

New Listing

ECS ICT BERHAD

Public Issue Of 27m New Shares And Offer For Sale Of 20m

5 April 2010

Offer Price : RM1.46

Fair Value : RM1.53

Table 1: Investment Statistics

Bloomberg: 3324746Z MK

FYE	Turnover	Pre-tax Profit	Net Profit	EPS	EPS Growth	PER	P/NTA	ROE	Gearing	GDY
Dec	(RMm)	(RMm)	(RMm)	(sen)	(%)	(x)	(x)	(%)	(x)	(%)
2009e	1,254.8	29.4	23.6	19.7	13.5	7.4	1.6	20.9	Net Cash	2.7
2010f	1,352.9	31.0	24.8	20.7	5.2	7.1	1.6	22.0	Net Cash	2.7
2011f	1,449.5	34.3	26.3	21.9	6.1	6.7	1.3	21.3	Net Cash	2.7
2012f	1,545.1	38.6	29.5	24.6	12.0	5.9	1.1	20.1	0.1	2.7

Valuations based on estimated fair value of RM1.53/share

Issued capital (m shares)	120 (RM0.50 par)	Market capitalisation (RMm)	183.6
---------------------------	------------------	-----------------------------	-------

- ◆ **Background.** ECSB is principally involved in the distribution of ICT products and enterprise systems to retailers, system integrators, and corporate dealers. Established in 1985, ECSB started off in the business of selling personal computers and in 1986 expanded into other ICT products and enterprise systems. Currently, the company is the authorised distributor for more than 30 global ICT OEMs (original equipment manufacturers). We estimate that ECSB has 6.4% share of domestic market in 2009.
- ◆ **ICT sector to ride on stronger growth in 2010-11.** We expect the ICT sector to register stronger growth in 2010-11. According to IDC Asean Research (IDC), 2010 IT spending in Malaysia is expected to grow to over US\$6bn, up 8% yoy (vs. -1.3% yoy in 2009). Key drivers include: 1) stronger corporate and consumer spending; 2) higher IT infrastructure spending by public sectors.
- ◆ **Risks.** We believe ECSB risk's are: 1) highly competitive market; 2) dependence on ICT Principals; and 3) Exposure to lower-margin sales.
- ◆ **Forecasts.** We estimate net profit to grow by 5.2%, 6.1%, and 12% for FY10, FY11, and FY12 respectively driven mainly by: 1) rising demand for ICT products stemming from higher corporate spending; 2) higher system integration projects from the public sector; and 3) higher penetration rates of PC and broadband amongst households.
- ◆ **Investment case.** We estimate FY09-12 EPS CAGR of 9.2%. While medium-term earnings visibility remains bright, we highlight that longer-term earnings growth hinges on stronger pick-up in corporate and public IT infrastructure spending. We have compared ECSB against global listed peers. By applying 30% discount to peers' weighted average FY10 PER of 10.6x to reflect it smaller market capitalisation, we derive a target PER of 7.4x for ECSE. Therefore, we estimate a fair value of RM1.53, based on 7.4x FY10 EPS.

LISTING DETAILS

Listing Sought : Main Market

Listing Date : 15th April 2010

Public Issue : 27.0 shares
including:
-13.4m via
Private
Placement
-3.6m to eligible
parties
-10.0m to public

MAJOR SHAREHOLDER

ECS Holdings.....43.83%

Wong Chin Wai
(603) 92802158
wong.chin.wai@rhb.com.my

Please read important disclosures at the end of this report.

- ◆ **Background.** ECSB is principally involved in the distribution of ICT products and enterprise systems to retailers, system integrators, and corporate dealers. Established in 1985, ECSB started off in the business of selling personal computers and in 1986 expanded into other ICT products and enterprise systems. In 2001, its parent company, ECS Holdings Limited was listed on the Singapore Exchange Mainboard. Currently, the company is the authorised distributor for more than 30 global ICT OEMs (original equipment manufacturers). Note that ECSB has four warehouses which are located in Kota Damansara, Penang, Kuching and Kota Kinabalu. We estimate that ECSB has 6.4% share of domestic market in 2009.

Table 2: Group Structure

Subsidiary	Shareholding	Operations
ECS Kush Sdn Bhd	100%	Management, Financial, and Logistics Services
ECS Astar Sdn Bhd	100%	Distribution of ICT Products
ECS KU Sdn Bhd	100%	Provision of ICT Systems and Services
ECS Pericomp	100%*	Distribution of Value ICT Products

* Listing exercise includes acquiring balance 20% minority interest.

Source: IPO prospectus

- ◆ **Products and services.** ECSB derives its income from three main segments:

- 1) **ICT Products.** The company distributes and markets a wide range of ICT products (i.e. desktop computers, notebooks, printers, scanners, and other peripherals) to resellers, system integrators and corporate dealers. Note that ECSB distribute ICT products from global ICT players such as Hewlett-Packard (HP), Apple and Samsung.
- 2) **Enterprise Systems.** ECSB provides enterprise systems (i.e. network, communication servers, and software products) to system integrators and corporate dealers. We highlight that margins for enterprise systems are 8-9%-pts higher than general ICT products given ECSB's ability to provide customised and value-added ICT infrastructure systems and enterprise solutions. Note that the company represents major enterprise systems suppliers such as Cisco, IBM, Juniper and Sun Microsystems.
- 3) **ICT Services.** This segment provides ICT services such as hardware support, maintenance, system integration, consultation, networks, management and implementation of ICT systems. Note that ECSB is the authorised service representative for Microsoft, IBM, and Linksys.

OUTLOOK

- ◆ **ICT sector to ride on stronger growth in 2010-11.** We expect the ICT sector to register stronger growth in 2010-11. According to IDC Asean Research (IDC), 2010 IT spending in Malaysia is expected to grow to over US\$6bn, up 8% yoy (vs. -1.3% yoy in 2009). Key drivers include:
- 1) **Stronger corporate spending.** We believe corporate's IT spending on enterprise systems and IT systems will gather momentum in 2010 stemming from pent-up demand after a lull in IT investments during the financial crisis. (vs. -1.3% in 09, see chart 3). Note that major equipment providers (i.e. Cisco and IBM) expect corporate spending on IT equipments to rise significantly in 2010 spurred by: 1) delay in the IT replacement cycle in 2008-09; 2) hardware spending for compatibility on the innovation of new products i.e. Windows 7; and 3) growth in network capacity.
 - 2) **Roll-out of cheaper notebooks to drive consumer IT spending.** Mobile PCs remain the main driver for the PC segment due to strong demand from emerging markets and roll-out of cheaper notebooks (based on new ultra-low-voltage technology). In 2010, we expect notebooks sales to pick up given still-low PC penetration rates of around 35% as well as growing trend towards mobile computing.

3) **National Broadband initiative (NBI)**. With the intention of improving socio-economic standing, the Government is taking steps to provide broadband services to the whole nation specifically to under-served and rural areas. The NBI would address the implementation of HSBB in these areas through community broadband access or community broadband access (CBS) in addition to special broadband packages. In the same vein, Telekom Malaysia Bhd (TM) is in the process of rolling-out of HSBB that includes the IPTV service and voice over internet Protocol (VoIP). We believe the adoption of HSBB would likely drive demand for ICT products arising from higher system integrations from the public sector as well as stronger broadband penetration of households.

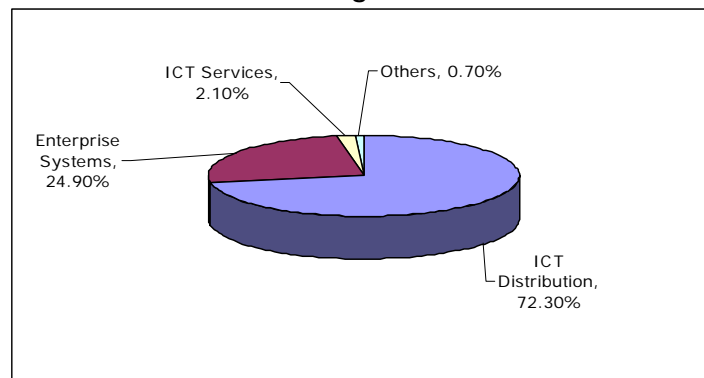
◆ **Business risks.** We believe the company faces a number of risks, including:

1) **Highly fragmented market** – We understand that ECSB operates in a highly-fragmented industry with the top five players (i.e. IM Malaysia, ECSB, JOS Malaysia, Servex and Planet) accounting for 28.3% of the market. We believe competition will be intense for distribution of ICT products given low entry barriers. In contrast, value-added ICT infrastructure systems and enterprise solutions business will be less competitive as it requires highly skilled and knowledge-based professionals.

2) **Dependence on ICT principals** – We highlight that 72.6% of the company's total purchases in 2008 are from HP Malaysia (HP). Note that ECSB is dependent on the appointment as an approved distributor by major ICT principals. Therefore, should HP terminate the distributorship, the company may lose a significant market share and consequently lower the group's earnings, in our opinion.

3) **Exposure to ICT products** – A lion share of the company's revenue comes from thin-margin ICT products i.e. sale of PC and notebooks. We believe intense competition and lower-than-expected demand for ICT products will create downward pressure on already very thin margins.

Chart 1: ECSB Business Segment Revenue Contribution



Source: Company

◆ **Future roadmap.** Management is planning to allocate RM5.0m of the proceeds to be used for: 1) enterprise solutions enhancement (i.e. ERP Systems); 2) enterprise systems expansion (i.e. offering a wider range of higher-margin products from Extreme Networks, EMC, Intermecc, Aruba, Oracle); and 3) geographical expansion.

Table 3: Utilisation Of Proceeds

Proposed utilisation	RMm	Time Frame for utilisation from date of listing
Working Capital	24.3	12 months
To fund the proposed 20% Pericomp Acquisition	5.4	< 7days
Business expansion	5.0	12 months
Estimated listing expenses	3.0	6 months
To fund the transfers	1.7	< 7 days

Source: Company

- ◆ **Dividend policy.** ECSB plans to pay out as much as 30% of net profits as dividends from FY10 onwards.

FORECASTS AND VALUATIONS

- ◆ **Forecasts.** We estimate net profit to grow by 5.2%, 6.1%, and 12% for FY10, FY11, and FY12 respectively driven mainly by: 1) rising demand for ICT products stemming from higher corporate spending; 2) higher system integration projects from the public sector; and 3) higher penetration rates of PC and broadband amongst households. We have assumed FY10-12 gross profit margins to remain stable at around 5.1% p.a. due to: 1) stronger contribution from higher-margins enterprise systems; and 2) effective cost management.
- ◆ **Valuations.** We estimate FY09-12 EPS CAGR of 9.2%. While medium-term earnings visibility remains bright, we highlight that longer-term earnings growth hinges on stronger pick-up in corporate and public IT infrastructure spending. We have compared ECSB against global listed peers. By applying a 30% discount to the peers' weighted average FY10 PER of 10.6x to reflect its smaller market capitalisation, we derive a target PER of 7.4x for ECSB. Therefore, we estimate a fair value of RM1.53, is based on 7.4x FY10 EPS.

Table 4: Peers Comparison

Company	Bloomberg ticker	Market Cap (US\$m)	FY11 PER (x)
Synnex Corp	SNX US	1,007.9	9.8
Ingram Micro Inc	IM US	2,903.3	10.3
Tech Data Corp	TECD US	2,170.1	11.3
Market cap-weighted average			10.6

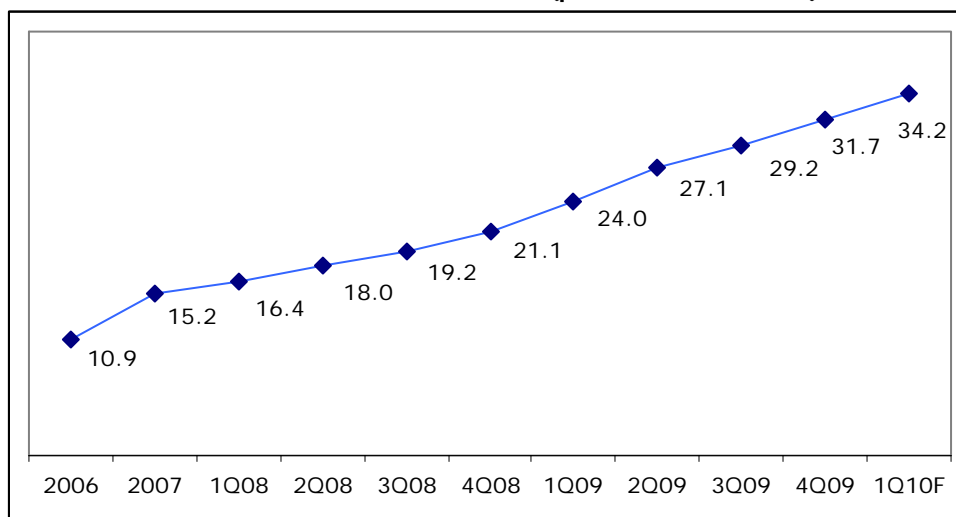
Source: RHBRI, Bloomberg

Table 5. Earnings Forecasts

FYE Dec (RMm)	2008	2009e	2010f	2011f	2012f
ICT Distribution	849.4	917.4	981.6	1040.5	1092.5
Enterprise Systems	293.1	319.5	349.8	384.8	425.2
ICT Services	24.8	26.3	28.1	30.4	33.1
Others	7.6	8.0	8.4	8.8	9.2
Turnover	1159.5	1254.8	1352.9	1449.5	1545.1
Cost of sales	(1100.9)	(1192.1)	(1271.8)	(1362.5)	(1436.9)
EBITDA	32.0	32.4	34.0	36.7	40.1
<i>EBITDA margin (%)</i>	<i>2.8</i>	<i>2.6</i>	<i>2.5</i>	<i>2.5</i>	<i>2.6</i>
Depreciation	(1.0)	(1.1)	(1.2)	(1.3)	(1.4)
EBIT	31.0	31.2	32.8	35.4	38.7
<i>EBIT margin (%)</i>	<i>2.7</i>	<i>2.5</i>	<i>2.4</i>	<i>2.4</i>	<i>2.5</i>
Interest income	0.0	0.0	0.0	0.0	0.0
Interest expense	(3.9)	(1.9)	(1.9)	(2.1)	(2.2)
Others income/exp	0.0	0.0	0.0	0.0	0.0
Exceptionals	0.0	22.1	0.0	1.0	2.0
Pretax profit	27.1	29.4	31.0	34.3	38.6
Taxation	(7.3)	(6.8)	(7.1)	(8.9)	(10.0)
Minority interest	1.0	1.0	1.0	1.0	1.0
Net profit	20.8	23.6	24.8	26.3	29.5

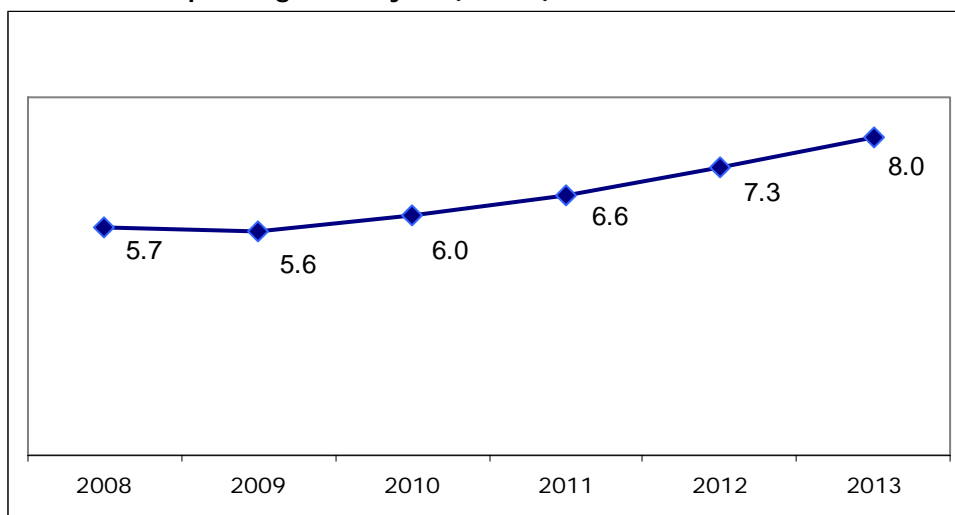
Source: Company data, RHBRI

Appendix

Chart 2: Penetration Rates for Broadband (per 100 households)


Source: MCMC

Chart 3: ICT Spending in Malaysia (US\$bn)



Source: IDC

IMPORTANT DISCLOSURES

This report has been prepared by RHB Research Institute Sdn Bhd (RHBRI) and is for private circulation only to clients of RHBRI and RHB Investment Bank Berhad (previously known as RHB Sakura Merchant Bankers Berhad). It is for distribution only under such circumstances as may be permitted by applicable law. The opinions and information contained herein are based on generally available data believed to be reliable and are subject to change without notice, and may differ or be contrary to opinions expressed by other business units within the RHB Group as a result of using different assumptions and criteria. This report is not to be construed as an offer, invitation or solicitation to buy or sell the securities covered herein. RHBRI does not warrant the accuracy of anything stated herein in any manner whatsoever and no reliance upon such statement by anyone shall give rise to any claim whatsoever against RHBRI. RHBRI and/or its associated persons may from time to time have an interest in the securities mentioned by this report.

This report does not provide individually tailored investment advice. It has been prepared without regard to the individual financial circumstances and objectives of persons who receive it. The securities discussed in this report may not be suitable for all investors. RHBRI recommends that investors independently evaluate particular investments and strategies, and encourages investors to seek the advice of a financial adviser. The appropriateness of a particular investment or strategy will depend on an investor's individual circumstances and objectives. Neither RHBRI, RHB Group nor any of its affiliates, employees or agents accepts any liability for any loss or damage arising out of the use of all or any part of this report.

RHBRI and the Connected Persons (the "RHB Group") are engaged in securities trading, securities brokerage, banking and financing activities as well as providing investment banking and financial advisory services. In the ordinary course of its trading, brokerage, banking and financing activities, any member of the RHB Group may at any time hold positions, and may trade or otherwise effect transactions, for its own account or the accounts of customers, in debt or equity securities or loans of any company that may be involved in this transaction.

"Connected Persons" means any holding company of RHBRI, the subsidiaries and subsidiary undertaking of such a holding company and the respective directors, officers, employees and agents of each of them. Investors should assume that the "Connected Persons" are seeking or will seek investment banking or other services from the companies in which the securities have been discussed/covered by RHBRI in this report or in RHBRI's previous reports.

This report has been prepared by the research personnel of RHBRI. Facts and views presented in this report have not been reviewed by, and may not reflect information known to, professionals in other business areas of the "Connected Persons," including investment banking personnel.

The research analysts, economists or research associates principally responsible for the preparation of this research report have received compensation based upon various factors, including quality of research, investor client feedback, stock picking, competitive factors and firm revenues.

The recommendation framework for stocks and sectors are as follows : -

Stock Ratings

Outperform = The stock return is expected to exceed the FBM KLCI benchmark by greater than five percentage points over the next 6-12 months.

Trading Buy = Short-term positive development on the stock that could lead to a re-rating in the share price and translate into an absolute return of 15% or more over a period of three months, but fundamentals are not strong enough to warrant an Outperform call. It is generally for investors who are willing to take on higher risks.

Market Perform = The stock return is expected to be in line with the FBM KLCI benchmark (+/- five percentage points) over the next 6-12 months.

Underperform = The stock return is expected to underperform the FBM KLCI benchmark by more than five percentage points over the next 6-12 months.

Industry/Sector Ratings

Overweight = Industry expected to outperform the FBM KLCI benchmark, weighted by market capitalisation, over the next 6-12 months.

Neutral = Industry expected to perform in line with the FBM KLCI benchmark, weighted by market capitalisation, over the next 6-12 months.

Underweight = Industry expected to underperform the FBM KLCI benchmark, weighted by market capitalisation, over the next 6-12 months.

RHBRI is a participant of the CMDF-Bursa Research Scheme and will receive compensation for the participation. Additional information on recommended securities, subject to the duties of confidentiality, will be made available upon request.

This report may not be reproduced or redistributed, in whole or in part, without the written permission of RHBRI and RHBRI accepts no liability whatsoever for the actions of third parties in this respect.



RHB DEALING AND RESEARCH OFFICES

MALAYSIA

RHB Investment Bank Bhd

Level 10, Tower One, RHB Centre,
Jalan Tun Razak
50400 Kuala Lumpur
P.O. Box 12699
50786 Kuala Lumpur, Malaysia
Tel (General) : (603) 9285 2233

Dealing Office

Tel (Dealing) : (603) 9285 2288
Fax (Dealing) : (603) 9284 7467

RHB Research Institute Sdn Bhd

Level 10, Tower One, RHB Centre,
Jalan Tun Razak
50400 Kuala Lumpur
P.O. Box 12699
50786 Kuala Lumpur, Malaysia
Tel (Research) : (603) 9280 2160
Fax (Research) : (603) 9284 8693

Lim Chee Sing

Director

RHBRI is a participant of the CMDF-Bursa Research Scheme and will receive compensation for the participation. Additional information on recommended securities, subject to the duties of confidentiality, will be made available upon request.

This report may not be reproduced or redistributed, in whole or in part, without the written permission of RHBRI and RHBRI accepts no liability whatsoever for the actions of third parties in this respect.