

Briefing Note
ECS ICT Bhd
Aug 12th, 2014
RM1.55
HOLD

Target (RM)	RM1.41 – RM1.61
MASA Codes	ECS / 5162
Bloomberg	ECS MK

Stock & Market Data

KLCI	1849.32
Listing	Main Market
Sector	Technology
Syariah Compliance	Yes
Par Value	RM0.50
Issued Shares	180.0m
Market Capitalisation	RM279.0m
1-year return	36.1%
52-week Hi/Lo	RM1.04 / RM1.73
1M Average Volume	0.6m shares
Estimated Free Float	20%
Major Shareholders: -	
ECS Holdings Ltd	41.0%
MD Foo Sen Chin	12.2%

Key Indicators @ FY14

PER (x)	10.2
PBV (x)	1.3
Net Debt/Equity (%)	Net cash
ROE (%)	12.8

Period: 2QFY14

Dividend: No dividend was declared for the quarter.

Actual versus expectations: Results were with our expectations, making up only 44.7% of our full year forecast. 2HFY14 is expected to be better.

Result highlights: ECS ICT recorded a 36.7% y/y jump in net profit to RM7.5m for 2Q versus RM5.5m last year, a result of the strong growth in the ICT Distribution segment. Revenue grew 29.8% y/y to RM389.9m from RM300.5m. The top line growth was attributed to the 38.2% revenue gain from its ICT Distribution segment to RM262.0m from RM189.6m. Enterprise Systems segment's revenue increased 8.7% to RM117.5m from RM108.1m, whereas ICT Services segment sales more than doubled to RM10.5m from RM2.8m.

For 1H14, revenue grew 20.4% y/y to RM747.6m versus RM620.8m last year. The growth was driven by the ICT Distribution segment, which grew 29.2% to RM513.6m, compared to RM397.5m. Enterprise

Systems segment sustained its performance at RM213.0m whereas ICT services posted revenue of RM21.0m, more than double last year's RM6.7m. Net profit grew 3.5% y/y to RM12.3m from RM11.9m.

Table 1. 2Qfy14 results

FYDec / RM'm	2QFY14	2QFY13	1QFY14	y/y Chg %	q/q Chg %	1HFY14	1HFY14	y/y Chg %
Revenue	389.9	300.5	357.7	29.8%	9.0%	747.6	620.8	20.4%
Cost of sales	(367.2)	(282.7)	(338.4)	29.9%	8.5%	(705.7)	(583.4)	21.0%
Gross profit	22.7	17.8	19.3	27.4%	17.5%	42.0	37.4	12.2%
Admin & Dist Exp	(12.7)	(11.2)	(12.3)	13.6%	3.0%	(25.0)	(22.2)	12.5%
Other income / (exp)	(0.0)	0.6	(0.7)	-105.2%	-95.5%	(0.7)	0.5	-244.1%
EBIT	10.0	7.2	6.3	37.4%	58.9%	16.2	15.7	3.4%
Interest income/(Exp)	0.4	0.3	0.4	26.4%	-10.7%	0.8	0.6	20.7%
Pretax profit	10.3	7.5	6.7	37.0%	54.6%	17.0	16.3	4.0%
Tax	(2.8)	(2.0)	(1.9)	37.9%	48.5%	(4.7)	(4.5)	5.4%
Net profit	7.5	5.5	4.8	36.7%	57.1%	12.3	11.9	3.5%
EPS	4.2	3.1	2.7	35.5%	55.6%	6.8	6.6	3.0%
GP margin	5.8%	5.9%	5.4%	-0.1%	0.4%	5.6%	6.0%	-0.4%
EBIT margin	2.6%	2.4%	1.8%	0.1%	0.8%	2.2%	2.5%	-0.4%
Tax rate	27.2%	27.0%	28.3%	0.2%	-1.1%	27.6%	27.3%	0.4%

Managing Director Mr Foo said, "The commendable results in the ICT Distribution segment in 2Q14 builds upon the strengthening buyer sentiment of ICT products, particularly personal computers (PCs) and mobility products, such as tablets and smartphones. In addition, Enterprise Systems segment also showed signs of recovery, with steady projects implementation leading to increased sales of servers and software products in 2Q14. We are optimistic that the improving ICT spending trend will continue into the second half of 2014, especially in the run up to the implementation of GST in April 2015."

Outlook

Recently ECS added another principal to its list. Soon, it will be distributing Seagate storage products and storage solutions. In addition, it is looking to distribute more brands of smartphones.

ECS will collaborate with system integrators and vendors to add more products and package in more "value added services".

ECS is constantly exploring avenues to expand its ICT services segment. ECS will have 4 strategic thrusts for the next 3 years i.e. Mobility; Cloud Computing; E-Commerce; and Services. ECS is on the look out for M&A opportunities in ICT services.

Valuation and recommendation



We make no changes to our forecast, as we anticipate 2nd half to perform better. In 1Q we noted that ECS would be able to double the sales of its mobility products. To support the higher sales, ECS has increased its inventory especially for the fast moving high demand smartphones and this has resulted in its cash hoarding reducing to RM44.1min Q2. We view the situation as temporary. As stocks are moved through to its sales channel, the cash level will then increase, albeit at a lower level than before, as more working capital is being utilised.

ECS stated that it is on the lookout for M&A opportunities, and hence likelihood of a capital management exercise has diminished. On this score,

we now changed our valuation model to a book value based model. We are not from using a earnings based valuation model for ECS, as we believe ECS is likely to face earnings reduction, post the GST period, if no new business opportunities are discovered or acquired. But some would argue that a book value based valuation would not fully value the intangibles i.e. its distribution network and management's expertise to work the network efficiency. But with earnings in a flux in the next 2 - 3 years, we believe the book value based valuation is the most appropriate.

Based on average of end- FY14 and FY15 book value per share of RM1.285 (average RM1.24 and RM1.33) and using a multiple of 1.10x – 1.25x (i.e. a 10 – 25% premium to book value) we derive a valuation range of between RM1.41 – RM1.61. **Since the stock is trading in between our fair valuation range, we keep our HOLD recommendation. BUY should the price falls below RM1.41 and sell if the price exceeds RM1.61.**

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FYDec / RM'm	2010A	2011A	2012A	2013A	2014F	2015F
Revenue	1271.5	1250.7	1276.1	1326.3	1360.0	1292.0
Pretax profit	39.4	40.9	40.3	36.6	37.0	34.9
Net profit	28.9	30.1	29.9	26.9	27.4	25.8
EPS (sen)	16.1	16.7	16.6	14.9	15.2	14.3
Pretax margin (%)	3.1%	3.3%	3.2%	2.8%	2.7%	2.7%
Net profit margin (%)	2.3%	2.4%	2.3%	2.0%	2.0%	2.0%
PER (x)	9.6	9.3	9.3	10.4	10.2	10.8
Dividend (sen)	-	5.3	5.5	5.5	5.5	5.5
Dividend yield (%)	-	3.4	3.5	3.5	3.5	3.5
Net Gearing (x)	0.1	Net cash	Net cash	Net cash	Net cash	Net cash
Book value/share (RM)	0.80	1.00	1.10	1.14	1.24	1.33
Price/Book (x)	1.9	1.6	1.4	1.4	1.3	1.2

Background

Established in 1985, ECS is in the business of distributing ICT products in Malaysia. ECS' range of products includes volume ICT products (notebooks, desktop, computers, printers and software) and value enterprise systems (network, communication infrastructure, servers and enterprise software). ECS has working relationships with more than 30 global brands such as Hewlett Packard, Asus, Dell, IBM, Cisco, Microsoft, Apple, Oracle, Epson, Samsung, Buffalo, Adobe, Juniper, Blue Coat, VMWare and Google. ECS has a nationwide distribution network of more than 3,000 resellers consisting of retailers, system integrators and corporate dealers.

ECS is part of the ECS group of companies that has similar businesses in China, Singapore, Thailand, Philippines, and Indonesia. By agreement, the companies' activities within the group do not cross borders to interfere with one another. Moreover, ECS in each country has separate dealership agreement with the international principals, even though the products distributed are the same. ECS Holdings Ltd (listed on SGX, Singapore) holds 41% of ECS.

ECS's business can be segmented into 3 categories, namely.

1. ICT products – Distribution of Notebooks, Tablet PCs, Personal computers, Printers, Software. LCD monitors, etc.
2. Enterprise systems – Distribution of Servers, Network Systems, Data centers, Enterprise software.
3. ICT Services - Provision of after sales services, integration and commission of ICT systems via more than 30 engineering personnel. In total, personnel have more than 150 certifications from 15 principals.

To support its business ECS has 4 major distribution hubs i.e. head office and flagship warehouse in Kota Damansara in Selangor, Jelutong in Penang, Kuching in Sarawak, and Kota Kinabalu in Sabah. It also has 2 regional offices in Kuantan, Pahang and Johor Bahru, Johor.

The key success factors for ECS has been: -

1. Established track record with more than 25 years in business
2. Partnership with key ICT players that trace back to the days when they commenced business
3. Distributes a wide range of products – more than 3,000.
4. Established distribution network with more than 3,000 resellers. Distribution network is supported by a fully integrated ERP system.
5. Strong technical team to provide after sales service, system integration and commission.
6. Strong financial management especially on cost control and inventory management. A strong balance sheet provides the working capital for holding the numerous products in inventory.

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