

# Flash Note



Refer to important disclosures at the end of this report

AllianceDBS Research, Malaysia Equity

17 Dec 2018

## VS Industry (VSI MK) : HOLD

Mkt. Cap: US\$499m | 3m Avg. Daily Val: US\$2.3m

Last Traded Price ( 14 Dec 2018): RM1.17

Price Target 12-mth: RM1.05 (10% downside) (Prev RM1.50)

Shariah Compliant: Yes

### Analyst

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### Hitting a speed bump

- 1QFY19 results below expectations; prospects increasingly challenging with reduced orders from its key customer and continued losses in China operations
- Cut FY19-21 earnings forecast by 39-43%
- Maintain HOLD with a lower TP of RM1.05

#### Forecasts and Valuation

FY Jul (RMm)	2018A	2019F	2020F	2021F
Revenue	4,089	3,900	3,626	3,750
EBITDA	284	277	299	330
Pre-tax Profit	176	161	177	199
Net Profit	151	135	147	163
Net Pft (Pre Ex.)	154	135	147	163
Net Pft Gth (Pre-ex) (%)	(5.9)	(12.6)	9.6	10.8
EPS (sen)	9.27	7.74	7.96	8.83
EPS Pre Ex. (sen)	9.46	7.74	7.96	8.83
EPS Gth Pre Ex (%)	(15)	(18)	3	11
Diluted EPS (sen)	8.74	7.58	7.81	8.66
Net DPS (sen)	4.22	3.52	3.62	4.01
BV Per Share (sen)	87.5	103	101	106
PE (X)	12.6	15.1	14.7	13.3
PE Pre Ex. (X)	12.4	15.1	14.7	13.3
P/Cash Flow (X)	9.1	6.0	6.9	7.7
EV/EBITDA (X)	8.3	7.6	7.2	6.5
Net Div Yield (%)	3.6	3.0	3.1	3.4
P/Book Value (X)	1.3	1.1	1.2	1.1
Net Debt/Equity (X)	0.1	CASH	CASH	CASH
ROAE (%)	12.2	8.4	8.0	8.5

Source of all data on this page: Company, AllianceDBS, Bloomberg Finance L.P.

### What's New

- VS Industry's (VSI) 1QFY19 revenue came in at RM1.1bn (-1% y-o-y, +6% y-o-y) with a headline net profit of RM39.8m (-8% y-o-y, +4% q-o-q).
- Excluding a one-off disposal loss of RM5.4m, core net profit came in at RM45.2m (-2% y-o-y, -15% y-o-y). The results were below our/consensus expectations, largely due to the larger than expected core operating losses of RM15m in China.
- The group declared its first interim dividend of 1sen for 1QFY19. This is within our expectations.

### Segmental Highlights

#### Malaysia

- Its Malaysian operations recorded revenue of RM886.8m (+9% y-o-y, +11% q-o-q) and PBT of RM66m (+7% y-o-y, +16% q-o-q) in 1QFY19, which formed 81% > 100% of group revenue/PBT. The stronger earnings were mainly due to production ramp up driven by higher sales orders.
- Despite improvements in its 1QFY19 results, we understand that sales orders from one of its key customers may decline from January 2019 onwards. This would adversely impact three of its production lines, resulting in about RM900m reduction in revenue per annum (about RM525m for FY19).
- On the other hand, the group intends to maintain its current 8k foreign workers in Malaysia given that the group is optimistic on securing some contract wins from other customers.
- We understand that the group is in advanced negotiations with >5 customers and is optimistic of winning some jobs in FY19. Nonetheless, we believe



that earnings contribution from these potential wins would likely come in only from FY20 onwards.

### China

- Its operations in China recorded revenue of RM112.2m (-25% y-o-y, -23% q-o-q) and a core operating loss of RM15m in 1QFY19 (LBT of RM17m in 1QFY18, LBT of RM26m in q-o-q) respectively.
- Despite an ongoing cost cutting exercise since the second half of 2018, we understand that sales orders have declined significantly caused by the ongoing US-China trade war.
- The group has accelerated its cost cutting exercise in view of declining sales orders. A round of retrenchment led to about RM3m+ redundancy payments during the quarter. We gather that the downsizing will continue in the upcoming quarters.

### Revision in earnings forecasts.

- We cut our FY19-21 earnings forecast by 39-43%, mainly to account for, (1) RM525m- RM900m revenue reduction for FY19-21 due to loss of orders from its key customer as highlighted above, (2) estimating FY19/20/21 operating losses of RM40m/RM20m/RM10m for its Chinese operations (previously assumed FY19/20/FY21 operating profits

of RM3m/RM3m/RM10m) and, (3) bookkeeping purposes.

- Despite the fact that the full impact of a RM900m top line reduction due to lower sales orders will only be felt in FY20, we are projecting a 10% y-o-y earnings growth in FY20, as we estimate that, (1) the group will be able to secure RM250m/per annum orders in FY19 with better margins, which will start contributing in FY20 and, (2) lower operating losses in its Chinese operations. The group's inability to secure further job wins could pose a downside risk to our earnings estimates.

### Valuation

- Post earnings revisions, we maintain our HOLD recommendation for the group with a lower TP of RM1.05 (previously RM1.50), based on an unchanged FY19 PER of 14x.
- Despite the recent correction of its share price, we do not see any significant catalysts to re-rate the stock in the near term in view of its cloudy earnings prospects.

### Quarterly Income Statement (RMm)

FY Jul	1Q2018	4Q2018	1Q2019	% chg yoy	% chg qoq
Revenue	1,085	1,011	1,076	(0.9)	6.4
Cost of Goods Sold	(969)	(893)	(959)	(1.1)	7.4
<b>Gross Profit</b>	<b>116</b>	<b>118</b>	<b>117</b>	<b>0.7</b>	<b>(1.2)</b>
Other Oper. (Exp)/Inc	(55.4)	(66.2)	(61.5)	11.0	(7.1)
<b>Operating Profit</b>	<b>60.4</b>	<b>51.9</b>	<b>55.1</b>	<b>(8.7)</b>	<b>6.3</b>
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	nm	nm
Associates & JV Inc	0.92	(7.0)	1.50	62.5	(121.5)
Net Interest (Exp)/Inc	(6.9)	(5.2)	(5.9)	14.3	(14.4)
Exceptional Gain/(Loss)	(2.6)	(14.7)	(5.4)	(112.1)	(63.2)
<b>Pre-tax Profit</b>	<b>51.9</b>	<b>25.1</b>	<b>45.3</b>	<b>(12.6)</b>	<b>80.9</b>
Tax	(17.3)	(1.3)	(16.7)	(3.2)	1,218.1
Minority Interest	8.84	14.7	11.2	26.7	(23.6)
<b>Net Profit</b>	<b>43.5</b>	<b>38.4</b>	<b>39.8</b>	<b>(8.4)</b>	<b>3.5</b>
Net profit bef Except.	46.0	53.1	45.2	(1.7)	(14.9)
EBITDA	80.7	66.4	79.8	(1.1)	20.3
<b>Margins (%)</b>					
Gross Margins	10.7	11.7	10.8		
Opg Profit Margins	5.6	5.1	5.1		
Net Profit Margins	4.0	3.8	3.7		

Source of all data: Company, AllianceDBS

### Target Price & Ratings History



**Note :** Share price and Target price are adjusted for corporate actions.

Source: AllianceDBS

Analyst: King Yoong CHEAH

### DISCLOSURE

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#### Stock rating definitions

STRONG BUY	-	> 20% total return over the next 3 months, with identifiable share price catalysts within this time frame
BUY	-	> 15% total return over the next 12 months for small caps, >10% for large caps
HOLD	-	-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps
FULLY VALUED	-	negative total return > -10% over the next 12 months
SELL	-	negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame

#### Commonly used abbreviations

Adex = advertising expenditure	EPS = earnings per share	PBT = profit before tax
bn = billion	EV = enterprise value	P/B = price / book ratio
BV = book value	FCF = free cash flow	P/E = price / earnings ratio
CF = cash flow	FV = fair value	PEG = P/E ratio to growth ratio
CAGR = compounded annual growth rate	FY = financial year	q-o-q = quarter-on-quarter
Capex = capital expenditure	m = million	RM = Ringgit
CY = calendar year	M-o-m = month-on-month	ROA = return on assets
Div yld = dividend yield	NAV = net assets value	ROE = return on equity
DCF = discounted cash flow	NM = not meaningful	TP = target price
DDM = dividend discount model	NTA = net tangible assets	trn = trillion
DPS = dividend per share	NR = not rated	WACC = weighted average cost of capital
EBIT = earnings before interest & tax	p.a. = per annum	y-o-y = year-on-year
EBITDA = EBIT before depreciation and amortisation	PAT = profit after tax	YTD = year-to-date

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