Maybank Kim Eng

Technology

Singapore

Venture (VMS SP)

Tempering expectations; LT growth drivers intact

BUY

Share Price	SGD 15.29
12m Price Target	SGD 18.85 (+23%)
Previous Price Target	*SGD 18.88*

Signs of incremental headwinds; LT drivers intact

Texas Instruments (TXN US, Not Rated) is observing broad-based weakness across end-markets, including those VMS participates in, due to the trade war. We see this as a short term headwind on VMS' volumes and lower our FY19-21E EPS by 2-8%. ROE-g/COE-g TP is largely unchanged at SGD18.85, now based on 2.1x FY20E P/B from FY19E previously. As i) LT growth drivers are intact; ii) this headwind appears priced in; and iii) 5% dividend yields are well supported by FCF, we remain BUYers on dips.

Headwinds may affect short-term volumes…

While VMS has not confirmed TXN as its supplier, we believe TXN is a reliable read-across to VMS' prospects as i) TXN is among the largest and most diversified chipmakers globally; and ii) nearly half of TXN's revenue is exposed to industrial and communications markets, including test & measurement, medical, and wired networking, sectors that VMS participates in. TXN blames increased cautiousness on the trade war for its disappointing 4Q19 guidance, and sees weakness persisting, as businesses "pull back" on production momentum. As such, we are concerned that near term volumes may be weaker than expected.

…but long-term drivers are intact

We remain constructive towards VMS' long-term prospects, as over a longer horizon, it is a beneficiary of production rerouting as a result of the trade war. VMS is also continually deepening relationships and focusing on value creation with customers, including those that enjoy exposure from exciting end-markets such as genomics, food safety and 5G infrastructure.

Accumulate on dips

Given the risk of negative revisions to consensus' forecasts, we see near-term headwinds to share price. However, we are accumulators on dips as i) this headwind appears priced in; and ii) DPS is backed by still strong cash flow. Even at a fair value of SGD14.00, which implies an unlikely FY19-22E earnings CAGR of -8%, FCF can comfortably fund DPS above SGD0.80; our current expectations are SGD0.70-0.75. A key risk is weaker than expected capex sentiment which could delay VMS' earnings recovery.

FYE Dec (SGD m)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue	4,005	3,485	3,624	3,696	3,918
EBITDA	460	457	446	458	511
Core net profit	361	370	354	362	407
Core FDEPS (cts)	126.0	127.8	122.3	123.9	139.2
Core FDEPS growth(%)	94.4	1.4	(4.3)	1.3	12.3
Net DPS (cts)	60.0	70.0	70.0	70.0	75.0
Core FD P/E (x)	16.2	10.9	12.5	12.3	11.0
P/BV (x)	2.7	1.7	1.8	1.7	1.6
Net dividend yield (%)	2.9	5.0	4.6	4.6	4.9
ROAE (%)	18.1	16.4	14.6	14.0	14.8
ROAA (%)	12.2	11.7	10.9	10.8	11.4
EV/EBITDA (x)	11.0	7.2	7.8	7.5	6.3
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Consensus net profit	-	-	364	381	395
MKE vs. Consensus (%)	-	-	(2.7)	(5.0)	3.0

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Company Description

Venture is an EMS and ODM provider with manufacturing facilities in Singapore, Malaysia, and China.

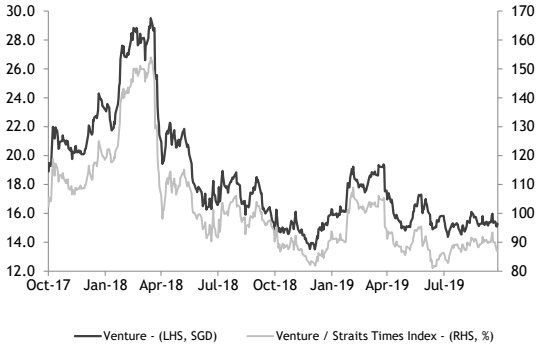
Statistics

52w high/low (SGD)	19.39/13.51
3m avg turnover (USDm)	11.1
Free float (%)	91.0
Issued shares (m)	290
Market capitalisation	SGD4.4B
	USD3.3B

Major shareholders:

WONG NGIT LIONG	7.0%
Schroder Investment Management (Singapor	4.9%
The Vanguard Group, Inc.	2.5%

Price Performance



	-1M	-3M	-12M
Absolute (%)	0	(3)	(1)
Relative to index (%)	(2)	2	(8)

Source: FactSet

Recent observations of incremental headwinds

Fig 1: MKE earnings forecasts revisions for VMS

	FY19E			FY20E			FY21E		
	New	Old	Chg (%)	New	Old	Chg (%)	New	Old	Chg (%)
Revenue (SGDm)	3,624.0	3,693.7	-1.9	3,696.5	3,878.4	-4.7	3,918.3	4,072.3	-3.8
Gross profit (SGDm)	919.8	942.0	-2.3	937.9	996.5	-5.9	1,003.3	1,048.3	-4.3
EBIT (SGDm)	409.6	427.6	-4.2	419.6	469.7	-10.7	472.1	508.6	-7.2
EBITDA (SGDm)	446.5	464.5	-3.9	457.6	508.7	-10.0	511.1	547.6	-6.7
Core net profit (SGDm)	353.8	360.5	-1.9	362.3	394.4	-8.1	407.0	425.0	-4.2
EPS (SGD)	1.22	1.25	-1.9	1.24	1.35	-8.1	1.39	1.45	-4.2
			Chg (ppt)			Chg (ppt)			Chg (ppt)
Gross margin	25.4%	25.5%	-0.1	25.4%	25.7%	-0.3	25.6%	25.7%	-0.1
SGA as % of sales	9.1%	9.0%	0.1	9.1%	8.8%	0.3	8.8%	8.6%	0.2

Source: Maybank Kim Eng

In the short term, we see evidence of rising cautiousness and this could offset tailwinds from new product ramp-ups. In Oct, the Chief Executive magazine reported that due to heightened uncertainties, only 46% of CEOs surveyed are expecting to increase capex in the following year. Such levels were last seen during the economic slowdown in 1H16.

To factor in such incremental headwinds, we cut FY19-21E EPS by 2-8%. Our ROE-g/COE-g TP is now based on 2.1x FY20E P/B (prev: 2.1x FY19E P/B), in turn based on FY20-22E average ROE of 14.4% and LTG of 2%.

In our view, a de-escalation of trade tensions which in turn translates to stronger capex sentiment may provide upside to our estimates. This is because VMS' long-term growth drivers remain intact.

Incremental headwinds are corroborated by the broad-based weakness observed by TXN. Key takeaways from TXN's 3Q19 earnings:

- Sentiment has deteriorated due to trade tensions. This has likely caused businesses at the front of the supply chain to "pull back" (likely referring to business/ production momentum), in turn affecting TXN. TXN said customers are "far more cautious" both YoY and sequentially.

- 3Q19 was the 4th consecutive quarter of YoY revenue declines, and TXN expects weakness to persist. This is a departure from historical norm, where TXN faced 4-5 quarters of YoY declines before returning to positive growth.

- Revenue: Industrial fell high/low single digits YoY/QoQ respectively. Communications equipment revenue fell 35% YoY/ 20% QoQ. Weakness was broad based across customers, sectors, regions and technologies.

Meanwhile, the CEO's Confidence Index has registered YoY declines since early 2019. We observed that YoY changes in VMS' share price have close correlation to YoY changes in the CEO Confidence Index. This may be because:

i) while VMS' revenues are diversified, its customers are largely US based; and

ii) reduced appetite for corporate spending affects VMS' volumes.

There have been exceptions to this trend, notably in 2007 and 2016-17, when strong earnings growth from VMS was able to help its share price "outperform" the challenging economic sentiment.

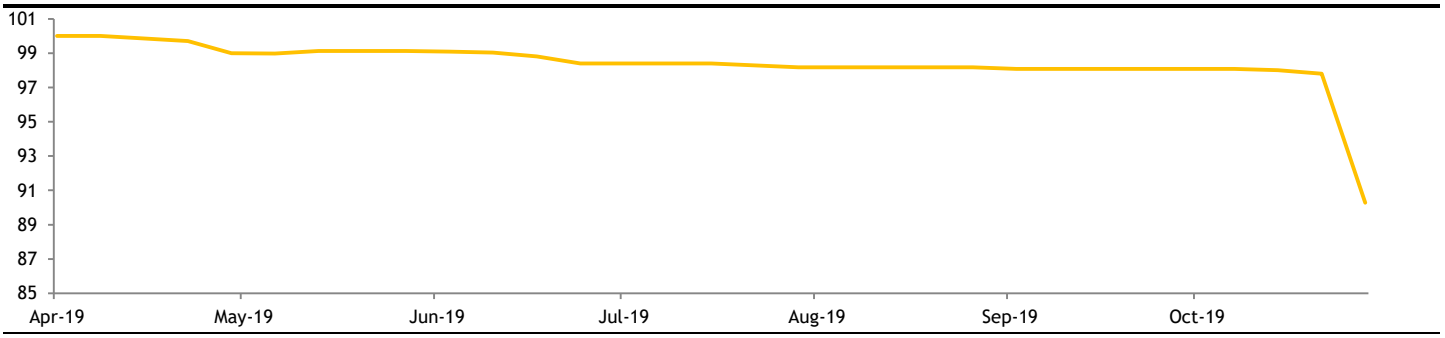
As VMS' earnings growth in 2017 was driven by broad-based strength across customers, aided by strong macro sentiment, we believe a reversal of this optimism is a headwind to near-term volumes.

Fig 2: TXN vs. VMS sector exposure (VMS' exposure in green font)

TXN's markets	TXN's sectors
Industrial (36% of TXN's FY18 revenue)	Factory automation & control, building automation, grid infrastructure, medical, test & measurement, aerospace & defense, appliances, motor drives, pro audio, video & signage, power delivery, electronic POS, industrial transport, lighting
Automotive (20% of revenue)	Infotainment & cluster, ADAS, passive safety, hybrid/electric/powertrain systems, body electronics & lighting
Personal electronics (23% of revenue)	Mobile phones, PC & notebooks, portable electronics, connected peripherals & printers, tablets, data storage, home theatre & entertainment, TV, wearables, gaming
Communications equipment (11% of revenue)	Wireless infrastructure, wired networking, broadband fixed line access, datacom module
Enterprise systems (7% of revenue)	Enterprise projectors, data centre & enterprise computing, enterprise machine
Other (calculators and other - 3% of revenue)	

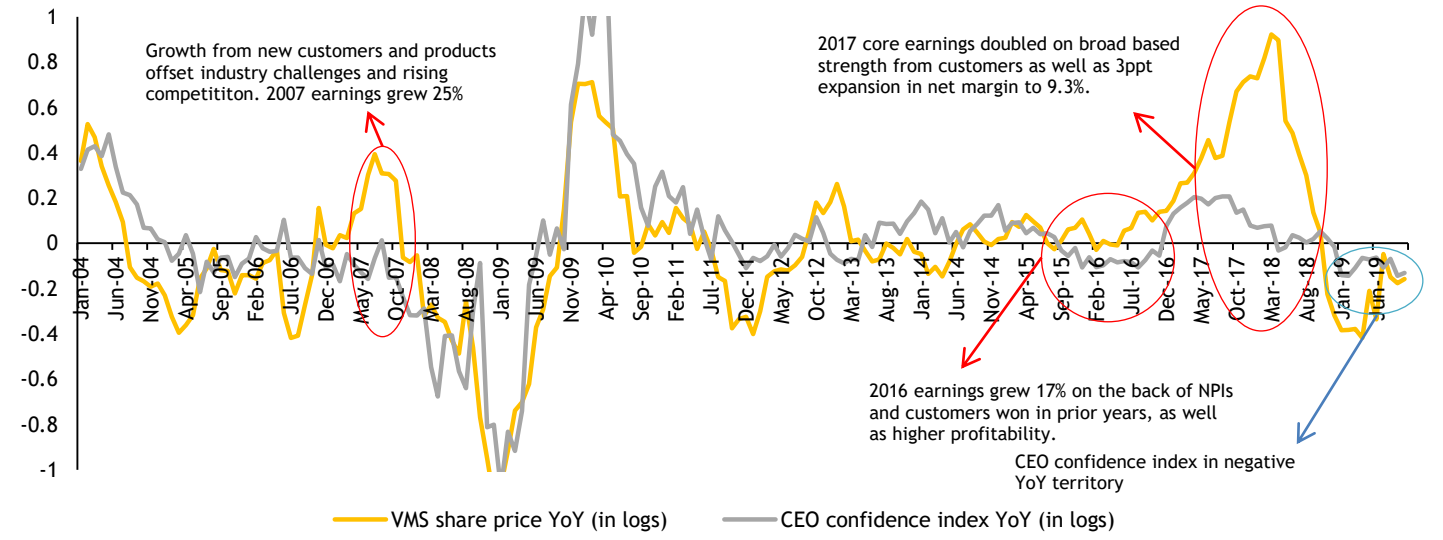
Green: VMS has exposure/ high probability of exposure to sector. Note that VMS' exposure to notebooks and tablets are for ruggedized ones for industrial applications.
Orange: Unsure of VMS' exposure to sector.
Black: VMS has no/ low probability of exposure to sector
Source: Texas Instruments, Company, Maybank Kim Eng

Fig 3: Consensus' FY20E revenue expectations for TXN moderated following its weaker outlook.



Source: Maybank Kim Eng

Fig 4: YoY changes in VMS' share price are correlated to changes in CEO Confidence Index.
Exceptions are 2007, 2016 and 2017, when strong earnings growth led share price to markedly "outperform" economic sentiment.



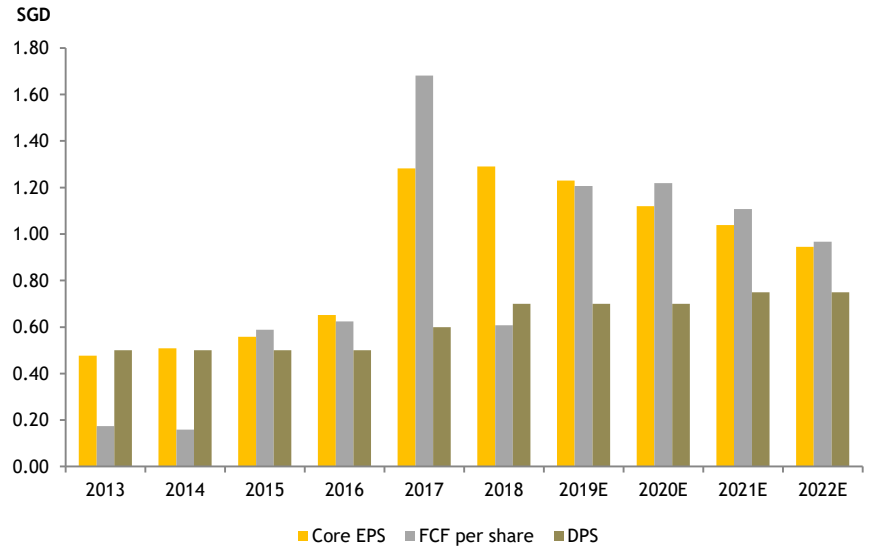
Source: Bloomberg, Company, Maybank Kim Eng

Headwinds likely priced in

Nevertheless, we remain constructive towards VMS over the longer term, as i) we expect more meaningful contributions from its customers production rerouting into VMS' facilities in coming years; ii) near-term headwinds appear priced in; and iii) DPS forecasts are backed by strong FCF.

Our analysis suggests that even if its FY19-22E earnings CAGR swings to -8%, implying a fair value of SGD14.00 on FY20E basis, strong FCF generation should still be able to fund DPS above SGD0.80 pa vs. our forecasts of SGD0.70-0.75. This translates to potential yields of above 5.3%.

Fig 5: Scenario analysis of FY19-22E PATMI CAGR of -8%: FCF should still be able to fund DPS above SGD0.80 through FY22E



Source: Company, Maybank Kim Eng

Fig 6: Implied earnings CAGRs at various share prices

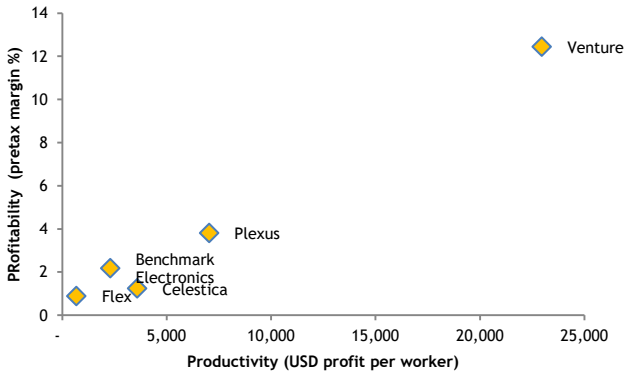
	Implied	
Share price (SGD)	FY20-22E average ROE	FY19-22E core earnings CAGR
20.00	15.0%	8.8%
19.00	14.4%	6.2%
18.00	13.8%	3.5%
17.00	13.2%	0.7%
16.00	12.6%	-2.2%
15.00	11.9%	-5.1%
14.00	11.3%	-8.1%
13.00	10.7%	-11.2%
12.00	10.0%	-14.3%
11.00	9.4%	-17.7%
10.00	8.8%	-21.0%

COE/LTG assumptions are unchanged at 8%/2%
Source: Maybank Kim Eng

Value Proposition

- VMS is an EMS company that has been consistently creating value for its customers. Able to design complex industrial products and reduce time-to-market.
- As such, it is able to generate industry-leading profitability due to pricing and productivity advantages, despite cutthroat competition.
- Good diversification with >100 active customers, many of them blue chip.
- Good exposure to test & measurement, and life-science customers, still largely underpenetrated due to regulatory requirements and high specs.

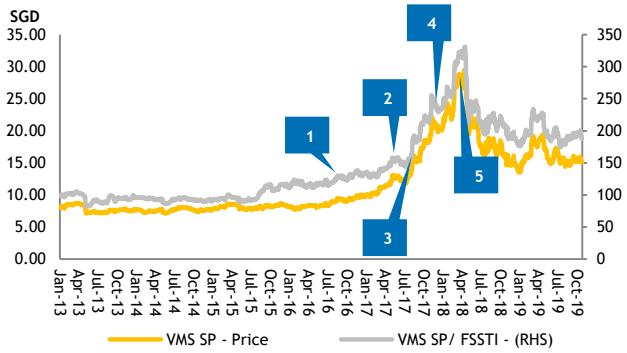
Industry-leading profitability and productivity



Source: Bloomberg, Companies

Price Drivers

Historical share price trend



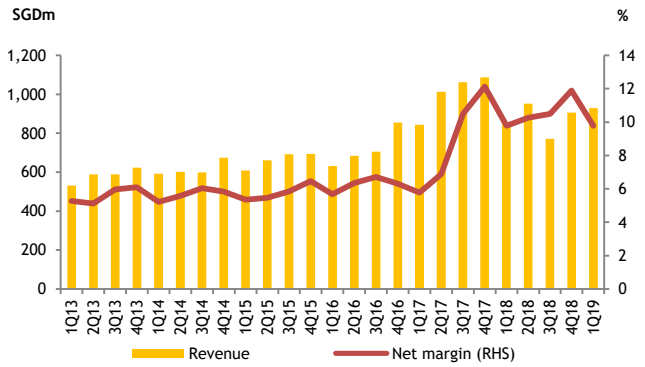
Source: Company, FactSet, Maybank Kim Eng

1. Street raised TPs for the first time in two years following strong 3Q/4Q16 earnings.
2. Strong 2Q17. Increasing market familiarity with the potential of VMS emanating from Illumina and cloud / 5G network spending.
3. CEO Wong Ngit Liong bought 400,000 shares at SGD15.26.
4. Strong 3Q17; management raised net-margin guidance.
5. Short-seller report alleging weaker-than-expected Philip Morris IQOS device growth would have knock-on effects on VMS.

Financial Metrics

- Revenue driven by allocations from existing customers and new projects.
- Operating margins should be steady or even expand from more products with higher R&D content & operating leverage.
- Net cash since 2008. Healthy FCF levels in FY19-21E could provide upside for dividends.

New level of profitability



Source: Company

Swing Factors

Upside

- Better-than-expected reception for high-growth products.
- Stronger US / global economy.
- Moderate USD strength as the revenue of VMS is entirely in USD.

Downside

- M&A among customers, and acquisitions of customers by competitors could disrupt orders.
- Excessive USD strength may erode customers' competitiveness. Excessive USD weakness may weaken its SGD earnings.
- Holding more inventories at its major hubs due to higher customer demand. This would tie up working capital.

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FYE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
Key Metrics					
P/E (reported) (x)	10.9	15.5	12.4	12.2	10.9
Core P/E (x)	16.0	10.8	12.4	12.2	10.9
Core FD P/E (x)	16.2	10.9	12.5	12.3	11.0
P/BV (x)	2.7	1.7	1.8	1.7	1.6
P/NTA (x)	2.7	1.7	1.8	1.7	1.6
Net dividend yield (%)	2.9	5.0	4.6	4.6	4.9
FCF yield (%)	8.2	4.4	9.3	6.6	9.2
EV/EBITDA (x)	11.0	7.2	7.8	7.5	6.3
EV/EBIT (x)	11.8	7.7	8.5	8.2	6.9
INCOME STATEMENT (SGD m)					
Revenue	4,004.5	3,484.6	3,624.0	3,696.5	3,918.3
Gross profit	934.4	923.0	919.8	937.9	1,003.3
EBITDA	460.1	456.6	446.5	457.6	511.1
Depreciation	(31.1)	(30.7)	(35.9)	(37.0)	(38.0)
Amortisation	(1.1)	(1.1)	(1.0)	(1.0)	(1.0)
EBIT	427.9	424.8	409.6	419.6	472.1
Net interest income /(exp)	2.8	8.2	5.0	5.0	5.0
Associates & JV	1.7	(0.1)	2.0	2.0	2.0
Exceptionals	11.3	0.0	0.0	0.0	0.0
Other pretax income	0.0	0.0	0.0	0.0	0.0
Pretax profit	443.8	433.0	416.5	426.5	479.1
Income tax	(71.0)	(62.9)	(62.5)	(64.0)	(71.9)
Minorities	0.1	(0.2)	(0.2)	(0.2)	(0.2)
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	372.8	369.9	353.8	362.3	407.0
Core net profit	361.5	369.9	353.8	362.3	407.0
BALANCE SHEET (SGD m)					
Cash & Short Term Investments	752.4	712.8	921.8	1,012.6	1,202.5
Accounts receivable	765.7	735.9	713.7	724.4	735.5
Inventory	699.6	808.2	747.7	763.9	865.3
Property, Plant & Equip (net)	197.9	230.7	220.1	212.6	206.2
Intangible assets	640.6	639.9	639.9	639.9	639.9
Investment in Associates & JVs	0.8	0.7	2.7	4.7	6.7
Other assets	87.1	76.4	60.9	60.9	60.9
Total assets	**3,144.2**	**3,204.6**	**3,306.8**	**3,419.1**	**3,717.0**
ST interest bearing debt	30.8	1.8	1.8	1.8	1.8
Accounts payable	591.3	529.0	552.7	505.4	612.6
LT interest bearing debt	0.0	0.0	0.0	0.0	0.0
Other liabilities	354.0	322.0	248.0	248.0	249.0
Total Liabilities	**976.1**	**852.5**	**802.1**	**754.9**	**863.1**
Shareholders Equity	2,165.8	2,349.9	2,502.2	2,661.6	2,851.1
Minority Interest	2.3	2.2	2.4	2.6	2.8
Total shareholder equity	**2,168.1**	**2,352.1**	**2,504.7**	**2,664.2**	**2,853.9**
Total liabilities and equity	**3,144.2**	**3,204.6**	**3,306.8**	**3,419.1**	**3,717.0**
CASH FLOW (SGD m)					
Pretax profit	443.8	433.0	416.5	426.5	479.1
Depreciation & amortisation	32.1	31.8	36.9	38.0	39.0
Adj net interest (income)/exp	0.0	0.0	0.0	0.0	0.0
Change in working capital	76.8	(170.9)	47.8	(74.2)	(4.3)
Cash taxes paid	(51.2)	(56.3)	(62.5)	(64.0)	(71.9)
Other operating cash flow	0.0	0.0	0.0	0.0	0.0
Cash flow from operations	499.8	237.6	436.8	324.3	439.9
Capex	(25.8)	(63.6)	(25.4)	(29.5)	(31.6)
Free cash flow	474.1	174.1	411.4	294.8	408.4
Dividends paid	(140.7)	(230.0)	(201.5)	(203.0)	(217.5)
Equity raised / (purchased)	48.0	41.5	0.0	0.0	0.0
Change in Debt	(61.8)	(29.0)	0.0	0.0	0.0
Other invest/financing cash flow	(55.5)	3.8	(1.0)	(1.0)	(1.0)
Effect of exch rate changes	(11.4)	0.0	0.0	0.0	0.0
Net cash flow	252.7	(39.6)	208.9	90.8	189.9

FYE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
Key Ratios					
Growth ratios (%)					
Revenue growth	39.3	(13.0)	4.0	2.0	6.0
EBITDA growth	78.9	(0.8)	(2.2)	2.5	11.7
EBIT growth	103.1	(0.7)	(3.6)	2.4	12.5
Pretax growth	105.6	(2.4)	(3.8)	2.4	12.3
Reported net profit growth	106.3	(0.8)	(4.3)	2.4	12.3
Core net profit growth	100.1	2.3	(4.3)	2.4	12.3
Profitability ratios (%)					
EBITDA margin	11.5	13.1	12.3	12.4	13.0
EBIT margin	10.7	12.2	11.3	11.4	12.0
Pretax profit margin	11.1	12.4	11.5	11.5	12.2
Payout ratio	45.4	54.2	56.9	56.0	53.4
DuPont analysis					
Net profit margin (%)	9.3	10.6	9.8	9.8	10.4
Revenue/Assets (x)	1.3	1.1	1.1	1.1	1.1
Assets/Equity (x)	1.5	1.4	1.3	1.3	1.3
ROAE (%)	18.1	16.4	14.6	14.0	14.8
ROAA (%)	12.2	11.7	10.9	10.8	11.4
Liquidity & Efficiency					
Cash conversion cycle	80.6	104.8	103.6	99.6	98.6
Days receivable outstanding	66.5	77.6	72.0	70.0	67.1
Days inventory outstanding	77.5	106.0	103.6	98.6	100.6
Days payables outstanding	63.4	78.7	72.0	69.0	69.0
Dividend cover (x)	2.2	1.8	1.8	1.8	1.9
Current ratio (x)	2.3	2.7	3.0	3.4	3.3
Leverage & Expense Analysis					
Asset/Liability (x)	3.2	3.8	4.1	4.5	4.3
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Net gearing (%) (excl. perps)	net cash	net cash	net cash	net cash	net cash
Net interest cover (x)	na	na	na	na	na
Debt/EBITDA (x)	0.1	0.0	0.0	0.0	0.0
Capex/revenue (%)	0.6	1.8	0.7	0.8	0.8
Net debt/ (net cash)	(721.6)	(711.0)	(920.0)	(1,010.8)	(1,200.7)

Source: Company; Maybank

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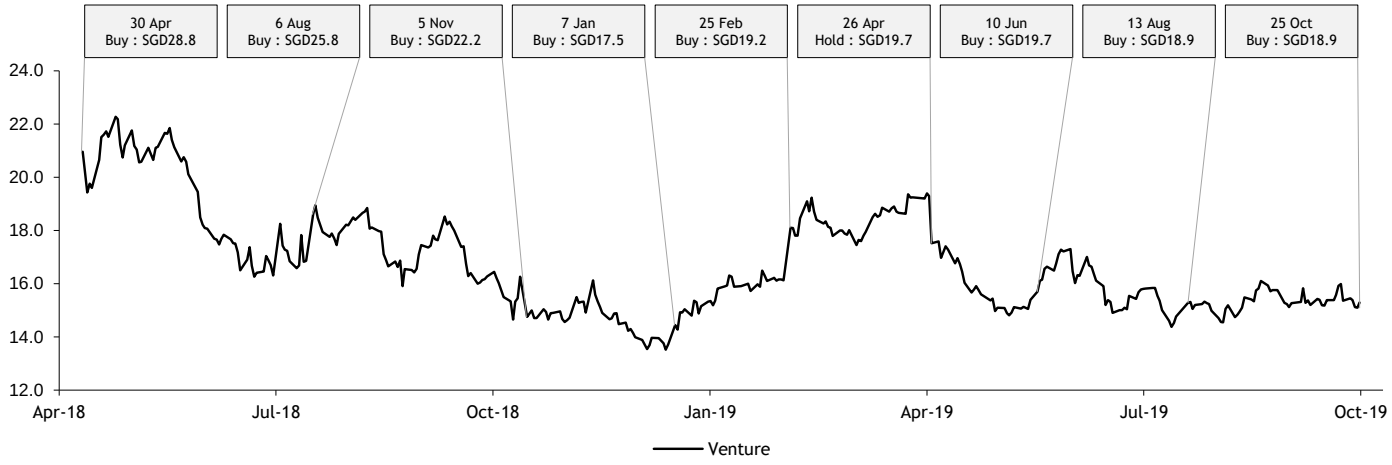

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