# Maybank IB Research

# ECS ICT (ECS MK)

Share Price: MYR1.63 Target Price: NA
Target Price: NA

MCap (USD): 81.7M ADTV (USD): 0.2M

Malaysia Logistics

## Riding the digital revolution

- A leading distributor for ICT products in Malaysia, with more than 5,000 resellers nationwide.
- 10% 3-year FY14-17 EPS CAGR, underpinned by 5% p.a. revenue growth and a slight expansion in profit margins.
- MYR2.00 fair value on CY15 PER of 11.3x.

## A leading distributor

ECS ICT (ECS), an MSC-status company, is a leading distributor of ICT products in Malaysia. It has more than 5,000 resellers nationwide and has close ties with 40 global brands such as Hewlett-Packard, Lenovo, Asustek, Dell, IBM, Oracle, Cisco, Microsoft, Apple, Samsung and XiaoMi. In 2014, ECS sold more than 3,000 stock keeping units (SKU).

## A beneficiary of ICT demand growth in Malaysia

ECS is a beneficiary of ICT spending in the country, which International Data Corporation (IDC) expects to be sustained well above the USD10b mark this year, driven by increasing hardware and software sales and ICT-related services. IDC also expects smartphone sales to grow by 8% to USD2.4b in 2015. What is positive also is that ECS is in talks with several other global smart device (i.e. smartphones, tablets and wearables) brand owners to further expand its smart devices portfolio.

We forecast a 10% 3-year FY14-17 EPS CAGR on the back of a 5% p.a. revenue growth and a slight expansion in blended profit margins on new mobility products (smart devices) offerings and recovery in Enterprise Systems distribution.

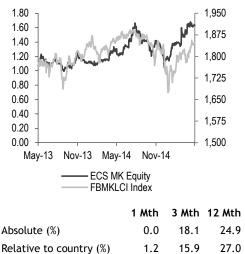
Valuations are undemanding with the stock trading at an historical FY14 PER of 10x versus a peer average of 13.6x. In fact, on stripping out the group's net cash of MYR0.50/share, valuations are even more attractive at an FY15 PER of just 6.3x on an ex-cash basis. Our MYR2.00 FV (+23% upside) pegs ECS' valuations to a CY15 PER of 11.3x, a 25% discount to that of the Bursa Malaysia Technology Index.

FYE Dec (MYR m)	FY13A	FY14A	FY15F	FY16F	FY17F
Sales	1,326.3	1,591.1	1,670.7	1,754.2	1,841.9
EBITDA	37.0	39.2	42.2	46.1	50.2
Core net profit	26.9	29.4	32.1	35.5	39.0
Core EPS (sen)	14.9	16.4	17.8	19.7	21.7
Core EPS growth (%)	-10.0	9.5	9.2	10.3	10.1
Net DPS (sen)	5.5	6.0	6.0	6.0	6.5
Core P/E (x)	10.9	10.0	9.1	8.3	7.5
P/BV (x)	1.4	1.3	1.2	1.1	1.0
Net dividend yield (%)	3.4	3.7	3.7	3.7	4.0
ROAE (%)	13.7	13.7	13.7	13.8	13.8
ROAA (%)	7.9	7.7	7.4	7.5	7.7
EV/EBITDA (x)	5.7	5.2	5.0	4.2	3.5
Net debt/equity (%)	Net cash				

# Not Rated

Key Data	
Shariah status	YES
52w high/low (MYR)	1.73/1.02
Free float (%)	25%
Issued shares (m)	180.0
Market capitalization	MYR293.4M
Major shareholders:	
-ECS Holdings	41%
-Sengin S/B	12%
-Oasis Hope S/B	<b>9</b> %

#### Share Price Performance



## FOR CIRCULATION IN MALAYSIA ONLY

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May 07, 2015

## **Company Background**

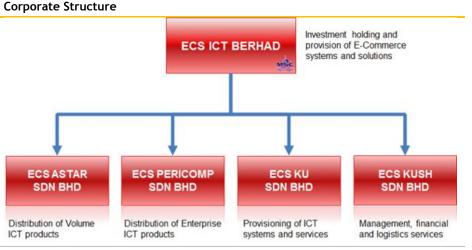
## A leading ICT distributor

ECS ICT Bhd (ECS), an MSC-status company, is a leading distributor of ICT products in Malaysia. The company was listed on the Main Market of Bursa Malaysia Securities on 15 Apr 2010 and it is a 41% associate of ECS Holdings, one of the leading ICT distributors in Asia Pacific, which has a network of more than 25,000 channel partners across China, Thailand, Malaysia, Singapore, Indonesia, the Philippines, Cambodia and Myanmar.

## Three business segments

Aside from the distribution of ICT products via 100% owned ECS ASTAR Sdn Bhd, ECT has two other business segments:

- Enterprise Systems via wholly-owned ECS PERICOMP Sdn Bhd, which is involved in the distribution of Enterprise ICT products to resellers, comprising mainly system integrators and corporate dealers; and
- ICT Services via wholly-owned ECS KU Sdn Bhd, which is involved in the provision of ICT systems and services.



Source: Company

In FY14, ICT distribution accounted for 70% of group revenue, but a lower 55% of group operating profit, with an operating profit margin of 1.9%. Enterprise Systems made up just 27% of group revenue but a larger 39% of operating profit, given its higher operating profit margin of 3.5%.

Revenue and earnings growth in FY14 was nevertheless driven predominantly by the ICT distribution division, with YoY growth rates of 32% and 49% respectively.

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ICT distribution       70%       1,112       842       32%         Enterprise systems       27%       428       469       -9%         ICT services       3%       51       21       146%         Total       100%       1,591       1,332       19%         Operating profit contribution       1,591       1,332       19%         ICT distribution       55%       21       14       49%         Enterprise systems       39%       15       21       -29%         ICT services       6%       2       1       235%         Profit margin       1.9%       1.6%       6%         ICT distribution       1.9%       1.6%       4.3%       4.5%         ICT distribution       1.9%       1.6%       4.3%       4.5%         ICT distribution       1.9%       1.6%       4.3%       4.5%         ICT services       4.3%       4.5%       4.5%       4.5%	Revenue contribution	% of total	FY14	FY13	Growth
ICT services 3% 51 21 146% Total 100% 1,591 1,332 19% Operating profit contribution ICT distribution 55% 21 14 49% Enterprise systems 39% 15 21 -29% ICT services 6% 2 1 235% Total 38 35 6% Profit margin ICT distribution 1.9% 1.6% Enterprise systems 3.5% 4.4% ICT services 4.3% 4.5%	ICT distribution	70%	1,112	842	32%
Total100%1,5911,33219%Operating profit contribution100%1,5911,33219%ICT distribution55%211449%Enterprise systems39%1521-29%ICT services6%21235%Total38356%Profit marginICT distribution1.9%1.6%Enterprise systems3.5%4.4%ICT services4.3%4.5%	Enterprise systems	27%	428	469	-9%
Operating profit contributionICT distribution55%211449%Enterprise systems39%1521-29%ICT services6%21235%Total38356%Profit marginICT distribution1.9%1.6%Enterprise systems3.5%4.4%ICT services4.3%4.5%	ICT services	3%	51	21	146%
ICT distribution       55%       21       14       49%         Enterprise systems       39%       15       21       -29%         ICT services       6%       2       1       235%         Total       38       35       6%         Profit margin         ICT distribution       1.9%       1.6%         Enterprise systems       3.5%       4.4%         ICT services       4.3%       4.5%	Total	100%	1,591	1,332	<b>19</b> %
ICT distribution       55%       21       14       49%         Enterprise systems       39%       15       21       -29%         ICT services       6%       2       1       235%         Total       38       35       6%         Profit margin         ICT distribution       1.9%       1.6%         Enterprise systems       3.5%       4.4%         ICT services       4.3%       4.5%					
Enterprise systems39%1521-29%ICT services6%21235%Total38356%Profit marginICT distribution1.9%1.6%Enterprise systems3.5%4.4%ICT services4.3%4.5%	Operating profit contribution				
ICT services6%21235%Total38356%Profit margin	ICT distribution	55%	21	14	49%
Total38356%Profit margin	Enterprise systems	39%	15	21	-29%
Profit marginICT distribution1.9%1.6%Enterprise systems3.5%4.4%ICT services4.3%4.5%	ICT services	6%	2	1	235%
ICT distribution1.9%1.6%Enterprise systems3.5%4.4%ICT services4.3%4.5%	Total		38	35	6%
ICT distribution1.9%1.6%Enterprise systems3.5%4.4%ICT services4.3%4.5%					
Enterprise systems3.5%4.4%ICT services4.3%4.5%	Profit margin				
ICT services 4.3% 4.5%	ICT distribution		1.9%	1.6%	
	Enterprise systems		3.5%	4.4%	
Total 2.4% 2.7%%	ICT services		4.3%	4.5%	
	Total		2.4%	2.7%%	

#### Revenue and operating profit margin (FY14 & FY13) (MYR'm)

Source: Company

## **ICT Distribution**

Via 100%-owned ECS ASTAR, ECS distributes a comprehensive range of ICT products including notebooks, personal computers, smartphones, tablets, printers and software for 40 leading principals. In 2014, ECS sold more than 3,000 SKUs. ECS also does value enterprise systems for network, communication infrastructure, servers and enterprise software. To-date, ECS has more than 5,000 resellers nationwide, comprising retailers, system integrators and corporate dealers.

## Partnering global brands

ECS forges close ties with 40 global brands such as Hewlett-Packard, Lenovo, Asustek, which contributed more than 10% to its revenue. Other anchor principals include Dell, IBM, Oracle, Cisco, Microsoft, Apple, Samsung and XiaoMi. Locally, it is the one-stop shop that resellers/dealers go to for ICT products.



Source: Company

## Backed by an advanced logistics centre

Spanning over 40,000 sq ft, ECS' flagship warehouse in Kota Damansara handles an average intake of five containers and output of twenty five lorries per day. It also has sales offices in Kuantan, Kuching, Kota Kinabalu and Johor Bahru. In Penang, the company maintains a sales office cum warehouse in Jelutong.

## **Enterprise Systems**

ECS PERICOMP commenced operations in 1986 to distribute computer peripherals and other hardware to PC dealers. It is today a leading value added distributor of Enterprise Systems and solutions to the IT industry.

ECS PERICOMP currently distributes Enterprise Servers, Storage, Network products and software to its distribution network of over 500 Enterprise IT resellers and System Integrators throughout Malaysia. It provides services in the field of Networking & Enterprise IT System Design, Presales Support, and System Integration Proposal in support of its Enterprise IT resellers and System Integrators.

## **ICT Services**

ECS KU is today the service delivery arm for ECS ASTAR and ECS PERICOMP. With over 30 service engineers, the company provides after-sales services in technical support, maintenance and product warranty services.

## Shareholders & management

## Hands-on shareholders

ECS is 41%-owned by ECS Holdings Ltd, a Singapore entity, one of the leading ICT distributors in Asia Pacific which has access to a network of more than 23,000 channel partners across China, Thailand, Malaysia, Singapore, Indonesia and the Philippines. In 2014, ECS Holdings was privatised by Hong Kong-listed VST Holdings at SGD0.68/sh. VST Holdings is also involved in ICT distribution in Asia Pacific. ECS' other major shareholder with an effective 12.2% stake is Mr Foo Sen Chin, ECS' co-founder and Executive Chairman.

## Very experienced management

ECS is led Mr. Soong Jan Hsung, who has been with the company for about 28 years. He started off as a sales executive but over the years, his hard work and dedication finally earned him the General Manager post in 1994. Subsequently, he was promoted to Executive Director in 2001 and Deputy Chief Executive Officer in 2014. In 2015, he was further promoted to Executive Director/CEO after the previous CEO, Mr Foo Sen Chin, was redesignated as Executive Chairman. Soong has more than 20 years of experience in the ICT distribution market. Mr. Foo is the co-founder. He has been active in the ICT industry in Malaysia for more than 30 years.

## Growing in a resilient market

The Malaysian ICT industry has been resilient despite economic challenges and according to International Data Corporation (IDC), the sales of hardware and software products rose 1.3% in 2014 to USD7.6b versus USD7.5b in the previous year. The smartphone market grew at a faster pace of 7% YoY to USD2.2b versus USD2.0b in 2013, as the penetration rate for smartphones jumped from 35% in 2013 to 53% in 2014. In 2014, nearly 10m units of smart devices were shipped into Malaysia and smartphones outnumbered tablets by a ratio of nearly four to one.

The outlook for smartphone segment remains robust driven by the influx of inexpensive Chinese brands, which has contributed to a 40% YoY jump in 2014 smartphone demand in Malaysia. IDC expects ICT spending in Malaysia to be sustained well above the USD10b mark this year, driven by increasing hardware and software sales and ICT-related services. It also expects smartphone sales to grow by 8% to USD2.4b in 2015.

After securing smartphone distributorship from three renowned brands -Lenovo in 2013, and ASUS and BenQ in 2014, ECS was appointed as the distributor for Microsoft Mobile and XiaoMi MiPad in 2015. Currently, we understand that ECS is in talks with several other global smartphone brands to further expand its smartphone portfolio. In Mar 2015, when ECS announced the distributorship of XiaoMi MiPad, its share price closed 17% higher compared to the previous day. ECS is also targeting "wearable technology" products, possibly as early as 2Q15. This is a natural progression as the company seeks to expand its product offering. Having said so, adoption for wearables may not be strong in the early stage.

## Sales to temporarily dip post GST

ECS would likely have benefited from the consumer rush to purchase ICT products prior to the implementation of GST on 1 Apr 2014 and we expect 1Q15 EPS to grow by 10-15% YoY on the stronger demand for ICT products. We understand that sales of smartphones, PCs and notebooks picked up towards end-Mar 2015 as consumer went on a pre-GST buying spree. Meanwhile, demand for Enterprise Systems would likely have stayed flat as corporates were prudent in spending.

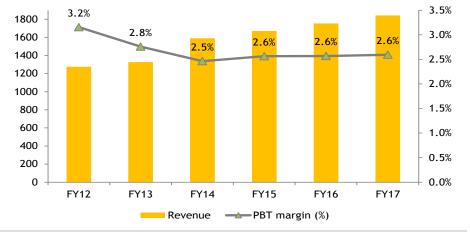
IDC expects the GST to negatively impact the local PC market in 2Q as both consumer and commercial spending is expected to slow down significantly and the market will take a few months to adapt to the new tax but should return to normal by mid 3Q 2015. This would imply that ECS' 2Q15 results could be affected by weak consumer spending post GST, but this would pick up again thereafter.

Management has nevertheless been proactive in securing new mandates and in Feb 2015, ECS was appointed to distribute four models of the Microsoft Lumia smartphones (Lumia 930, Lumia 830, Lumia 735 and Lumia 535) to the IT channel and consumer electronic chain stores in Malaysia. Moreover in Mar 2015, the group was appointed by China-based XiaoMi to be its authorised distributor of the XiaoMi MIPad tablets in Malaysia.

## Financials & valuations

## It is a low margin business

ECS operates in a thin margin environment. In FY12-14, the group achieved a pretax margin of between 2.5%-3.2% albeit over MYR1b revenue. This, however, is the nature of trading businesses, particularly ECS' business as a distributor. For instance, DKSH Holdings (DKSH MK, MYR5.31, Not Rated), which is a large distributor of retail products in Malaysia, reported a pretax margin of just 1.5% in FY14 and an average pretax margin of 2.6% in FY13-FY14.



#### Revenue and pre-tax profit margin trend (FY12 - FY17E)

Source: Company, Maybank KE

## FY13 earnings hit by product mix and unfavourable forex

ECS' FY13 net profit fell 10% YoY due to an unfavourable product mix. In 2013, the group sold more PCs and mobility products than networking and storage products, resulting in a 0.6-ppt fall in its gross profit margin to 6.1% from 6.7% in 2012. A strong USD also does not work in favour of the group as about 30% of its purchases are imported. In 2013, the MYR weakened by ~2% against the USD compared to 2012. Having said so, we understand that the group practises hedging in USD purchase. Hence, any adverse impact is limited.

## FY14 earnings rebounded

FY14 was a year of recovery with net profit bouncing back 9% YoY, almost on par with FY12's net profit, as revenue grew 20% YoY.

- The ICT Distribution division saw revenue jump 32% YoY on the back of the strong demand for smartphones and decent sales of other ICT products. The group's portfolio of products expanded and during the year, ECS Astar was appointed by Nasdaq-listed Seagate to distribute its full range of branded storage solutions. In April 2014, the company was appointed the distributor for the ASUS Zenfone range while in Aug 2014, it began distributing the new Microsoft Surface Pro 3 tablet. In Sept 2014, it added a new brand to its smartphone portfolio i.e. BenQ.
- The strong growth witnessed by the ICT Distribution division was mitigated in part by a 9% YoY decline in revenue from the Enterprise Systems division due to (i) the reclassification of extended warranties from this division to the ICT Services division, as well as (ii) slower project implementations during the year.

Since ICT Distribution margins are lower than that of Enterprise Systems, the group's operating profit margin slipped to 2.4% in FY14 from 2.7% in FY13, thus contributing to the slower overall operating profit growth of just 6% versus revenue growth of 20%.

## 3-year EPS CAGR of 10%

We forecast a 10% 3-year FY14-17 EPS CAGR on the back of a 5% p.a. revenue growth for FY15-17 and a slight expansion in profit margins. Our 5% revenue growth for FY15 is lower than Gartner's 7.5% forecast but in line with IDC's expectation of a 5% increase in local ICT spending. Meanwhile, new mobility products (smartphones) and recovery in Enterprise Systems distribution should lead to higher margins going forward. We impute a higher group EBIT margin of 2.5%/2.6%/2.7% for FY15/16/17 respectively.

## Cash conversion cycle is healthy

Management acknowledged that it is operating in a razor-thin margin environment. Hence, managing cash flow is crucial to keep the company afloat. ECS' cash conversion cycle (CCC) is healthy at 34 days in FY14, and we forecast its CCC to remain stable at 35 days for FY15-17.

## Cash per share of MYR0.50

ECS has a very strong balance sheet with no borrowings. As at Dec 2014, the company is sitting on MYR89.7m cash, which translates to ~MYR0.50/sh. This is equivalent to 30% of its share price.

## 30% dividend policy

ECS intends to pay out not less than 30% of net profit attributable to shareholders as dividends. Based on our forecasts, ECS will pay out a net dividend yield of 3.7%-4.0% for FY15-17. In FY12-14, ECS has paid out 3.4-3.7%.

## Indicative fair value of MYR2.00

Valuations are undemanding with the stock trading at an historical FY14 PER of 10x or a 26% discount to the historical PER average of 13.6x for its peers in the trading/distribution industry. We expect FY15 valuations to come in lower, with a prospective PER of just 9.1x. In fact, on stripping out the group's net cash of MYR0.50/share, valuations are even more attractive at an FY15 PER of just 6.3x on an ex-cash basis.

We peg ECS' valuations to a FY15 PER of 11.3x, a 25% discount to that of the Bursa Malaysia Technology Index of 15.1x to derive a fair value of MYR2.00 (+23%). This fair value translates to a historical FY14 PER of 12.2x, which would be an approximate 10% discount to the historical peer average of 13.6x. This discount largely reflects ECS' smaller market capitalisation size and its more cyclical product offerings. Nevertheless, where ECS stands out is in its healthy balance sheet and decent dividend yields.

## Peers comparison

Stock	Shr px	Mkt cap	ТР	PER (x)	PER (x)	P/B (x)	ROAE (%)	Net margin (%)	Net debt/eqy (%)	Net yield (%)
	(MYR)	(MYR m)	(MYR)	FY14A	FY15E	FY14A	FY14A	FY14A	FY14A	FY14A
DKSH	5.31	837.4	NR	14.0	na	1.8	13.0	1.1	Net cash	0.0
Yee Lee	1.99	361.6	NR	13.3	na	1.0	8.0	3.9	18.0	1.5
Simple avg		599.5		13.6	na	1.4	10.5	2.5	18.0	0.8
ECS ICT	1.63	293.4	NR	10.0	9.1	1.3	13.7	1.8	Net cash	3.7

Source: Bloomberg, Maybank KE

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