

MALAYSIA GEMS CONFERENCE HIGHLIGHTS

VSTECs (VST MK)

Harnessing Both DC And Non-DC Drivers For Accelerated Growth

While the full fruition from the burgeoning colocation DCS may take time to materialise, VSTECs is benefiting from the comprehensive DC equipment deployment and solution offerings on all fronts. It is currently leveraging on the growth in device refreshment cycles, higher contribution from government contracts and Starlink penetration in Malaysia. Additional impetus could be the acceleration of SME digitalisation in Malaysia via collaboration with LGMS. Maintain BUY. Target price: RM5.02.

WHAT'S NEW

- Encouraging uptake of Starlink in Malaysia.** Since VSTECs signed the distributorship with Starlink on Jan 24, the uptakes of Starlink in Tier 2-4 cities, rural areas, and East Malaysia have been encouraging, thanks to Starlink's LEO satellites. We understand that the monthly run rate for Starlink's kit is at several thousand units with superior margins compared to traditional ICT distribution. Note that Starlink has recently introduced the Starlink Mini, about the size of a thick laptop and designed for portability, making it ideal for backpackers. This device offers internet speeds over 100Mbps and consumes less power than its predecessors. Furthermore, the setup is quicker (less than five minutes) and it can operate for 2-3 hours on a portable battery pack. As an authorized distributor of Starlink, we believe these innovations will substantially enhance Starlink's adoption rates, which will continue to drive growth for VSTECs in the long run.
- Rising recurring revenue from software and cloud services.** Note that recurring income constitutes a high single digit percentage of total revenue. We expect this to improve to a double digit percentage on: a) higher contributions from VMWARE's virtualisation software under the new distributorship agreement (100% market share in Malaysia from 50% previously), and b) additional cloud services revenue stream following the launch of data centres (DC) by AWS and Microsoft Azure in Malaysia. Notably, DC-related revenue currently contributes over 50% of the enterprise systems segment and management targets a higher contribution of up to 70% of the enterprise services segment.
- Accelerate digitalisation of SME in Malaysia via StarSentry.** On 4 Jun 24, VSTECs signed a distributorship agreement with LGMS for the distribution of StarSentry. StarSentry is a subscription-based, user-friendly cybersecurity solution designed for SMEs, offering plug-and-play setup and including cyber risk insurance at an affordable price. It aligns with Malaysia's National Cyber Security Bill to bolster SMEs' defences, marking the country's first solution of its kind. The annual subscription fee for this service is RM12,900. With approximately 1.15m SMEs in Malaysia, this translates to a total addressable market (TAM) of RM14.8b to both VSTECs and LGMS. Note that the contribution from the SME is less than 10% of the group's revenue.

KEY FINANCIALS

Year to 31 Dec (RMm)	2021	2022	2023F	2024F	2025F
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)	23.9	22.7	19.6	15.9	13.2
P/B (x)	3.5	3.1	2.8	2.6	2.3
EV/EBITDA (x)	17.5	15.8	14.7	11.5	9.4
Dividend yield (%)	1.6	1.7	1.8	3.1	2.6
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

(Maintained)

Share Price	RM4.00
Target Price	RM5.02
Upside	+25.5%

COMPANY DESCRIPTION

VSTECs 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:	VSTECs MK
Shares issued (m):	356.6
Market cap (RMm):	1,426.4
Market cap (US\$m):	303.5
3-mth avg daily t'over (US\$m):	1.4

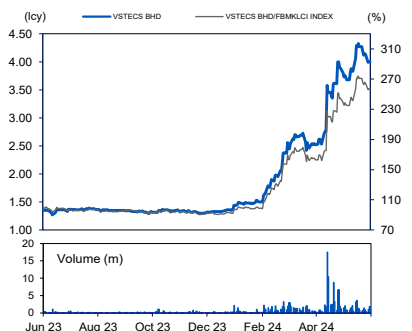
Price Performance (%)

52-week high/low	RM1.26/RM4.45			
1mth	3mth	6mth	1yr	YTD
5.3	68.8	205.0	192.0	200.1

Major Shareholders

	%
VSTECs Holding Ltd	45.6
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

- 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 (50%) with improved margins from service components. Also, 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. Note that VMware holds a market share of about 80% in server virtualisation, which has been instrumental in charting VSTECS's growth as a distributor.
- 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, about 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 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 is already involved 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.

EARNINGS REVISION/RISK

- Earnings revision.** None.
- We forecast a three-year revenue/core net profit CAGR of 12%/20%,** assuming: a) growth from the ICT distribution segment is driven by the resurgence of the PC and notebook cycle and strong Starlink adoption in Malaysia; b) growth from the enterprise services segment is mainly fuelled by the DC boom in Malaysia; and c) increased ICT services revenue commands higher margins, thereby lifting the group's overall margin. We have not accounted for any potential orders from colocation DCs for IT equipment.

VALUATION/RECOMMENDATION

- Maintain BUY with an unchanged 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.

ENVIRONMENTAL, SOCIAL, GOVERNANCE (ESG)

Environmental <ul style="list-style-type: none"> - Electricity withdrawal from main grid reduced by 20% yoy in 2023. - Solar power constituted 41% of total electricity consumed in 2023. - 26% reduction in paper consumption.
Social <ul style="list-style-type: none"> - Maintaining a 50% male-female composition among total employees. - The group recorded zero work fatalities over the past nine years. - 100% local employees.
Governance <ul style="list-style-type: none"> - Zero confirmed corruption or harassments cases reported. - Zero fines or penalties from regulatory authorities. - 57% of directors are independent.

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	
NETWORKING <ul style="list-style-type: none"> • High scale up to 400G • AI Machine Learning ready • Leader 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 2 protection against malware • Leaders in magic quadrant for firewalls 	
SERVERS <ul style="list-style-type: none"> • Hacks 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 • Enterprise 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
Deprec. & amort.	(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 (adj.)	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)
Deprec. & amort.	1.7	3.1	1.6	1.0
Working capital changes	0.0	0.0	1.0	2.0
Other operating cashflows	49.4	(55.4)	(29.3)	(57.2)
Investing	(1.8)	8.1	7.2	7.4
Capex (maintenance)	0.3	(1.0)	(1.0)	(1.0)
Investments	(3.0)	(1.0)	(1.0)	(1.0)
Proceeds from sale of assets	0.0	0.0	0.0	0.0
Others	0.1	0.0	0.0	0.0
Financing	3.1	0.0	0.0	0.0
Dividend payments	(3.6)	(25.6)	(44.8)	(37.8)
Issue of shares	(22.1)	(25.5)	(44.8)	(37.8)
Proceeds from borrowings	0.0	0.0	0.0	0.0
Loan repayment	(0.8)	(1.3)	(1.3)	(1.3)
Others/interest paid	0.0	0.0	0.0	0.0
Net cash inflow (outflow)	0.6	(0.1)	(0.1)	(0.1)
Beginning cash & cash equivalent	104.3	(1.0)	21.6	19.2
Changes due to forex impact	46.6	150.9	149.9	171.4
Ending cash & cash equivalent	0.0	0.0	0.0	0.0

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	57.1	57.1	57.1
Cash/ST investment	150.9	149.9	171.4	190.7
Other current assets	600.3	674.8	759.2	860.5
Total assets	812.0	883.3	988.7	1,109.2
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	9.7
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 (adj.)	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	3.0
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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