RHB Research Institute Sdn Bhd
A member of the RHB Banking Group
Company No: 233327 -M

5 April 2010

New Listing

ECS ICT BERHAD

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

Offer Price : RM1.46

Fair Value : RM1.53

Table 1: Investment Statistics — **Bloomberg: 3324746Z MK**

FYE Dec	Turnover (RMm)	Pre-tax Profit (RMm)	Net Profit (RMm)	EPS (sen)	EPS Growth (%)	PER (x)	P/NTA (x)	ROE (%)	Gearing (x)	GDY (%)
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%

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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.

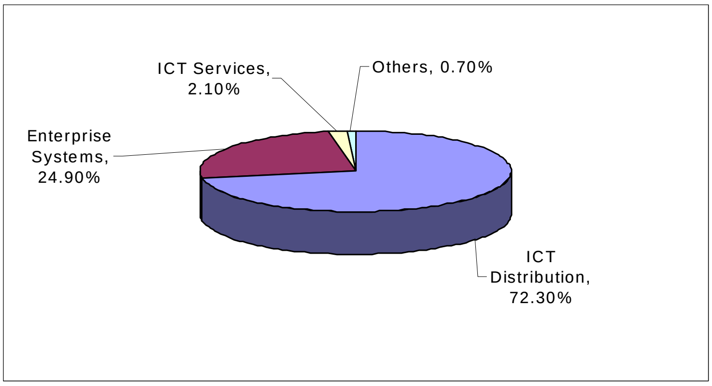
- **Business risks.** We believe the company faces a number of risks, including:

  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, Intermec, 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

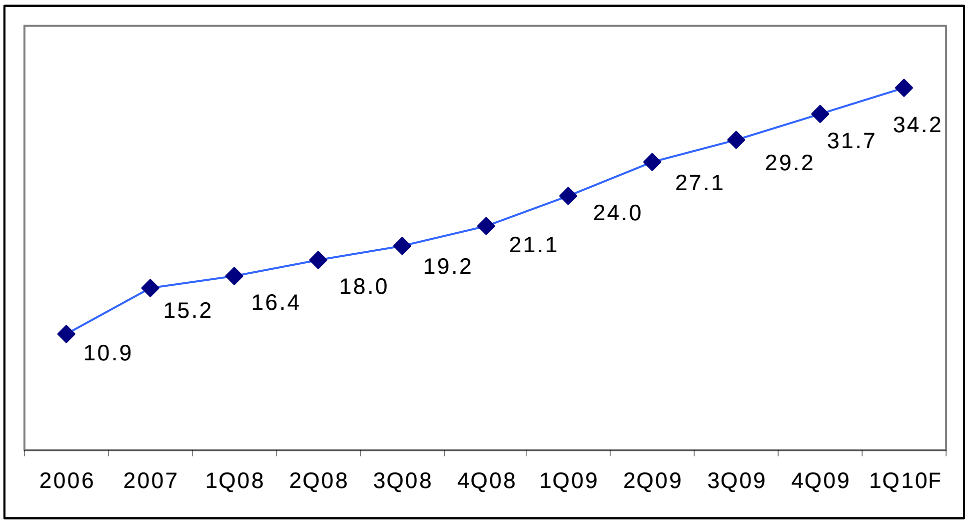
Table 5. Earnings Forecasts

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**
EBITDA margin (%)	*2.8*	*2.6*	*2.5*	*2.5*	*2.6*
Depreciation	(1.0)	(1.1)	(1.2)	(1.3)	(1.4)
EBIT	**31.0**	**31.2**	**32.8**	**35.4**	**38.7**
EBIT margin (%)	*2.7*	*2.5*	*2.4*	*2.4*	*2.5*
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

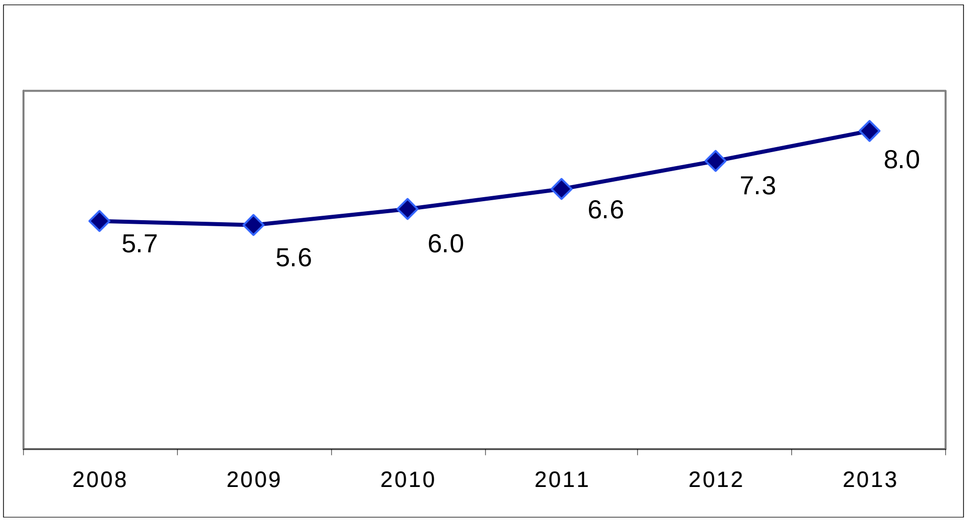
Appendix

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



Source: MCMC

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



Source: IDC

IMPORTANT DISCLOSURES

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.

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