

SMALL/MID CAP HIGHLIGHTS

VSTECS (VST MK)

Unveiling The Cornerstone Of The Digital Revolution

VSTECS, Malaysia's leading distributor of ICT products and enterprise solutions, is reaping the fruits of its rapid expansion. In addition to the organic growth from the device refreshment cycle, it is also enjoying low-hanging fruits from the burgeoning data centre expansion and cloud migration in Malaysia. We see multiple legs of growth that can supercharge a three-year revenue/core net profit CAGR of 24%/30%. Initiate coverage with BUY and a target price of RM5.02.

INVESTMENT HIGHLIGHTS

- Spearheading growth via portfolio expansion.** Since its inception as a distributor of personal computers (PC) in 1985, VSTECS has evolved into an established distributor of ICT products, enterprise systems and ICT services, boasting a diverse clientele base spanning various industries and encompassing more than 4,000 resellers and channel partners. VSTECS has achieved uninterrupted profitability in the past 38 years by effectively managing a vast inventory which is currently more than 100,000 SKUs. It has a market share of approximately 50% of the brands it represents. Not resting on its laurels, the group has been constantly forging strategic partnerships with global technology giants (with more than 50 brands' principals) such as Apple, Nvidia, and Microsoft, solidifying its position as a leading distributor in Malaysia.
- The cornerstone of the burgeoning Malaysia DC industry.** Notably, data centre (DC)-related revenue contributes 40-50% of its enterprise systems segment. According to Knight Frank Malaysia, there are over 40 DCs operating in Malaysia with capacities ranging between 100-150MW, and an additional capacity of 1,400MW anticipated over the next 5-10 years (excluding global hyperscalers), which present a blue ocean for VSTECS. Note that the group has a complete enterprise systems portfolio for DC, which encompasses software (virtualisation from VMWARE), IT equipment (network, storage, and servers), cybersecurity, and energy infrastructure (including uninterruptible power supply (UPS) systems and smart cooling systems). Moving forward, management foresees contributions from DC-related revenue further increasing up to 70% of its enterprise services segment.
- Riding on twin turbo drivers for ICT – Starlink and AI PC.** As Starlink's authorised distributor, VSTECS will provide internet connectivity to Tier 2, 3, and 4 cities, rural areas, and East Malaysia using Starlink's low Earth orbit (LEO) satellites. This initiative supports the government's goal of 100% internet penetration. With Malaysia's fixed broadband penetration at 50.6% as of 4Q23, there is an untapped market of about 4.5m customers which translates to a total addressable market (TAM) of RM10.4b. Additionally, IDC projects a resurgence in global PC shipments in 2024 following a slump in 2023, marking the start of a new demand cycle. The new AI chipset notebooks by Intel and AMD in 2H24, along with replacement cycles, will likely boost demand. The Boston Consulting Group expects AI-capable PCs to comprise 80% of the PC market by 2028.

KEY FINANCIALS

Year to 31 Dec (RMm)	2022	2023	2024F	2025F	2026F
Net turnover	2770.6	2727.2	3035.6	3413.8	3868.3
EBITDA	79.5	82.7	89.0	111.8	135.9
Operating profit	76.6	79.6	92.2	113.4	136.9
Net profit (rep./act.)	59.7	67.4	72.9	89.5	107.9
Net profit (adj.)	59.7	62.9	72.9	89.5	107.9
EPS (sen)	16.7	17.6	20.4	25.1	30.3
PE (x)	22.9	21.7	18.7	15.3	12.7
P/B (x)	3.3	3.0	2.7	2.5	2.2
EV/EBITDA (x)	16.8	15.1	14.0	11.0	8.9
Dividend yield (%)	1.6	1.7	1.9	3.3	2.8
Net margin (%)	2.2	2.3	2.4	2.6	2.8
Net debt/(cash) to equity (%)	(8.1)	(25.7)	(23.1)	(25.2)	(25.4)
Interest cover (x)	151.4	62.7	72.6	89.4	107.8
ROE (%)	14.5	14.8	14.5	16.3	17.4

Source: VSTECS, Bloomberg, UOB Kay Hian

BUY

Share Price	RM3.83
Target Price	RM5.02
Upside	31.1%

COMPANY DESCRIPTION

VSTECS Berhad, is the leading distributor of ICT products to consumers and enterprises in Malaysia. Founded in 1985, the Group distributes a wide range of ICT products to both consumer and enterprise and provides IT services in the form of pre-sales, integration, and post-sales in support of the brands represented. The three business segments are ICT Distribution, Enterprise Systems, and ICT Services.

STOCK DATA

GICS sector	ICT Distributor
Bloomberg ticker:	VST MK
Shares issued (m):	356.6
Market cap (RMm):	1,365.8
Market cap (US\$m):	290.6
3-mth avg daily t'over (US\$m):	1.2
Price Performance (%)	

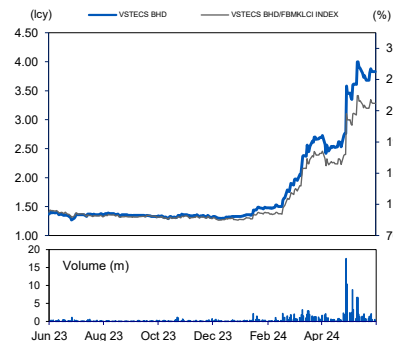
52-week high/low

1mth	3mth	6mth	1yr	YTD
38.8	109.3	185.8	179.6	188.0

Major Shareholders

	%
VSTECS Holding Ltd	44.9
Sengin Sdn Bhd	12.2
Dasar Technologies Sdn Bhd	8.6
FY23 NAV/Share (RM)	1.22
FY23 Net Cash/Share (RM)	0.42

PRICE CHART



Source: Bloomberg

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STOCK IMPACT

- Potential order from colocation DCs for IT equipment.** This order has yet to be reflected in our valuation. Unlike hyperscale DCs that procure their IT equipment directly, VSTECS targets the colocation DCs market, which typically secures its IT equipment from VSTECS. IT equipment encompasses networking, storage, and servers. According to C_TEC and the US Chamber of Commerce, approximately 73% of initial DC capex is attributed to IT equipment. Based on our channel checks, the estimated cost of IT equipment per megawatt (MW) is RM40m-50m. With 200MW of colocation DCs currently under construction, this presents a TAM of around RM10b. It is worth noting that VSTECS holds a market share of 50% in the enterprise systems distribution in Malaysia, indicating a significant opportunity in this blue-ocean market segment. Note that the majority of colocation DCs in Malaysia are still in the construction and mechanical and electrical (M&E) phase. VSTECS has already engaged in this phase by providing UPS systems and smart cooling systems. Typically, this phase takes 1-2 years to complete before transitioning to the installation of IT equipment.
- Margin and market share expansion through new distributorship agreement with VMWARE.** Under the new agreement, VSTECS will now have a 100% market share for the distribution of VMWARE solutions in Malaysia (around 50%) with improved margins from service components. Additionally, VSTECS will expand its role to provide technical support capabilities for select products and customers. We gathered that 20-30% of the VMWARE solution distribution will potentially translate to post-sales ICT services, which typically have better margins. With these factors in play, management expects the contribution from VMWARE to grow by multiple legs, despite having to incur talent acquisition cost from absorbing service personnel.

EARNINGS REVISION/RISK

- We forecast a three-year revenue/core net profit CAGR of 12%/20%**, assuming: a) growth from the ICT distribution segment driven by the resurgence of the PC and notebook cycle and strong Starlink adoption in Malaysia, b) growth from the enterprise services segment mainly fuelled by the booming DC market in Malaysia, and c) higher ICT services revenue, which commands higher margins, thereby lifting the group's overall margin. Note that we have yet to account for any potential orders from colocation DCs for IT equipment.

VALUATION/RECOMMENDATION

- Initiate coverage with a BUY recommendation and a target price of RM5.02**, based on 20.0x FY25F PE. Given the lack of local listed peers for valuation benchmarking, we use a 1.0x PEG ratio (compared to 2.0x PEG ratio which is the average peak PEG valuation of tech names during the 2021 tech run), reflecting a three-year net profit CAGR of 20% from FY23. The booming DC industry in Malaysia, reminiscent of the tech bull cycle in 2021, supports this valuation.

BUSINESS ACTIVITIES

ICT DISTRIBUTION	Laptops / Tablets	Smartphones	Peripherals	Wearables	IoT
ENTERPRISE SYSTEMS	Servers	Analytics	Cloud Services	Cybersecurity	Network Systems
ICT SERVICES	Pre-Sales	System Architecture	Implementation	Training	Post-Sales Support
SOFTWARE & IT SOLUTIONS	App Development	Digital Workflow	Systems Consulting	Cloud Consulting	Process Automation

Source: VSTECS

KEY PRINCIPAL RELATIONSHIPS

STRONG PRINCIPAL RELATIONSHIPS



Source: VSTECS

INDUSTRIES SERVED AND JOB SCOPE

INDUSTRIES	%	SCOPE
Financial Services	22%	Cloud, Enterprise Software, Cybersecurity
Telco	20%	Telco Equipment, DC & Network Infra
Public sector	18%	DC, Network Infra & Cybersecurity
Education	12%	Client Computing
Energy	10%	Enterprise Software, Client Computing
Healthcare	8%	DC, hyperconverged computing
Transportation	5%	DC & Network Infra & Cybersecurity
Others	5%	Various

Source: VSTECS

VSTECS' DC PRODUCTS AND SOLUTIONS

DC PRODUCTS & SOLUTIONS	DESCRIPTION	LOGOS
NETWORKING	<ul style="list-style-type: none"> Highly scalable up to 400G AI / Machine learning ready Leaders in DC networking Fast deployment and simple O&M 	
CYBER SECURITY	<ul style="list-style-type: none"> Next generation firewall Multi-layered segmentation Full layer 7 protection against malware Leaders in edge quadrant for firewalls 	
SERVERS	<ul style="list-style-type: none"> Nvidia certified GPU servers Accelerated computing, energy efficiency Direct water-cooling server 	
STORAGE	<ul style="list-style-type: none"> Full flash/hybrid mode available High service, fault tolerant Integration with backup software 	
SOFTWARE	<ul style="list-style-type: none"> Virtualisation, resource optimisation High availability, disaster recovery Cloud integration, next gen AI 	
ENERGY	<ul style="list-style-type: none"> Modular data centre systems Digital control lithium power UPS Smart cooling system 	

Source: VSTECS

PROFIT & LOSS

Year to 31 Dec (RMm)	2023	2024F	2025F	2026F
Net Turnover	2,727.2	3,035.6	3,413.8	3,868.3
EBITDA	82.7	89.0	111.8	135.9
Depreciation & Amortisation	(3.1)	(3.1)	(1.6)	(1.0)
EBIT	79.6	92.2	113.4	136.9
Associate Contributions				
Net Interest Income/(Expense)	(1.3)	(1.3)	(1.3)	(1.3)
Pre-tax Profit	82.8	95.9	117.8	142.0
Tax	(15.4)	(23.0)	(28.3)	(34.1)
Minorities	0.0	0.0	0.0	0.0
Net Profit	67.4	72.9	89.5	107.9
Net Profit (Adjusted)	62.9	72.9	89.5	107.9

CASH FLOW

Year to 31 Dec (RMm)	2023	2024F	2025F	2026F
Operating	107.6	25.6	67.4	58.1
Pre-tax Profit	82.8	95.9	117.8	142.0
Tax	(22.8)	(23.0)	(28.3)	(34.1)
Depreciation & Amortisation	1.7	3.1	1.6	1.0
Associates	0.0	0.0	1.0	2.0
Working Capital Changes	49.4	(55.4)	(29.3)	(57.2)
Other Operating Cashflows	(1.8)	8.1	7.2	7.4
Investing	0.3	(1.0)	(1.0)	(1.0)
Capex (Growth)	(3.0)	(1.0)	(1.0)	(1.0)
Investments	0.0	0.0	0.0	0.0
Proceeds from Sale of Assets	0.1	0.0	0.0	0.0
Others	3.1	0.0	0.0	0.0
Financing	(3.6)	(25.6)	(44.8)	(37.8)
Dividend Payments	(22.1)	(25.5)	(44.8)	(37.8)
Issue of Shares	0.0	0.0	0.0	0.0
Proceeds from Borrowings	(0.8)	(1.3)	(1.3)	(1.3)
Loan Repayment	0.0	0.0	0.0	0.0
Others/Interest Paid	0.6	(0.1)	(0.1)	(0.1)
Net Cash Inflow (Outflow)	104.3	(1.0)	21.6	19.2
Beginning Cash & Cash Equivalent	46.6	150.9	149.9	171.4
Changes Due to Forex Impact	0.0	0.0	0.0	0.0
Ending Cash & Cash Equivalent	150.9	149.9	171.4	190.7

BALANCE SHEET

Year to 31 Dec (RMm)	2023	2024F	2025F	2026F
Fixed Assets	3.7	1.6	1.0	1.0
Other LT Assets	57.1	58.6	56.1	51.5
Cash/ST Investment	150.9	149.9	171.4	190.7
Other Current Assets	600.3	668.5	749.7	849.1
Total Assets	812.0	878.5	978.3	1,092.2
ST Debt	2.5	1.7	1.7	1.7
Other Current Liabilities	315.6	326.7	378.6	420.4
LT Debt	0.0	0.0	0.0	0.0
Other LT Liabilities	4.1	4.1	4.1	4.1
Shareholders' Equity	456.4	503.8	548.6	618.7
Minority Interest	0.0	0.0	0.0	0.0
Total Liabilities & Equity	812.0	872.2	968.9	1,080.8

KEY METRICS

Year to 31 Dec (%)	2023	2024F	2025F	2026F
Profitability				
EBITDA Margin	3.0	2.9	3.3	3.5
Pre-tax Margin	3.0	3.2	3.4	3.7
Net Margin	2.3	2.4	2.6	2.8
ROA	8.3	8.3	9.1	9.9
ROE	14.8	14.5	16.3	17.4
Growth				
Turnover	(1.6)	11.3	12.5	13.3
EBITDA	4.0	7.6	25.6	21.5
Pre-tax Profit	3.4	15.8	22.8	20.5
Net Profit	13.0	8.1	22.8	20.5
Net Profit (Adjusted)	5.4	15.8	22.8	20.5
EPS	5.4	15.8	22.8	20.5
Leverage				
Debt to Total Capital	0.3	3.8	3.4	3.1
Debt to Equity	0.0	6.6	6.1	5.4
Net Debt/(Cash) to Equity	(25.7)	(23.1)	(25.2)	(25.4)
Interest Cover (x)	62.7	72.6	89.4	107.8

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