

ECS ICT Bhd

Initiating Coverage

BUY

Current Price : RM1.67
Consensus Price : n/a
Target Price : RM1.94

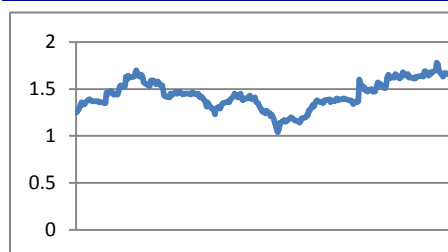
Key Statistics

Bloomberg Ticker	ECS MK
Masa Ticker / Stock Code	ECS/5162
Shares Issued (m)	180.0
Market Capitalisation (RM'm)	300.6
52 Week Hi/Lo Price (RM)	1.83/1.02
Avg Trading Volume (3-mth)	516,185
Est Free Float (m)	43.7
YTD Returns (%)	41.53
Beta	0.96

Major Shareholders (%)

ECS HOLDINGS LTD	41.02
SENGIN SDN BHD	12.05

1-Year Share Price Performance



Analyst: Research Team
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Gadgets Purveyor to Malaysia's Techies

We re-initiate coverage on ECS with a BUY rating and a target price of RM1.94 based on 10x PER pegged to its estimated FY15 EPS of 19.4sen. We expect a strong price appreciation for reasons of its 1) steadily growing earnings 2) strong cashflows that will sustain its attractive dividend yield. Lastly, growth in Malaysia's ICT market affordable smartphone brands segment will keep ECS' earnings chugging along.

ECS is a leading distributor for Information & Communications Technology (ICT) in Malaysia dealing with personal computers, smartphones, notebooks, printers, software, network and communication infrastructure, servers and enterprise software. The Group's business segments can be divided into 3 parts comprising of ICT Distribution, Enterprise Systems and ICT Support Services.

ECS ASTAR distributes many of the leading ICT brands in the market and has entrenched partnerships with 40 global brands like Adobe, Aerohive, Apple, ASUS, Lenovo, Microsoft, Xiaomi etc. Being the largest ICT distributor in Malaysia, ECS' distribution channels cover retailers, resellers and online retailers. The group has an effective distribution network of more than 5000 ICT and mobility resellers in the market.

Table 1 :Investment Highlights & Earnings Forecasts

FYE 31st Dec	2013	2014	2015(F)	2016(F)	2017(F)
Revenue (m)	1326.2	1591.1	1,710.4	1,864.4	2,050.8
EBITDA (m)	36.7	39.2	37.9	40.5	43.3
Net Profit (m)	26.9	29.4	30.0	31.1	32.5
EPS (sen)	14.9	16.3	19.4	22.4	25.7
Gross Profit Margin (%)	6.1%	5.5%	5.2%	5.1%	5.1%
EBITDA Margin (%)	2.77	2.46	2.22	2.00	1.80
Net Profit Margin (%)	2.03	1.85	1.76	1.67	1.58
P/E Ratio	11.17	10.22	9.20	8.28	7.45
Net Dividend Yield (%)	3.1	3.4	3.4	3.6	3.6
ROE (%)	13.7	13.7	13.8	14.0	14.1
ROA (%)	7.9	7.7	7.1	6.6	6.0
Dividends per share (sen)	5.5	6.0	6.0	6.5	6.5

Source: Company

Corporate Background

ECS ASTAR Sdn Bhd, ECS Pericomp Sdn Bhd, ECS Ku Sdn Bhd and ECS Kush Sdn Bhd are subsidiary companies wholly owned by ECS ICT Bhd. ECS ICT is an MSC- Status company, and a leading distribution hub for Information & Communications Technology (ICT) in Malaysia. ECS and its subsidiaries started in 1985 with 30 years of experiences in ICT business.

Mr Soong Jan Hsung, the Executive Director/Chief Executive Officer of ECS is responsible of the overall management of the Group. Mr Soong is appointed as ECS CEO since 1st January 2015. Mr Soong joined the Board on 21st February 1997. He first joined the Group as a sales executive with ECS Pericomp Sdn Bhd. He was promoted to be the General Manager in 1994 and was promoted to the Executive Director position 7 years later.

Mr Foo Sen Chin is the Executive Chairman and a member of the Remuneration Committee of ECS ICT Bhd. Mr Foo was appointed Executive Chairman on 1st January 2015. Mr Foo is an advisor to the current Council of PIKOM, Association of Computer and Multimedia Industry of Malaysia.

Illustration 1:- Corporate Structure

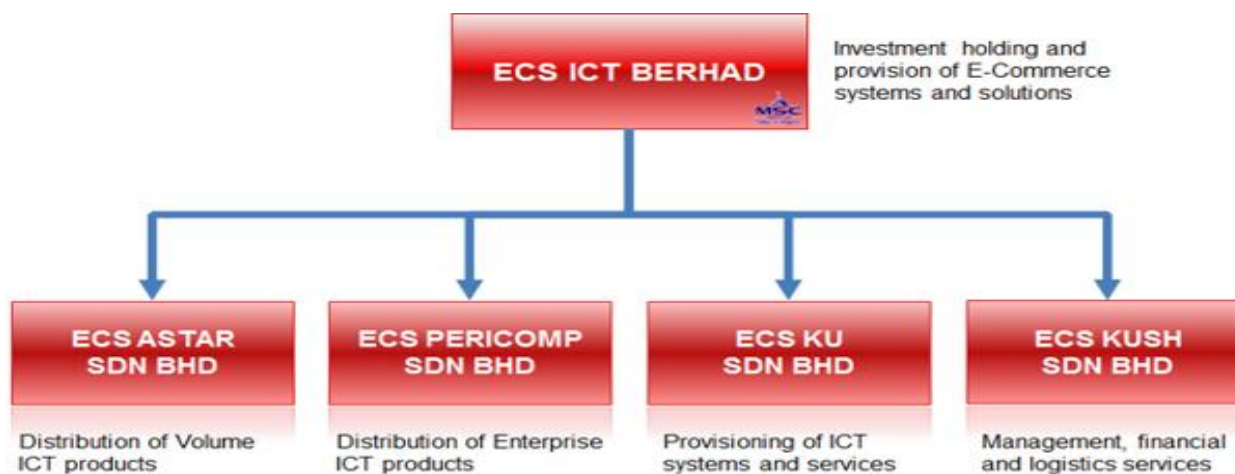


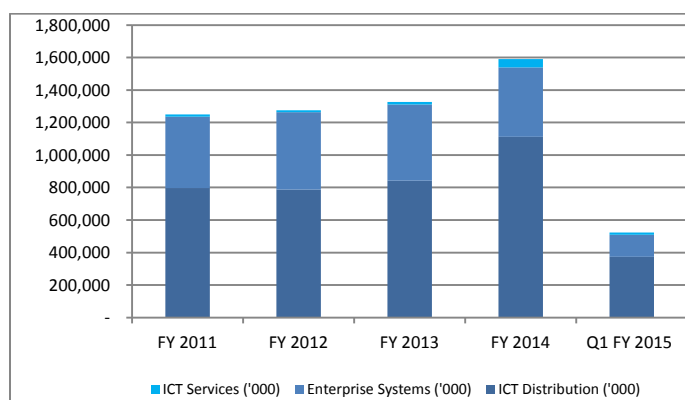
Table 2:- Corporate Structure

Company	Principle Activities
ECS ASTAR Sdn Bhd	Distribution of IT hardware PC's, notebooks, printers and related equipment
ECS PERCOMP Sdn Bhd	Distribution of computer peripherals and other hardware to PC dealers
ECS KU Sdn Bhd	Provide after sales services in technical support, maintenance and product warranty services
ECS KUSH Sdn Bhd	Provides back end and operational services to the entire ECS Group.

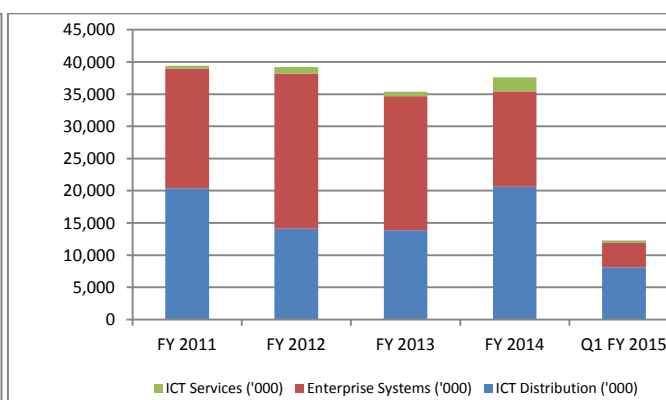
Source: Company

Segment Information

Graph 1:- Revenue Breakdown (000s)



Graph 2:- Segment Profit Before Tax (000s)



Source: Company

The ICT Distribution segment contributes the most to the group's revenue at about 70% of the total revenue in FY 2014. Despite the sizeable revenues generated from this segment, the profit margin is only about 1.9%. The Enterprise Systems segment contributes 27% of total revenue in FY 2014 and it nets a bigger profit margin of 3.5%. The ICT Services segment that contributes around 3% of the group's revenue has a highest profit margin of 4.3%.

The pre-GST shopping spree by the consumers benefited ECS as net profit in 1Q15 rose to RM9.4 million. In 1Q15, the revenue of the group escalated 46.2% to RM522.9 million from RM357.7 million as compared to the previous year. The ICT distribution segment had the highest YoY increment of 48.2% to RM372.8 million from RM251.6 million. Revenue from the Enterprise Systems increased by 43.5% to RM137.1 million while the revenue from ICT services improved by 21.9% to RM12.9 million.

The post-GST implementation has already started to take a toll on ECS. Consumer spending has decreased and the management guidance is some of their retailers experienced as much as a 40% decrease in their sales in April. However, management is positive that things will return to normal by the third quarter of the year driven by new models being introduced into the market.

Key Investment Themes

Mobility devices to be a growth catalyst

Malaysia's ICT sector is still growing and according to market survey consultants Gartner, Malaysia's IT spending is expected to increase by 7.5% in CY 2015. ECS expanded their mobility products portfolio as ECS was appointed as the distributor of Microsoft Mobile smartphones and they are the only distributor for Xiaomi to distribute their Mipad in Malaysia recently. Lenovo and ASUS smartphones are ranked 2nd and 3rd respectively in Malaysia. International Data Corporation (IDC) is of the view that sales of the affordable smartphone brands like Lenovo and Asus will continue to increase this year. ECS also plans to expand their company's smartphone distribution into tier 2 cities like Malacca and Seremban by having more resources in the cities to ensure a more sufficient sales coverage.

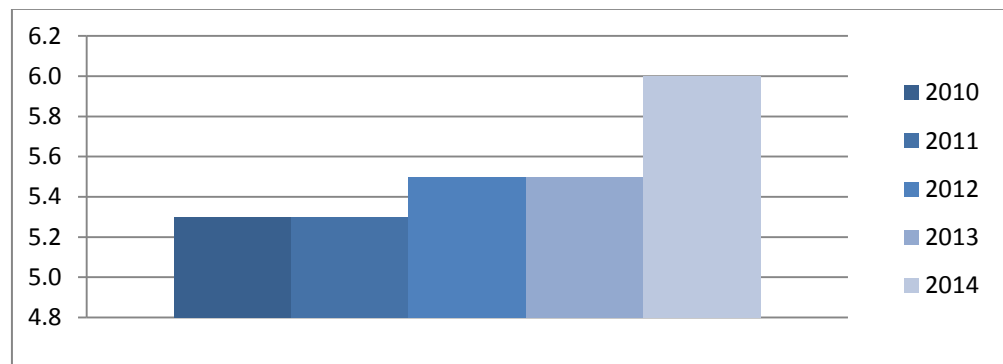
There will be a time in the future where the market trend is about the 'wearable products'. Wearable products like the Apple watch and ASUS Zenwatch will play a prominent role in future technology. The Group is looking to expand its mobility devices portfolio by including the related products like 'wearable technologies' mobile applications, mobile security and Enterprise mobility solutions. ECS will be monitoring the trend to ensure that they will be ready when the time comes as they are already looking to add 'wearable technology' and 'internet of things' products in the second half of 2015. IDC forecasts that there will be 45.7 million wearable devices that will be shipped within the year and expects the shipments to increase to 126.1 million units by 2019.

ECS also plans to expand their Enterprise System segment by targeting more projects and to work with System Integrators and vendors to implement IT systems on to public projects like the KLMRT. The group is also looking to expand their ICT Services segment through merger and acquisitions in relation to ICT Services.

Dividend payout ratio

ECS has a dividend payout policy of 30% on their net profit. In FY14, ECS proposed a final dividend of 3.0 sen subjected to shareholders' approval. The total dividend payout amounts to RM10.8 mil or 36.7% of total group net profit which includes the already-paid first interim dividend of 3.0 sen per share. The total Net Dividend Yield for FY14 is 3.7%.

Graph 2:- Dividend Payout Per Share (sen)



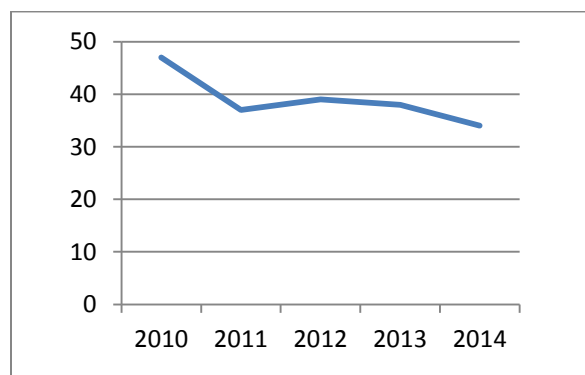
Source: Company and Inter-Pacific

Investment Risk

Operating in a thin profit margin business

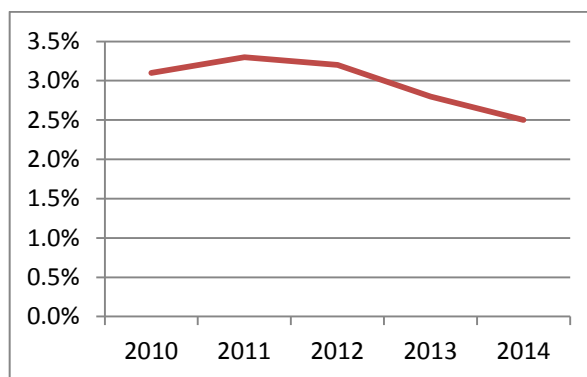
It is always the case for ICT providers to reduce the price of their products over the life of the products as there will always have new technological products being introduced to the market, hence the low profit margin. The historical pre-tax profit margin for ECS was in between 2.5%-3.3%. Management is aware acutely that they are working in a low margin environment therefore they keep their Cash Conversion Cycle under tight control at only 34 days in FY14.

Graph 3: Cash Conversion Cycle (days)



Source: Company and Inter-Pacific

Graph 4 : Pre-tax Profit Margin (%)



Source: Company and Inter-Pacific

Foreign currency fluctuation risks

Majority of ECS group purchases are conducted in USD. Therefore any rapid appreciation of the USD such as over 2H FY14, had a negative impact on ECS's profitability. The cost of goods sold had increased by approximately 21% in FY14. ECS has a proactive hedging policy to reduce the unfavorable movements of the USD. However, there are still risks that the appreciation of the USD will impact ECS's operating results as not all USD denominated purchases are fully hedged.

Forecasts And Assumptions

Table 3 : 1QFY15 Revenue Breakdown

Revenue (RM'm)	1QFY14	1QFY15	YoY chg (%)
ICT Distribution	251.60	372.83	48.2
Enterprise Systems	95.53	137.12	43.5
ICT services	10.58	12.90	21.9
Total	357.72	522.86	46.2

Source: Inter-Pacific

Overall revenue increased YoY due to buying by the consumers to beat the implementation of 6% GST nationwide.

Forecasts

Our forecast is ECS group revenue will grow at a CAGR of 7% in FY14-FY17 on the back of improving net profit (CAGR of 10%) across its business segments. Our forecast is the ICT Distribution segment will improve by 7% in FY15 due to the increase in demand for affordable smartphone brands and the introduction of wearable products and “internet of things” into the ICT market. We anticipate that the earnings for Enterprise Systems to increase by 6% in FY15. Projects associated with the MRT system will definitely improve revenue for this segment. We expect the ICT Services segment to grow between 20%-28% in the medium term as the management is targeting expansion of its ICT Services segment a major core growth driver.

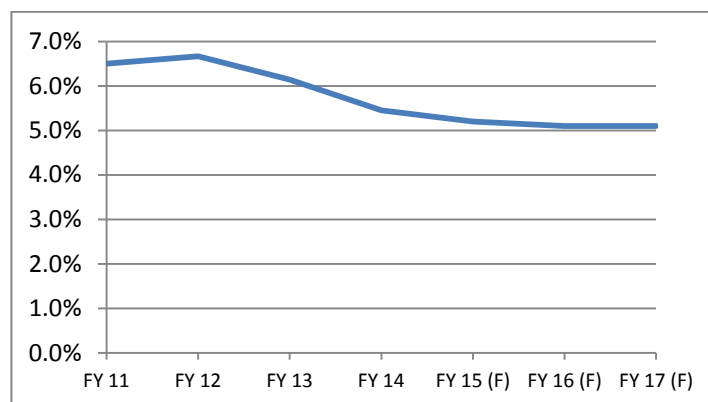
Table 4 : Revenue Forecast and Assumption

RM (RM'm)	FY 11	FY 12	FY 13	FY 14	FY 15 (F)	FY 16(F)
ICT Distribution	797.49	787.23	842.14	1,112.34	1,195.7	1,303.4
Growth (%)		(1.3)	7.0	32.1	6.9	7.5
Enterprise Systems	439.42	475.52	469.48	427.58	453.23	482.3
Growth (%)		8.2	(1.3)	(8.9)	6.0	3.0
ICT services	13.778	13.38	14.65	51.20	61.44	78.64
Growth (%)		(2.9)	9.6	249.5	20.0	28.0
Total	1,250.69	1,276.12	1,326.26	1,591.12	1,710.4	1,864.4

Source: Company and Inter-Pacific

Total group revenue has been increasing at a steady pace over the years. However the gross profit margin has been decreasing over the years. This is mainly because of the low operating profit margin of the ICT Distribution segment. We forecast that the operating profit margin to decrease at a slower pace. The revenue increment contribution from both the Enterprise Systems and ICT Services will help buffer the overall operating profit since the two segments offer better operating profit margins than ICT Distribution.

Graph 5 : Gross Profit Margin (%)



Source: Company and Inter-Pacific

Valuations and Recommendation

We are placing a near-term fair value of RM1.85 on ECS shares based on 9.9x PER pegged to its estimated FY15 EPS of 18.8sen. We benchmark valuations for ECS at levels observed for Engtex, which is also into the trading business and a similar market capitalisation. As in the case of Engtex, the chief investor concern is the low pretax margin on turnover, though we see steadier long term growth for ECS than has been observed over the years for Engtex, which operates in a cyclical industry. The target price implies an upside of 10%. We like ECS for its 1) limited coverage from a research perspective that has limited investor awareness and that has kept valuations relatively low 2) steadily growing earnings 3) attractive dividend yield that is rising as the cash pile grows

Table 5 : Peer Comparison as at 5/06/15

Company	Price (RM)	Market Cap (RM m)	Forward PER (x)	P/B (x)	D/E (x)	Dividend Yield (%)
Engtex Group Berhad	1.10	325.8	9.17	0.52	1.5	0.91
DKSH Holdings (M) Berhad	5.25	827.7	N/A	0.55	2.15	0.0
ECS ICT	1.67	300.6	9.28	1.37	0.84	3.59

Source: Inter Pacific and Bloomberg

Ratings System

Ratings:

Description:

BUY	Total return is expected to exceed 15% in the next 12 months
NEUTRAL	Total return is expected to be between above -15% to 15% in the next 12 months
SELL	Total return is expected to be below -15% in the next 12 months

Abbreviation

Abbreviation

Definition

PER	Price Earnings Ratio
PEG	PER to Growth
EPS	Earnings per Share
FYE	Financial Year End
FY	Financial Year
CY	Calendar Year
MoM	Month-on-Month
QoQ	Quarter-on-Quarter
YoY	Year-on-Year
YTD	Year-to-Date
p.a.	Per Annum
DCF	Discounted Cash Flow
FCF	Free Cash Flow
NAV	Net Asset Value

Abbreviation

Definition

CAGR	Compounded Annual Growth Rate
CAPEX	Capital Expenditure
DPS	Dividend per Share
ROA	Return on Asset
ROE	Return on Equity
PBT	Profit Before Tax
PAT	Profit After Tax
EV	Enterprise Value
EBIT	Earnings Before Interest And Tax
EBITDA	EBIT Depreciation & Amortisation
WACC	Weighted Average Cost of Capital
NTA	Net Tangible Asset
BV	Book Value

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