Briefing Note **Nov 11th, 2014**

ECS ICT Bhd

RM1.45

HOLD

Target (RM)	RM1.41 – RM1.61
MASA Codes	ECS / 5162
Bloomberg	ECS MK
Stock & Market Data	
KLCI	1827.93
Listing	Main Market
Sector	Technology
Syariah Compliance	Yes
Par Value	RM0.50
Issued Shares	180.0m
Market Capitalisation	RM259.2m
1-year return	18.4%
52-week Hi/Lo	RM1.10 / RM1.73
1M Average Volume	0.1m shares
Estimated Free Float	20%
Major Shareholders: -	
ECS Holdings Ltd	41.0%
MD Foo Sen Chin	12.2%
Key Indicators @ FY14	
PER (x)	9.5
PBV (x)	1.2
Net Debt/Equity (%)	Net cash
ROE (%)	12.8

Period: 3QFY14

Dividend: A dividend of 3sen was declared for the quarter – payout of 27.6% of 9MFY14 earnings.

Actual versus expectations: Results were inline with our expectations, making up 72% of our full year forecast. Traditionally, Q4 has always been ECS best quarter.

Result highlights: Revenue grew 13.9% to RM392.0m in 3Q14, versus RM344.2m in 3Q13. The revenue growth was due to stronger sales of Personal Computers (PCs), notebooks and smartphones. Hence, ICT Distribution segment posted 30.3% gain to RM278.5m from RM213.7m previously. Enterprise Systems contributed RM98.5m, lower by 22.7% y/y. ICT Services' revenue rose to RM15.0m. Net profit for the group rose 37.9% to RM7.3m.

For nine months period, ECS posted revenue of RM1.1bn, up 18.1% y/y. Revenue growth was driven by the ICT Distribution and ICT Services segment, (RM792.0m and RM36.1m, respectively, up 29.6% and 269.8% y/y). Enterprise Systems contributed RM311.5m, down 9.5% y/y. The lower contribution was due to shifting of some revenue to the Service segment despite the origination of the revenue was from Enterprise Systems. Net profit was up 14.1% to RM19.6m.

Table 1. 3QFY14 results

FYDec / RM'm	3QFY14	3QFY13	2QFY14	y/y Chg %	q/q Chg %	9MFY14	9MFY13	y/y Chg %
Revenue	392.0	344.2	389.9	13.9	0.5	1139.6	965.0	18.1
Cost of sales	(373.2)	(324.7)	(367.2)	14.9%	1.6	(1078.9)	(908.1)	18.8
Gross profit	18.8	19.5	22.7	-3.4%	-17.1	60.8	56.9	6.8
Admin & Dist Exp	(11.9)	(12.3)	(12.7)	-2.8%	-5.9	(36.9)	(34.5)	7.1
Other income / (exp)	2.0	(0.4)	(0.0)	-	-	1.3	0.1	-
EBIT	8.9	6.8	10.0	30.9	-10.5	25.1	22.5	11.7
Interest income/(Exp)	0.2	0.4	0.4	-46.0	-46.6	1.0	1.0	-3.4
Pretax profit	9.1	7.2	10.3	27.0	-11.8	26.1	23.5	11.0
Tax	(1.8)	(1.9)	(2.8)	-3.5	-35.0	(6.5)	(6.4)	2.7
Net profit	7.3	5.3	7.5	37.9	-3.1	19.6	17.2	14.1
EPS (sen)	4.0	2.9	4.2	37.9	-4.8	10.9	9.5	14.7
GP margin	4.8%	5.7%	5.8%	-0.9ppt	-1.0ppt	5.3%	5.9%	-0.6ppt
EBIT margin	2.3%	2.0%	2.6%	0.3ppt	-0.3ppt	2.2%	2.3%	-0.1ppt
Tax rate	20.1%	26.4%	27.2%	-6.3ppt	-7.2ppt	25.0%	27.0%	-2.0ppt

Managing Director Mr Foo said, “We witnessed strong sales growth from our ICT Distribution segment over the last five quarters, inline with higher demand for PCs, notebooks and smartphones. We intend to expand this segment further, especially our smartphone distribution channels and increase the number of brands we carry. We were recently appointed by BenQ to distribute its F5 and T3 smartphones. Coupled with our existing Lenovo and ASUS brands, we are much represented in the fastest growing segment of smartphones market i.e. the lower to mid priced phones.”

Outlook

ECS will continue to leverage on the increasing demand for mobile devices. It is optimistic it will sign on another phone manufacturer, after adding BenQ in 3Q.

Budget 2015 allocation for high speed broadband will translate to opportunities for ECS when implementation takes off.

Its lookout for M&A targets has not materialise into something tangible. Nevertheless, it remains diligent in its search for the right candidate.

Valuation and recommendation

We make no changes to our forecast. As explain in our previous note, we do expect ECS’s profitability to ease, post the implementation of GST as some of the current spending on ICT products is related to GST implementation. We note that year-to-date its Enterprise segment has not increase its topline contribution which could be due to big companies (affected by GST implementation) still studying their options and have yet to choose their vendor.

We retain our valuation model that is based on its book value. We are not using an earnings based valuation model for ECS, as in our opinion, ECS is likely to record lower earnings 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.**

FYDec / RM'm	2010A	2011A	2012A	2013A	2014F	2015F
Revenue	1271.5	1250.7	1276.1	1326.3	1518.3	1442.4
Pretax profit	39.4	40.9	40.3	36.6	36.5	34.6
Net profit	28.9	30.1	29.9	26.9	27.4	26.3
EPS (sen)	16.1	16.7	16.6	14.9	15.2	14.6
Pretax margin (%)	3.1%	3.3%	3.2%	2.8%	2.4%	2.7%
Net profit margin (%)	2.3%	2.4%	2.3%	2.0%	1.8%	1.8%
PER (x)	8.9	8.6	8.7	9.7	9.5	9.9
Dividend (sen)	-	*5.3*	*5.5*	*5.5*	*5.5*	*5.5*
Dividend yield (%)	-	3.7	3.8	3.8	3.8	3.8
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)	1.8	1.4	1.3	1.3	1.2	1.1

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.