Maybank Kim Eng

Technology

Singapore

Venture (VMS SP)

Recovery delayed; D/G to HOLD

HOLD *[Prior:BUY]*

Share Price	SGD 13.96
12m Price Target	SGD 13.90 (+5%)
Previous Price Target	*SGD 18.23*

Risk-reward balanced; await better valuations

We cut FY20-21E EPS by 13-20% to factor in i) VMS' partially shut factories in Malaysia and ii) increasingly cautious customer and supply chain outlook. We expect consensus to cut earnings expectations as VMS' has historically underperformed expectations during times of weakening economic fundamentals. Our ROE-g/COE-g TP falls to SGD13.90, based on 1.5x FY20E P/B (prev: 2x) as we raise COE assumption to 9% (prev: 8%) to account for the stock's increased volatility. D/g to HOLD from BUY.

Demand and supply shocks will delay recovery

VMS' facilities in Malaysia are near totally shut from 18-Mar to 14-Apr due to a government-directed movement control order (MCO) to curb the spread of Covid-19. Production of medical goods likely would have continued, as these are exempted from the MCO. Malaysia accounts for at least 65% of VMS' production capacity. A few customers that were previously upbeat, such as Honeywell, Thermo Fisher and Broadcom have turned cautious. We fear that an increasingly uncertain environment increases the risk that customers may defer new product introductions (NPIs) till economic conditions improve.

Healthy balance sheet, cash flow and customers

We still like VMS for its i) net cash to equity position of 29%, ii) free cash flow that fully funds FY20E DPS of SGD0.70, and iii) diversified customer base (top 20 customers account for 70-80% of revenue). Specifically, a snapshot of 16 well known customers suggest most are decent paymasters, and have healthy liquidity, leverage and interest coverage ratios.

Wait for better margin of safety

We expect volatility to persist, and do not rule out that investors may be able to pick up the stock at better valuations. VMS is currently trading at a FY20E yield of 5% and P/B of 1.6x which are around long-term mean. For comparison, forward yield peaked at 12.4% while forward P/B troughed at 0.6x during GFC. Key risk to our view is if we have under or overestimated forecasts amid a highly dynamic environment with many moving parts.

FYE Dec (SGD m)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue	3,485	3,633	3,306	3,637	4,001
EBITDA	456	448	372	433	493
Core net profit	369	362	297	344	394
Core FDEPS (cts)	127.4	124.9	102.0	118.3	135.3
Core FDEPS growth(%)	1.4	(2.0)	(18.4)	16.0	14.4
Net DPS (cts)	70.0	70.0	70.0	70.0	70.0
Core FD P/E (x)	10.9	13.0	13.7	11.8	10.3
P/BV (x)	1.7	1.9	1.6	1.5	1.4
Net dividend yield (%)	5.0	4.3	5.0	5.0	5.0
ROAE (%)	16.3	14.9	11.7	12.9	13.9
ROAA (%)	11.6	11.2	9.1	10.1	10.9
EV/EBITDA (x)	7.2	8.8	8.7	7.3	6.4
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Consensus net profit	-	-	381	395	na
MKE vs. Consensus (%)	-	-	(22.2)	(12.9)	na

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Company Description

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

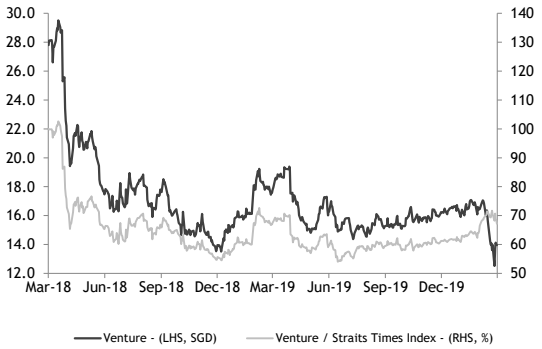
Statistics

52w high/low (SGD)	19.39/12.52
3m avg turnover (USDm)	18.1
Free float (%)	91.0
Issued shares (m)	290
Market capitalisation	SGD4.0B
	USD2.8B

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 (%)	(15)	(14)	(21)
Relative to index (%)	4	10	0

Source: FactSet

Link to sector note:

Singapore Technology - Bracing for a storm | NEUTRAL

Supply disruptions and demand shock could negate strong 2H20 product pipeline

We slash VMS' FY20-21E EPS by 13-20% to account for i) near total shutdown of VMS' factories in Malaysia (where around 65% of production capacity is located), due to a four-week movement control order); ii) global supply chain disruptions; and iii) weakening capex appetite amid increased economic uncertainties.

VMS' earnings tend to underperform consensus during times of challenging economic conditions, and we believe this time is no different. We see risks that new products slated for 2H20 may be pushed out as customers await more conducive economic conditions. Anecdotally, some customers that were previously upbeat about prospects have now turned cautious, such as Honeywell, Thermo Fisher and Broadcom, and anticipate more will do the same.

As the manufacturing of medical devices are deemed an "essential" and are exempted from the MCO, we believe some of these lines remain open to produce such goods.

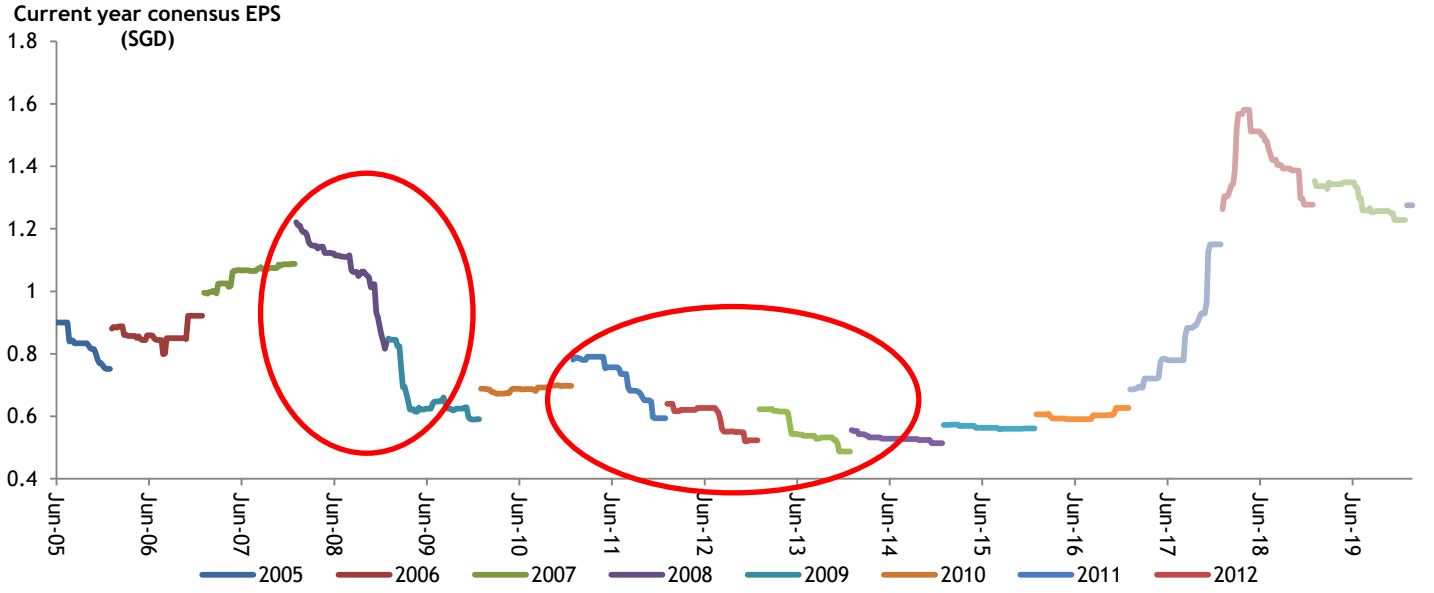
We continue to favour VMS in the long-term given its solid execution track record with customers, as well as robust product pipeline. We do not rule out pent-up demand from 2021-onwards following two years of weak capex appetite (2019-20). A key risk to this view is a protracted economic downturn that lasts beyond 2020.

Fig 1: Forecast changes

	FY20E			FY21E			FY22E		
	New	Old	Chg (%)	New	Old	Chg (%)	New	Old	Chg (%)
Revenue (SGDm)	3,306.4	3,767.9	-12.2	3,637.1	3,993.9	-8.9	4,000.8	4,113.8	-2.7
Gross profit (SGDm)	810.1	934.4	-13.3	902.0	998.5	-9.7	1,000.2	1,020.2	-2.0
EBIT (SGDm)	336.2	427.7	-21.4	396.1	456.2	-13.2	454.5	441.7	2.9
EBITDA (SGDm)	371.9	463.3	-19.7	433.1	492.8	-12.1	492.8	479.3	2.8
Core net profit (SGDm)	296.6	371.0	-20.0	344.2	395.2	-12.9	393.8	382.5	3.0
EPS (SGD)	1.02	1.28	-20.0	1.18	1.36	-12.9	1.37	1.33	3.0
			Chg (ppt)			Chg (ppt)			Chg (ppt)
Gross material margin	24.5%	24.8%	-0.3	24.8%	25.0%	-0.2	25.0%	24.8%	0.2
SGA as % of sales	9.4%	9.0%	0.4	9.2%	9.2%	0.0	9.2%	9.3%	-0.1

Source: Maybank Kim Eng

Fig 2: During times of challenging business outlook, e.g. 2008-09, and 2011-14, consensus typically has to revise EPS lower.



Source: Bloomberg, Maybank Kim Eng

Fig 3: Sensitivity analysis of implied earnings expectation at various share prices

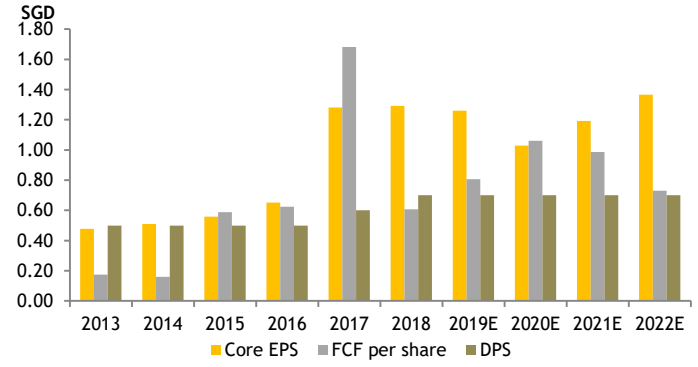
Share price (SGD)	FY20-22E average ROE	Implied FY19-22E earnings CAGR (linear basis)
20.00	16.9%	15.5%
19.00	16.2%	12.6%
18.00	15.5%	9.6%
17.00	14.8%	6.6%
16.00	14.1%	3.6%
15.00	13.4%	0.5%
14.00	12.7%	-2.8%
13.00	12.0%	-6.1%
12.00	11.2%	-9.6%
11.00	10.5%	-13.1%
10.00	9.8%	-16.9%

COE/LTG assumptions for this sensitivity analysis are at 9%/2% respectively.
Source: Maybank Kim Eng

Strong balance sheet and cash flow dynamics

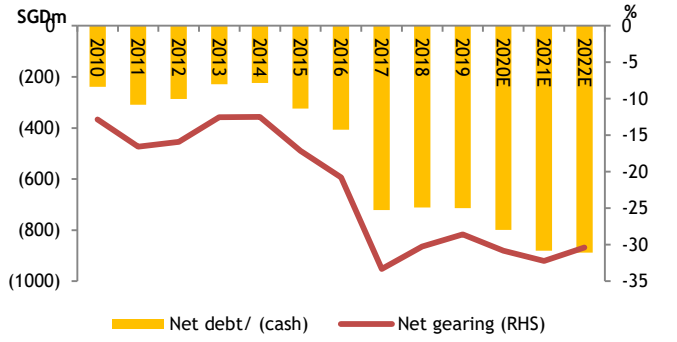
We believe that VMS' strong FCF generation can still help it maintain its SGD0.70 DPS. Furthermore, VMS boasts a respectable balance sheet with net cash to equity of 29%. Based on 16 well-known customers, we note overall healthy liquidity, net gearing and interest coverage ratios, suggesting that customers are well positioned to tide short-term economic difficulties. VMS is well diversified, with top 20 customers accounting for 70-80% of revenue in any given year.

Fig 4: DPS is comfortably funded by FCF per share



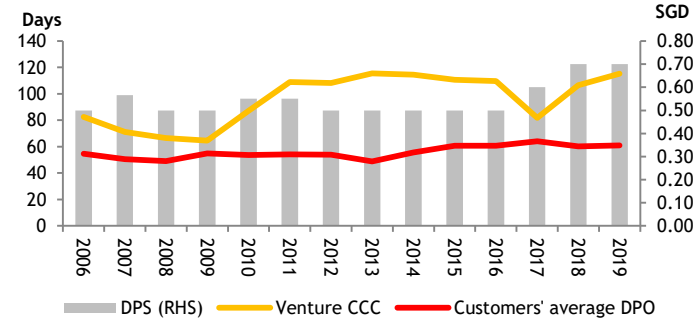
Source: Company, Maybank Kim Eng

Fig 5: Balance sheet is strong



Source: FactSet, Company, Maybank Kim Eng

Fig 6: Although cash conversion cycle has increased through the years, it has not impeded its ability to pay dividends. Customers' average days of payables outstanding has been stable, even throughout the GFC



Source: FactSet, Company, Maybank Kim Eng

Fig 7: Customers' liquidity, leverage and coverage snapshot

Customer	Quick ratio (x)	Net debt/ equity	Interest coverage (x)
Average	**1.83**	**-16%**	**10.29**
Agilent	1.21	29%	12.8
ABB	1.10	44%	27.3
Broadcom	1.44	160%	3.0
Honeywell	1.10	34%	17.2
HP Inc	0.53	-94%	15.7
PerkinElmer	1.33	73%	6.4
Keysight	2.64	8%	8.9
NCR	0.93	236%	3.3
Illumina	6.15	-33%	19.1
Lumentum	5.60	-8%	1.1
Marvell	1.71	13%	-2.1
Thermo Fisher	1.38	54%	6.3
Waters	1.68	-665%	14.9
Fortive	0.88	72%	7.1
Philips	0.96	32%	13.1
Philip Morris	0.60	-215%	10.7

Source: FactSet,

Valuation

Our TP of SGD13.90 is based on 1.5x FY20E P/B (prev: 2x), in turn based on FY20-22E average ROE of 12.8%, and a higher COE of 9% (prev: 8%). COE is raised as we increase our beta assumption of 1x from 0.85x to factor higher volatility of the stock since we initiated coverage in Jan-18.

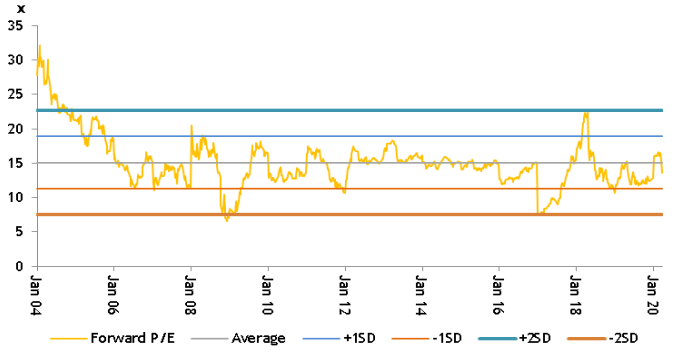
On FY20E basis, VMS is trading on 5% yield and 1.6x P/B, which are near long-term mean. During the GFC, VMS troughed at 0.6x forward P/B and 12.4% yield.

Fig 8: Peer comparisons

Company	BBG Code	MKE Rec	MKE TP (LC)	Price (LC)	FYE mm	Mcap USDm	P/E (x) Act	P/E (x) FY1	P/E (x) FY2	P/E (x) FY3	EV /EBITDA (x) FY1	PBR (x) FY1	Div yield (%) FY1
Venture Corp	VMS SP	Buy	13.90	13.96	12	2,829	11.1	13.7	11.8	10.3	8.1	1.6	5.0
Singapore listed EMS and precision engineering peers													
Valuetronics	VALUE SP	Buy	0.82	0.51	03	154	5.9	7.4	7.8	6.4	0.8	1.0	8.4
Sunningdale Tech	SUNN SP	NR	-	0.85	12	113	13.6	10.2	9.2	8.8	-	0.4	-
HI-P Int'l	HIP SP	Hold	0.78	0.83	12	515	8.3	12.3	9.9	8.3	3.5	1.1	3.0
Average							**10.6**	**13.1**	**11.3**	**9.8**	**6.9**	**1.4**	**4.7**
High mix low volume EMS peers													
Benchmark Elec	BHE US	NR	-	18.23	12	670	13.8	16.9	11.0	-	-	-	-
Plexus	PLXS US	NR	-	51.14	09	1,501	14.9	15.2	11.4	9.1	7.6	1.6	-
Average							**14.6**	**15.8**	**11.3**	**9.1**	**7.6**	**1.6**	**-**
Global EMS peers													
Hon Hai	2317 TT	NR	-	70.10	12	32,155	8.8	8.5	8.6	7.6	4.6	0.8	5.6
Flex	FLEX US	NR	-	8.05	03	4,057	7.1	6.6	6.2	5.1	3.1	1.4	0.0
Jabil	JBL US	NR	-	23.85	08	3,627	8.0	8.2	6.4	6.0	3.2	1.9	1.4
Pegatron	2938 TT	NR	-	60.10	12	5,192	8.1	10.6	9.8	11.0	3.5	1.0	6.8
SKP Resources	SKP MK	NR	-	0.77	03	221	9.8	9.5	7.0	6.1	6.3	1.5	5.5
V.S. Industry	VSI MK	Hold	0.75	0.75	07	323	8.3	11.5	9.4	8.3	4.9	0.9	4.8
Sanmina	SANM	NR	-	25.32	09	1,789	7.4	9.0	8.0	9.6	-	-	0.0
FIH Mobile	2038 HK	NR	-	0.88	12	931	-	5.7	5.7	-	-	-	0.0
Celestica	CLS CN	NR	-	4.65	12	365	6.5	5.1	3.8	-	1.6	-	0.0
Fabrinet	FN US	NR	-	48.34	06	1,791	12.7	12.7	11.2	10.1	7.1	1.8	-
Average							**8.6**	**8.6**	**8.4**	**7.8**	**4.3**	**1.0**	**5.4**

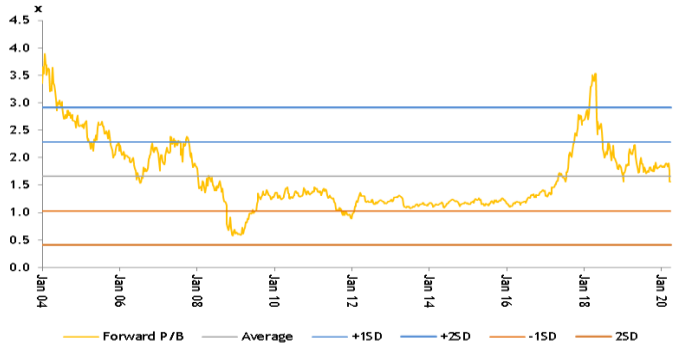
Source: FactSet, Bloomberg, Maybank Kim ENg

Fig 9: Forward P/E band



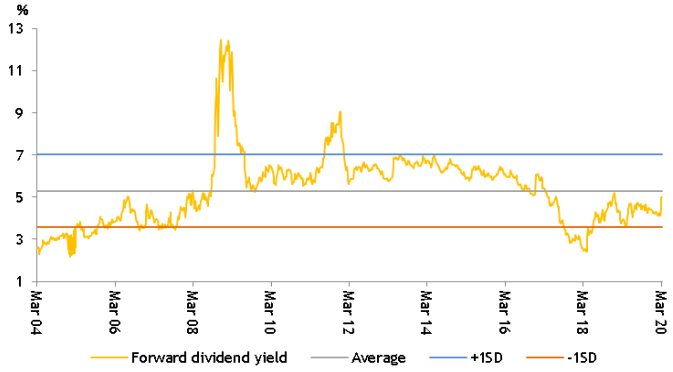
Source: Company, Maybank Kim Eng

Fig 10: Forward P/B band



Source: FactSet, Company, Maybank Kim Eng

Fig 11: Forward dividend yield band

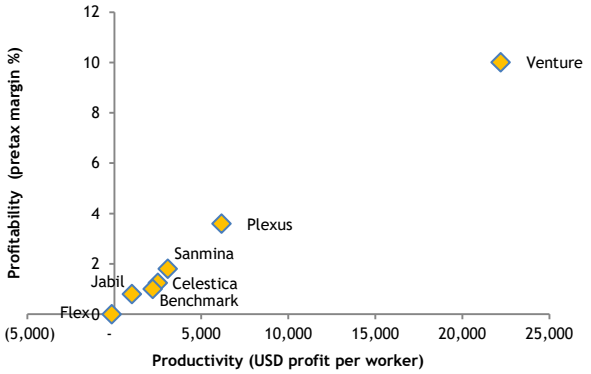


Source: Company, Maybank Kim Eng

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.
- Facing pricing pressure and increased competition. However, margins are still industry leading.
- Good diversification with >100 active customers, many of them blue chips.
- Good exposure to test & measurement, and life-science customers, still largely underpenetrated due to regulatory requirements and high specs.

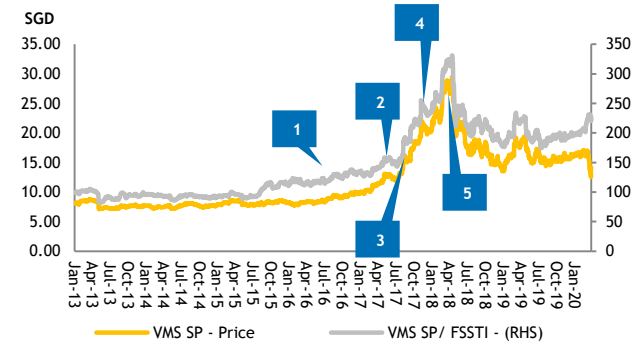
Industry-leading profitability and productivity



Source: Bloomberg, Companies

Price Drivers

Historical share price trend



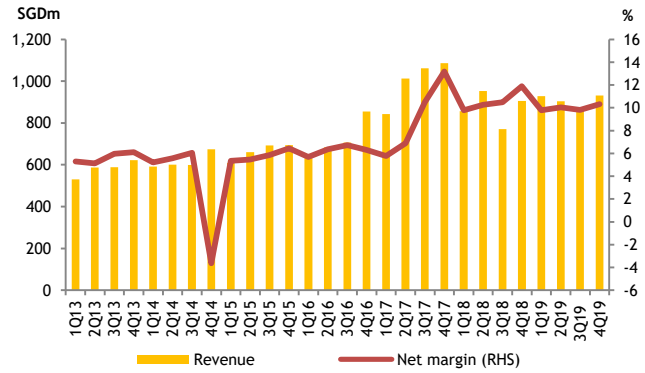
Source: Company, FactSet, Maybank Kim Eng

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

- We are expecting earnings to decline 18% in FY20E due to supply and demand shocks as a result of Covid-19.
- Operating margins should be steady from more products with higher R&D content & cost control.
- 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	FY18A	FY19A	FY20E	FY21E	FY22E
Key Metrics					
P/E (reported) (x)	15.5	12.8	13.6	11.7	10.2
Core P/E (x)	10.8	12.9	13.6	11.7	10.2
Core FD P/E (x)	10.9	13.0	13.7	11.8	10.3
P/BV (x)	1.7	1.9	1.6	1.5	1.4
P/NTA (x)	1.7	1.9	1.6	1.5	1.4
Net dividend yield (%)	5.0	4.3	5.0	5.0	5.0
FCF yield (%)	4.3	5.0	7.6	7.1	5.2
EV/EBITDA (x)	7.2	8.8	8.7	7.3	6.4
EV/EBIT (x)	7.8	9.7	9.6	7.9	6.9
INCOME STATEMENT (SGD m)					
Revenue	3,484.6	3,633.4	3,306.4	3,637.1	4,000.8
Gross profit	953.8	906.8	810.1	902.0	1,000.2
EBITDA	455.5	448.2	371.9	433.1	492.8
Depreciation	(30.7)	(38.7)	(34.7)	(35.9)	(37.3)
Amortisation	(1.1)	(1.0)	(1.0)	(1.0)	(1.0)
EBIT	423.7	408.5	336.2	396.1	454.5
Net interest income /(exp)	8.2	10.5	9.0	9.0	9.0
Associates & JV	(0.1)	0.0	0.0	0.0	0.0
Exceptionals	0.0	0.0	0.0	0.0	0.0
Other pretax income	0.0	0.0	0.0	0.0	0.0
Pretax profit	431.9	419.0	345.2	405.1	463.5
Income tax	(62.9)	(56.6)	(48.3)	(60.8)	(69.5)
Minorities	(0.2)	(0.3)	(0.2)	(0.2)	(0.2)
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	368.8	362.1	296.6	344.2	393.8
Core net profit	368.8	362.1	296.6	344.2	393.8
BALANCE SHEET (SGD m)					
Cash & Short Term Investments	712.8	714.5	800.0	881.7	889.3
Accounts receivable	735.9	898.9	767.9	886.2	977.1
Inventory	808.2	706.2	730.1	843.5	882.9
Property, Plant & Equip (net)	230.7	231.7	228.9	228.3	230.3
Intangible assets	639.9	667.5	667.5	667.5	667.5
Investment in Associates & JVs	0.7	0.8	0.8	0.8	0.8
Other assets	76.4	54.7	46.2	46.2	46.2
Total assets	**3,204.6**	**3,274.2**	**3,241.4**	**3,554.2**	**3,694.1**
ST interest bearing debt	1.8	1.1	1.1	1.1	1.1
Accounts payable	529.0	490.3	439.8	609.3	558.1
LT interest bearing debt	0.0	0.0	0.0	0.0	0.0
Other liabilities	322.0	284.0	207.0	208.0	207.0
Total Liabilities	**852.5**	**775.7**	**647.8**	**818.3**	**766.1**
Shareholders Equity	2,349.9	2,496.2	2,590.9	2,733.2	2,925.0
Minority Interest	2.2	2.4	2.6	2.8	3.0
Total shareholder equity	**2,352.1**	**2,498.6**	**2,593.5**	**2,735.9**	**2,928.0**
Total liabilities and equity	**3,204.6**	**3,274.2**	**3,241.4**	**3,554.2**	**3,694.1**
CASH FLOW (SGD m)					
Pretax profit	431.9	419.0	345.2	405.1	463.5
Depreciation & amortisation	31.8	39.7	35.7	36.9	38.3
Adj net interest (income)/exp	0.0	0.0	0.0	0.0	0.0
Change in working capital	(170.9)	(125.8)	5.1	(61.3)	(182.4)
Cash taxes paid	(56.3)	(61.7)	(48.3)	(60.8)	(69.5)
Other operating cash flow	0.0	0.0	0.0	0.0	0.0
Cash flow from operations	236.6	271.1	337.6	320.0	249.8
Capex	(63.6)	(39.7)	(31.9)	(35.4)	(39.3)
Free cash flow	173.0	231.4	305.7	284.6	210.6
Dividends paid	(230.0)	(201.9)	(201.9)	(201.9)	(201.9)
Equity raised / (purchased)	41.5	7.9	0.0	0.0	0.0
Change in Debt	(29.0)	(0.7)	0.0	0.0	0.0
Other invest/financing cash flow	3.8	(35.9)	(18.3)	(1.0)	(1.0)
Effect of exch rate changes	0.0	0.0	0.0	0.0	0.0
Net cash flow	(40.7)	0.6	85.5	81.7	7.6

FYE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Key Ratios					
Growth ratios (%)					
Revenue growth	(13.0)	4.3	(9.0)	10.0	10.0
EBITDA growth	(0.8)	(1.6)	(17.0)	16.4	13.8
EBIT growth	(0.7)	(3.6)	(17.7)	17.8	14.7
Pretax growth	(2.4)	(3.0)	(17.6)	17.4	14.4
Reported net profit growth	(0.8)	(1.8)	(18.1)	16.0	14.4
Core net profit growth	2.3	(1.8)	(18.1)	16.0	14.4
Profitability ratios (%)					
EBITDA margin	13.1	12.3	11.2	11.9	12.3
EBIT margin	12.2	11.2	10.2	10.9	11.4
Pretax profit margin	12.4	11.5	10.4	11.1	11.6
Payout ratio	54.4	55.7	68.1	58.7	51.3
DuPont analysis					
Net profit margin (%)	10.6	10.0	9.0	9.5	9.8
Revenue/Assets (x)	1.1	1.1	1.0	1.0	1.1
Assets/Equity (x)	1.4	1.3	1.3	1.3	1.3
ROAE (%)	16.3	14.9	11.7	12.9	13.9
ROAA (%)	11.6	11.2	9.1	10.1	10.9
Liquidity & Efficiency					
Cash conversion cycle	105.1	113.7	127.2	116.4	117.4
Days receivable outstanding	77.6	81.0	90.7	81.9	83.8
Days inventory outstanding	107.2	100.0	103.6	103.6	103.6
Days payables outstanding	79.7	67.3	67.1	69.0	70.0
Dividend cover (x)	1.8	1.8	1.5	1.7	2.0
Current ratio (x)	2.7	3.1	3.6	3.2	3.6
Leverage & Expense Analysis					
Asset/Liability (x)	3.8	4.2	5.0	4.3	4.8
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)	0.0	0.0	0.0	0.0	0.0
Capex/revenue (%)	1.8	1.1	1.0	1.0	1.0
Net debt/ (net cash)	(711.0)	(713.4)	(798.9)	(880.6)	(888.2)

Source: Company; Maybank

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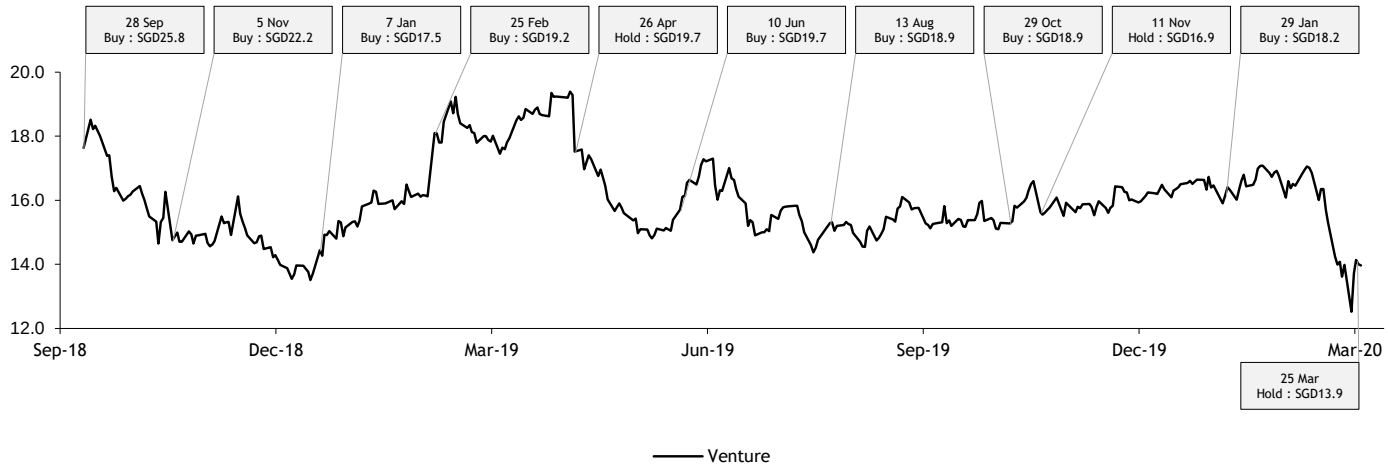

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