

Venture (VMS SP)

From strength to strength

FY17 beat on margin expansion; TP raised 13%

VMS delivered FY17 core PATMI of SGD361.5m (+100 YoY), which was 10.6%/7.5% ahead of our/consensus forecasts. This was driven by margin expansion as a result of increased R&D and strong cost control. We tweaked our margin assumptions and raised FY18/19E EPS by 8%/12%. TP is also increased to SGD31.20, now based on FY18E P/B of 3.7x vs. a P/E of 18.8x, previously (see below). We continue to believe that VMS is a beneficiary of multifaceted growth drivers that have yet to peak. Maintain BUY.

Broad-based revenue growth

FY17 revenue grew 39% YoY and met our expectation. Growth was broad-based, as VMS attributed c75% of revenue accruing from customers with good growth prospects across several technology domains. VMS is hinting at cSGD50m of capex in FY18 on top of the USD29.3m property acquisition recently completed in Silicon Valley. While VMS states that the investment is to boost advanced manufacturing capabilities, we do not preclude part of this budget could be for capacity expansion given the vast amount of land acquired since 2016.

R&D drives growth and profitability

Excluding the SGD11.7m gain from the disposal of Fischer Tech in 4Q17, VMS still achieved a phenomenal 12.1% core net margin (+5.8ppt YoY), achieved through a combination of strong R&D and cost control. R&D expense has picked up since 3Q16 and accelerated in 4Q17 amid increased customer requirements. This could bode well for FY19E revenue growth prospects as R&D has historically preceded revenue growth by 1.5 to 2 years. Management reemphasized the need for R&D to foster customer engagement and profitability improvement.

Valuation

The recent results has strengthened our confidence that VMS' ROEs have shifted to a higher level. The ROE-g/COE-g methodology helps us capture the marked improvement in the ROE profile for VMS, which was in the single digit range for the better part of the last decade. VMS declared a DPS of SGD0.60 in FY17, in line with our expectation. Our TP of SGD31.20 is now based on FY18E P/B of 3.7x (FY18-20E avg. ROE: 20.5%, COE: 7.1%), vs. our previous valuation based on a P/E of 18.8x (10% above the 17x mean for high-mix, low volume peers).

FYE Dec (SGD m)	FY16A	FY17A	FY18E	FY19E	FY20E
Revenue	2,874	4,005	4,663	5,344	5,886
EBITDA	257	460	581	686	782
Core net profit	181	361	454	540	620
Core FDEPS (cts)	64.8	126.0	158.4	188.4	216.0
Core FDEPS growth(%)	16.5	94.3	25.7	19.0	14.7
Net DPS (cts)	50.0	60.0	65.0	70.0	80.0
Core FD P/E (x)	42.5	21.9	17.4	14.6	12.8
P/BV (x)	3.9	3.6	3.2	2.8	2.5
Net dividend yield (%)	1.8	2.2	2.4	2.5	2.9
ROAE (%)	9.4	18.1	19.7	20.7	20.9
ROAA (%)	6.8	12.2	13.9	14.9	15.2
EV/EBITDA (x)	9.1	11.0	12.1	10.0	8.3
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Consensus net profit	-	-	399	466	na
MKE vs. Consensus (%)	-	-	13.9	15.9	na

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BUY

Share Price	SGD 27.56
12m Price Target	SGD 31.20 (+13%)
Previous Price Target	SGD 27.50

Company Description

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

Statistics

52w high/low (SGD)	27.60/10.71
3m avg turnover (USDm)	20.6
Free float (%)	91.2
Issued shares (m)	285
Market capitalisation	SGD7.9B
	USD5.9B

Major shareholders:

WONG NGIT LIONG	7.1%
Sprucegrove Investment Management Ltd.	5.8%
Silchester International Investors LLP	5.8%

Price Performance



	-1M	-3M	-12M
Absolute (%)	20	31	156
Relative to index (%)	19	27	124

Source: FactSet

Revisions to estimates

Fig 1: MKE forecast revisions for VMS

	FY18E			FY19E		
	New	Old	Chg (%)	New	Old	Chg (%)
Revenue (SGDm)	4,662.7	4,653.0	0.2	5,343.8	5,210.8	2.6
Gross profit (SGDm)	1,125.2	1,104.7	1.9	1,309.8	1,250.7	4.7
EBIT (SGDm)	544.9	502.1	8.5	648.8	576.4	12.6
EBITDA (SGDm)	580.7	528.1	10.0	685.6	602.4	13.8
Core net profit (SGDm)	454.2	418.4	8.6	540.3	480.0	12.6
EPS (SGD)	1.58	1.47	8.1	1.88	1.68	12.1
			Chg (ppt)			Chg (ppt)
Gross margin	24.1%	23.7%	0.4	24.5%	24.0%	0.5
SGA as % of sales	8.4%	8.9%	-0.5	8.3%	8.8%	-0.5

Source: Maybank Kim Eng

We have raised FY18/19E EPS by 8%/12% after tweaking our assumptions for gross margin and SGA as a % of sales to reflect the better than expected results by VMS.

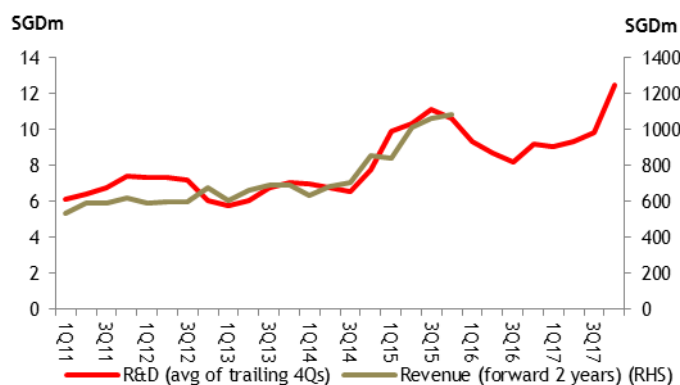
Three takeaways from 4Q17 & FY17 results

Core PATMI was SGD361.5m (+100% YoY), 10.6%/7.5% ahead of our/consensus forecasts. This was driven by a positive margin surprise in 4Q17 as a result of R&D efforts and strong cost control. FY17 revenue of SGD4b was also in line.

Takeaways from this set of results:

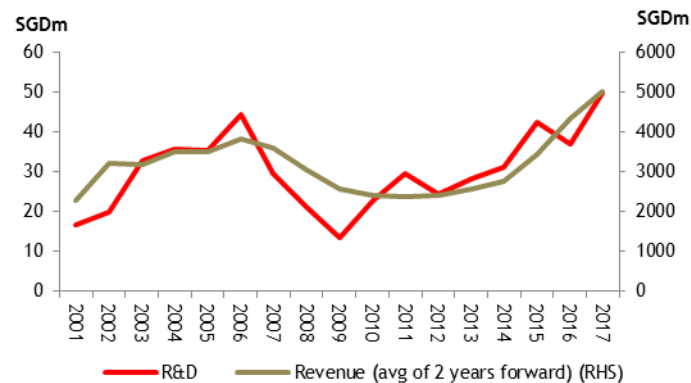
- **Broad-based revenue growth:** 4Q17/FY17 revenue grew 27.1%/39.3% YoY, respectively, and was largely broad-based. Management attributed c75% of revenue to growth customers. Segmentally, revenues surged from Test & Measurement / Medical & Life Sciences / Others (TMO) by 83.9% to SGD2.3b during the year; these businesses now account for 57% of total group revenue. VMS stated that customers in this segment are quite sticky because of the stringent qualification processes and the high demands required to provide value-added services to the overall design and manufacturing needs of the customers.
- **R&D drives growth and profitability:** 4Q17/FY17 R&D expenses jumped 84.8%/35.2% YoY, driven by increased customer requirements. FY17 R&D expense of cSGD50m was the highest in at least a decade. VMS reemphasized the need for R&D and deep customer engagement in order to improve profitability. The recent pick-up in R&D expenses portends well for higher revenue growth in FY19E (see Fig. 's 2, 3), which R&D typically leads by 1.5 to 2 years.
- **Capex also an indicator of growth:** Management hinted at cSGD50m of capex in FY18E on top of the USD29.4m property acquisition in Silicon Valley earlier this year. This is for the development of new engineering and advanced manufacturing capabilities. This is higher than the SGD20-30m depreciation charge. We do not preclude that some of the capex budget is earmarked for capacity expansion given that Venture has ample land.

Fig 2: R&D exp. accelerated in 4Q17. R&D rise in FY15 preceded revenue growth in FY17.



Source: Company, Maybank Kim Eng

Fig 3: Over a longer timeframe, R&D has historically preceded revenue growth by about 1.5 to 2 years



Source: Company, Maybank Kim Eng

Fig 4: P&L summary

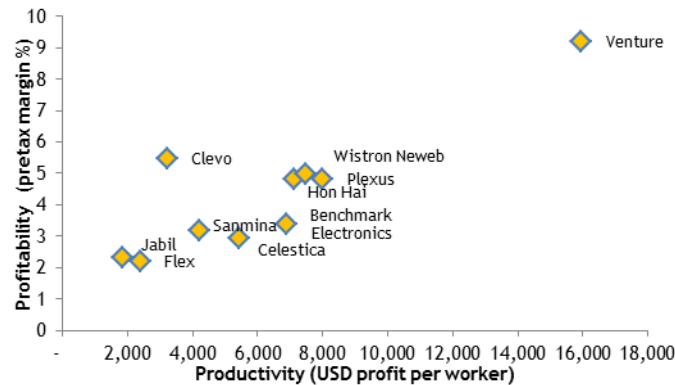
FYE Dec	4Q17	3Q17	4Q16	QoQ Chg	YoY Chg	FY17	FY16	YoY Chg	MKE	FY17A vs FY17E
	(SGD m)	(SGD m)	(SGD m)	(%)	(%)	(SGD m)	(SGD m)	(%)	FY17E	(%)
Revenue	1,086.5	1,061.9	854.6	2.3	27.1	4,004.5	2,874.2	39.3	4,009.0	-0.1
COGS	(802.0)	(809.5)	(656.9)	-0.9	22.1	(3,070.2)	(2,217.4)	38.5	(3,072.9)	-0.1
Gross profit	284.5	252.4	197.7	12.7	43.9	934.4	656.8	42.3	936.2	-0.2
Total SGA	(87.0)	(83.9)	(74.1)	3.7	17.5	(346.1)	(285.0)	21.4	(360.8)	-4.1
R&D Expenses	(23.1)	(11.8)	(12.5)	95.8	84.8	(49.9)	(36.9)	35.2	(52.1)	-4.2
Other Op. Income	0.4	1.1	1.4	-67.4	-75.1	2.3	2.9	-21.3	2.0	13.5
Other Op. Expenses	(19.2)	(26.9)	(49.3)	-28.5	-61.0	(112.7)	(127.0)	-11.3	(135.0)	-16.5
EBIT	155.4	130.8	63.2	18.8	145.9	427.9	210.7	103.1	390.2	9.7
EBITDA	163.9	139.7	76.8	17.3	113.4	459.0	255.8	79.4	416.2	10.3
Net Int. Income (Exp)	1.2	0.5	0.6	148.6	81.6	2.8	2.2	28.9	2.2	27.5
Associates Income	0.0	0.0	1.2	nm	-100.0	1.7	3.0	-43.6	1.7	0.0
Exceptional Items	11.7	0.0	0.0	nm	nm	11.3	0.0	nm	0.0	nm
Pretax Profit	168.3	131.3	65.1	28.2	158.5	443.8	215.9	105.6	394.1	12.6
Taxation	(25.0)	(19.9)	(11.1)	25.5	125.3	(71.0)	(35.2)	102.0	(67.0)	6.0
Net profit	143.3	111.4	54.0	28.7	165.3	372.7	180.7	106.3	327.1	13.9
Minority Interest	(0.1)	(0.0)	0.1	83.3	-205.8	(0.1)	0.0	nm	0.2	nm
PATMI	143.3	111.4	53.9	28.7	165.7	372.8	180.7	106.3	326.9	14.0
Core PATMI	131.6	111.4	53.9	18.2	144.0	361.5	180.7	100.1	326.9	10.6
Core EPS (SGD)	0.46	0.40	0.20	16.5	135.9	1.28	0.65	96.7	1.16	10.5
				Change (ppt)				Change (ppt)		Difference (ppt)
Gross margin	26.2%	23.8%	23.1%	2.4	3.0	23.3%	22.9%	0.5	23.4%	0.0
EBIT margin	14.3%	12.3%	7.4%	2.0	6.9	10.7%	7.3%	3.4	9.7%	1.0
Core net margin	12.1%	10.5%	6.3%	1.6	5.8	9.0%	6.3%	2.7	8.2%	0.9

Source: Company, Maybank Kim Eng

Value Proposition

- An EMS 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 price products for industry-leading profitability and productivity despite cutthroat competition.
- Good diversification with 180 active customers, many of them blue chip.
- Good exposure to test & measurement & life-science customers, still largely underpenetrated due to regulatory requirements and high specs.

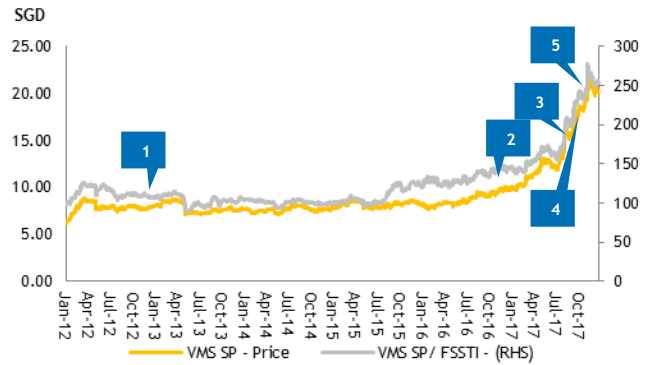
Industry-leading profitability and productivity



Source: Bloomberg, Companies

Price Drivers

Historical share price



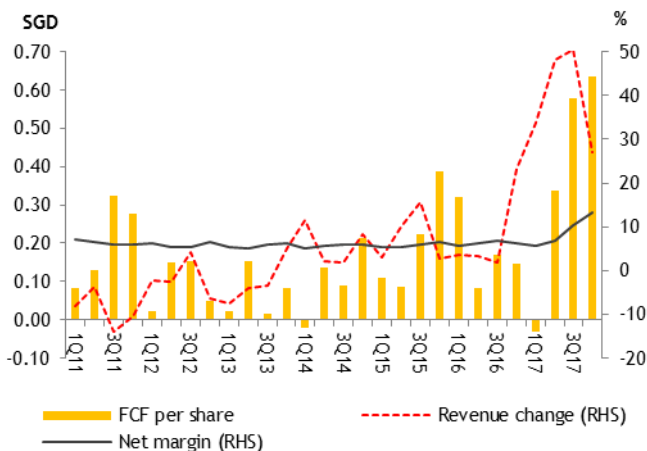
Source: Company, Maybank Kim Eng, FactSet

1. US economic weakness and disruptions from M&A activity among customers.
2. Street raised TPs for the first time in two years following strong 3Q/4Q16 earnings.
3. Strong 2Q17. Increasing market familiarity with the potential of VMS emanating from Illumina and cloud & 5G network spending.
4. CEO Wong Ngit Liong bought 400,000 shares at SGD15.26.
5. Strong 3Q17; management raised net-margin guidance.

Financial Metrics

- Revenue driven by allocations from existing customers and new projects. Could include smokeless cigarette devices and smart toothbrushes in the near term.
- Operating margins should continue to expand from more products with higher R&D content & operating leverage.
- Net cash since 2008. Rising FCF in FY19-20E could provide upside for dividends.

Rising profitability & cash flow as revenue ramps up



Source: Company

Swing Factors

Upside

- Better-than-expected reception for high-growth products.
- Strength of 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 or discontinue orders.
- Excessive USD strength may erode customer competitiveness. Excessive USD weakness may weaken its SGD earnings.
- Customer demand for VMS to hold more inventories at its major hubs. This will tie up working capital.

FYE 31 Dec	FY16A	FY17A	FY18E	FY19E	FY20E
Key Metrics					
P/E (reported) (x)	13.5	10.9	17.3	14.5	12.7
Core P/E (x)	42.3	21.5	17.3	14.5	12.7
Core FD P/E (x)	42.5	21.9	17.4	14.6	12.8
P/BV (x)	3.9	3.6	3.2	2.8	2.5
P/NTA (x)	3.9	3.6	3.2	2.8	2.5
Net dividend yield (%)	1.8	2.2	2.4	2.5	2.9
FCF yield (%)	2.3	6.1	3.6	5.1	7.8
EV/EBITDA (x)	9.1	11.0	12.1	10.0	8.3
EV/EBIT (x)	11.1	11.8	12.9	10.5	8.7
INCOME STATEMENT (SGD m)					
Revenue	2,874.2	4,004.5	4,662.7	5,343.8	5,885.9
Gross profit	656.8	934.4	1,125.2	1,309.8	1,450.1
EBITDA	257.1	460.1	580.7	685.6	782.0
Depreciation	(26.2)	(31.1)	(34.8)	(35.9)	(38.0)
Amortisation	(20.2)	(1.1)	(1.0)	(1.0)	(1.0)
EBIT	210.7	427.9	544.9	648.8	743.0
Net interest income / (exp)	2.2	2.8	2.5	2.5	3.7
Associates & JV	3.0	1.7	0.0	0.0	0.0
Exceptionals	0.0	11.3	0.0	0.0	0.0
Other pretax income	0.0	0.0	0.0	0.0	1.0
Pretax profit	215.9	443.8	547.4	651.2	747.7
Income tax	(35.2)	(71.0)	(93.1)	(110.7)	(126.9)
Minorities	(0.0)	(0.1)	(0.2)	(0.2)	(1.2)
Perpetual securities	0.0	0.0	0.0	0.0	0.0
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	180.7	372.6	454.2	540.3	619.5
Core net profit	180.7	361.3	454.2	540.3	619.5
Preferred Dividends	0.0	0.0	0.0	0.0	0.0
BALANCE SHEET (SGD m)					
Cash & Short Term Investments	499.7	752.4	847.8	1,048.3	1,426.1
Accounts receivable	713.0	765.7	843.8	971.6	995.8
Inventory	623.0	699.6	754.1	881.6	892.8
Property, Plant & Equip (net)	203.2	197.9	253.3	254.8	258.3
Intangible assets	641.0	640.6	640.6	640.6	640.6
Investment in Associates & JVs	20.3	0.8	0.8	0.8	0.8
Other assets	58.4	87.1	62.6	62.6	62.6
Total assets	2,758.5	3,144.2	3,403.1	3,860.3	4,276.9
ST interest bearing debt	92.6	30.8	30.8	30.8	30.8
Accounts payable	490.9	591.3	649.3	765.4	790.2
LT interest bearing debt	0.0	0.0	0.0	0.0	0.0
Other liabilities	212.0	354.0	286.0	286.0	286.0
Total Liabilities	796.0	976.1	965.9	1,082.0	1,106.8
Shareholders Equity	1,960.1	2,165.8	2,434.7	2,775.6	3,166.2
Minority Interest	2.4	2.3	2.5	2.7	3.9
Total shareholder equity	1,962.5	2,168.1	2,437.2	2,778.3	3,170.1
Perpetual securities	0.0	0.0	0.0	0.0	0.0
Total liabilities and equity	2,758.5	3,144.2	3,403.1	3,860.3	4,276.9
CASH FLOW (SGD m)					
Pretax profit	215.9	443.8	547.4	651.2	747.7
Depreciation & amortisation	46.4	32.1	35.8	36.9	39.0
Adj net interest (income)/exp	0.0	0.0	0.0	0.0	0.0
Change in working capital	(10.0)	76.8	(118.3)	(139.1)	(10.6)
Cash taxes paid	(33.5)	(51.2)	(93.1)	(110.7)	(126.9)
Other operating cash flow	0.0	0.0	0.0	0.0	1.0
Cash flow from operations	215.9	499.8	371.9	438.3	650.2
Capex	(42.9)	(25.8)	(90.3)	(37.4)	(41.4)
Free cash flow	173.0	474.1	281.6	400.9	608.7
Dividends paid	(138.4)	(140.7)	(185.2)	(199.5)	(227.9)
Equity raised / (purchased)	20.4	48.0	0.0	0.0	0.0
Perpetual securities	0.0	0.0	0.0	0.0	0.0
Change in Debt	(42.4)	(61.8)	0.0	0.0	0.0
Perpetual securities distribution	0.0	0.0	0.0	0.0	0.0
Other invest/financing cash flow	27.2	(68.4)	(1.0)	(1.0)	(1.0)
Effect of exch rate changes	(0.3)	0.5	0.0	0.0	0.0
Net cash flow	39.5	251.7	95.4	200.4	379.8

FYE 31 Dec	FY16A	FY17A	FY18E	FY19E	FY20E
Key Ratios					
Growth ratios (%)					
Revenue growth	8.2	39.3	16.4	14.6	10.1
EBITDA growth	14.9	78.9	26.2	18.1	14.1
EBIT growth	18.6	103.1	27.3	19.1	14.5
Pretax growth	18.8	105.6	23.4	19.0	14.8
Reported net profit growth	17.3	106.2	21.9	19.0	14.7
Core net profit growth	17.3	99.9	25.7	19.0	14.7
Profitability ratios (%)					
EBITDA margin	8.9	11.5	12.5	12.8	13.3
EBIT margin	7.3	10.7	11.7	12.1	12.6
Pretax profit margin	7.5	11.1	11.7	12.2	12.7
Payout ratio	76.7	45.4	40.8	36.9	36.8
DuPont analysis					
Net profit margin (%)	6.3	9.3	9.7	10.1	10.5
Revenue/Assets (x)	1.0	1.3	1.4	1.4	1.4
Assets/Equity (x)	1.4	1.5	1.4	1.4	1.4
ROAE (%)	9.4	18.1	19.7	20.7	20.9
ROAA (%)	6.8	12.2	13.9	14.9	15.2
Liquidity & Efficiency					
Cash conversion cycle	107.6	80.6	73.0	71.0	69.0
Days receivable outstanding	80.4	66.5	62.1	61.2	60.2
Days inventory outstanding	95.7	77.5	74.0	73.0	72.0
Days payables outstanding	68.5	63.4	63.1	63.1	63.1
Dividend cover (x)	1.3	2.2	2.5	2.7	2.7
Current ratio (x)	2.4	2.3	2.6	2.7	3.0
Leverage & Expense Analysis					
Asset/Liability (x)	3.5	3.2	3.5	3.6	3.9
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)	0.4	0.1	0.1	0.0	0.0
Capex/revenue (%)	1.5	0.6	1.9	0.7	0.7
Net debt/ (net cash)	(407.1)	(721.6)	(817.0)	(1,017.4)	(1,395.2)

Source: Company; Maybank

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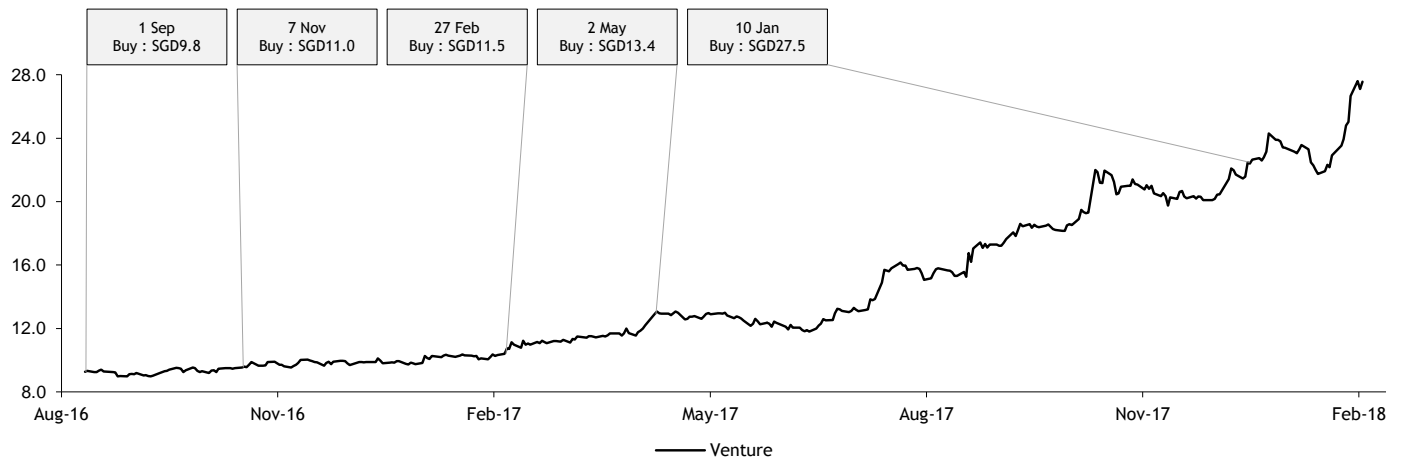
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