

ECS ICT Bhd

09 Sep 2010

KDN: PP10837/03/2011 (029371)

TRADING BUY

Current Price	RM1.14
New Target Price	RM1.56
Previous Target Price	RM1.56
Previous Recommendation	TRADING BUY
Upside To Target	+36.8%

Stock Codes

Masa	ECS / 5162
Bloomberg	ECS MK

Stock & Market Data

FBMKLCI	1,434.14
Listing	Main
Sector	Technology
Syariah Compliance	YES
Par Value	RM0.50
Issued Shares	120.0mn
Market Capitalisation	RM136.8mn
YTD Chg In Share Price	-
52-week Hi/Lo	RM1.49/RM1.05
3M Average Volume	55,503
Estimated Free Float	40.0%

Majority Shareholders

ECS Holdings Ltd	- 41.0%
Teo Soo Pin S/B	- 12.0%
Sengin S/B	- 12.0%

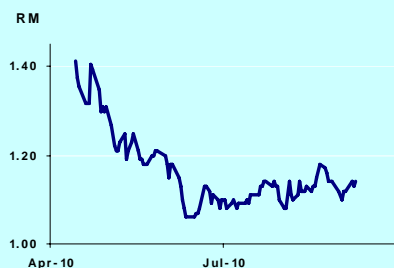
Historical Price Ratios

FYE	2006	2007	2008	2009
PER (x)	N.A.	N.A.	N.A.	N.A.
PBV (x)	N.A.	N.A.	N.A.	N.A.
ROE (%)	N.A.	N.A.	27.5	31.8

Share Performance

	1mth	3mth	12mth
Absolute	+2.7%	+0.8%	N.A.
vs. KLCI	-2.6%	-9.5%	N.A.

Share Price Performance Chart



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Fundamentally strong, but under-appreciated

- Results Review.** The recently reported 1H2010 revenue and net profit of RM626.2mn and RM13.5mn were pretty much in-line with our earnings projections of RM1,520.1mn and RM26.8mn, respectively. Taking a seasonally stronger 2H2010 into considerations, the results in fact were above our projections. We understand the net profit increased >30% on YoY basis, on the back of a decent revenue growth of approximately 6% as well as expansion in net profit margin that had expanded to 2.5% from 2.0% in 2Q2009. We understand that the better profit margins in 1H2010 as opposed to 1H2009 were partly due to higher contribution from Enterprise System. Besides, the improving operation efficiency, i.e. the economics of scale, has also improved the profitability of the Company. The ROE and ROA of FY2009 were recorded at 30.6% and 9.6%, respectively, as opposed to 23.7% and 11.7% in 1H2010 on 6-month annualised basis. The lower ROE was due to larger equity base post listing. Cash conversion cycle continues to be well maintained at <60days.
- Business directions.** To grow from strength to strength, ECS has to capture more market share by way of wider product range and distribution network. The group has outlined 3 pronged business strategies. **Firstly**, ECS is eyeing the higher margin enterprise system market. In fact, ECS Pricomp has recently appointed official distributor for Fujitsu' enterprise systems. **Secondly**, ECS is in the midst of stepping up infrastructure to strength its distribution and logistics efficiency as well as to improve customer interaction experience by appointing resellers and employing more sales staffs at branches. **Thirdly**, ECS also plans to enhance its operational efficiency/payment collection by implementing process re-engineering to increase efficiency and productivity.
- 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 as weaker and small players will eventually be diminished; hence our projected revenue growth rate of 13.0% seems achievable. Besides, we understand that could start recognising the RM30.0mn product supplying sales to YTL-Group for their rollout of WiMAX project in the final quarter of FY10.

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
Net DPS (sen)	N.A.	N.A.	6.7	8.2
NTA/Share (RM)	0.7	0.9	1.2	1.4
Net Debt	45.8	27.5	Net Cash	Net Cash
Net Gearing (%)	66.9	33.0	Net Cash	Net Cash
PER (x)	5.6	4.3	5.1	4.2
Net Dividend Yield (%)	N.A.	N.A.	5.9	7.2
ROE	27.5	31.8	23.5	20.8
ROA	8.5	9.3	8.0	8.3
P/NTA (x)	1.5	1.3	0.9	0.8

- **Dividend policy.** The management has reaffirmed its dividend policy of 30% payout on net profit from FY10 onwards. Thus far, the company has declared a 4.0 sen as an interim dividend for FY10. Based on our earnings forecast, we believe the Group should be able to pay a full year gross DPS of 9 sen, or 6.7 sen net of tax, translating into a gross and net yields of 7.9% and 5.9%.

Our view. We believe ECS has been under-appreciated among investment community. While the company seems like a trading company, it is actually a leading player in ICT distribution with long and consistent track records. Moreover, we reckon that it is not an easy industry to survive needless to say doing well. We have seen some listed ICT product trading companies such as Compugates Holdings, whose results have been in red thus far, and Mangotone Group has turned into a PN17-status company. 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 has proven to have all of these criteria. As such, the Group is well-position to take market share from smaller players.

In additional, we also believe there is a general misconception with ECS' business model. While we reckon that ECS has low net profit margin, it is not a "pure" trading company as per its high ROE and decent ROA. This is because as a net cash company, as at end-June10, the high annualised ROE of ECS was not attributed to high financial leverage but it was due mainly to the fast asset turnover of <80 days or >4.6x within a year. And, we understand that such superb turnover can only be done with a reliable and up-to-date IT system.

- **Valuation & recommendation.** We notice that its Singapore listed parent company, ECS Holdings Ltd, is traded at FY10 PER of 4.0x. Assuming a holding company discount of 25%, ECS ICT should be valued at 5.3x FY PER. Note that ECS ICT's ROE is almost double than ECS Holdings Ltd. Besides, we also note that the price multiples of Singapore is normally lower than its Malaysian peers. For instance, the FSSTI is normally trading 20%-30% discount to FBMKLCI. As such, we reckon that **ECS ICT should be pegged at RM1.56**, 7.0x to its FY10 EPS of 22.4 sen, suggesting 36.8% upside from here. We believe there is no direct comparable in Malaysia. Hence, we double check ECS' valuations against a list of Malaysia Technology stocks (*see Table 1*). We noticed that ECS' valuations are undemanding. Coupled with a net dividend yield of 5.9%, the stock offers potential return of 42.7%. Hence, **we maintain our TRADING BUY call.**

Table 1: Consensus Estimates of Selective List of Technology Stocks (as at 8 September 2010)

NAME	Price (RM)	Historical PER (x)	Est. Current Year PER (x)	Est. Next Year PER (x)	Est. Div. Yld.	Hist. ROE	Hist. PBV (x)	Current Year Net Profit Growth	Next Year Net Profit Growth	Consensus Target Price (RM)	% Upside / (Downside)	6M Beta
UNISEM (M) BERHAD	1.87	20.39	7.22	6.88	4.3%	6.9%	1.25	182.4%	5.0%	2.69	43.7%	2.21
MALAYSIAN PACIFIC INDUSTRIES	5.83	11.61	9.57	8.55	6.0%	14.6%	1.57	21.3%	12.0%	6.87	17.8%	1.11
GLOBETRONICS TECHNOLOGY BHD	1.21	20.22	15.13	12.10	5.8%	7.1%	1.39	33.7%	25.0%	1.21	0.0%	1.80
JCY INTERNATIONAL BHD	1.07	10.55	7.43	6.56	3.7%	25.5%	2.73	42.0%	13.2%	1.59	48.6%	1.61
NOTION VTEC BHD	1.73	7.45	7.09	6.01	3.7%	23.9%	1.19	5.1%	18.0%	1.89	9.2%	0.77
ECS ICT BHD	1.14	5.67	4.65	3.93	5.3%	31.8%	1.26	21.9%	18.4%	1.45	27.2%	0.50
MY EG SERVICES BHD	0.77	26.74	18.66	11.95	1.4%	27.1%	5.44	43.3%	56.1%	0.82	7.2%	2.19
EA HOLDINGS BHD	0.48	20.43	17.14	14.12	0.0%	18.2%	3.72	19.2%	21.4%	0.36	-25.0%	1.00
VITROX CORP BHD	1.26	100.64	7.88	5.73	0.9%	3.9%	3.58	1178.0%	37.5%	1.72	36.5%	1.72
JADI IMAGING HOLDINGS BHD	0.30	19.42	11.80	10.54	1.7%	11.8%	1.84	64.6%	12.0%	0.31	5.1%	0.17
TOTAL / AVERAGE	N.M.	17.33	9.20	7.79	4.0%	17.8%	2.25	56.4%	14.1%	N.M.	31.4%	1.58
ECS HOLDINGS LTD	0.52*	2.05	4.00	3.47	6.7%	15.4%	0.69	-48.7%	15.4%	N.A.	N.A.	1.20**

Source: Bloomberg

* In Singapore Dollar Terms

** Against FSSTI

(RM'mn)	2Q2010	1Q2010	QoQ Chg.	2Q2009	YoY Chg.1	6MFY10	6MFY09	YoY Chg.2
<u>Income Statement Summary</u>								
Revenues	311.14	315.10	-1.3%	294.10	5.8%	626.24	N.A.	N.A.
Operating Profit	10.84	8.22	31.9%	N.A.	N.A.	19.07	N.A.	N.A.
Profit Before Tax	10.58	7.70	37.5%	8.50	24.5%	18.28	N.A.	N.A.
Net Profit	7.80	5.70	37.0%	5.90	32.3%	13.50	N.A.	N.A.
<u>Balance Sheet Summary</u>								
Cash and bank balances	16.90	24.35	-30.6%	N.A.	N.A.	16.90	N.A.	N.A.
Inventories	97.49	83.05	17.4%	N.A.	N.A.	97.49	N.A.	N.A.
Trade and other receivables	145.70	162.18	-10.2%	N.A.	N.A.	145.70	N.A.	N.A.
Other Current Assets	1.35	0.05	>100%	N.A.	N.A.	1.35	N.A.	N.A.
Total Current Assets	261.44	269.63	-3.0%	N.A.	N.A.	261.44	N.A.	N.A.
Property, plant and equipment	3.55	3.46	2.6%	N.A.	N.A.	3.55	N.A.	N.A.
Investment in associates	N.A.	N.A.	N.A.	N.A.	N.A.	-	N.A.	N.A.
Intangible assets	0.57	N.A.	N.A.	N.A.	N.A.	0.57	N.A.	N.A.
Other Non-Current Assets	1.08	1.52	-29.1%	N.A.	N.A.	1.08	N.A.	N.A.
Total Non-Current Assets	5.19	4.97	4.4%	N.A.	N.A.	5.19	N.A.	N.A.
Total Assets	266.63	274.61	-2.9%	N.A.	N.A.	266.63	N.A.	N.A.
Trade and other payables	116.80	122.68	-4.8%	N.A.	N.A.	116.80	N.A.	N.A.
Short term borrowings	11.80	52.00	-77.3%	N.A.	N.A.	11.80	N.A.	N.A.
Other Current Liabilities	6.02	4.41	36.5%	N.A.	N.A.	6.02	N.A.	N.A.
Total Current Liabilities	134.62	179.09	-24.8%	N.A.	N.A.	134.62	N.A.	N.A.
Borrowings	N.A.	N.A.	N.A.	N.A.	N.A.	-	N.A.	N.A.
Other Non-Current Liabilities	0.07	0.15	-51.0%	N.A.	N.A.	0.07	N.A.	N.A.
Total Non-Current Liabilities	0.07	0.15	-51.0%	N.A.	N.A.	0.07	N.A.	N.A.
Minority Interests	N.A.	6.33	-100.0%	N.A.	N.A.	-	N.A.	N.A.
Total Shareholders' Funds	131.94	89.03	48.2%	N.A.	N.A.	131.94	N.A.	N.A.
Total Equity & Liabilities	266.63	274.61	-2.9%	N.A.	N.A.	266.63	N.A.	N.A.
<u>Cashflow Summary</u>								
Net cash generated from operating activities	5.20	10.03	-48.2%	N.A.	N.A.	15.23	N.A.	N.A.
Net cash from/(used in) investing activities	(5.78)	(0.08)	>100%	N.A.	N.A.	(5.86)	N.A.	N.A.
Net cash used in financing activities	(6.87)	(9.84)	-30.2%	N.A.	N.A.	(16.70)	N.A.	N.A.
Net change in cashflow	(7.45)	0.11	<100%	N.A.	N.A.	(7.33)	N.A.	N.A.
<u>Per Share Data</u>								
Number of Shares (Weighted Average)(mn shares)	117.54	92.00	27.8%	N.A.	N.A.	117.54	N.A.	N.A.
EPS (sen)	6.64	6.19	7.2%	N.A.	N.A.	11.48	N.A.	N.A.
Gross DPS (sen)	N.A.	4.00	N.M.	N.A.	N.A.	4.00	N.A.	N.A.
BV/share (RM)	1.12	0.97	16.0%	N.A.	N.A.	1.12	N.A.	N.A.
NTA/share (RM)	1.12	0.97	15.5%	N.A.	N.A.	1.12	N.A.	N.A.
<u>Selected Ratios</u>								
Operating Profit Margin	3.5%	2.6%	33.6%	N.A.	N.A.	3.5%	N.A.	N.A.
Profit Before Tax Margin	3.4%	2.4%	39.2%	2.9%	17.6%	3.4%	N.A.	N.A.
Net Profit Margin	2.5%	1.8%	38.7%	2.0%	25.0%	2.5%	N.A.	N.A.
Annualised Inventory Turnover (Days)	28.59	24.05	18.9%	N.A.	N.A.	28.59	N.A.	N.A.
Annualised Receivable Turnover (Days)	42.73	46.97	-9.0%	N.A.	N.A.	42.73	N.A.	N.A.
Annualised Payable Turnover (Days)	34.26	35.53	-3.6%	N.A.	N.A.	34.26	N.A.	N.A.
Gross Gearing	8.9%	58.4%	-84.7%	N.A.	N.A.	8.9%	N.A.	N.A.
Net Gearing	-3.9%	31.1%	-112.5%	N.A.	N.A.	-3.9%	N.A.	N.A.
Annualised ROA	11.7%	8.3%	41.1%	N.A.	N.A.	11.7%	N.A.	N.A.
Annualised ROE	23.7%	25.6%	-7.6%	N.A.	N.A.	23.7%	N.A.	N.A.

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Stock ratings used in this report are defined as follows:

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

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