nra capital

ECS Holdings Ltd

Initiating Coverage

BUY

Current Price **S$0.845**
14 Feb 2011

Fair Value S$1.42

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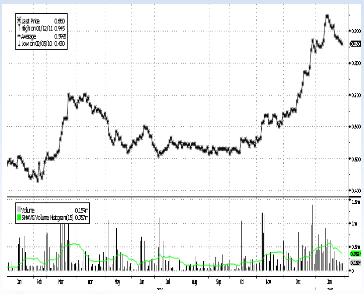
Historical Chart



Source: Bloomberg

Stock Statistics

Market Cap	S$308.73m
52-HI	S$0.970
52-LOW	S$0.405
Avg Vol (1 yr)	257,704
Shares Outstanding	365.4m
Free Float	36.5m

Key Indicators

ROE 11F	16.3%
ROA 11F	5.9%
P/BK	1.1x
Gearing	0.46

Major Shareholders

VST	89%

Hitting record highs, but still undervalued

- **Initiate coverage with Buy recommendation.** We believe ECS is poised for strong growth in view of 1) distribution rights for Apple products, 2) exposure to high growth markets such as China and Indonesia. Short-term catalyst could be dual listing on the Taiwan Exchange. Most importantly, its valuation is truly undervalued compared to its peers. Our target price of S$1.42 is pegged to 10x FY11 PER, about 28% discount to the sector valuation.

- **Riding on Apple's products.** ECS recently announced that it has clinched nation-wide distribution rights for Apple's iPad and iPhone 4 in China. The products, which were sold in China starting 4Q2010, will contribute positively to the company's top line and bottom line, albeit modestly. Substantial contribution will start only stream in 2011. Based on conservative assumptions, we estimate that potential sales brought by these two products could be about S$348m.

- **Proxy to emerging markets.** Revenue from Indonesia grew almost 43% to S$220m in 2009. The upside potential in the world's fourth most populous country is still huge on the back of low PC ownership rate of about 1.5%. We predict Indonesia's sales to hit more than 30% growth for 2010 and 2011 on strengthening infrastructure and expanding market coverage in the country. Besides Indonesia, ECS has put its sight on emerging markets such as Vietnam and India. It also has a presence in Philippines via associated companies, with offices in Cebu, Davao and Manila.

- **Powering Ahead in Chinese Market.** China is the largest revenue contributor, amounting to slightly more than half of the total revenue. Revenue in China grew 11% to S$1.7b in 2009 while we are likely to see a marginal growth of 4% in 2010 due to decline in sales from notebooks and servers. We predict growth to resume strongly with the new distribution rights it secured from Apple, Dell, and perhaps Lenovo. Our sales forecast for China is 29% growth in 2011 and 19% in 2012, much higher than industry growth of 13%. It has also made inroads to the second and third tier cities in China and is accelerating its efforts in expanding its channel network into the fourth and fifth tier cities.

- **Rerating catalysts**. Explosive sales for iPad and iPhone 4 in China, lower SGA on cost control measures, gain in market shares

- **Risks.** Pricing pressures, tech spending slower than expected, volatility in quarterly margins

Key Financial Data					
(SGD m, FYE Dec)	**2008**	**2009**	**2010F**	**2011F**	**2012F**
Sales	2,949.9	3,252.0	3,019.5	3,538.2	4,103.9
Gross Profit	149.5	158.7	152.5	181.2	210.7
Net Profit	29.4	38.2	50.8	51.8	60.3
Basic EPS (cents)	8.0	10.5	13.9	14.2	16.5
Diluted EPS (cents)	8.0	10.5	13.9	14.2	16.5
EPS growth (%)	26.1	29.9	33.0	2.1	16.3
PER (x)	10.5	8.1	6.1	6.0	5.1
NTA/share (cents)	55.9	61.9	72.8	83.4	96.1
DPS (cents)	2.7	3.0	3.5	3.8	4.3
Div Yield (%)	3.2	3.6	4.1	4.5	5.1

Source: Company, NRA Capital estimates

Company Background

ECS, established in 1985 and listed on SGX Mainboard in 2001, is a leading Information and Communications Technology (ICT) products and services provider. The company has three business segments, namely Enterprise Systems, IT Services and Distributions. ECS represents IT vendors such as Apple, Cisco, Dell, EMC, Hewlett-Packard, IBM, Lenovo, Microsoft, Oracle, Samsung, Symantec, etc. It has more than 23,000 active channel partners spanning across China, Thailand, Malaysia, Singapore, Indonesia and the Philippines. The company was acquired by VST Holdings in 2007 with the offer price of S$0.67. The parent, which currently owns about 89% of the company, is a top three Asian distributor of a wide range of IT products including, data storage device, CPUs, media products, PC motherboards and server to resellers and end users.

Geographical, product and customer summary

Distribution segment with a typical EBIT margin that ranges between 1.0 and 1.4% is the largest revenue contributor, accounting for nearly 63% of total revenue in FY09. The EBIT margin for Enterprise segment is generally higher, varying from 1.8% to 2.2%. It contributes almost 36% of total revenue. Lastly, IT services is the highest margin segment, spanning from 5% to 8%, but it only contributes less than 1% of total revenue.

1) **Enterprise Systems:** design, install, and implement IT infrastructure for MNCs, local governments and domestic companies.
2) **IT Services:** provide a comprehensive range of professional, technical support and training services. The services are split into four major pillars, namely storage & data availability, info-security, E-services and application integration
3) **Distributions:** distribute fast moving products by leveraging on a well established and highly efficient logistical and ICT infrastructure.

Product (SGDm)	FY08	% of rev	FY09	% of rev	FY10F	% of rev	FY11F	% of rev
Distribution	1783.0	60.4	2034.2	62.6	1871.5	62.0	2208.4	62.4
Enterprise Systems	1133.3	38.4	1187.9	36.5	1116.7	37.0	1295.3	36.6
IT Services	33.6	1.2	29.9	0.9	31.3	1.0	34.5	1.0
Total	**2949.9**	**100.0**	**3252.0**	**100.0**	**3019.5**	**100.0**	**3538.2**	**100.0**

Source: Company, NRA estimates

Revenue by geography is divided between North Asia (NA) and South East Asia (SEA). SEA region comprises Thailand, Malaysia, Indonesia and Singapore while NA region only consists of China. Following the successful listing of Malaysian subsidiary in mid-April 2010, the stake attributable to the company was reduced to just 41%. As such, it ceased to be a subsidiary and become an associate of the company. As a result, revenue was deconsolidated from the group’s financial statements. This is why the revenue from Malaysia is estimated to drop substantially in FY10. Indonesia, an emerging country with huge growth potential, is likely to surge significantly in FY10 and FY11. Meanwhile, China is estimated to grow single digit in FY10, thanks to HP’s struggles over market share in China. Nevertheless, the second largest economy in the world would be the key growth driver for the company in FY11 and FY12 in view of a strong product category add-ins from Apple and Dell.

Geography (SGD m)	FY08	% of rev	FY09	% of rev	FY10F	% of rev	FY11F	% of rev
China	1,515.6	51.4	1,685.2	51.8	1,747.7	57.9	2,258.4	63.8
Thailand	494.1	16.8	505.9	15.6	536.3	17.7	573.8	16.2
Malaysia	498.4	16.9	559.1	17.2	139.8	4.6	-	-
Singapore	287.8	9.8	281.5	8.6	298.3	9.9	319.2	9.0
Indonesia	153.9	5.1	220.3	6.8	297.5	9.9	386.7	11.0
Total	**2,949.9**	**100.0**	**3,252.0**	**100.0**	**3,019.5**	**100.0**	**3,538.2**	**100.0**

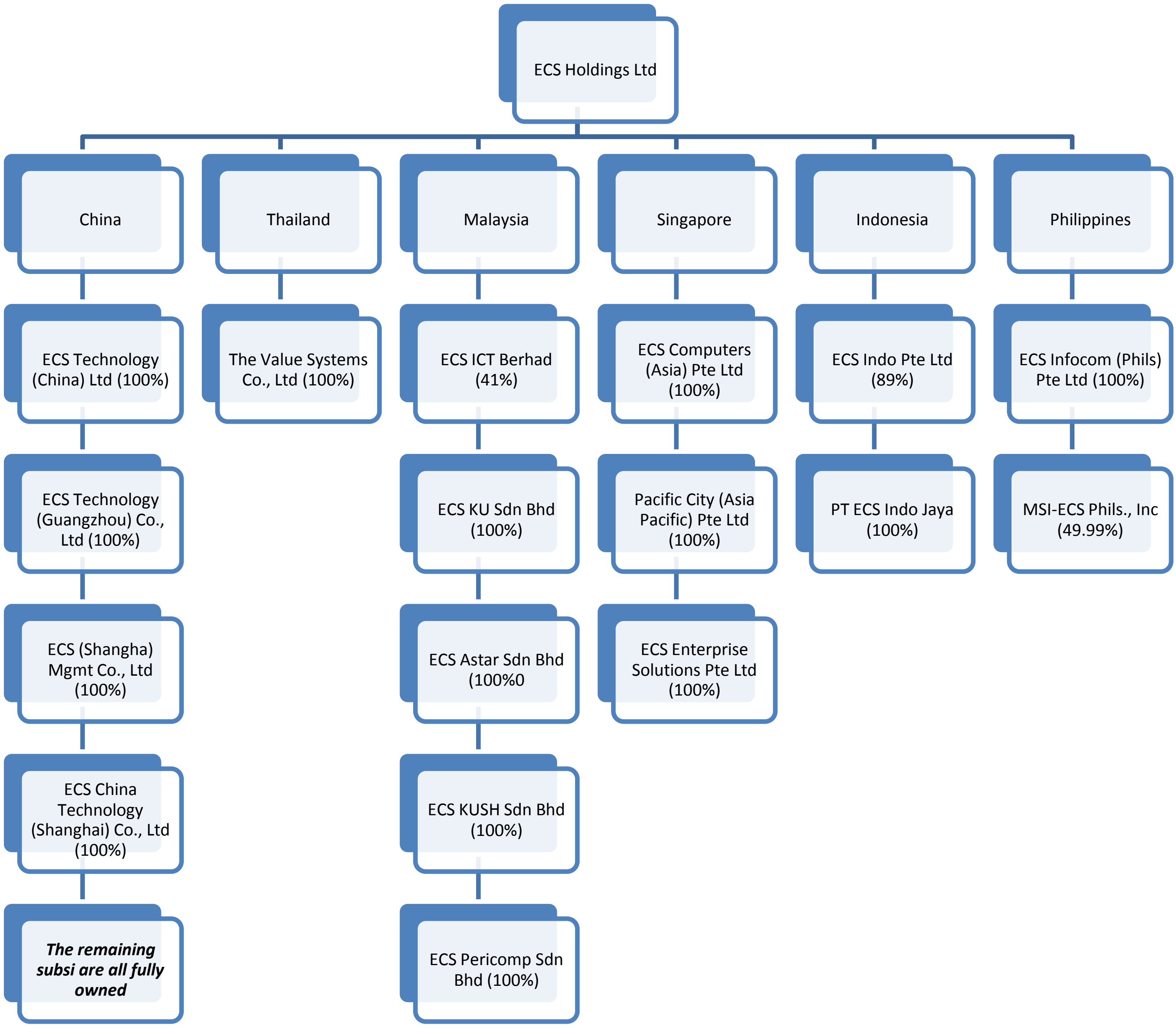
Source: Company, NRA estimates

Type of customers comprises value-added resellers, system integrators, direct accounts (end-users) and retailers. Major customers include Accenture, NCS, China

Mobile, China Unicom, Huawei, etc but none of them contributed more than 5% of total revenue. We expect no major changes in the customer mix.

Customers	% of rev
Value-added resellers	47.4
System integrators	10.6
Direct accounts	2.2
Retailers	35.5
Others	4.3
Total	**100.0**

Group Structure



Source: Company

Company Outlook

Riding on Apple's Astounding Growth

Apple's agency rights to boost company profile. ECS recently announced that it has clinched nation-wide distribution rights for Apple's iPad and iPhone 4 in China. The products, which started going on sale in China in 4Q2010, would contribute positively to the company's top line and bottom line, albeit modestly initially. Substantial contribution will only stream in from 2011. The success in securing agency rights from Apple would help raise its profile in China. Besides that, this would enhance its competitiveness in the Chinese market given that its largest peer in China, Digital China, failed to win the distribution rights for both products.

One of the first three iPad distributors. Apple announced in October 2010 that it appointed the first three designated distributors for its iPad in China and ECS Technology (China) was one of them. The other two are Changhong IT and Beijing Hanlinhui Information Industry Co., according to people close to the matter. Apple started selling Wi-Fi models of the iPad in Sep 2010, almost 5 months after its first launch in the US. Of note, iPad costs higher in China than in the US with 16G version priced at RMB3988 (S$770) and 64G model at RMB5588 (S$1082). Apple predicts about 2 mil units to be sold in China in 2011. Assuming 10% market share (lower than 33%, equal share among the three distributors), S$770 ASP (lower range of the selling price), iPad could boost ECS's revenue by S$154m.

Capturing iPhone 4 growth. After the initial iPhone 4 launch in September in China, all of the products displayed at Apple stores and outlets run by China Unicom and the Suning chain stores were snapped up. To speed up the product reach throughout the country, Apple in December appointed three more IT distributors. ECS Technology (China) Ltd. was again selected together with Changhong IT, and Beijing Founder Century. iPhone 4 is selling at RMB4999 (S$971) for 16G and RMB5999 (S$1165) for 32G. We estimate iPhone sales unit in China to hit about 4m in 2011. Assuming 5% market share and lower range of ASP, iPhone 4 would add about S$194m to the company sales.

Apple making headways in China. Apple reported first quarter results ended 25 Dec 2010 that exceeded analysts' consensus. Sales gained 71% to a record US$27b while profit soared 78% to US$6b. During the period, Apple sold 7.3m iPads (75% qoq growth) and 16.2m iPhone (15% qoq growth, 86% yoy growth). Of particular, sales in China (including Hong Kong and Taiwan) registered US$2.6b, four times higher than the same period the year before. The enormous efforts put by Apple to penetrate Chinese market are paying off remarkably well. The astounding growth was in no small part attributed to its move to release iPad and iPhone 4 to the Chinese market faster than they used to. Both products were launched in China less than six months after the US release. In the case of iPhone 3GS, the timing gap between the US launch and official shipments to China was more than two years, which harbored huge gray market for Apple's products.

More agency rights could be the catalyst. Understanding sales momentum brought by increasing brand recognition in China and the drawback of delaying official launch in Chinese market, Apple is accelerating launch of new products. It has already indentified China as the next development market. This presents vast opportunity for ECS if it could successfully create value to its vendor by extending the reach of its products and capturing market shares for resellers and suppliers. Of late, Chinese press released that 3G iPad, which has been approved by China's State Regulatory Commission, will hit the China market in Mid-Feb 2011. It could be a catalyst if ECS emerges as the winner for the distribution right.

Product and Geographic Diversification

Risk of over-reliance on HP. Previously, ECS procured almost 40% of its total purchase from HP, much higher than 25% that Ingram Micro purchased. There is a risk of over-reliance on one particular vendor. Lack of product diversification makes the company vulnerable to market dynamics or actions taken by the main vendor. Sometimes it will be affected too if the market demand for specific product lines changes. In fact, ECS sales in China were affected by HP's quality issues in the country in the first half of 2010. Chinese consumers filed a joint complaint against the US company over its laptop's faulty graphic chips and display screens.

HP losing market share. The recent data released by Gartner showed that HP is losing share in the PC market, sliding from 19.4% in 4Q2009 to 18.8% in 4Q2010. Although the decline does not shake HP off its long-standing position as the top PC producer in the world, its dominance would be threatened by rising peers as well as mounting competition from PC tablets.

Table 8: Preliminary WW PC Vendor Unit Shipment estimates for 4Q10

PC Shipments	4Q10	Mkt shr (%)	4Q09	Mkt shr (%)	yoy Growth
HP	17,581,525	18.8	17,786,986	19.6	-1.2
Acer	11,852,617	12.7	12,075,091	13.3	-1.8
Dell	10,801,225	11.6	10,395,288	11.5	3.9
Lenovo	9,481,565	10.1	7,809,357	8.6	21.4
Toshiba	5,346,700	5.7	4,768,306	5.3	12.1
Others	38,416,677	41.1	37,816,171	41.7	1.6
Total	**93,480,309**	**100.0**	**90,651,199**	**100.0**	**3.1**

Source: Gartner

Mitigate risk by broadening customer bases and deepening product range. In addition to Apple, ECS had signed an agreement with Dell to sell computer desktops and notebooks in China. The company is also negotiating distribution rights in China with Lenovo. With the newly added partners, purchases from HP could reduce to 30% in one year or so.

Aggressive growth in Indonesia. Revenue from Indonesia grew almost 43% to S$220m in 2009, accounting for only about 6.8% of total revenue. The growth rate was faster than sector growth rates as the distribution channels established in the country and efforts to expand markets start to bear fruits. The upside potential in the country is still huge on the back of low PC ownership rate in the country. According to Business Monitor International ("BMI"), computer hardware CAGR for the 2010 to 2015 period is forecast at about 16%, driven by a low PC penetration rate of about 1.5%. Also, it projected that Indonesian PC sales in 2011 to hit US$2.9b in 2011, from US$2.6b in 2010. We predict Indonesia's sales to hit more than 30% growth for 2010 and 2011 on strengthening infrastructure and expanding market coverage in the country. We forecast proportion of Indonesia's sales to cross 10% in FY2011.

Proxy to emerging markets. Besides Indonesia, ECS has put its sight on emerging markets such as Vietnam and India. It also has presence in Philippines via associated companies, which have offices in Cebu, Davao and Manila. ECS is positioned to take advantage of higher growth potential in these emerging markets by leveraging its expertise and best practices gained in mature markets such as Singapore. Through understanding local culture and armed with a global perspective, its success in one country can be replicated in other new territories. Unlike Ingram Micro and Tech Data, ECS's geographical exposure is characterized by high growth emerging countries.

Powering Ahead in Chinese Market

Fourth largest in China, aiming number three. ECS ranked number four in China, behind Digital China, Synnex and Ingram Micro in sequential order. China is the largest revenue contributor, amounting to slightly more than half of the total revenue. Revenue in China grew 11% to S$1.7b in 2009 while we are likely to see a marginal growth of 4% in 2010 due to decline in sales from notebooks and servers. We predict growth to resume strongly with the new distribution rights it secured from Apple, Dell, and perhaps Lenovo. Our sales forecast for China is 29% growth in 2011 and 19% in 2012.

Expanding into fourth and fifth-tier cities. ECS currently has 9,000 channel partners, up from 8,200 last year, spread throughout 20 Chinese cities. It has already made its presence felt in cities like Beijing, Shanghai, Guangzhou, Hong Kong, Chengdu, Shenyang, Shenzhen, Wuhan and Xi'an. It has made inroads to the second and third tier cities in China and is accelerating its efforts in expanding its channel network into the fourth and fifth tier cities.

Outpacing 13% CAGR industry growth. According to BMI, spending on IT products and services in China is forecast to hit US$92.5b in 2010, increasing to US$153.5b by 2014. Total IT spending in China is projected to grow at a CAGR of 13% over the five year period on favorable fundamentals. Among them are vast potential rural market, gradual modernization across the sectors, government spending and 12th five year plan that encourages domestic consumption, urbanization and infrastructure. We would like to stress that ECS will likely experience robust growth that outpaces sector growth, given its underlying business developments.

Financial Overview

Profit and Loss Statement

Table 8: margins estimate

P&L	2008	2009	2010F	2011F
Revenue	2949.9	3252.0	3019.5	3538.2
Gross margin (%)	5.07	4.88	5.05	5.12
SG&A (%)	3.04	2.81	3.23	3.17
Operating margin (%)	2.03	2.07	1.82	1.95
EBITDA margin (%)	2.13	2.16	1.90	2.04
PBT margin (%)	1.40	1.76	2.17	1.89
EPS (cts)	8.0	10.5	13.9	14.2

Source:Companies, NRA Capital Estimates

Revenue: We expect revenue to dip 7.2% in 2010 as its Malaysian operation ceased to be a subsidiary and became associate following the listing in April 2010. If effect of deconsolidation is excluded, ECS revenue is estimated to grow at about 8.4%. We estimate revenue growth to hit 17.2% in 2011, driven by strong growth in China and Indonesia

Gross margin: For every 10 bps change in gross margin, the impact on annual and quarterly earnings is about S$3m and S$$0.75m respectively. On quarterly basis, we observed that the sequential change in gross margin in the past varied from minus 90 bps to 80 bps. In other words, the corresponding impact on quarterly earnings could range between minus S$6.8m and S$6m. Nevertheless, the volatility was often nullified by provisions such as allowance for doubtful receivables. We estimate gross margin to climb 17 bps and 7 bps to 5.05% in 2010 and 5.12% in 2011 respectively on improved product mix and stable pricing environment.

SG&A: SG&A is estimated to be higher in 2010 due to deconsolidation effect from Malaysian subsidiary. We predict SGA to improve to 3.23% in 2011 from 3.17% in 2010, thanks to improvement in leverage from greater scale in operation.

PBT margin: We forecast PBT margin in 2011 to be 2.17%, about 300 bps higher than operating margin. This is attributable to the nearly S$13m fair value gain from Malaysia-listed associate and its shares of profit.

EPS: We expect EPS growth in 2011 to be a low-single digit despite expectation of strong growth in revenue and improvement in operating margin. The lackluster growth rate is due to one-off fair value gain in 2010.

Balance Sheet

Table 8: Balance sheet

Balance sheet	2008	2009	2010F	2011F
Financial leverage	3.1	3.4	2.7	2.8
Current ratio	1.7	1.5	1.7	1.6
Total debt/ equity	0.8	0.7	0.6	0.6
Ebitda / interest expense	5.5	13.2	8.8	10.6
Net gearing	0.60	0.49	0.39	0.36
Cash conversion cycle	40.7	38.5	41.9	37.2
Dividend payout ratio	33.6	28.7	25.2	26.8

Source:Companies, NRA Capital Estimates

Account receivables. Distribution business requires huge working capital, specifically for account receivables and inventories. Over the period from FY07 to FY09, the average receivable days and inventories days were 54 and 21 days. Minus away average payable days of 35 days, cash conversion cycle was 40 days. As the company grows in size, more cash will be locked up by working capital requirement.

Debt and credit facilities. As at Dec 2009, ECS maintained credit lines of S$410m, of which S$333m were unsecured. It had raised a US$89 million syndicated loan from various financial institutions in August 2010 to refinance its existing debt and fund its expansion.

Dividend. Dividends were paid throughout the financial crisis. It paid 1.5 cents in FY07, 2.7 cents in FY08 and 3.0 cents in FY09 on increasing earnings. Payout ratio over the period ranged from 23% to 34%. Though we expect the company to continue to reward shareholders, our dividend payout ratio estimate is at the lower end of the range. ECS needs more funds retained and deployed in high growth countries.

Dual listing. ECS has announced it plans to raise about US$50 million from the listing of its Taiwan Depository Receipts. It is in the process of submitting documents to Taiwan's regulator and aims to make its debut on the Taiwan Stock Exchange in the first half of 2011. The proceeds will be mainly used for expansion in China.

Cash Flow

Table 8: Free cash flow estimates

Cash Flow	2008	2009	2010F	2011F
Total profit	29,386	38,181	50,782	51,824
Depreciation and Amortization	2,915	2,828	2,571	3,245
Working capital changes	(29,565)	(24,293)	3,133	(29,306)
Capex	(3,514)	(1,854)	(2,000)	(15,000)
Free cash flow	(778)	14,862	54,485	10,763
FCF per share (cts)	-0.2	4.1	14.9	2.9

Source:Companies, NRA Capital Estimates

Working capital changes. Distribution is a working-capital intensive business, which is one of the reasons why investors shy away from this industry. Our estimate for 2010 working capital is S$3.1m, thanks to the lower turnover. The downside to our estimate could be the inventory spike-up from Apple’s products. We forecast S$29.3m required in 2011 to finance sales growth.

Capex. We estimate capex in 2011 to be S$15m earmarked for setting up new offices and infrastructure.

Risks

Pricing pressure from competition. Aggressive pricing by competitors could pose a risk to ECS's revenue and gross margin. Pricing pressure is not uncommon given that the ITC products are similar across distributors and resellers. Price cutting can occur when market slows, distributors fight for market shares. Sometimes, changes in channel program can motivate distributors to churn volume but at lower pricing. Particularly, channel program that is volume-based will encourage distributors to lower price and therefore gain volume in order to qualify for the program.

Tech spending could be slower than expected. We predict ITC spending in China and Indonesia will grow at least double digit CAGR in the years ahead on low PC penetration rate. If the spending does not rise as expected, this will weigh on our estimates.

Growth in China hinges on new products. Distribution rights from Apple and Dell and their respective projected sales to ECS were incorporated in our modeling. Our projection of 29% growth in China in 2011 is way above 13% estimated growth for IT spending in China. The projected excess growth rate is attributed to new distribution rights and aggressive channel expansion to fourth to fifth tier cities. Downside to our estimates is possible if 1) Agency rights for the same products are awarded to other rivals in Chinese market, 2) poor response from customers to the new products, 3) termination of agreement, 4) change in supplier terms or conditions.

Quarterly changes in gross profit margin and ebit margins. Every 10 bps change in gross margin would have earnings impact of almost S$0.75m. Change could be due to several reasons, including product mix, seasonality, etc. We observe that 4Q has a higher likelihood to see gross margin expansion, followed by margin compression in the subsequent quarter. The expansion is in no small part due to higher sales in 4Q.

Table 8: Volatility in margins

Volatility in margins (bps)	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10	4Q10F	1Q11F	2Q11F
Gross margin (sequential chng)	53	-58	40	-91	88	-52	64	-61	-16	88	15	-43	0
EBIT margin (sequential chng)	18	-12	-5	11	77	-11	-10	-21	100	-29	-23	-21	1

Source:Companies, NRA Capital Estimates

Management

Mr Tay Eng Hoe was appointed as the ***Chairman*** of the Company on 27 September 2010. Prior to this appointment, he was the Vice Chairman and an Executive Director. Mr Tay is the founder of the ECS Group and also ECS Computers (Asia) Pte Ltd, Singapore subsidiary. He brings with him more than 25 years of experience in the IT business. Mr Tay is also an Executive Director of VST Holdings Limited. In August 2005, he was conferred the Public Service Medal by the President of the Republic of Singapore in recognition for his public service to the country. Mr Tay holds a Bachelor of Science (Honours) degree from the LaTrobe University and a Master of Business Administration from the University of Melbourne.

Mr Narong Intanate was appointed ***Group Chief Executive Officer*** on 1 July, 2010 and is the founder and Executive Chairman of The Value Systems Co., Ltd. (Thailand subsidiary) since 1988. He is actively involved in the management of The Value Systems Co., Ltd. and plays a pivotal role in steering the strategic direction of The Value Systems. He was appointed as an Executive Director of the Company on 15 December 2000. He holds a Bachelor of Science in Business Administration and a Master of Business Administration from California State University.

Mr Eddie Foo is the ***Group Chief Financial Officer*** of the Company and is concurrently the Group Company Secretary. Mr Foo is responsible for the corporate finance and treasury, reporting, accounts, tax, information technology and investor relations of ECS Holdings. He is also a director on the boards of various ECS companies. Mr Foo has several years of financial management and audit experience in multinational and public accounting firms. Mr Foo holds a Bachelor degree in Accountancy from the Nanyang Technological University and is a member of the Institute of Certified Public Accountants of Singapore.

Competition

ECS compete against broad-based IT distributors. Some of them are specialized in local markets such as Digital China while others have regional presence such as Synnex and Ingram Micro. There are also competitors whose focus is on a particular product segment. For instance, Avnet is mainly involved in components and enterprise products business. Other than distributors, ECS might compete with suppliers that employ a direct-sales model. The competition among the industry players could induce pricing pressure. To win sales and charge higher prices to protect margins, distributors always resort to value-added services such as tailored solutions to customer needs, speed of delivery, credit terms, marketing program and financing. Breath of product lines and services is also key to attract customers.

Table 8: Peers' profiles

	Digital China	**Synnex**	**ECS Holdings**	**Ingram Micro**	**Tech Data**
Revenue by Geography	China (100%)	China (71%) Taiwan (15%) Australia (14%)	China (52%) Indonesia (7%) Thailand (16%) Malaysia (17%) Singapore (8%)	North America (40%) EMEA (30%) Asia Pacific (20%) Latin America (5%)	America (45%) Europe (55%)
Revenue by product	Distribution (45%) System (28%) Supply chain (17%) IT services (9%)	Distribution (70%) Telecom. (18%) Components (12%)	Distribution (63%) Enterprise (36%) IT services (1%)	Peripherals (42%) Systems (28%) Software (18%) Networking (12%)	Peripherals (35%) Systems (30%) Software (17%) Networking (17%)
Rank in China	No.1 in China	No.2 in China; No.1 in Taiwan	No.4 in China;	No.3 in China	Nil
Strength	-Strong connection with Chinese government, SOE -Having the first mover advantage in 4-6 tier cities -Better product diversification -Higher GPM	-Strong presence in Taiwan -Better cost control, lower SGA	-High exposure to emerging markets -Greater geographical diversification -Lower SG&A %	-Ingram Micro Logistics to boost margins -Value-added services such as data mining initiatives -Scale and Leverage	-Scale and leverage
Weakness	- Higher geographical risk - Higher SG&A%	- Weaker connection with Chinese government & SOEs - Lack of product diversification	- Weaker connection with Chinese government & SOEs	- Slower growth due to high exposure to developed countries	- Slower growth due to high exposure to developed countries

Source:Companies, NRA Capital Estimates

Ingram Micro, the largest distributor in the world in terms of revenue, saw its sales hitting nearly S$43b in 2009, almost 13 times bigger than that of ECS. It has the widest geographic footprint. The number of markets that it has presence in is larger than any other broad-based IT distributors. We believe Ingram ranks number three in the Chinese market. It has the advantage of scale and leverage as well as broad base of products and services. Given the gigantic size, growth and SGA are the tradeoff. HP represented about 25% of the company's total sales, with the rest of the vendors contributing less than 10%.

Digital China is the largest player in China with approximately 25% market share. Its annual sales in 2009 were about three times bigger than ECS. However, it is subject to high geopolitical risk as it relied on one market only. It is blessed with strong connection with Chinese government and SOE, giving them high chances to secure agreements and contracts. It is likely to see gross margin expansion, thanks to its growing software services and smart card segment, which has gross margin of 15-20%. Its hardware business is expected to grow moderately on HP market shares struggle and failure to get iPad and iPhone 4 distribution rights recently. HP is 15% of its total revenue, Cisco at 9%, Dell at 9%, Asus at 8% and Lenovo at 7%. Additionally, it also suffered high SGA.

Synnex is the leader in Taiwan, but ranks after Digital China in Chinese market. Its revenue was about 3 times larger than ECS in 2009. Its effort to cut operating costs has come to fruition. Its operating expense ratio is likely to be lowest among its rivals, at just 2.4%, versus Digital China 5.3%. It saw strong growth in handset and consumer product lines due to stronger industry growth and product category add-ins. Sales in handset should see about 60% yoy growth in 2010 and 30% in 2010, thereby the segment becoming increasingly important the company. It is the most valued IT distributor, as evidenced by its highest price-earnings ratio, thanks to its remarkable growth, excellent cost control and risks being well mitigated by diversified geographic and product exposure.

Table 8: Relative valuation

Name	Code	Price (Local)	MktCap (S$ m)	Actual PER (x)	Y1 PER (x)	Y2 PER (x)	PBR (x)	ROE (%)	ROC (%)	ROA (%)	Yield (%)
Average			***2577.2***	***13.4***	***11.6***	***9.8***	***2.0***	***15.7***	***11.1***	***5.3***	***1.4***
Median			***2806.0***	***12.4***	***10.6***	***9.2***	***1.5***	***15.8***	***10.1***	***4.7***	***1.0***
ECS	**ECS SP**	0.85	308.7	6.1	6.0	5.1	1.1	15.4	8.8	4.8	3.6
Digital China	861 HK	14.58	2619.0	15.7	15.7	12.9	3.3	22.5	17.1	6.1	1.9
Synnex	2347 TT	73.00	4818.7	22.0	19.0	15.7	3.3	16.2	11.4	9.5	3.0
VST	856 HK	2.62	543.0	-	7.8	6.6	1.8	20.7	11.7	4.7	0.0
Ingram Micro	IM US	20.78	4180.7	10.7	9.4	7.9	1.1	10.2	8.8	3.7	0.0
Tech Data	TECD US	50.03	2992.9	12.45	11.9	10.6	1.1	9.4	8.7	3.3	0.0

Note: PBR, ROE and Dividend yield are based on latest financial year numbers
Source:Bloomberg, NRA Capital Estimates

Table 9: Financial analysis

Name	FYE	SALES (SGD)	GPM (%)	OPM (%)	NPM (%)	SALES GRTH (%)	EPS GRTH (%)	CCC (days)	FIN LEV (x)	INT COV. (x)	DEBT/ EQY (x)
Average			***5.2***	***1.5***	***1.3***	***16.9***	***29.1***	***31.8***	***3.2***	***8.6***	***45.4***
Median			***5.1***	***1.4***	***1.1***	***13.2***	***31.3***	***30.1***	***3.0***	***9.3***	***43.7***
ECS	**12/2009**	**3252.0**	**4.9**	**2.0**	**1.2**	**10.2**	**31.3**	**38.4**	**3.2**	**11.8**	**64.1**
Digital China	03/2010	9234.7	6.6	1.3	1.6	18.6	24.8	19.5	3.7	5.1	36.9
Synnex	12/2009	9713.1	4.0	1.6	2.2	16.2	46.7	47.5	2.3	9.1	50.6
VST	03/2010	4092.2	4.8	1.8	1.0	78.9	-13.1	33.7	4.4	4.3	89.1
Ingram Micro	12/2009	42908.4	5.7	1.1	0.7	-14.1	-	25.2	2.7	11.8	12.6
Tech Data	01/2010	31962.2	5.2	1.2	0.8	-8.2	55.9	26.6	2.9	9.5	19.3

Note: Financial figures are based on lastest fiancial year numbers while order is based on latest annoucement
Source:Bloomberg, NRA Capital Estimates

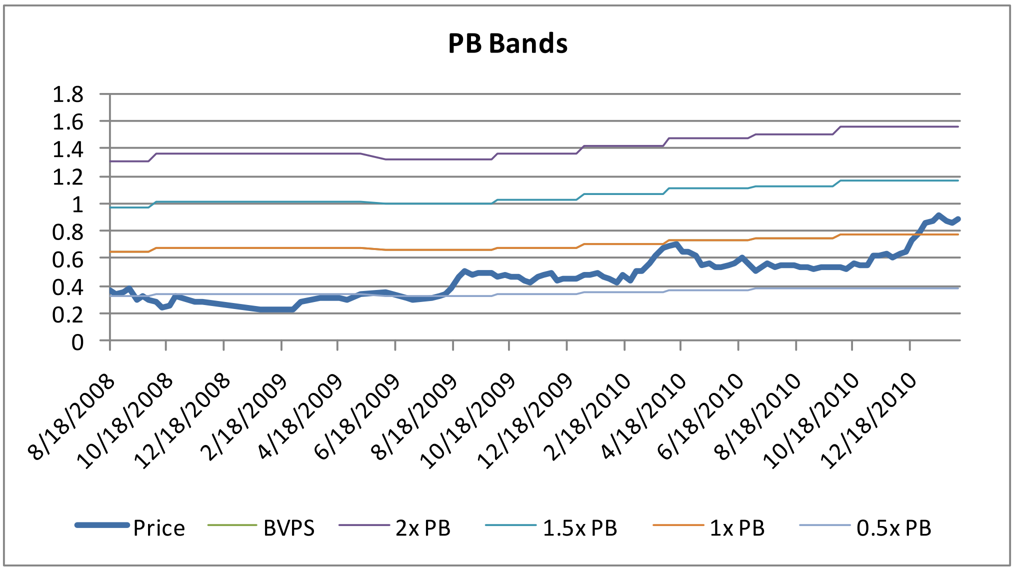
Attractive valuation, low PE and PB, yet high yield. ECS is relatively undervalued as compared to its peers. Note that VST is its parent, so we exclude it in our comparison analysis. ECS is trading at 6.0x FY10 PER, as compared with Digital China 15.7x, Synnex 19.0x, Ingram Micro 9.4x, and Data Tech 11.9x. ECS is valued close to its book value, on par with Ingram Micro and Tech Data while the market value for both Chinese peers is three times higher than their book value. Additionally, dividend yield for ECS is approximately 3.6%, the highest among the peers.

Premium in operating margin. ECS saw its operating margin improving over the years, thanks to its cost control measures. The performance metric was the highest among the peers, although its gross margin was below average. In other words, its SGA was lower than all peers, except Synnex.

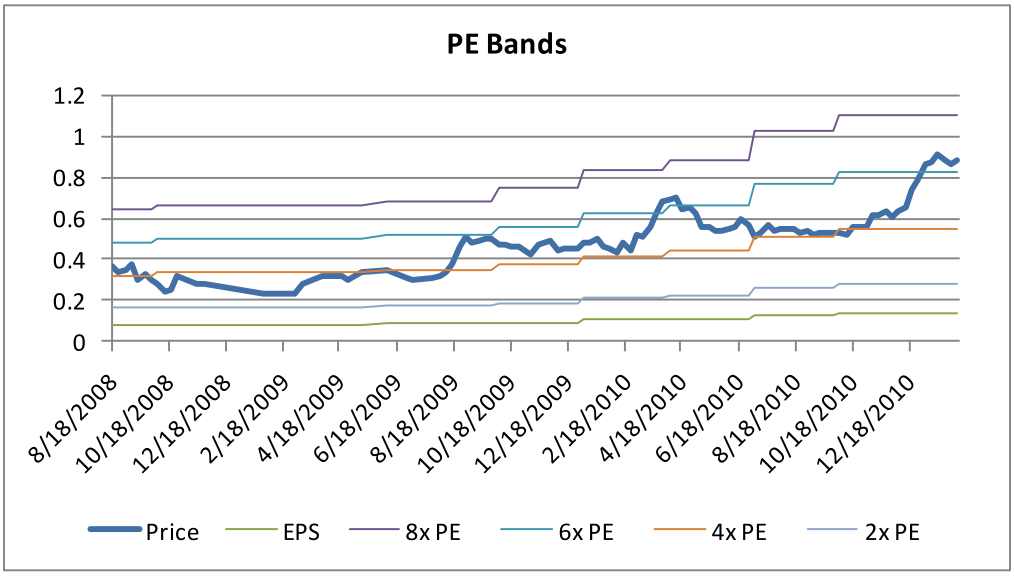
Valuation and Recommendation

Initiate coverage with Buy recommendation and target price of S$1.42. We believe ECS is poised for strong growth in view of 1) distribution rights for Apple's products, 2) exposure to high growth markets such as China and Indonesia. Short-term catalyst could be dual listing in the Taiwan Exchange. Most importantly, its valuation is truly undervalued compared to its peers. Our target price of 1.41 is pegged to 10x FY11 PER, about 28% discount to the sector valuation.

Rerating catalysts. Explosive sales for iPad and iPhone 4 in China, lower SGA on cost control measures, gain in market shares



Source: Company, NRA



Source: Company, NRA

Profit & Loss *(SGD m, FYE Dec)*	**2008**	**2009**	**2010F**	**2011F**	**2012F**
Revenue	2,949.9	3,252.0	3,019.5	3,538.2	4,103.9
Operating expenses	(2,895.7)	(3,185.8)	(2,964.0)	(3,467.9)	(4,022.4)
EBITDA	**54.2**	**66.2**	**55.5**	**70.3**	**81.6**
Depreciation & amortisation	(2.9)	(2.8)	(2.6)	(3.2)	(3.5)
EBIT	**51.3**	**63.4**	**52.9**	**67.1**	**78.1**
Net interest & invt income	(11.1)	(4.7)	(5.3)	(5.9)	(6.2)
Associates' contribution	0.5	1.2	5.0	5.8	6.0
Exceptional items	0.7	(2.7)	13.0	0.0	0.0
Pretax profit	**41.4**	**57.2**	**65.6**	**66.9**	**77.8**
Tax	(8.1)	(14.0)	(13.8)	(14.1)	(16.3)
Minority interests	3.9	4.9	1.0	1.1	1.2
Net profit	**29.4**	**38.2**	**50.8**	**51.8**	**60.3**
Shares at year-end (m)	365.4	365.4	365.4	365.4	365.4

Balance Sheet *(SGD m, as at Dec)*	**2008**	**2009**	**2010F**	**2011F**	**2012F**
Fixed assets	10.9	8.3	7.7	19.5	21.0
Intangible assets	33.5	33.5	33.5	33.5	33.5
Other long-term assets	11.8	14.2	48.2	54.0	59.9
Total non-current assets	**56.3**	**56.0**	**89.4**	**107.0**	**114.4**
Cash and equivalents	50.5	51.1	76.8	84.5	49.1
Stocks	175.3	217.7	185.1	220.5	260.0
Trade debtors	444.7	548.5	462.3	519.1	636.9
Other current assets	0.0	0.0	0.0	0.0	0.0
Total current assets	**670.5**	**817.4**	**724.2**	**824.1**	**946.0**
Trade creditors	275.4	409.7	311.0	373.9	453.6
Short-term borrowings	126.6	113.8	118.8	128.8	133.8
Other current liabilities	4.0	7.1	7.1	7.1	7.1
Total current liabilities	**406.0**	**530.6**	**436.9**	**509.8**	**594.5**
Long-term borrowings	66.8	63.4	73.4	77.9	74.9
Other long-term liabilities	1.9	2.7	2.7	2.7	2.7
Total long-term liabilities	**68.7**	**66.1**	**76.1**	**80.6**	**77.6**
Shareholders' funds	**237.8**	**259.5**	**299.3**	**338.4**	**384.8**
Minority interests	14.3	17.2	1.2	2.3	3.5
NTA/share (SGD)	0.56	0.62	0.73	0.83	0.96
Total Assets	**726.8**	**873.4**	**813.5**	**931.0**	**1,060.4**
Total Liabilities + S'holders' funds	**726.8**	**873.4**	**813.5**	**931.0**	**1,060.4**

Cash Flow *(SGD m, FYE Dec)*	**2008**	**2009**	**2010F**	**2011F**	**2012F**
Pretax profit	41.4	57.2	65.6	66.9	77.8
Depreciation & non-cash adjustments	2.4	3.9	(31.4)	(2.6)	(2.5)
Working capital changes	(29.6)	(24.3)	3.1	(29.3)	(77.6)
Cash tax paid	(8.9)	(12.1)	(13.8)	(14.1)	(16.3)
Others	11.1	4.7	6.5	6.8	7.1
Cash flow from operations	**16.4**	**29.3**	**30.1**	**27.8**	**(11.4)**
Capex	(3.5)	(1.9)	(2.0)	(15.0)	(5.0)
Net investments & sale of FA	0.0	0.0	0.0	0.0	0.0
Others	1.0	2.2	0.0	0.0	0.0
Cash flow from investing	**(2.6)**	**0.3**	**(2.0)**	**(15.0)**	**(5.0)**
Debt raised/(repaid)	12.6	(10.6)	15.0	14.5	2.0
Equity raised/(repaid)	0.0	0.0	0.0	0.0	0.0
Dividends paid	(5.5)	(9.9)	(11.0)	(12.8)	(13.9)
Cash interest & others	(10.8)	(7.6)	(6.5)	(6.8)	(7.1)
Cash flow from financing	**(3.7)**	**(28.0)**	**(2.5)**	**(5.1)**	**(19.0)**
Change in cash	**10.1**	**1.6**	**25.6**	**7.7**	**(35.4)**
Change in net cash/(debt)	**(2.5)**	**12.2**	**10.6**	**(6.8)**	**(37.4)**
Ending net cash/(debt)	**(142.9)**	**(126.1)**	**(115.5)**	**(122.2)**	**(159.7)**

KEY RATIOS *(FYE Dec)*	**2008**	**2009**	**2010F**	**2011F**	**2012F**
Revenue growth (%)	5.8	10.2	(7.2)	17.2	16.0
EBITDA growth (%)	14.3	22.2	(16.1)	26.6	16.0
Pretax margins (%)	1.4	1.8	2.2	1.9	1.9
Net profit margins (%)	1.0	1.2	1.7	1.5	1.5
Interest cover (x)	4.8	12.5	8.5	10.3	11.5
Effective tax rates (%)	19.6	24.6	21.0	21.0	21.0
Net dividend payout (%)	33.6	28.7	25.2	26.8	26.1
Debtors turnover (days)	54.0	55.7	62.1	52.4	52.9
Stock turnover (days)	22.1	23.2	25.6	22.1	22.5
Creditors turnover (days)	35.4	40.4	45.9	37.2	38.8

Source:Bloomberg, NRA Capital Estimates

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