

INITIATE COVERAGE

VSTECS Holdings (856 HK)

Leading IT Distributor Riding The AI Wave

VSTECS is the eighth-largest IT distributor globally with an established presence in SEA and China. We forecast a three-year net profit CAGR of 9.2% in 2024-26, fuelled by the rising adoption of AI, refresh cycles for consumer electronics and diversifying cloud services. We like VSTECS' operating efficiency and cash conversion. We expect a dividend yield of 4.4%/5.1% in 2024-25 on solid cash flow generation. Initiate coverage with BUY. Target price: HK\$5.47.

INITIATE COVERAGE

- **Leading IT distributor with established presence in APAC.** VSTECS Holdings (VSTECS) is the largest IT distributor in Southeast Asian (SEA) countries (including Singapore, Malaysia and Thailand) and is the second largest IT distributor in China. It serves more than 50,000 partners in APAC and has become the most trusted partner of global technology companies, thanks to its value-added services and comprehensive product portfolio covering 80% of global leading technology companies and unicorns.
- **Riding on accelerating AI adoption.** We expect VSTECS to benefit from the accelerating AI deployment, supported by: a) increasing sales of GPU servers, backed by the burgeoning data centre construction in SEA, b) the adoption of AI-PC, which is expected to account for 40% of total PCs by 2025, and c) the rollout of GenAI smartphones, which is forecasted to grow at a 78% CAGR in 2024-28. We estimate sales contribution of AI products to reach 20% in 2024-25, vs 12% in 1H24 and 6% in 2023.
- **Starlink deployment in SEA...** VSTECS is Starlink's preferred partner when it entered Asia. It began to distribute Starlink's standard kits in Malaysia and Indonesia in early-24 and has received positive feedback on its market entry in the Philippines and Thailand. We believe VSTECS is poised for opportunities from the uptake of Starlink in other SEA countries, thanks to its first-mover advantage and established distribution network.
- **...and diversifying cloud services.** Cloud computing revenue grew at a 22.4% CAGR in 2021-23 as VSTECS extended its cloud services to multi-cloud management platforms, computing power scheduling and AI management. We forecast VSTECS' cloud computing segment to register a 14.0% CAGR in 2024-26 as AI advancement continues to drive increasing demand for computing power and cloud services.
- **Accelerated expansion in SEA.** Sales from SEA grew at a 6.4% CAGR in 2021-23 on rising demand for digitalisation. We expect SEA to be VSTECS' key growth driver in 2024-26, backed by the wave of IT infrastructure upgrades and the large population base in SEA. We expect revenue contribution from SEA to reach 30% and 35% in 2024-25 respectively (vs 24% in 2023) and net profit contribution from SEA to reach 40% and close to 50% in 2024-25 respectively (vs 35% in 2023).

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KEY FINANCIALS

| Year to 31 Dec (HK\$m)        | 2022   | 2023   | 2024F  | 2025F  | 2026F  |
|-------------------------------|--------|--------|--------|--------|--------|
| Net turnover                  | 77,324 | 73,891 | 79,570 | 86,417 | 93,898 |
| Operating profit              | 1,313  | 1,426  | 1,466  | 1,621  | 1,792  |
| Net profit (rep./act.)        | 823    | 922    | 929    | 1,058  | 1,201  |
| EPS (cents)                   | 58.2   | 65.6   | 66.1   | 75.3   | 85.5   |
| PE (x)                        | 7.7    | 6.8    | 6.7    | 5.9    | 5.2    |
| P/B (x)                       | 0.8    | 0.8    | 0.7    | 0.7    | 0.6    |
| Dividend yield (%)            | 3.8    | 5.8    | 4.4    | 5.1    | 5.7    |
| Net margin (%)                | 1.1    | 1.2    | 1.2    | 1.2    | 1.3    |
| Net debt/(cash) to equity (%) | 62.9   | 62.2   | 52.8   | 49.8   | 47.0   |
| ROE (%)                       | 10.6   | 11.6   | 11.0   | 11.7   | 12.1   |
| Consensus net profit          | -      | -      | 979    | 1,115  | 1,238  |
| UOBKH/Consensus (x)           | -      | -      | 0.95   | 0.95   | 0.97   |

Source: VSTECS, UOB Kay Hian

BUY

|              |          |
|--------------|----------|
| Share Price  | HK\$4.46 |
| Target Price | HK\$5.47 |
| Upside       | 22.7%    |

COMPANY DESCRIPTION

VSTECS Holdings offers cloud services, mobile internet, system equipment, software, information security, network infrastructure, data storage, computer components, Internet of Things application, gaming, drones and virtual reality products. The company serves clients in the Asia Pacific region.

STOCK DATA

|                                 |                        |
|---------------------------------|------------------------|
| GICS sector                     | Information Technology |
| Bloomberg ticker:               | 856 HK                 |
| Shares issued (m):              | 1,433                  |
| Market cap (HK\$m):             | 6,391                  |
| Market cap (US\$m):             | 819                    |
| 3-mth avg daily t'over (US\$m): | 1.4                    |

Price Performance (%)

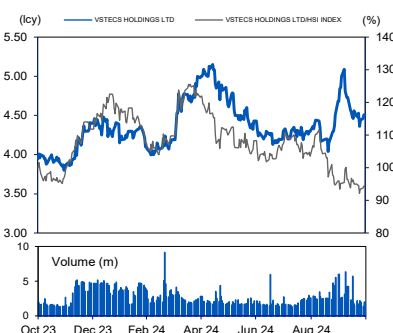
|                  |             |             |            |            |
|------------------|-------------|-------------|------------|------------|
| 52-week high/low | 5.24/3.66   |             |            |            |
| <b>1mth</b>      | <b>3mth</b> | <b>6mth</b> | <b>1yr</b> | <b>YTD</b> |
| (1.1)            | 6.2         | (10.8)      | 11.5       | 1.4        |

Major Shareholders

|                   |       |
|-------------------|-------|
| Li Jialin& family | 41.61 |
|-------------------|-------|

|                                   |      |
|-----------------------------------|------|
| FY24 NAV/Share (HK\$)             | 6.19 |
| FY24 Net Debt (Cash)/Share (HK\$) | 3.27 |

PRICE CHART



Source: Bloomberg

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### VALUATION/RECOMMENDATION

- **Initiate coverage with BUY and a target price of HK\$5.47**, based on 7.3x 2025F PE, pegged to its historical mean in 2019-24. The company is now trading at 6.1x one-year forward PE, which is 0.5SD below its historical mean in 2019-24. We like VSTECS for its industry-leading operating efficiency, backed by effective working capital management, comprehensive product portfolio and extensive APAC footprint.

### EARNINGS REVISION/RISK

- We estimate revenue to grow 7.7%/8.6%/8.7% to HK\$79,570m/HK\$86,417m/HK\$93,898m in 2024-26 respectively, driven by rising AI adoption, growing demand for consumer electronics and diversifying cloud services. We forecast blended gross margin to remain relatively stable at 4.6%/4.7%/4.7% in 2024-26 and expect net profit to grow 0.8%/13.9%/13.5% to HK\$929m/HK\$1,058m/HK\$1,201m respectively in 2024-26, thanks to increasing gross profit and stringent cost controls.

### SHARE PRICE CATALYST

- Key consumer electronics product upgrades drive replacement demand and cooperation with leading cloud services provider.

### KEY ASSUMPTIONS

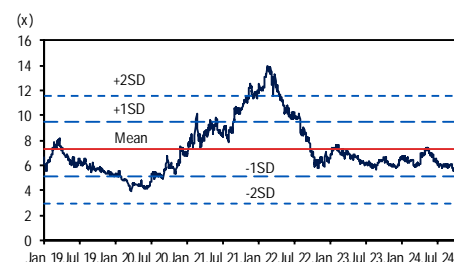
| (HK\$m)               | 2022   | 2023   | 2024F  | 2025F  | 2026F  |
|-----------------------|--------|--------|--------|--------|--------|
| Revenue               | 77,324 | 73,891 | 79,570 | 86,417 | 93,898 |
| Consumer electronics  | 33,075 | 30,394 | 32,065 | 33,989 | 36,029 |
| Enterprise systems    | 41,358 | 40,414 | 44,051 | 48,456 | 53,302 |
| Cloud computing       | 2,891  | 3,084  | 3,454  | 3,972  | 4,568  |
| Revenue Growth (%)    | (1.3)  | (4.4)  | 7.7    | 8.6    | 8.7    |
| Consumer electronics  | 2.5    | (8.1)  | 5.5    | 6.0    | 6.0    |
| Enterprise systems    | (5.4)  | (2.3)  | 9.0    | 10.0   | 10.0   |
| Cloud computing       | 23.4   | 6.7    | 12.0   | 15.0   | 15.0   |
| Revenue Breakdown (%) | 100.0  | 100.0  | 100.0  | 100.0  | 100.0  |
| Consumer electronics  | 42.8   | 41.1   | 40.3   | 39.3   | 38.4   |
| Enterprise systems    | 53.5   | 54.7   | 55.4   | 56.1   | 56.8   |
| Cloud computing       | 3.7    | 4.2    | 4.3    | 4.6    | 4.9    |

Source: VSTECS, UOB Kay Hian

### PEER COMPARISON

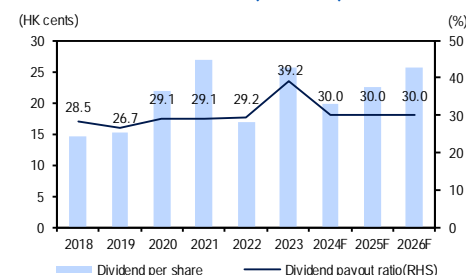
| Company                     | Ticker    | Rec       | Price @<br>28 Oct 24<br>(lcy) | Market<br>Cap<br>(HK\$m) | ----- PE -----<br>2024F 2025F<br>(x) (x) | -- EPS growth --<br>2024F 2025F<br>(%) (%) | ROE<br>2024F<br>(%) | --- Dividend Yield ---<br>2024F 2025F<br>(%) (%) |  |
|-----------------------------|-----------|-----------|-------------------------------|--------------------------|--|--|---------------------|--|--|
| VSTECS                      | 856 HK    | BUY       | 4.46                          | 6,391                    | 6.7 5.9                                  | 0.8 13.9                                   | 11.0                | 4.4 5.1  |  |
| <b>China-listed peers</b>   |           |           |                               |                          |  |  |                     |  |  |
| Digital China               | 000034 SZ | NOT RATED | 32.09                         | 23,421                   | 15.2 12.6                                | 21.2 20.2                                  | 14.6                | 2.0 2.4  |  |
| <b>Taiwan-listed peers</b>  |           |           |                               |                          |  |  |                     |  |  |
| Synnex Technology           | 2347 TT   | NOT RATED | 72.2                          | 28,902                   | 14.1 12.3                                | 17.0 14.4                                  | 11.5                | 4.4 5.2  |  |
| <b>US-listed peers</b>      |           |           |                               |                          |  |  |                     |  |  |
| Avnet                       | AVT US    | NOT RATED | 53.92                         | 36,750                   | 12.2 8.7                                 | (29.8) 39.0                                | 9.0                 | 2.4 2.5  |  |
| Arrow Electronics           | ARW US    | NOT RATED | 132.39                        | 54,672                   | 12.3 9.1                                 | (50.1) 53.7                                | 11.4                | n.a. n.a.  |  |
| TD Synnex                   | SNX US    | NOT RATED | 120.58                        | 80,027                   | 10.3 9.4                                 | 4.9 39.4                                   | 12.0                | 1.3 1.5  |  |
| <b>Average</b>              |           |           |                               | <b>57,150</b>            | <b>11.6 9.0</b>                          | <b>(25.0) 44.0</b>                         | <b>10.8</b>         | <b>1.9 2.0</b>                                   |  |
| <b>Average of all peers</b> |           |           |                               | <b>44,754</b>            | <b>12.8 10.4</b>                         | <b>(7.3) 33.3</b>                          | <b>11.7</b>         | <b>2.6 2.9</b>                                   |  |

### FORWARD PE BAND



Source: VSTECS, UOB Kay Hian

### DIVIDEND PAYOUT RATIO (2018-26F)



Source: VSTECS, UOB Kay Hian

### PROFIT & LOSS

| Year to 31 Dec (HK\$m)        | 2023         | 2024F        | 2025F        | 2026F        |
|-------------------------------|--------------|--------------|--------------|--------------|
| Net turnover                  | 73,891       | 79,570       | 86,417       | 93,898       |
| EBITDA                        | 1,544        | 1,605        | 1,757        | 1,926        |
| Deprec. & amort.              | (118)        | (139)        | (137)        | (133)        |
| <b>EBIT</b>                   | <b>1,426</b> | <b>1,466</b> | <b>1,621</b> | <b>1,792</b> |
| Other non-operating income    | 76           | 39           | 39           | 39           |
| Net interest income/(expense) | (340)        | (334)        | (326)        | (318)        |
| <b>Pre-tax profit</b>         | <b>1,162</b> | <b>1,171</b> | <b>1,334</b> | <b>1,514</b> |
| Tax                           | (240)        | (242)        | (276)        | (313)        |
| Minorities                    | -            | -            | -            | -            |
| <b>Net profit</b>             | <b>922</b>   | <b>929</b>   | <b>1,058</b> | <b>1,201</b> |

### CASH FLOW

| Year to 31 Dec (HK\$m)                      | 2023           | 2024F        | 2025F        | 2026F        |
|---|----------------|--------------|--------------|--------------|
| <b>Operating</b>                            | <b>640</b>     | <b>1,399</b> | <b>583</b>   | <b>580</b>   |
| Pre-tax profit                              | 1,162          | 1,171        | 1,334        | 1,514        |
| Tax   | (240)          | (242)        | (276)        | (313)        |
| Deprec. & amort.                            | 118            | 139          | 137          | 133          |
| Working capital changes                     | (650)          | 27           | (908)        | (1,042)      |
| Others                                      | 250            | 304          | 296          | 288          |
| <b>Investing</b>                            | <b>138</b>     | <b>(120)</b> | <b>(120)</b> | <b>(100)</b> |
| Capex (growth)                              | (39)           | (120)        | (120)        | (100)        |
| Others                                      | 177            | -            | -            | -            |
| <b>Financing</b>                            | <b>(1,373)</b> | <b>(757)</b> | <b>(586)</b> | <b>(618)</b> |
| Dividend payments                           | (247)          | (453)        | (290)        | (330)        |
| Issue of shares                             | -              | -            | -            | -            |
| Proceeds from borrowings                    | 24,020         | 24,000       | 24,000       | 24,000       |
| Loan repayment                              | (24,368)       | (24,000)     | (24,000)     | (24,000)     |
| Others/interest paid                        | (779)          | (304)        | (296)        | (288)        |
| <b>Net cash inflow (outflow)</b>            | <b>(596)</b>   | <b>523</b>   | <b>(123)</b> | <b>(138)</b> |
| <b>Beginning cash &amp; cash equivalent</b> | <b>3,246</b>   | <b>2,649</b> | <b>3,171</b> | <b>3,048</b> |
| Changes due to forex impact                 | (1)            | -            | -            | -            |
| <b>Ending cash &amp; cash equivalent</b>    | <b>2,649</b>   | <b>3,171</b> | <b>3,048</b> | <b>2,910</b> |

### BALANCE SHEET

| Year to 31 Dec (HK\$m)                | 2023          | 2024F         | 2025F         | 2026F         |
|---------------------------------------|---------------|---------------|---------------|---------------|
| Fixed assets                          | 909           | 894           | 881           | 851           |
| Other LT assets                       | 1,226         | 1,222         | 1,219         | 1,215         |
| Cash/ST investment                    | 3,325         | 3,848         | 3,724         | 3,586         |
| Other current assets                  | 29,560        | 28,714        | 30,944        | 33,488        |
| <b>Total assets</b>                   | <b>35,020</b> | <b>34,678</b> | <b>36,769</b> | <b>39,140</b> |
| ST debt                               | 8,233         | 8,233         | 8,233         | 8,233         |
| Other current liabilities             | 18,323        | 17,504        | 18,827        | 20,328        |
| LT debt                               | 209           | 209           | 209           | 209           |
| Other LT liabilities                  | 32            | 32            | 32            | 32            |
| Shareholders' equity                  | 8,223         | 8,699         | 9,467         | 10,338        |
| Minority interest                     | 0             | 0             | 0             | 0             |
| <b>Total liabilities &amp; equity</b> | <b>35,020</b> | <b>34,678</b> | <b>36,769</b> | <b>39,140</b> |

### KEY METRICS

| Year to 31 Dec (%)        | 2023  | 2024F | 2025F | 2026F |
|---------------------------|-------|-------|-------|-------|
| <b>Profitability</b>      |       |       |       |       |
| Gross margin              | 4.7   | 4.6   | 4.7   | 4.7   |
| Operating margin          | 1.9   | 1.8   | 1.9   | 1.9   |
| Net margin                | 1.2   | 1.2   | 1.2   | 1.3   |
| ROE                       | 11.6  | 11.0  | 11.7  | 12.1  |
| ROA                       | 2.6   | 2.7   | 2.9   | 3.1   |
| <b>Growth</b>             |       |       |       |       |
| Turnover                  | (4.4) | 7.7   | 8.6   | 8.7   |
| Gross profit              | 3.5   | 5.7   | 9.4   | 9.4   |
| Pre-tax profit            | 7.4   | 0.8   | 13.9  | 13.5  |
| Net profit                | 12.0  | 0.8   | 13.9  | 13.5  |
| EPS                       | 12.8  | 0.8   | 13.9  | 13.5  |
| <b>Leverage</b>           |       |       |       |       |
| Debt to total capital     | 24.1  | 24.3  | 23.0  | 21.6  |
| Debt to equity            | 102.7 | 97.0  | 89.2  | 81.7  |
| Net debt/(cash) to equity | 62.2  | 52.8  | 49.8  | 47.0  |
| Interest cover (x)        | 4.2   | 4.4   | 5.0   | 5.6   |

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