Briefing Note Aug 14th, 2013

ECS ICT Bhd

RM1.18

BUY

Target (RM)	RM1.34
MASA Codes	ECS / 5162
Bloomberg	SUCB MK
Stock & Market Data	
KLCI	1795.09
Listing	Main Market
Sector	Industrial Products
Syariah Compliance	Yes
Par Value	RM0.50
Issued Shares	180.0m
Market Capitalisation	RM210.6m
1-year return	16.5%
52-week Hi/Lo	RM0.99 / RM1.36
1M Average Volume	0.05m shares
Estimated Free Float	20%
Major Shareholders: -	
ECS Holdings Ltd	40.0%
Singin Sdn Bhd	11.8%
Key Indicators @ FY13	
PER (x)	7.0
PBV (x)	1.0
Net Debt/Equity (%)	Net cash
ROE	15.2

Period: Q2FY13

Dividend: No dividend was declared for the quarter.

Actual versus expectations: Q2 results were slightly below consensus expectations; 2nd half expected to better than 1H on optimism that post GE13, ICT spending will improve.

Result highlights: For Q2FY13, ECS ICT Bhd (ECS) earned lower revenue of RM300.5m (RM309.3m: Q2FY12) due to lower revenue from ICT distribution and ICT services segments. Profit before tax for Q2 was not much change y/y at RM7.5m. Comparing performance for Q2FY13 vis-à-vis Q2FY12 –

1. ICT distribution - revenue decreased by 10.9% due to softer market for notebook, pretax profit decreased by 20.8% to RM3.1m.
2. Enterprise system - revenue increased by 17.6% due to higher sales of servers, networking products and enterprise software, pretax profit increased by 30.6% to RM3.8m.
3. ICT services - revenue decreased by 38.8%, pretax profit decreased 52.0% to RM0.2m.

For 1HFY13, ECS recorded revenue of RM620.8m, (+1.0% y/y) due to higher revenue from Enterprise system segment making up for the lower revenue from ICT distribution segment. Pretax profit decrease by 13.1% y/y. ICT distribution's revenue decreased by 3.2% due to lower peripherals and printer consumables sales and lowering pretax profit by 6.8%. Enterprise system contributed 10.4% hike in revenue from projects on networking products and enterprise software and but pretax profit decreased by 21.8% due to lower profit margin from the product mix. In services, revenue decreased by 15.9%; pretax profit decrease 27.8% to RM0.4m.

Quarter on quarter, pretax profit of RM7.5m was lower due to lower profit from all three segments.

Table 1. Quarterly results & comparison

FYDec / RM'm	2Q13	2Q12	1Q13	y/y Chg %	q/q Chg %	1H13	1H12	y/y Chg %
Revenue	300.5	309.3	319.8	-2.8	-6.0	620.3	614.6	0.9
Gross profit	17.8	17.9	19.6	-0.6	-9.2	37.4	39.7	-5.8
Pretax profit	7.5	7.5	8.8	0.0	-14.8	16.3	18.8	-13.3
Tax	-2	-1.9	-2.4	5.3	-16.7	-4.4	-5.1	-13.7
Net profit	5.5	5.6	6.4	-1.8	-14.1	11.9	13.7	-13.1
EPS (sen)	3.1	3.1	3.5	0.0	-11.4	6.6	7.6	-13.2
GP margin (%)	5.9	5.8	6.13			6.0	7.6	
Pretax profit margin (%)	2.5	2.4	2.75			2.6	6.5	
Tax rate (%)	26.7	25.3	27.3			27.0	27.1	

Outlook

ECS is anticipating a better second half on account of higher spending after the 13th General elections. ICT spending in Malaysia is expected to hit USD10.6bn in 2013, up from USD10.2bn in 2012, driven by smart devices and enterprise systems. *(Source: IDC)* Driving this growth is the smart phone penetration that is to grow to 60% from the current 30% in two years time. In addition, Malaysia has the potential to be a leading cloud computing data storage center due to its developed infrastructure and low natural disaster risk.

Growth strategies moving forward

Expand its range of tablet PCs – Appointed by Microsoft to distribute Surface RT and Surface Pro. ECS is now major tablet PC distributor to the local market, with models from Apple, Samsung, Asus and Lenovo in the stable.

Increase number of brands in smartphone portfolio – ECS is now distributor for Hauwei and Lenovo range of smart phones.

Target new opportunities in cloud computing – ECS is leveraging on partnership with IBM to distribute its IBM SmartCloud computing solutions. It is also targeting to sign up with an established cloud service provider.

Valuation and recommendation

Anticipating that 2H will be better, we are forecasting ECS to make 10.2sen in the second half to bring FY13 EPS to 16.8sen. Based on a PER of 8x on FY13 EPS of 16.8sen, ECS is valued at RM1.34. Dividend at 30% payout amounts to 5 sen per share, hence dividend yield is about 4.2%. Our valuation is above the market as we feel ECS is in a good position to increase the dividend quantum; an increase to a 50% payout would equate to a yield of 7%. In addition, backed by net cash per share of 43sen per share, ECS is in a position to have a capital management exercise to return some funds to shareholders. (In this respect, shareholders activism is needed to persuade the board to move for the exercise.)

Our PER rating of 8x is slightly more than half of the market's PER (based on FBMKLCI stocks), as we feel ECS is operating in a mature market (based on its current portfolio of products). Its new venture into distributing smartphones and cloud computing will take some gestation, before results are seen at the bottom line. Hence we see ECS performance over the next two years to be flattish. However, despite the lack of growth, we recommend a BUY for the stock (upside potential is 16%) as we are of the opinion upside potential for the stock exceeds the downside risk, in view of a possible hike in dividend and capital repayment.

Table 2. Profit & Loss Forecast

FYDec / RM'm	2010A	2011A	2012A	2013F	2014F
Revenue	1271.5	1250.7	1276.1	1320.3	1359.9
Pretax profit	39.4	40.9	40.3	41.2	43.7
Net profit	28.9	30.1	29.9	30.3	32.5
EPS (sen)	16.1	16.7	16.6	16.8	18.1
Pretax margin	3.1%	3.3%	3.2%	3.1%	3.2%
Net profit margin	2.3%	2.4%	2.3%	2.3%	2.4%
PER (x)	7.3	7.1	7.1	7.0	6.5
Dividend yield (%)	4.5	4.5	4.6	4.2	4.7
Net Gearing (x)	0.1	Net cash	Net cash	Net cash	Net cash
Book value/share (RM)	0.8	1	1.1	1.2	1.3
Price/Book	1.5	1.2	1.1	1.0	0.9

The opinion and information contained herein are based on available data believed to be reliable and this report is provided for information purposes only. It is not to be construed as an offer, invitation to buy or sell the securities mentioned herein. Jupiter Securities Sdn Bhd does not warrant the accuracy stated in any manner herein and no reliance upon such things by anyone should give rise to any claim whatsoever. The directors and staff of Jupiter Securities Sdn Bhd may have an interest in the securities mentioned.

Background

Established in 1985, ECS is in the business of distributing ICT products in Malaysia ECS' range of products include 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 activities. 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.

The opinion and information contained herein are based on available data believed to be reliable and this report is provided for information purposes only. It is not to be construed as an offer, invitation to buy or sell the securities mentioned herein. Jupiter Securities Sdn Bhd does not warrant the accuracy stated in any manner herein and no reliance upon such things by anyone should give rise to any claim whatsoever. The directors and staff of Jupiter Securities Sdn Bhd may have an interest in the securities mentioned.