

Trading idea

8 September 2020

VSTECs Berhad

Not Rated

Benefiting from sustainable ICT spending

Fair Value: RM2.84

Share Price	RM2.12
Fair value	RM2.84

Company Description

VSTECs Berhad distributes information and communication technology products. The Company offers a range of notebooks, personal computers, smartphones, tablets, wearables, printers, network and communication infrastructure servers, and enterprise software systems.

Stock Data

Bursa / Bloomberg code	5162 / VST MK
Board / Sector	Main / Technology
Syariah Compliant status	Yes
Issued shares (m)	178.50
Par Value (RM)	N/A
Market cap. (RM'm)	378.42
52-week price Range	0.7 – 2.76
Beta (against KLCI)	1.06
3-m Average Daily Volume	1.79
3-m Average Daily Value	3.47

Share Performance

	1m	3m	12m
Absolute (%)	-17.5	44.2	109.9
Relative (%-pts)	-14.2	84.4	122.1

Major Shareholders

Major Shareholders	%
Vstecs Holdings Singapore Ltd	43.12
Sengin Sdn Bhd	12.15
Dasar Technologies Sdn Bhd	8.63

Historical Chart



Source: Bloomberg

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Investment Merits

- Market leader in the industry.** VSTECs Berhad (VSTECs) is primarily involved in distributing a comprehensive range of ICT products comprising notebooks, personal computers, smartphones, tablets, wearables, printers, software, network and communication infrastructure, servers, and enterprise software from more than 40 leading principals like Hewlett Packard, Asus, Lenovo, Apple, Dell, Microsoft, Cisco, Samsung, VMWare and IBM. VSTECs has over 35 years in ICT gadgets industry. The Group has grown from a small company to the current one of the market leaders in Malaysia's ICT products distribution industry with over 6,600 resellers in the whole country.
- Capitalising on the post-pandemic "new normal".** We foresee rising spending of corporates and government agencies on upgrading IT platforms (such as video conferencing facilities, cloud computing, and cybersecurity software) in coming years in preparation for another possible pandemic-like lockdown under their business continuity plans requirements or to facilitate the remote workflows. Thus, this will largely benefit VSTECs, being one of the largest ICT gadgets & enterprise solution providers in the country. For instance, recent government's plan such as Jalanan Digital Negara (Jendela) which aims to improve digital communications in the country, to be implemented under the 12th Malaysia Plan (2021–2025), will be another catalyst for VSTECs for its future business expansion.
- Unique business model to fend off competition.** VSTECs focuses immensely on ICT product distribution in which it imports "volume products" and resells to dealers as well as retailers to profit on the thin margin (1.0% - 1.7%). The business model is hard to attract new entrants or competitors mainly due to the unpleasant net margin and the extremely high revenue turnover is needed to ensure the profitability of the business. Economies of scale is another critical factor to ensure the sustainability of the business in a long run. Still, a sizeable ICT distributor like VSTECs has the negotiating power with ICT principals in pricing their ICT gadgets.
- Online sales to further complement the existing business and margin.** VSTECs currently has close to 15 self-managing authorized online stores on Lazada & Shopee which help to reduce the

dependence on ICT resellers or dealers so as to enjoy better profit margin compared with the conventional sales method. VSTECS treats the online stores seriously by promising next day delivery and commanding quality customer service to directly communicate with the end-users. After securing authorized online stores on online shopping platforms for the past few years, the Group's turnover deriving from these platforms saw a robust YoY growth of 50–100% in FY2019.

- **Banking on Enterprise IT and Business Solutions.....** The Group also imports “value products” including servers, network systems, data centers, enterprise software, and cloud services which command nearly double-digit gross profit margin to complement its Consumer Business segment. Notably, VSTECS has over 30 years of relationship with certain well-known brands which is unlikely for newcomers to be the sales representatives for them. Furthermore, the Group will be focusing on a range of enterprise infrastructures by offering recurring, maintenance, and contract-based projects to make the business model more flexible, defensive and versatile.
- **.....as well as its strategic associate to drive growth.** To further propel the Group's top line and bottom line, VSTECS acquired 40% stake in isatec (which specializes in workflow automation) to complement its core business in CY2019. isatec has over 25 years' experience in digital process automation, mobile & software engineering, system consulting, and digital performance management. The segment has seen a decent business growth and commands handsome profit margin which we strongly believe the collaboration will benefit VSTECS pertaining to the potential synergy creation. Hence, we expect VSTECS to record higher sales and profit margin in the near future amid providing more value-added services as compared to the traditional ICT distribution business.
- **Smartphone changing cycle is overdue with new models in the pipeline.** The most-sought iPhone with 5G connectivity is expected to be launched in October 2020 indicating the new phone changing cycle will be coming very soon. We think the next and subsequent years will trigger people's desires and interests to change or upgrade their smartphones after their existing ones being used for the past 3–4 years. Notably, the top 3 Apple models in Malaysia in respect of market share as of 2QCY2019 were iPhone 7+, iPhone 6, and iPhone 7. These models were launched few years back and will be seen as older generation gadgets after launching of the 5G iPhone. Having said that, we only envisage the local Telco operators to fully launch their 5G network services as earliest as 2HCY2011 with ready

hardware and software infrastructures in place.

- **Fundamental counts.** VSTECS recorded RM821.5m revenue (+3% YoY) and gross profit RM44.7m (+11% YoY) in 1HFY20 pursuant to higher sales of notebooks, printer, and monitor which happened during MCO & RMCO periods. Also, the profit recognition of isatec under its associate level contributed positively to the Group's profit margin. VSTECS has achieved a stunning track record in which it never incurred any loss for the past 35 years despite the ultra-thin profit margin. Moreover, VSTECS recorded a respectable average 5-year return on equity of 11.00% on top of average 1.5% net profit margin. We notice that the pivotal factor behind its high return on capital was due to its high asset turnover which ranked no.7 out of 973 companies in local bourse as of today. For the past 5 financial years (FY15-FY19), VSTECS has generously rewarded its shareholders by maintaining an average 35% dividend payout ratio (ex-special). Meanwhile, the Group has been sitting as a net cash company since FY2010. The comfort cash conversion cycle (days) level for the past 3 financial years (FY17, FY18, FY19) held relatively well in which it recorded 47 days, 54 days, and 45 days respectively, and the ratio was further improved to 30.1 days in 2QFY20 mainly due to longer credit turnover days and shorter inventory turnover days.

Valuation & Recommendation

- **We derive a fair value of RM2.84 for VSTECS.** Our valuation is pegged at 12x FY21F EPS of 24sen. Our target PE assigned is based on upcycle valuation of small-cap players in local bourse. We advise investors to accumulate the stock on current share price weakness as our fair value of the stock renders 34% upside from current closing.

Risk factors

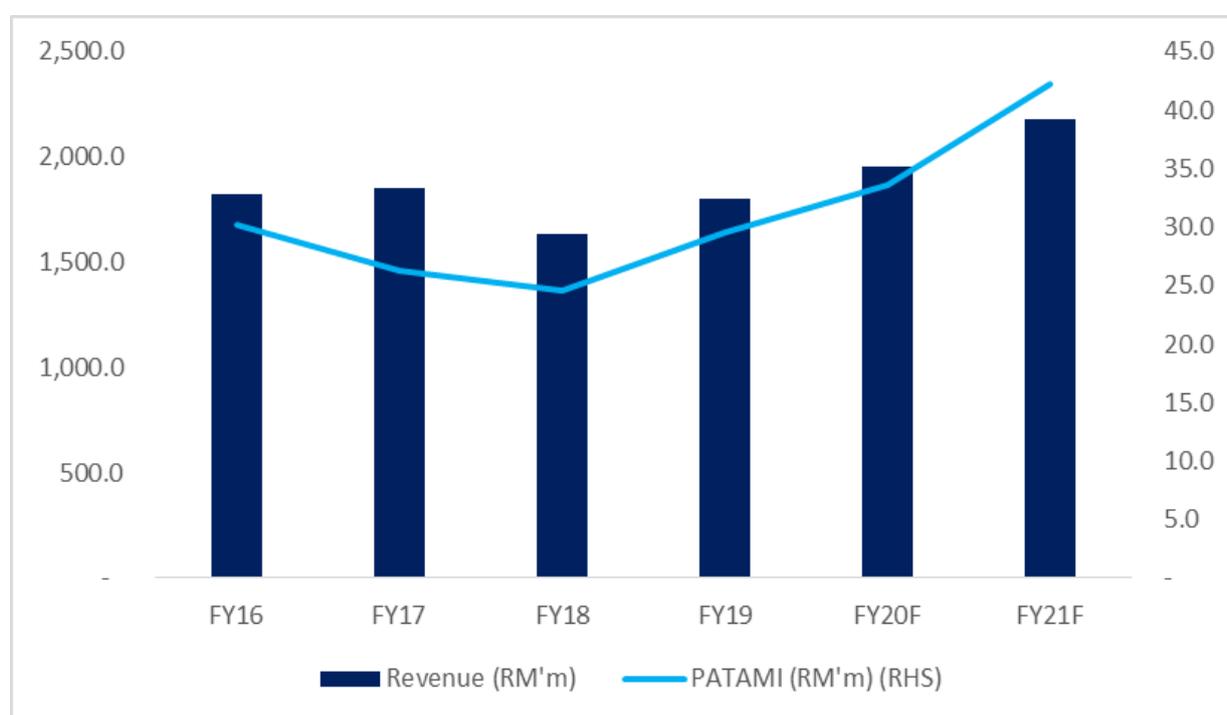
- **Subdued consumer sentiment to impact buying activity after loan moratorium being lifted.**
- **Subject to volatility of USD.**
- **Political uncertainty affecting government spending.**
- **CAPEX cut by private corporates post-pandemic.**

Financial Summary

	FY16	FY17	FY18	FY19	FY20F	FY21F
	RM'm	RM'm	RM'm	RM'm	RM'm	RM'm
Revenue (RM'm)	1,823.4	1,855.0	1,632.3	1,802.3	1,952.8	2,176.3
-Cost of sales	(1,730.80)	(1,767.60)	(1,545.50)	(1,709.00)	(1,851.21)	(2,056.64)
Gross Profit	92.60	87.40	86.82	93.30	101.54	119.70
-Other income	2.70	1.40	(0.13)	2.20	2.31	2.19
-Distribution expenses	(34.07)	(34.27)	(35.00)	(37.62)	(41.01)	(45.70)
-Administration expenses	(22.14)	(21.70)	(20.80)	(21.80)	(23.43)	(26.12)
EBIT	39.09	32.83	30.89	36.08	39.41	50.07
-Finance costs	1.30	2.13	1.93	0.08	-	-
-Share of JV/Asso.	-	0.66	-	3.12	4.80	5.52
PBT	40.39	35.62	32.82	39.28	44.21	55.59
-Tax	(10.23)	(9.38)	(8.12)	(9.71)	(10.61)	(13.34)
PATAMI (RM'm) (RHS)	30.2	26.2	24.6	29.6	33.6	42.3
Margin (%)						
Gross profit margin	5.1%	4.7%	5.3%	5.2%	5.2%	5.5%
EBIT margin	2.1%	1.8%	1.9%	2.0%	2.0%	2.3%
PBT margin	2.2%	1.9%	2.0%	2.2%	2.3%	2.6%
PATAMI margin	1.7%	1.4%	1.5%	1.6%	1.7%	1.9%
Growth (%)						
Revenue growth		1.7%	-12.0%	10.4%	8.3%	11.4%
GP growth		-5.6%	-0.7%	7.5%	8.8%	17.9%
EBIT growth		-16.0%	-5.9%	16.8%	9.2%	27.1%
PBT growth		-11.8%	-7.9%	19.7%	12.6%	25.7%
PATAMI growth		-13.0%	-6.3%	20.2%	13.6%	25.7%
EPS (sen)	16.90	14.70	13.78	16.56	18.82	23.67
P/E	12.55	14.42	15.38	12.80	11.26	8.96

(Source: Company, JF Apex)

Financial Chart



(Source: Company, JF Apex)

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JF APEX SECURITIES - RESEARCH RECOMMENDATION FRAMEWORK

STOCK RECOMMENDATIONS

- BUY** : The stock's total returns* are expected to exceed 10% within the next 12 months.
- HOLD** : The stock's total returns* are expected to be within +10% to – 10% within the next 12 months.
- SELL** : The stock's total returns* are expected to be below -10% within the next 12 months.
- TRADING BUY** : The stock's total returns* are expected to exceed 10% within the next 3 months.
- TRADING SELL** : The stock's total returns* are expected to be below -10% within the next 3 months.

SECTOR RECOMMENDATIONS

- OVERWEIGHT** : The industry as defined by the analyst is expected to exceed 10% within the next 12 months.
- MARKETWEIGHT** : The industry as defined by the analyst is expected to be within +10% to – 10% within the next 12 months.
- UNDERWEIGHT** : The industry as defined by the analyst, is expected to be below -10% within the next 12 months.

*capital gain + dividend yield

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