forex gain or even forex loss incurred following the uptick of MYR against USD. But, this will be mitigated by operational efficiency and earnings improvement in overseas productions with both Indonesia and China operations returning into the black.

### *Impact of Brexit*

**Market worries that Brexit could pose a threat to VS as Dyson is one of the major clients for the Group**. Dyson is a British-based technology company that designs and manufacturers vacuum cleaners, hand dryers, bladeless fans and heaters. It is still premature to assess any conclusion pertaining to the possible negative impact of Brexit on VS as Brexit negotiation will take at least 2 years and in the meantime, management expects things to be remain unchanged.

As for current market exposure, the only major client of the Group with UK / EU exposure is Dyson. However, the contract amount is not significant. Most of VS's product shipments for Dyson are to countries outside UK and EU. Some key destination markets include Japan and China. In fact, Dyson's sales are mostly coming from outside EU. Based on a media report, The Telegraph, Dyson's sales to EU is 19%, against 81% to the rest of the world.

## Peer Comparison

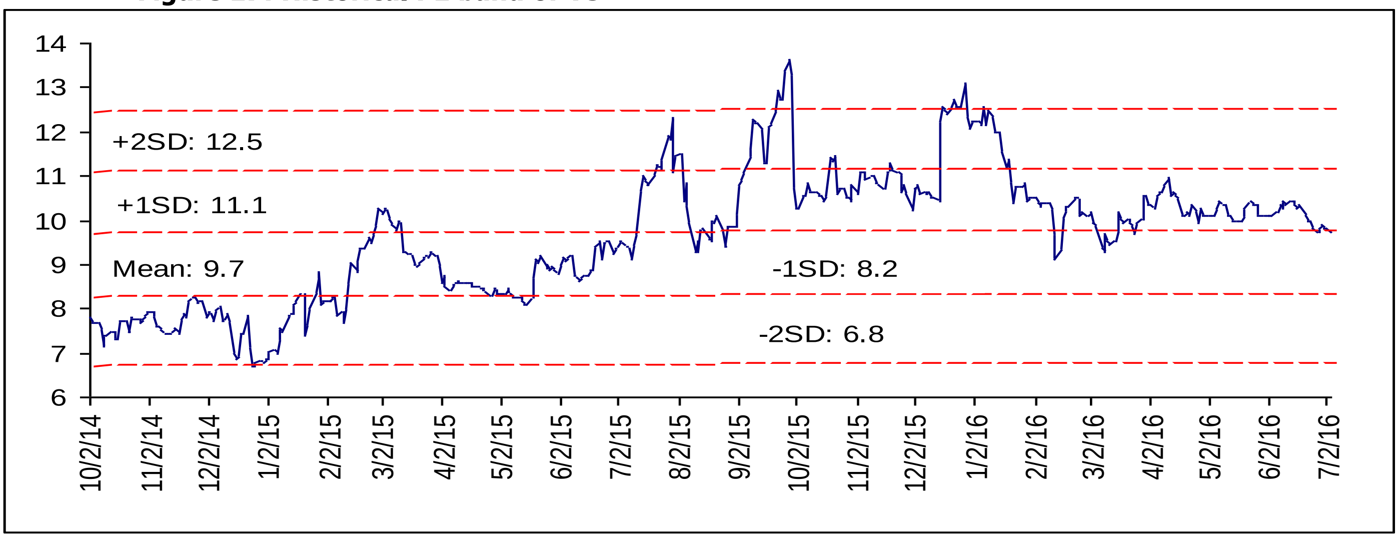
**Figure 16: Peer Comparison**

| Company | Ticker | Rec | Share Price @ 4 July 16 (RM) | Target price (RM) | Market Cap. (RMm) | P/E (x) FY2015 | P/E (x) FY2016F | P/E (x) FY2017F | ROE (%) FY2015 | ROE (%) FY2016F | P/B (x) FY2015 | P/B (x) FY2016F | Dividend Yield (%) FY2016F |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **VS Industry** | **VSI MK Equity** | **BUY** | **1.18** | **1.50** | **1368.8** | **10.4** | **10.2** | **8.5** | **17.1** | **14.2** | **1.4** | **1.2** | **4.1** |
| SKP Resources | SKP MK Equity | N.R. | 1.2 | 1.71 | 1404.1 | 16.0 | 10.3 | 8.7 | 33.4 | 40.1 | 4.0 | 3.5 | 4.6 |
| EG industries | EG MK Equity | N.R. | 0.84 | 1.09 | 177.5 | 2.7 | 10.9 | 7.0 | 20.9 | 8.5 | 0.6 | N.A. | N.A. |
| PIE Industrial | PIE MK Equity | N.R. | 12.48 | 14.55 | 958.6 | 19.5 | 15.8 | 12.9 | 14.0 | 15.0 | 2.5 | 2.3 | 3.0 |
| Uchi Technologies | UCHI MK Equity | N.R. | 1.54 | 1.65 | 669.9 | 13.1 | 12.5 | 12.1 | 23.3 | 25.2 | 2.9 | 2.6 | 6.8 |
| LCTH Corp | LCTH MK Equity | N.R. | 0.57 | N.A. | 205.2 | 8.2 | N.A. | N.A. | 12.6 | N.A. | 1.0 | N.A. | N.A. |
| **Average (excluding VS industry)** | | | | | | **11.9** | **12.4** | **10.2** | **20.8** | **22.2** | **2.2** | **2.8** | **4.8** |

*Source: Bloomberg, JF Apex*

## Historical PE

**Figure 17: Historical PE band of VS**




*Source: Bloomberg, JF Apex*

## Valuation & Recommendation

**We initiate coverage on VS with a target price of RM1.50**, based on 12.5x FY2017F PE with diluted EPS forecast of 12 sen. The PER assigned for valuation of VS is at the sector average PE and +2 standard deviation above mean of historical PE of the Group. The target PE is warranted in view of the Group's capability of securing sizeable orders from Dyson and its potential strategic acquisition of a healthcare and wellness company under its China operation to further expand its earnings in FY17F.

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## JF APEX SECURITIES - RESEARCH RECOMMENDATION FRAMEWORK

**STOCK RECOMMENDATIONS**

**BUY** : The stock's total returns* are expected to exceed 10% within the next 12 months.

**HOLD** : The stock's total returns* are expected to be within +10% to – 10% within the next 12 months.

**SELL** : The stock's total returns* are expected to be below -10% within the next 12 months.

**TRADING BUY** : The stock's total returns* are expected to exceed 10% within the next 3 months.

**TRADING SELL** : The stock's total returns* are expected to be below -10% within the next 3 months.

**SECTOR RECOMMENDATIONS**

**OVERWEIGHT** : The industry as defined by the analyst is expected to exceed 10% within the next 12 months.

**MARKETWEIGHT** : The industry as defined by the analyst is expected to be within +10% to – 10% within the next 12 months.

**UNDERWEIGHT** : The industry as defined by the analyst, is expected to be below -10% within the next 12 months.

*capital gain + dividend yield

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