5 October 2022

Technology | Hardware & Equipment

VSTECS (VST MK)

Non Rated

Riding The Digital Transformation Wave

Fair Value (Return):	MYR1.64 (+53%)
Price:	MYR1.07
Market Cap:	USD82.3m
Avg Daily Turnover (MYR/USD)	0.07m/0.01m

- **MYR1.64 FV based on 9x FY23F P/E.** VSTECS is riding on the relentless digital transformation wave in the private and public domains, which we think will sustain the strong demand for its products – especially in the enterprise segment – which should lead to another year of record earnings. We expect the Government to continue promoting digitalisation efforts in the upcoming Budget 2023. Its FY22F ex-cash P/E of 4.8x is a steep gap from its peers' valuations of 10-20x trailing P/Es. A cash cow like VSTECS deserves a valuation re-rating, on the back of healthy yields of 5-6%.
- **Riding the digital transformation wave.** VSTECS stands to benefit from Budget 2022 allocations for digital enablement, ie the MYR700m and MYR200m allocated to increase digital connectivity (especially in rural areas) and SME digitalisation – to digitalise manual processes and documents. Consequently, it received numerous inquiries from businesses rushing to implement post-lockdown digital infrastructure. We expect the enterprise segment to continue recording growth, supported by strong enterprise project sales pipelines and public policies.
- **Lower consumer demand cushioned by public sector and others.** Despite the expected lower consumer demand for ICT devices after two superb years following the new work-from-home (WFH) trend, VSTECS' on-hand orders for personal computer (PC) notebooks – especially from the public sector – will be the main driver for its FY22 ICT devices sales revenue, in our view. Under Budget 2022, the Government extended special tax exemptions to individuals, of up to MYR2,500 for device purchases, and consumers tend to utilise their budgets in the 4Q of any given year.
- **We forecast a 3-year earnings CAGR of 10.2%**, supported by expansions in product range and distribution channels, the rollout of 5G services, and the Government's digitalisation efforts. We also noticed the surge in demand for cybersecurity, cloud computing, and data centre products. With these factors in mind, VSTECS' enterprise systems business should continue to grow faster than its ICT distribution wing in the near future – hence improving the product mix, as it fetches higher margins.
- **Closing the valuation gap.** We believe VSTECS' current valuation (net cash of MYR60.2m) is very undemanding, at just 6.2x trailing 12-month P/E (-3SD from the 5-year mean of 9.3x). This is despite its market leadership and representation of all world-renowned ICT brands, strong earnings delivery track record, and sustainable growth prospects. TD Synnex (SNX US, NR), which is in the Top 3 of ICT products and enterprise systems distribution here, trades at 20x. VSTECS' indirect local ICT product resellers and solutions players – eg SNS Network, Heitech Padu, and Mesiniaga – currently trade at 10-13x P/E. The gap between VSTECS and its international and local indirect peers is too steep, especially with its higher profit margins and ROEs, and healthier balance sheet. Key risks: Business failure of its ICT principals, slower-than-expected ICT adoption, ICT products adoption slowdown among consumers, and FX risks.

Forecasts and Valuation	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Total turnover (MYRm)	2,017	2,626	2,934	3,151	3,466
Recurring net profit (MYRm)	37	56	61	67	75
Recurring net profit growth (%)	29.4	48.7	9.6	10.3	12.3
Recurring P/E (x)	10.29	6.89	6.27	5.68	5.06
P/B (x)	1.1	1.0	0.9	0.8	0.7
P/CF (x)	10.17	na	9.88	16.64	32.93
Dividend Yield (%)	2.6	3.5	5.2	5.7	6.4
EV/EBITDA (x)	5.38	3.67	3.28	2.98	2.78
Return on average equity (%)	11.6	15.7	15.4	15.3	15.5
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash

Source: Company data, RHB

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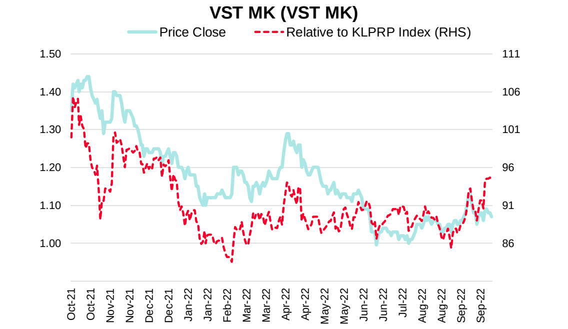
Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(13.7)	0.9	2.9	(8.6)	(21.9)
Relative	(0.8)	7.2	6.7	5.3	(7.1)
52-wk Price low/high (MYR)					1.00 – 1.44



Source: Bloomberg

Note:
Small cap stocks are defined as companies with a market capitalisation of less than USD0.5bn.

Financial Exhibits

Asia
Malaysia
Technology
VSTECS
VST MK

Valuation basis

9x P/E on FY24 earnings

Key drivers

i. Re-rating catalysts;
ii. Higher 2H22 to take it to another record year;
iii. Riding the wave of digital transformation;
iv. Benefiting from future 5G developments;
v. Represents most established ICT brands with new digital platforms.

Key risks

i. Business failure of ICT principals;
ii. Slower-than-expected adoption of ICT;
iii. Slowdown of consumer demand for ICT products;
iv. Continual global shortages in chip components;
v. Exposure to FX risks.

Company Profile

VSTECS is a leading distribution hub for ICT products – hardware and software – in Malaysia.

Financial summary (MYR)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Recurring EPS	0.10	0.16	0.17	0.19	0.21
DPS	0.03	0.04	0.06	0.06	0.07
BVPS	0.93	1.05	1.17	1.29	1.43
Return on average equity (%)	11.6	15.7	15.4	15.3	15.5

Valuation metrics	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Recurring P/E (x)	10.29	6.89	6.27	5.68	5.06
P/B (x)	1.1	1.0	0.9	0.8	0.7
FCF Yield (%)	9.8	(5.5)	9.3	5.2	2.3
Dividend Yield (%)	2.6	3.5	5.2	5.7	6.4
EV/EBITDA (x)	5.38	3.67	3.28	2.98	2.78
EV/EBIT (x)	5.62	3.91	3.35	3.05	2.85

Income statement (MYRm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Total turnover	2,017	2,626	2,934	3,151	3,466
Gross profit	106	139	179	195	216
EBITDA	49	78	82	90	101
Depreciation and amortisation	(2)	(5)	(2)	(2)	(3)
Operating profit	47	73	80	88	99
Net interest	2	1	1	2	2
Pre-tax profit	49	75	82	91	102
Taxation	(12)	(19)	(21)	(23)	(26)
Reported net profit	37	56	61	67	75
Recurring net profit	37	56	61	67	75

Cash flow (MYRm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Change in working capital	17.1	0.6	(78.3)	(21.6)	(43.5)
Cash flow from operations	37.8	(20.9)	38.7	23.0	11.6
Capex	0.0	0.0	(3.0)	(3.0)	(3.0)
Cash flow from investing activities	0.4	9.5	(3.6)	(3.7)	(3.9)
Dividends paid	(9.8)	(13.4)	(19.9)	(21.9)	(24.6)
Cash flow from financing activities	(10.9)	(14.3)	(17.3)	(18.7)	(21.1)
Cash at beginning of period	71.0	98.3	72.7	90.4	91.0
Net change in cash	27.3	(25.7)	17.8	0.6	(13.4)
Ending balance cash	98.3	72.7	90.4	91.0	77.6

Balance sheet (MYRm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Total cash and equivalents	98	73	90	91	78
Tangible fixed assets	8	6	8	9	9
Total investments	23	24	25	25	26
Total assets	559	688	730	775	826
Short-term debt	0	0	1	2	3
Total liabilities	225	312	314	315	316
Total equity	334	376	416	461	511
Total liabilities & equity	559	688	730	775	826

Key metrics	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Revenue growth (%)	11.9	30.2	11.7	7.4	10.0
Recurrent EPS growth (%)	29.5	49.3	9.9	10.4	12.3
Gross margin (%)	5.3	5.3	6.1	6.2	6.2
Operating EBITDA margin (%)	2.4	3.0	2.8	2.9	2.9
Net profit margin (%)	1.9	2.1	2.1	2.1	2.2
Dividend payout ratio (%)	26.3	24.1	32.7	32.6	32.6
Capex/sales (%)	0.0	0.0	0.1	0.1	0.1
Interest cover (x)	385	338	521	759	746

Source: Company data, RHB

Investment Thesis

Represents most established ICT brands. VSTECS has formed strategic partnerships and established track records with world-leading ICT principals. It has been a distribution partner with brands such as HP Malaysia, IBM, Apple, and Cisco for more than 10 years. The group's close working relationship with these ICT principals should provide it with enhanced clarity with regards to the latest trends in ICT technology, enabling it to make more strategic decisions. Its strong principal relationships are also essential in securing new distributorships, while extending existing ones – major ICT principals look at a company's track record as a key criterion when offering distributorships of their product offerings and services.

When compared to its local peers, VSTECS represents a broader range of ICT devices brands, especially for PCs and notebooks. It also has its own warehouse to store all its 110,000 stock-keeping units (SKUs). Stamping its presence on e-commerce channels, VSTECS operates the official online brand stores for HP to fulfil the online business-to-business (B2B) and business-to-consumer (B2C) coverage on behalf of the brand principal. It also operates 14 official online brand stores across Lazada and Shopee for brands such as HP, Lenovo & Asus. Supported by its broad range of products, high efficiency, and competitive credit terms, VSTECS has gained a bigger market share based on revenue in 2021. It has a network of more than 4,600 resellers, and these include recently listed reseller SNS Network and those in malls like Plaza Low Yat in Kuala Lumpur.

Since early 2022, VSTECS has also widened its product range under the ICT distribution segment. It has started to distribute IoT home appliances like TVs, refrigerators and air conditioner units, among others. For example, it now distributes Smartmi products to retail physical stores such as Senheng and Harvey Norman, as well as through Senheng's app and other e-commerce channels.

Expect stronger 2H22 results and, as such, another record year. Through the Keluarga Malaysia Student Device Package (PRSIS) initiative, VSTECS is playing a vital role in distributing some of the 600,000 tablets for B40 university students by 2024. We understand that half the orders were fulfilled in 1H22, and the remainder will be fulfilled in 2H22. Hence, despite the expected lower consumer demand for ICT devices, demand from the education sector will buoy its ICT devices sales revenue, in our view.

In addition, under Budget 2022, the Government extended special tax exemptions to individuals, of up to MYR2,500 for device purchases – these include mobile phones, PCs, and tablets. We note that consumers tend to utilise their budgets in the 4Q of any given year. Consequently, we have always seen VSTECS record higher revenues in ICT distribution during this period.

Riding the digital transformation wave. VSTECS also stands to benefit from the previous federal budget's allocations for digital enablement – where MYR700m allocated to increase digital connectivity, especially in rural areas, and MYR200m set aside for SME digitalisation, allowing the latter to digitalise manual processes and documents. As a result, the group received numerous inquiries from businesses that were rushing to implement post-lockdown digital infrastructure. Despite the strong enterprise project sales pipelines, deployment continues to be delayed due to the global shortage in chip components – we expect the outstanding orders to be split over to 2H22.

VSTECS will ride on the Government's initiatives to drive ICT adoption in the country, through the 12th Malaysia Plan – this is part of the latter's efforts to shift Malaysian workers towards becoming a more technologically literate, thinking workforce. As such, the group foresees higher demand for ICT products and services from enterprise businesses looking to upgrade their IT facilities. This is essential for such companies to remain relevant in the market, and become more resilient and future-proof. Moving forward, VSTECS strives to be the preferred source supplier to such resellers, especially system integrators, as it expects the enterprise segment to be its future key growth driver.

Benefiting from future 5G developments. The Ministry of Communications & Multimedia has announced that all identified 5G spectrums have been allocated to Digital Nasional for the provision of 5G services throughout Malaysia. These include the 700MHz, 3.5GHz, and 28GHz bands. The top three mobile telecommunication companies are likely to launch 5G services in 2023, and are enhancing data centre capacities in anticipation of 5G requirements. VSTECS stands to benefit from both the front-end – through the distribution of 5G-enabled devices – and back-end via network infrastructure opportunities.

As mentioned above, chip shortages continue to delay project implementation of enterprise systems. Management expects shortages to persist for the next six months. Despite this – and based on existing momentum – the enterprise systems segment will grow this year, in our view.

On another bright note, due to the long lead time for enterprise systems products, end-customers are subscribing to the cloud as an alternative. VSTECS distributes cloud computing and services – including from established brands like IBM, Microsoft Azure, and Alibaba Cloud. We note that the group is the only distributor for Alibaba Cloud in Malaysia so far. Supported by its broad product range, growing cloud subscription, and managed services under the ICT services segment, we expect increased recurring services revenues that can provide further earnings visibility ahead.

The shorter device replacement cycle (3-4 years), anticipated demand for 5G devices, and continuing growth of remote workplaces will provide sustainable growth for its ICT distribution segment, in our view.

New digital platforms. VSTECS is looking to grow its e-commerce business through alternative channels – in collaboration with telecommunications companies and super apps – to enhance its distribution reach. We believe this will be a catalyst for the group to capture market share, while serving a wider consumer base in future.

Closing in the valuation gap. VSTECS has delivered profits since 2014, ie its listing, thanks to its operating efficiencies, broad range of established ICT products brands, and experienced management. The group has also consistently paid dividends every year since its IPO. In the past three years, VSTECS' dividend payout ratio ranged between 33% and 37%. Coupled with its net cash position, we believe its current valuation is unfair when compared with international peers and local indirect ones. Note: The group's international peer involved in the ICT products distribution and enterprise system business here, TD Synnex, has a higher net gearing ratio and lower net margins of 1.2%, and is trading at 20x P/E on the New York Stock Exchange. In our view, the huge gap between VSTECS and TD Synnex (one of the top three distributors of ICT products and enterprise systems in Malaysia) is too steep, especially with its higher profit margins and healthier balance sheet.

When comparing VSTECS to its indirect local ICT products and solutions players (which are also its clients) – such as SNS Network, Heitech Padu, and Mesiniaga – the latter are trading at 10-13x P/E vs the group's trailing P/E of just 6x. We consider this unwarranted, given that VSTECS supplies ICT products to SNS Network, while supplying enterprise systems hardware to Mesiniaga and Heitech Padu. It is also worth noting that the group has a healthier balance sheet, with net cash of MYR60.2m, ie MYR0.17 per share, as at 2Q22.

Financial Overview And Valuation

Results highlights. In the last four years, VSTECS has shown a gradual improvement in core earnings, with a 2018-2021 CAGR of 30.7%. The earnings breakout was mainly attributed to the group's capability in distributing ICT products, expansion in the enterprise systems business, and surging demand for ICT products during the various MCOs. Notably, VSTECS clocked record earnings in 2021, with a core net profit of MYR55m (+49.5% YoY) mainly due to surging pent-up demand for laptops and computers, and the expedition of digitalisation efforts followings the WFH and study-from-home trends.

VSTECS recorded a core net profit of MYR13m (+31.6% YoY, +9.5% QoQ) in 2Q22, which translates into 1H22 core earnings of MYR24.9m (+10% YoY). The better 1H22 results were mainly attributed to higher revenues from enterprise systems with more project transactions, which also fetch better margins. There was also higher demand for commercial notebooks, networking hardware and software, as well as cloud services.

Strong net cash position. VSTECS has been in a net cash position since 2010. The group has a healthy balance sheet with net cash of MYR60.2m or MYR0.17 per share as at 2Q22. We expect VSTECS to stay in a net cash position over FY22-24.

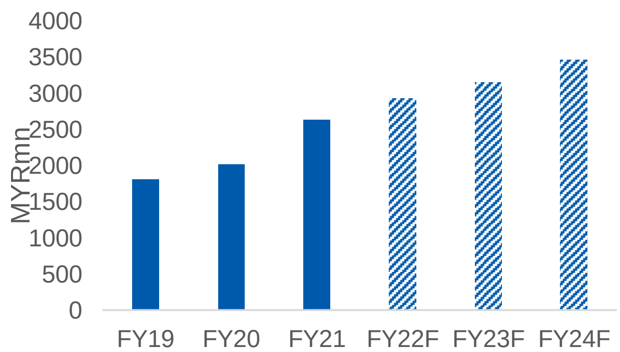
ROE. Over the past three years, ROE ranged between 10% and 16%. With the expected increase in FY23F-25F earnings, we expect the group's ROE to stay within this range.

Dividends. While it does not have a dividend policy, VSTECS has a track record of paying dividends. Over FY19-21, DPS ranged between 3 sen and 5.7 sen, reflecting the group's strong balance sheet. It intends to distribute dividends amounting to 33% of annual PATAMI, going forward. We forecast dividend yields of 5.7-6.6% from FY22 to FY24.

Earnings forecasts. The 2H of any given year usually benefits from seasonal buying behaviour, where consumers and enterprises tend to utilise their budgets towards the end of the year, coupled with some government initiatives, eg extensions of special tax exemptions for the purchase of digital devices and Budget 2022's allocations for digital enablement. VSTECS is also committed towards implementing the other half of the 600,000 units of tablets for B40 university students. Going forward, we expect it to chart a 3-year earnings CAGR of 10.2%, supported by the expansion of its product range and distribution channels, as well as the rollout of 5G services and government digitalisation efforts. We also notice there is a surging demand for cybersecurity and cloud computing products, as well as data centres. With these in mind, VSTECS' enterprise systems business will continue to grow faster than its ICT distribution segment in the near future, in our view and boost its product mix – as the latter fetches higher margins. In a blue sky scenario, the Government may make some allocations for ICT devices, as well as other digital enablement initiatives in Budget 2023, which should further boost VSTECS' business.

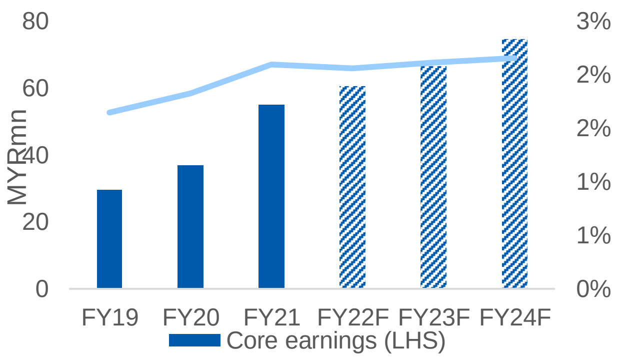
Fair value. We like the stock for its market-leading position in the industry. While we acknowledge that margins are on the lower end, it is the nature of the trading business that serves as a stumbling block to new entrants. VSTECS' local indirect peers (SNS Network, Mesiniaga, and Heitech Padu) are trading between 10x and 13x P/E. After taking into account its low-margin business, we ascribe a P/E of 9x on its FY23F earnings to derive a FV of MYR1.64. Our ascribed P/E of 9x is also in line with its average historical 5-year P/E of 9.3x. A decent dividend yield of more than 5% is another plus point. Especially in the current high interest rate environment, a value stock like VSTECS deserves a re-rating from its current P/E of merely 6.2x, coupled with its profit-making track record since being listed.

Figure 1: Revenue trend



Source: Company data, RHB

Figure 2: Core profit trend



Source: Company data, RHB

Figure 3: Peer comparison

Company	Country	FYE	Mkt Cap (USDm)	Price 3-Oct-22	P/E (x)			Div. Yld (%)	ROE (%)	EV/ EBITDA	NP growth (%)		PEG
				(Local currency)	Actual	1 Yr Fwd	2 Yr Fwd	1 Yr Fwd	1 Yr Fwd	1 Yr Fwd	1 Yr Fwd	2 Yr Fwd	
VSTECS	MA	12/2022	82.1	1.07	6.2	6.4	5.7	5.5	15.6	4.0	-3.3	11.3	0.5
Local Peers													
Datasonic Group	MA	03/2023	286.1	0.47	116.6	18.0	16.7	3.2	20.9	13.1	549.2	7.4	2.3
Microlink Solutions	MA	03/2023	142.6	0.62	23.4								
SNS Network Technology	MA	01/2023	93.7	0.27	10.8								
Iris Corp	MA	03/2023	80.7	0.12	98.8								
Kronologi Asia	MA	01/2023	67.2	0.44	11.8	19.3	13.3		4.5		-38.7	44.6	0.3
Omesti	MA	03/2023	40.2	0.35	-8.3								
Infoline Tec Group	MA	12/2022	32.4	0.42	17.2								
Dataprep Holdings	MA	12/2022	24.0	0.17	-9.1								
Mesiniaga	MA	12/2022	16.8	1.29	12.7								
Heitech Padu	MA	12/2022	14.6	0.67	-3.8								
Mkt. Cap Weighted Avg.			**157.5**		**58.4**	**18.2**	**16.1**		**17.7**		**437.3**	**14.4**	**1.9**
Simple Avg.			**79.8**		**27.0**	**18.6**	**15.0**		**12.7**		**255.3**	**26.0**	**1.3**
International Peers													
Td Synnex	US	11/2022	7970.3	83.93	20.4	7.3	6.7	1.4	13.8	6.7	179.6	8.1	0.8
Arrow Electronics	US	12/2022	6104.7	95.13	5.5	4.2	5.4	0.0	27.3	4.2	31.5	-22.8	na
Avnet	US	06/2023	3518.8	37.17	5.1	5.4	6.0	2.9	15.6	4.6	-5.8	-10.0	na
Resideo Technologies	US	12/2022	2900.6	19.91	12.0	8.3	6.8		15.6	4.9	45.0	21.2	0.3
Scansource	US	06/2023	681.3	27.05	7.7	6.5	6.0		13.0	5.2	18.4	8.1	0.7
Wayside Technology Group	US	12/2022	119.0	26.60	13.3								
Bsquare	US	12/2022	23.5	1.15	-10.5								
Taitron Components	US	12/2022	22.8	3.81	11.4								
Mkt. Cap Weighted Avg.			**5719.9**		**12.0**	**6.2**	**6.2**	**1.2**	**18.2**	**5.3**	**82.5**	**-2.0**	**0.4**
Simple Avg.			**2667.6**		**8.1**	**6.3**	**6.2**	**1.4**	**17.1**	**5.1**	**53.7**	**0.9**	**0.6**
Overall Mkt. Cap Weighted Avg.			**5499.7**		**13.9**	**6.4**	**6.3**	**1.3**	**18.0**	**5.3**	**88.5**	**0.0**	**0.5**
Overall Simple Avg.			**1208.8**		**19.3**	**10.1**	**8.8**	**1.9**	**15.8**	**6.3**	**110.6**	**8.7**	**0.8**

Source: Bloomberg, RHB

Figure 4: Operating metrics

Company	Revenue 3-year CAGR	Net profit 3-year CAGR	Gross profit margin	EBITDA margin	Net profit margin	Net gearing (latest)
VSTECS	17.2%	30.7%	5.3%	2.7%	2.1%	Net Cash
Local Peers						
Datasonic Group	-19.2%	-46.6%	53.9%	21.0%	7.5%	Net Cash
Microlink Solutions	1.9%	-179.5%	29.9%	20.6%	11.7%	Net Cash
SNS Network Technology	87.2%	294.5%	8.5%	5.7%	3.2%	35.3
Iris Corp	-14.3%	-130.2%	18.5%	6.5%	1.6%	Net Cash
Kronologi Asia	23.6%	13.1%	20.5%	15.4%	7.7%	Net Cash
Omesti	-4.0%	-46.0%	43.2%	20.3%	-6.6%	35.9
Infoline Tec Group	33.3%	30.1%	38.2%	24.1%	17.5%	Net Cash
Dataprep Holdings	-8.6%	29.4%	18.7%	-20.1%	-30.4%	Net Cash
Mesiniaga	9.9%	-185.7%	NA	3.1%	2.3%	Net Cash
Heitech Padu	-10.8%	-16.5%	NA	0.3%	-5.9%	55.6
Mkt. Cap Weighted Avg.	**4.8%**	**-30.9%**	**34.8%**	**15.2%**	**5.3%**	
Simple Avg.	**1.3%**	**-59.1%**	**28.9%**	**9.7%**	**0.9%**	
International Peers						
Td Synnex	16.9%	9.6%	6.0%	2.6%	1.2%	45.6
Arrow Electronics	5.1%	15.7%	12.2%	5.4%	3.2%	50.4
Avnet	8.5%	-264.2%	12.2%	4.6%	2.8%	40.8
Resideo Technologies	6.6%	-15.8%	26.7%	12.1%	4.1%	26.8
Scansource	-2.8%	38.9%	12.1%	4.5%	2.5%	31.1
Wayside Technology Group	15.9%	36.1%	16.2%	5.0%	3.2%	Net Cash
Bsquare	-18.1%	-45.4%	13.4%	-7.3%	-5.6%	Net Cash
Taitron Components	1.7%	13.4%	47.7%	26.3%	23.3%	Net Cash
Mkt. Cap Weighted Avg.	**10.2%**	**-35.0%**	**11.8%**	**5.0%**	**2.5%**	
Simple Avg.	**4.2%**	**-26.5%**	**18.3%**	**6.6%**	**4.4%**	
Mkt. Cap Weighted Avg.	**10.0%**	**-34.9%**	**12.6%**	**5.4%**	**2.6%**	
Simple Avg.	**7.4%**	**-25.0%**	**23.6%**	**8.3%**	**2.4%**	

Source: Bloomberg, RHB

Company Overview

VSTECS is a leading distribution hub for ICT products in Malaysia. The group purchases ICT hardware and software from multiple international leading ICT principals such as HP, Cisco, and Microsoft, and distributes them to resellers – typically comprising system integrators, solutions providers, service providers, corporate dealers, and retailers. Some of the products commonly purchased by resellers include PCs, notebooks, smartphones, tablets, printers, software, network and communication infrastructure, servers, and enterprise software.

The group's business segments are:

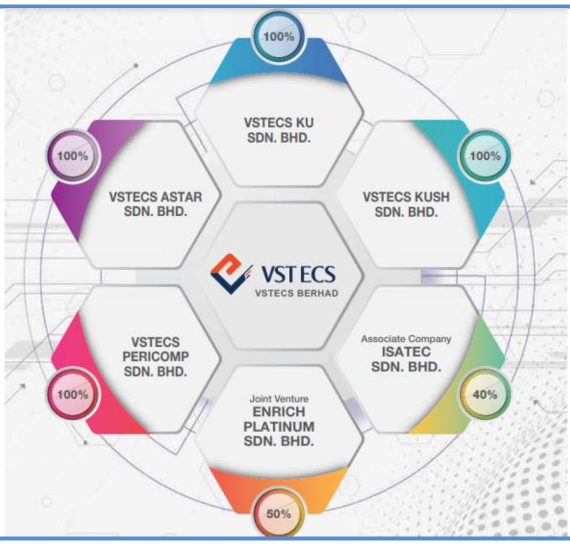
i. **ICT distribution (57.4% of FY21 revenue):** Distribution of volume ICT products to resellers, comprising mainly retailers

ii. **Enterprise systems (38.5% of FY21 revenue):** Distribution of enterprise ICT products to resellers, comprising mainly system integrators and corporate dealers

iii. **ICT services (4.1% of FY21 revenue):** Provisioning of ICT systems and services

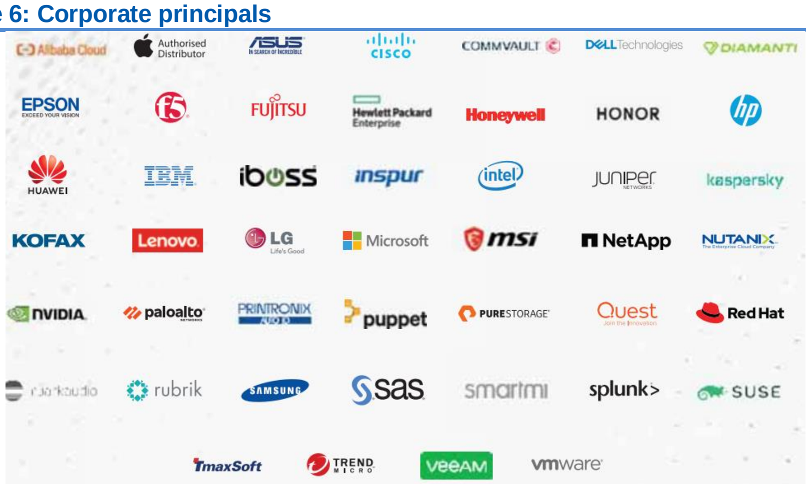
VSTECS is led by an experienced management team. CEO Soong Jan Hsung contributed significantly to the group in becoming Malaysia's leading ICT hub. Chan Puay Chai, the group CFO, has over 20 years of experience in financial planning and control, financial compliance, credit management, risk management, and other financial and management-related functions. They are supported by the rest of the senior management team, who all have over 20 years of experience in the field.

Figure 5: Corporate structure



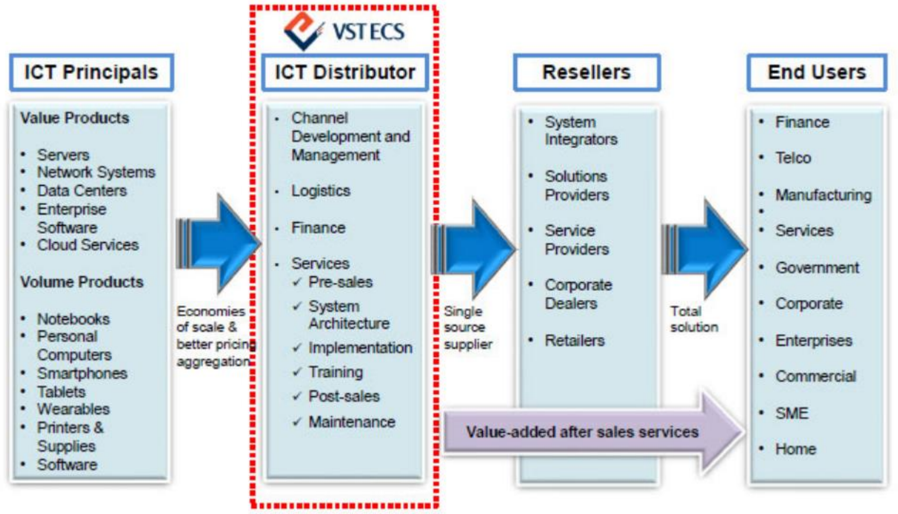
Source: Company data

Figure 6: Corporate principals



Source: Company data

Figure 7: Business model



Source: Company data

Figure 8: ICT products

Source: Company

Key Risks

Business failure of ICT principals. As a distributor, VSTECS faces the risk of losing distributorship from its ICT principals like HP, Dell, Alibaba Cloud, and Microsoft Azure, to name a few. However, we think the risk of it losing distributorships is unlikely in the near term, as VSTECS has been working very well with its principals – some even provide the group with a higher market share of stocks, compared to its local competitors. To mitigate such risks, VSTECS will continue to maintain good business relationships with its principals, as well as its capabilities in distribution and after-sales services.

Slower-than-expected adoption of ICT in Malaysia could also hurt VSTECS' growth in both the ICT products and enterprise system businesses. In the current high interest rate environment, some enterprises may pause their pace of digitalising their business processes. On a brighter note, this could be partly offset by the hybrid working environment, awareness on the importance of cybersecurity, increasing need of data storage, as well as arrival of 5G services. To mitigate this risks, VSTECS monitors government initiatives and the macroeconomic environment closely, and reacts swiftly to market demand.

Slowdown in consumer demand for ICT products. We do see a slowdown in consumer demand for ICT products like laptops and computers, as most consumers and enterprises have purchased their devices during the pandemic, given the WFH and study-from-home trends. The risk is inevitable and could impact VSTECS' ICT distribution business (top revenue generator), if not managed properly. Fortunately, in the current year, VSTECS managed to clinch a significant share of some government initiatives, particularly in the education sector. Going forward, the group will work closely with the Government in any projects related to digitisation initiatives.

The continued global shortage in chip components could lead to a shortage of raw materials for VSTECS. This could slow down its sales from the distribution of ICT products.

Exposure to FX risks. VSTECS, as a distributor, usually earns a fixed margin in MYR, depending on the volume and quantity, regardless of FX fluctuations – except for the c.26% of inventory which is purchased in USD terms. To mitigate the FX risk, the group has a practice of hedging forward its USD-denominated purchases by fixing the FX rates on payment due dates or purchasing forward-currency contracts. This practice ensures stability in the costing of its trade purchases, irrespective of currency market fluctuations. Historically, VSTECS has managed to navigate through the appreciation of the USD (in 2016 and 2017), when the FX rate rose to USD4.60 per MYR, and still managed to achieve GPM of 3.8% in its ICT product distribution segment. In 1H22, VSTECS achieved a GPM of 3.7% in this segment.

Recommendation Chart

Source: RHB, Bloomberg

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