

# ECS ICT Bhd

11 May 2010

KDN: PP10837/03/2011 (029371)

## TRADING BUY

Current Price	RM1.29
New Target Price	RM1.56
Previous Target Price	-
Previous Recommendation	-
Upside To Target	+20.9%

### Stock Codes

Masa	ECS / 5162
Bloomberg	ECS MK

### Stock & Market Data

KLCI	1,333.97
Listing	Main
Sector	Technology
Syariah Compliance	YES
Par Value	RM0.50
Issued Shares	120.0mn
Market Capitalisation	RM154.8mn
YTD Chg In Share Price	-
52-week Hi/Lo	RM1.54/RM1.22
3M Average Volume	-
Estimated Free Float	40.0%
Majority Shareholders	
	ECS Holdings – 40.0%
	Teo Soo Pin S/B – 10.0%
	Sengin S/B – 10.0%

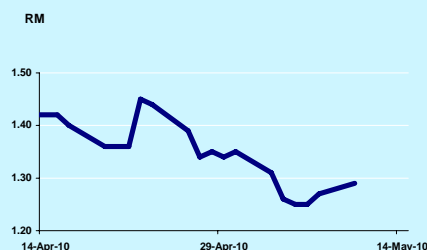
### Key Indicators @ FY10F

ROA	8.0%
ROE	23.5%
Net Gearing	Net Cash
Price/NTA	1.0x

### Share Performance

	1mth	3mth	12mth
Absolute	n/a	n/a	n/a
vs. KLCI	n/a	n/a	n/a

### Share Price Performance Chart



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## Beyond A Trading Company

- Brief profile.** ECS is a leading ICT distribution hub in Malaysia. It was established back in 1985. ECS distributes an extensive product range ( $\approx 2,900$  stock keeping units) via an efficient distribution infrastructure of 2,500 nationwide resellers, consisting of retailers, system integrators and corporate dealers. ECS has warehouses in Kota Damansara, Penang, Kuching and Kota Kinabalu. Outside Klang Valley, ECS has also 2 sales offices in Kuantan and Johor Bahru.
- Business strategies.** To grow from strength to strength, ECS has outlined 3 pronged business strategies. Firstly, ECS is in the midst of stepping up infrastructure to strength its distribution and logistics efficiency as well as to improve customer interaction experience. Secondly, ECS also plans to expand its sales office and warehouses outside of Klang Valley by appointing more resellers in wider geographical reach. Thirdly, ECS is in addition eyeing the higher margin enterprise system market. In order to excel in this area, ECS has committed to setting up a technology centre for testing and demonstration of configurations, proof of concepts and software applications.
- Recent developments.** On 23 March 2010, ECS was appointed as a distributor of ASUS products (mainly notebooks and Eee PCs or net-books). We understand ASUS is thus far the fastest growing notebook brand in Malaysia. We also ensured by the management that the dealership in ASUS will not cannibalise the sales of similar products of other brands that currently distributed by ECS i.e. HP notebooks. As part of the efforts to penetrate the enterprise system market, ECS has successfully secured a RM30.0mn worth of network products supplied contract from YTL-Group for the rollout of WiMAX project. This contract will serve as a reference project for ECS' future enterprise system projects.
- Going forward,** we believe the company should continue to grow in-line with the projected industry of 9.1% p.a. (from 2009 to 2013), at least, due to the increase in PC and notebooks ownership as well as higher internet broadband penetration. We also believe the market share of ECS to increase, hence our more optimistic growth targets.
- Financial highlights.** ECS has recently announced its 1QFY10 results. The revenue and net profit were recorded at RM315.1mn and RM5.8mn respectively. While there are no quarterly and yearly comparisons as the company was just listed, we understand from the management that the sales and net profit had grown by 7.2% and 52.9% YoY. The quantum leap in net profit was also partly attributed by stronger net profit margin, which grew from 1.3% to 1.8%. Coupled with the new distribution-ship of ASUS and the book in of RM30mn supply contract by YTL-Group in this year end, we reckon that ECS should be able to achieve full year revenue and net profit of RM1,520.1mn and RM26.8mn, respectively, representing annual growth rates of 13% and 11%.
- Dividend policy.** We understand that the management is also committed paying out at least 30% of its net profits as dividends from FY2010 onwards. This translates into a FY10 DPS of 6.7 sen. In fact, the company has declared a 4.0 sen as an interim dividend for FY10, in conjunction with their 1QFY10 results. This interim dividend will go "ex" on 27 May and will be payable on 15 June.

**Our view.** ECS is a leading player in ICT distribution with long and consistent track records while the company seems like a trading company, on the surface, due to its low profit margins (see Chart 2). However, this is not exactly true should one examine the ROE and ROA of the company. While it is undeniable that the profit margins were low (pre-tax:  $\approx 2.3\%$ - $2.5\%$  and net:  $\approx 1.6\%$ - $1.8\%$ ), the ROE of the firm was still remaining high at  $29.7\%$ , on average, for the last 2 financial years. This was due mainly to the fast asset turnover of  $\approx 70$  days, or  $>5x$  within a year, and was not attributed to high financial leverage (see Table 2). As at end-December 2009, the net gearing of ECS stood at  $33.0\%$ . Going forward, despite a drop in ROE due to larger equity base and net cash position after IPO, we still believe the ROE should however comfortably stand above  $20\%$  in FY10 and FY11 pursuant to improvement in profit margins. Moreover, we reckon that it is not an easy industry to do well, even can survive. We have seen some listed ICT product trading companies such as Compugates Holdings and Mangotone Group whose results have been in red thus far. This could mean a high barrier of entry (even if it is trading in nature) and the need of a strong distribution network as well as a supply of wide range of products in order to remain competence in this tough operating environment. ECS is proven to have all of these criteria.

**Valuation & recommendation.**

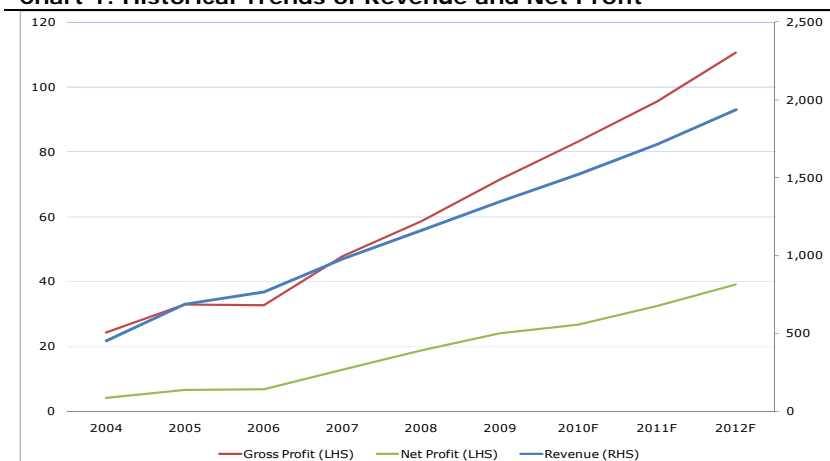
We believe there is no direct comparable in Malaysia. Hence, we value ECS using ROE-adjusted Price Multiples valuations by comparing ECS' FY09 and FY10 ROEs against its parent company that listed in Singapore, and a Malaysia leading trading company DKSH Holdings Malaysia. Based on the extrapolated price multiples (see Table 4), we believe **the stock should be valued at RM1.56, suggesting 21% upside from here.** Coupled with an estimated gross dividend yield of  $5.3\%$ , this stock deserves a **"TRADING BUY"** rating.

**Table 1: Investment Statistics**

FYE 31 Dec (RM'mn)	2008	2009	2010F	2011F
Revenue	1,159.5	1,345.6	1,520.1	1,713.0
Revenue Growth	18.7%	16.0%	13.0%	12.7%
Net Profit	18.9	24.2	26.8	32.6
Net Profit Growth	46.9%	28.1%	11.1%	21.5%
Consensus	N.A.	N.A.	N.A.	N.A.
EPS (sen)	20.5	26.3	22.4	27.2
DPS (sen)	N.A.	N.A.	0.067	0.082
NTA/Share (RM)	0.74	0.91	1.21	1.40
Net Debt	45.8	27.5	Net Cash	Net Cash
Net Gearing	66.9%	33.0%	Net Cash	Net Cash
PER (x)	6.1	4.8	5.6	4.6
Dividend Yield	N.A.	N.A.	5.3%	6.5%
ROE	27.5%	31.8%	23.5%	20.8%
ROA	8.5%	9.3%	8.0%	8.3%
P/NTA (x)	1.7	1.4	1.0	0.9

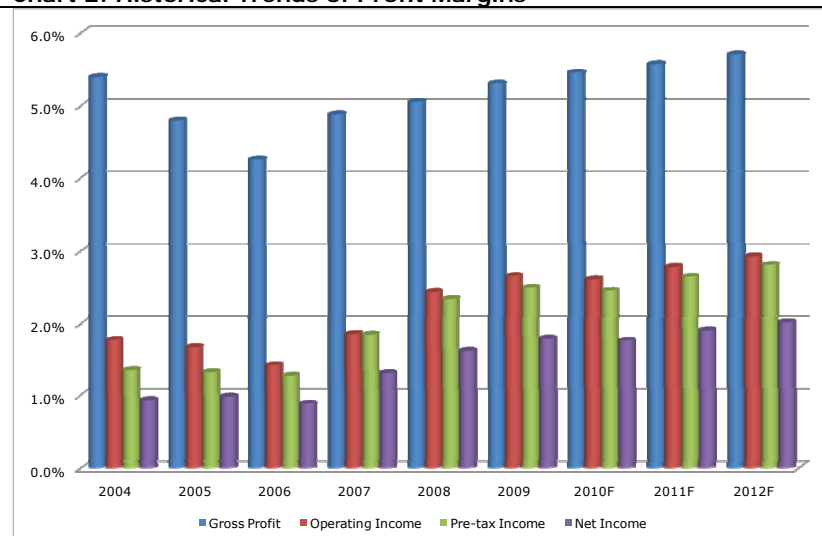
Source: Bloomberg, MIMB Research

**Chart 1: Historical Trends of Revenue and Net Profit**



Source: Bloomberg, MIMB Research

Chart 2: Historical Trends of Profit Margins



Source: Bloomberg, MIMB Research

Table 2: 1QFY10 Quarterly Results Announcement

(RM'mn)	1QFY10	4QFY09	Q-o-Q % Chg.	1QFY09	Y-o-Y % Chg.
<b>Revenue</b>	<b>315.10</b>	<b>N.A.</b>	<b>N.A.</b>	<b>293.91</b>	<b>7.2%</b>
<i>ICT Distribution</i>	221.165	N.A.	N.A.	N.A.	N.A.
<i>Enterprise System</i>	90.72	N.A.	N.A.	N.A.	N.A.
<i>Others</i>	3.21	N.A.	N.A.	N.A.	N.A.
Cost of Sales	(296.53)	N.A.	N.A.	N.A.	N.A.
<b>Gross Profit</b>	<b>18.56</b>	<b>N.A.</b>	<b>N.A.</b>	<b>N.A.</b>	<b>N.A.</b>
Other Operating Expenses - Net	(10.34)	N.A.	N.A.	N.A.	N.A.
<b>Results from Operating Activities</b>	<b>8.22</b>	<b>N.A.</b>	<b>N.A.</b>	<b>5.97</b>	<b>37.7%</b>
Interest Expenses	(0.54)	N.A.	N.A.	N.A.	N.A.
Interest Income	0.01	N.A.	N.A.	N.A.	N.A.
<b>Profit Before Tax</b>	<b>7.70</b>	<b>N.A.</b>	<b>N.A.</b>	<b>5.23</b>	<b>47.0%</b>
<i>ICT Distribution</i>	5.212	N.A.	N.A.	N.A.	N.A.
<i>Enterprise System</i>	2.081	N.A.	N.A.	N.A.	N.A.
<i>Others</i>	0.40	N.A.	N.A.	N.A.	N.A.
Tax Expenses	(1.90)	N.A.	N.A.	N.A.	N.A.
<b>Profit After Tax</b>	<b>5.80</b>	<b>N.A.</b>	<b>N.A.</b>	<b>N.A.</b>	<b>N.A.</b>
Minority Interest	(0.10)	N.A.	N.A.	N.A.	N.A.
<b>Net Profit</b>	<b>5.70</b>	<b>N.A.</b>	<b>N.A.</b>	<b>3.79</b>	<b>50.2%</b>
<b>Per Share Data</b>					
EPS (sen)	6.2	N.A.	N.A.	N.A.	N.A.
DPS (sen)	4.0	N.A.	N.A.	N.A.	N.A.
BPS (sen)	96.8	N.A.	N.A.	N.A.	N.A.
<b>Margins &amp; Profitability</b>					
Gross Profit	5.9%	N.A.	N.A.	N.A.	N.A.
Profit Before Tax	2.4%	N.A.	N.A.	1.8%	37.2%
<i>ICT Distribution</i>	2.4%	N.A.	N.A.	N.A.	N.A.
<i>Enterprise System</i>	2.3%	N.A.	N.A.	N.A.	N.A.
<i>Others</i>	12.5%	N.A.	N.A.	N.A.	N.A.
Net Profit	1.8%	N.A.	N.A.	1.3%	40.1%
ROE (Annualised)	26.4%	N.A.	N.A.	N.A.	N.A.
ROA (Annualised)	8.0%	N.A.	N.A.	N.A.	N.A.

Source: Bursa Announcement

**Table 3: ROE Decomposition**

FYE: 31-December	2008	2009	2010f	2011f
NP/PBT (x)	0.70	0.72	0.72	0.72
PBT/Rev (%)	2.3%	2.5%	2.5%	2.6%
Rev/ATAs (x)	5.21	5.17	4.54	4.37
ATAs/AE (x)	3.25	3.43	2.93	2.50
ROE (%)	27.5%	31.8%	23.5%	20.8%
ROA (= ROE/(ATAs/AE)) (%)	8.5%	9.3%	8.0%	8.3%

Source: Bloomberg, MIMB Research

**Table 4: Relative Valuations**

	Last Price	Hist. P/E (x)	Prosp. P/E (x)	Hist. P/B	Hist. ROE	Est. ROE
ECS Holdings Ltd (SDG)	0.555	5.31	4.63	0.78	15.4%	16.4%
DKSH Holdings Malaysia (RM)	0.700	6.51	N.A.	0.77	13.9%	N.A.
ECS ICT BHD (RM)	N.A.	12.87*	6.63*	0.89*	31.8%	23.5%

\* Extrapolate from the comparables of ECS Holdings and DKSH Holdings after adjusted for the historical and estimated ROEs of ECS ICT.

Source: Bloomberg, MIMB Research

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Stock ratings used in this report are defined as follows:

<b>BUY</b>	Share price expected to appreciate more than 15% over a 12-month period
<b>TRADING BUY</b>	Share price expected to appreciate 10% or more within a 3- to 6-month period
<b>NEUTRAL</b>	Share price expected to be within +/- 15% over a 12-month period
<b>TAKE PROFIT</b>	Target price reached, may accumulate if share price drops more than 15% below target price
<b>SELL</b>	Share price expected to depreciate more than 15% over a 12-month period
<b>NOT RATED</b>	MIMB does not provide research coverage or rating for this company

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