

TMT

Outperform (Initiate)

Target Price: 5.01HKD

Current Price: 4.13HKD

Projected Growth: **21.32%**
Market Data

Date	Jul.19.2019
Closing Price (HKD)	4.13
Total Shares (Mn)	1,453
Market Cap(HKD/Mn)	6,002
Net Assets (HKD/Mn)	5,047
Total Assets (HKD/Mn)	23,877
BVPS(HKD)	3.5

Source:Wind

Related Report**Overseas Research-**

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0856.HK VSTECs HOLDINGS LIMITED**Giant APAC ICT distributor, cloud computing drives 2019FY growth**

07/24/2019

Key Financial Indicators

FY	2018A	2019E	2020E	2021E
Revenue (100Mn/HKD)	625	732	834	926
YoY (%)	14.56%	17.18%	13.88%	11.11%
Net Profit (100Mn/HKD)	7.4	8.5	10.0	11.4
YoY (%)	3.40%	15.33%	16.96%	14.24%
Gross Margin (%)	4.50%	4.60%	4.65%	4.70%
Net Profit Margin (%)	1.19%	1.17%	1.20%	1.23%
ROE (%)	14.99%	15.93%	16.52%	16.68%
EPS (Cent/HKD)	51.6	58.8	68.8	78.5
OCFPS (HKD)	-0.59	0.27	0.29	0.42

Source: Company Disclosure, Industrial Securities Research Institute

Investment Highlight

- **VSTECs is a top-notch ICT distributor in APAC, and its revenue growth in 2019 will be mainly driven by distributing Alibaba Cloud.** Beginning cloud service business in 2013, the company has built competitive barriers based on its distributor or strategic partnerships with cloud service providers. The company's total revenue reached HK\$62.5 billion in 2018, of which cloud services accounted for 26.1% with an annual growth rate of 54.2%. In Mar 2019, VSTECs became the national distributor of Alibaba Cloud, which Asia's biggest and the world's third-largest cloud service provider by revenue. VSTECs's cloud computing and big data distribution revenue is thus expected to grow 48% to HK\$24 billion in 2019.
- **VSTECs builds competitive barriers with its two-sided effect and a professional engineer team and increases its business scale with rapid expansion in Southeast Asia.** The company's connection to over 240 Fortune Global 500 upstream companies and 48,000 downstream distribution channels creates a distinct two-sided effect, and its engineer team of more than 1000 people further strengthens its competitive barriers. In 2018, VSTECs's revenue in Southeast Asia grew 24.3% yoy to HK\$13.1 billion. The rapid growth in Southeast Asia expands the company's business footprint and enhances its advantage of scale.
- **VSTECs builds its business foundation with distribution and opens up upward potential with related services.** The abundant transaction data enables it to provide supply chain services, including digital logistics and supply chain finance. Leveraging its downstream relationships, the company actively carries out high-margin distribution related services and accumulates transaction data. With a small loan license, the company has promising potential in transaction-data-based supply chain finance and consumer loans. Moreover, its subsidiary VES Supply Chains provides one-stop warehouse logistics to its merchants. The company's expanding distribution related services enhances its supply chain management and improves its revenue growth potential.
- **Investment suggestions:** VSTECs is a top-notch ICT distributor in APAC. We expect its revenue to be HK\$73.2/83.4/92.6 billion and its net profit to be HK\$0.85/1.00/1.14 billion in 2019/20/21. The initial coverage target price is HK\$5.01/share, or PE of 8.5/7.3/6.4 in 2019/20/21 and an expected increase of 21.32%. We give the "Outperform" rating for the initial coverage.
- **Potential risks:** unexpected macroeconomic growth; industry competition intensified; unexpected slow business progress; uncollectible accounts risk
- This English translation of the original Chinese version <伟仕佳杰：亚太区 ICT 分销巨头，2019 发力云计算> issued by Industrial Securities on 2019.7.20. is for information purpose only. In case of a discrepancy, the Chinese original will prevail.



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Report Text

1、VSTECS: Top-Notch APAC ICT Distributor

1.1 A Growing Top-Notch ICT Distributor in APAC

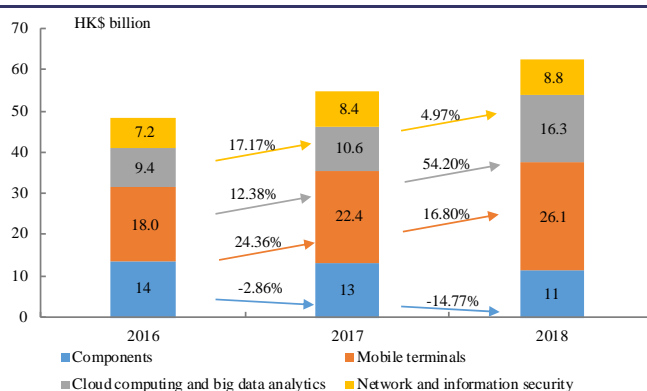
VSTECS is a top-notch ICT (Information, Communication, and Technology) distributor in the APAC region. The company’s main businesses include components, mobile terminals, cloud computing and big data analytics, and network and information security. In 2018, the company’s total revenue increased 14.56% to HK\$62.484 billion, achieving a CAGR of 31% since its listing in 2002. Due to improvements in the distribution portfolio, VSTECS’s overall gross margin increased consecutively from 3.72% in 2015 to 4.50% in 2018. By 2018, the company had established 87 branches in first-tier to fifth-tier cities of 9 countries, and 48 of the branches are in China.

Table 1. VSTECS’s Overall Performance



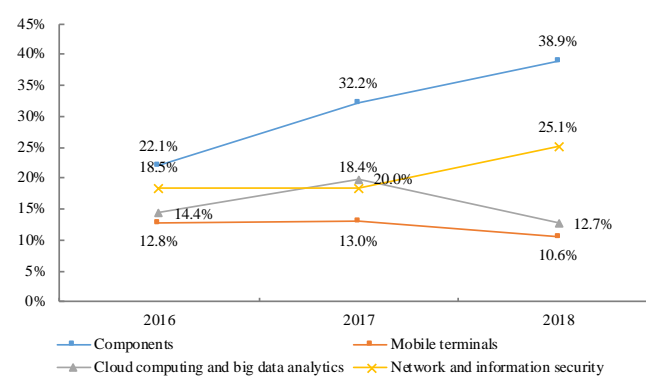
Source: company announcements, Industrial Securities

Chart 1. VSTECS’s revenue segments



Source: the company, Industrial Securities

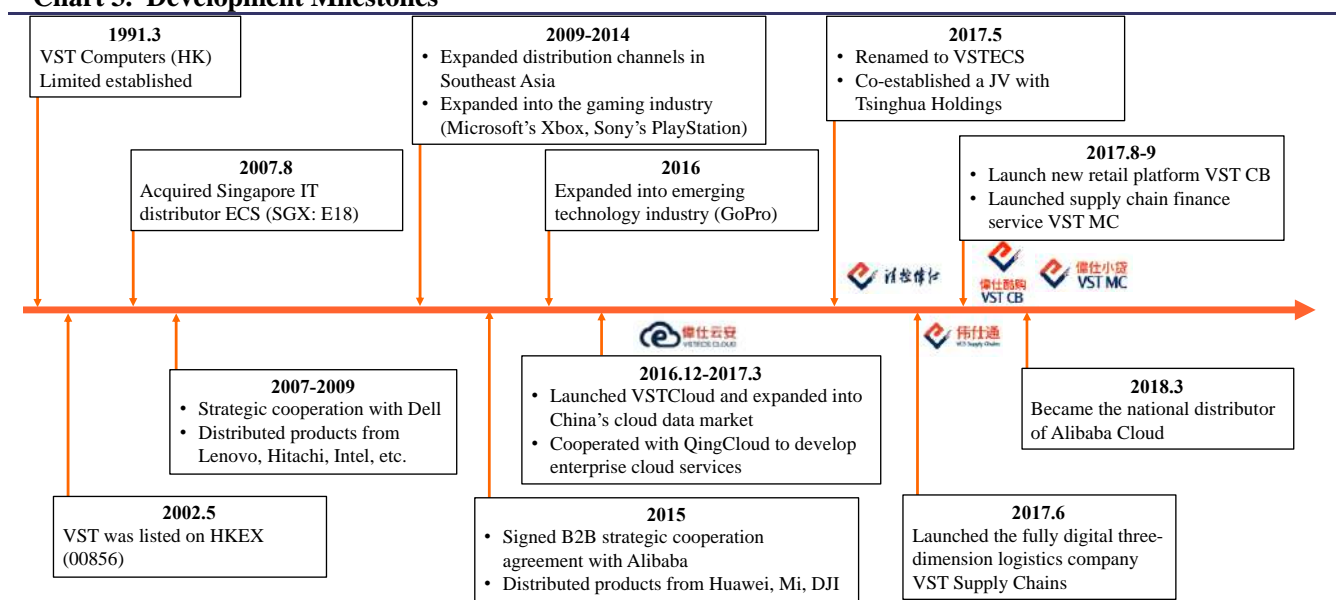
Chart 2. Operating profit ratio of each segment



Source: the company, Industrial Securities

VSTECS has developed from a traditional component distributor to a first-class ICT distributor, driven by its SKU growth and service expansion. The company

was established in 1991 and listed in HKEX in 2002, and it acquired the Singapore IT distributor ECS (SGX: E18) in 2007. Since then, the company has been stably expanding in terms of its product line and operating locations. Backed by its rich upstream and downstream channels, the company has also transformed from traditional distribution to ICT distribution. In 2018, the company's cloud computing and big data analytics segment revenue grew 54.20% to HK\$16.279 billion.

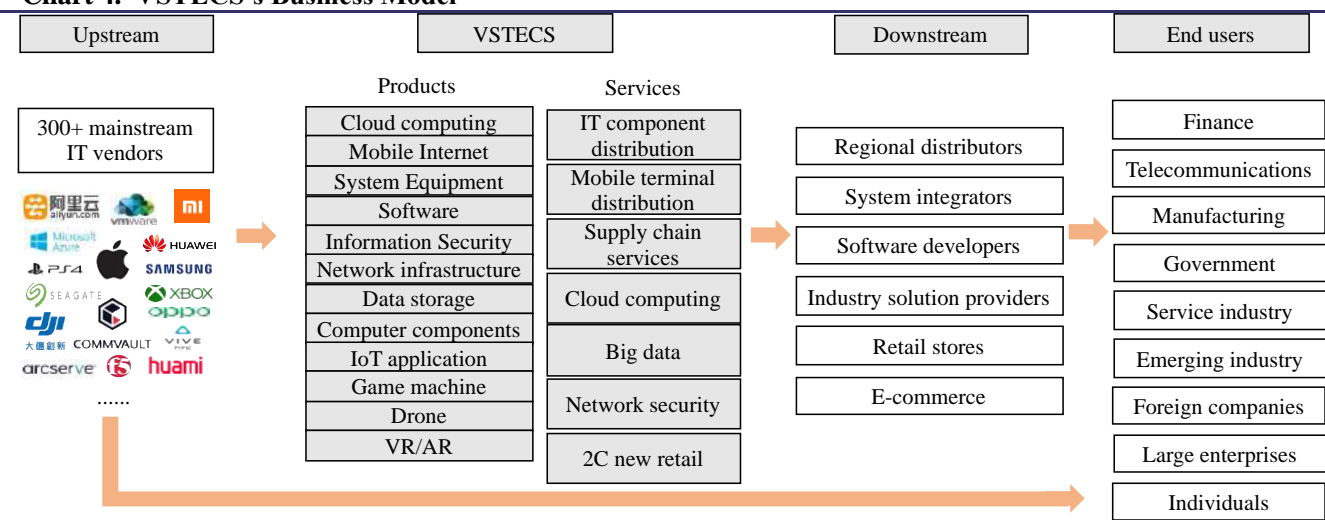
Chart 3. Development Milestones


Source: the company, Industrial Securities

1.2 Business Model: Based on Distribution and Enhanced by Service

As a pivot of its abundant upstream and downstream resources, VSTECS improves the sales efficiency while builds its scale and know-how barriers. The company cooperates with more than 300 mainstream IT vendors upstream, of which more than 240 are Fortune Global 500 companies. The company also has 48,000 channel partners downstream, who cover end users in finance, telecommunications, manufacturing, government, and multiple other fields. With its rich upstream and downstream resources and the abundant know-how experience, VSTECS has accumulated high scale and know-how barriers, which will be further strengthened as VSTECS's revenue grows.

VSTECS empowers its partners with products and services and creates a promising big data ecosystem. VSTECS distributes as many as 12 types of products, including cloud computing, mobile Internet, system equipment, software, information security, etc. Through its 28 years of experience in distribution business, the company has developed a solid foundation to provide distribution-related services. VSTECS has actively carried out distribution-related services to its downstream partners and accumulated a large amount of data. In the future, VSTECS is expected to empower its partners with services and build a higher barrier with its big data ecosystem.

Chart 4. VSTECS's Business Model

Source: the company, Industrial Securities

1.3 Business Analysis: Revenue Mainly Contributed by Mobile Terminals, Profit Mainly Contributed by Components

VSTECS's cloud computing and big data analytics segment grows rapidly while mobile terminal segment expands stably. Through partnerships with top-tier cloud technology companies such as QingCloud and Alibaba Cloud, VSTECS's cloud computing and big data analytics segment expands robustly, growing 12.38%/54.20% in 2017/2018. The mobile terminal segment grew stably at a CAGR of 20.52% in the past three years and took up 41.8% of the company's total revenue in 2018. Because of the IT component industry's downward pressure, VSTECS's component segment has been declining recently. The company is also developing its supply chain business and network safety business. With more revenue coming from services, VSTECS's profit ratio is expected to improve.

Table 1. Segmental Revenue Share, Operating Profit Share, and Revenue CAGR

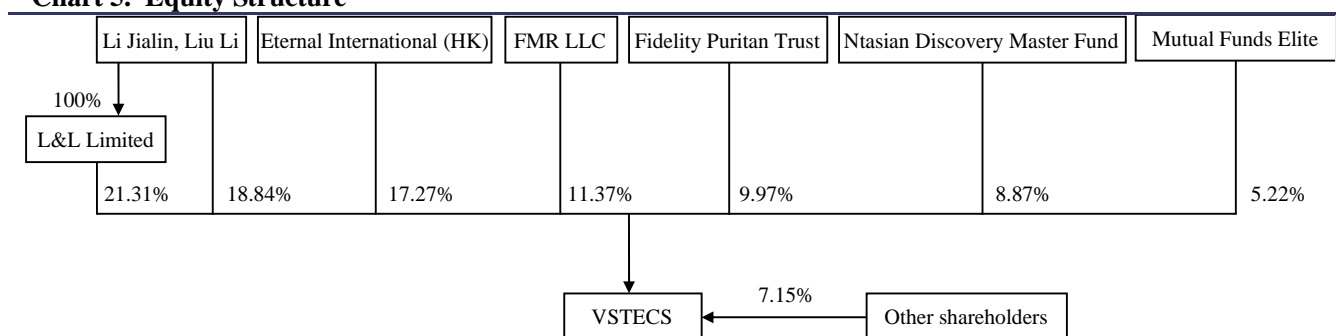
Business Segments	Revenue/OP Share	2016-2018 CAGR
Components		
<ul style="list-style-type: none"> IT components (CPUs, hard disks) Supply chain business 	18.1% / 38.4%	-9.01%
Mobile terminals		
<ul style="list-style-type: none"> IT complete machine (PCs, mobile phones, drones, smart watches, 3D printers, game machines, etc.) 	41.8% / 24.2%	20.52%
Cloud computing and big data analytics		
<ul style="list-style-type: none"> System tools (middleware, operating system, Unix/NT servers, databases, and storage) IT infrastructure design and execution, training, maintenance and support services 	26.1% / 18.0%	31.64%
Network and information security		
<ul style="list-style-type: none"> Network hardware and software required by big data and cloud computing 	14.1% / 19.3%	10.90%

Source: the company, Industrial Securities

1.4 Equity Structure and Management Team

VSTECS's CEO, Li Jialin, and his wife, Liu Li, are the actual controllers of the company, and Li Jialin is also one of the founders of VST Computer. In terms of the equity structure, CEO Li Jialin and his wife Liu Li hold a total of 40.15% of the company's shares, and the A-share listed company Eternal Asia indirectly holds 17.27%. In terms of the management team, the company's senior management staff have high education and abundant experience in the IT industry. An efficient management team lays the foundation for the company's long-term development.

Chart 5. Equity Structure



Source: the company, TianYanCha, Industrial Securities

Table 2. Management Team

Name	Position	Profile
Li Jialin	One of the founders, Chairperson, CEO	A bachelor's degree in engineering from THU in 1983, and a master's degree in management engineering in 1986 He co-founded VST Computer in Hong Kong in 1991 and is currently the chairperson of VSTECS
Zhou Yibing	Vice-Chairperson	A bachelor's degree in precision machinery and precision instrument from USTC in 1985, a master's degree in fluid mechanics in 1989 He has accumulated more than 20 years of experience in IT company management and industry strategy. He was a senior management staff of Lenovo Group and Digital China group and is the ED of ITSS China. He became VSTECS's vice-chairperson in 2018.
Wang Weixin	CFO	A bachelor's degree in economics from UCL and a master's degree in ADMIS from LSE. A senior member of ICAEW and HKICPA.
Zou Yingzi	COO	A BA(Hons) International Business from University of Huddersfield. She has been working in the group since 1996 and was initially responsible for business development in east and north China. She was appointed COO in 2002.

Source: the company, Industrial Securities

2. Growth Driven by Cooperation with Global Leaders and Cloud Services

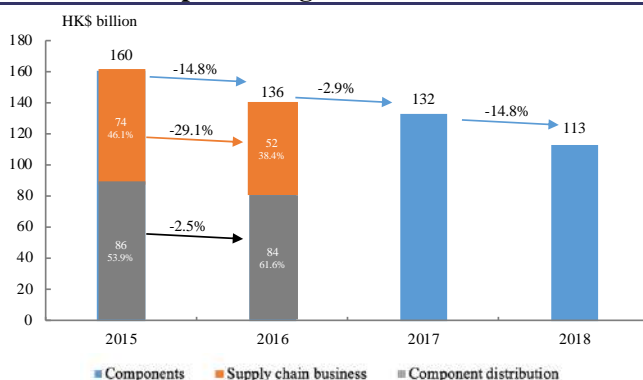
2.1 Component Distribution: Transforming to ICT Distribution and Supply Chain Business

VSTECS's component segment include the IT component distribution subsegment and the supply chain subsegment. The IT component distribution subsegment is mildly declining due to the industry downturn, and the supply chain business is still in the development stage.

2.1.1 Started with Component Distribution and Transformed to ICT Distribution

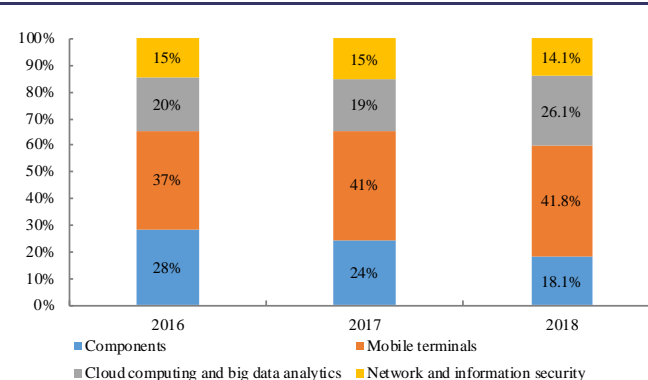
VSTECs started out as an IT component distributor. Before acquiring ECS Holdings, VST Holdings had been the agent for well-known vendors including Seagate, AMD, Supermicro, Maxtor, Lexar, Corsair, WD, AsRock, and Patriot. After acquiring ECS Holdings in 2007, the company became one of the Top 3 distributors in APAC. Between 2007 and 2009, the company became a strategic partner of Dell and a distributor of Lenovo, Hitachi, and Intel.

As the sales model in IT distributor industry changes and the demand for new businesses such as cloud computing erupts, VSTECs has stably transformed from traditional distribution to ICT distribution. Its revenue from the component segment declined at a CAGR of -9.01% from 2015 to 2018. The revenue from the IT component distribution subsegment declined 29.1% in 2015, while the revenue from the new cloud computing segment increased more than 50% in 2018.

Chart 6. Component Segment Revenue

Source: the company, Industrial Securities

Note: the company re-arranged business segments in 2017

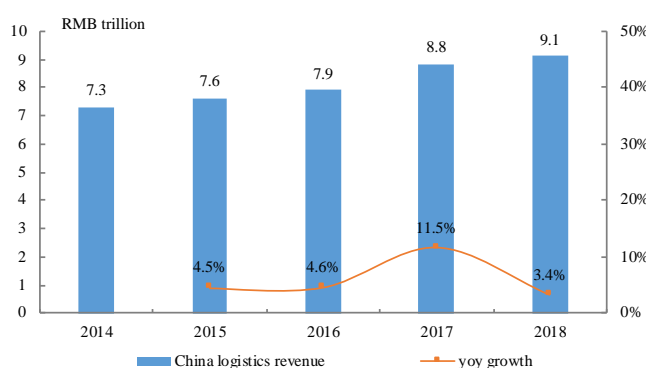
Chart 7. Main Business Revenue Share

Source: the company, Industrial Securities

2.1.2 Supply Chain Business: Developing Digital Logistics and Supply Chain Finance in a Hundred-Trillion Market

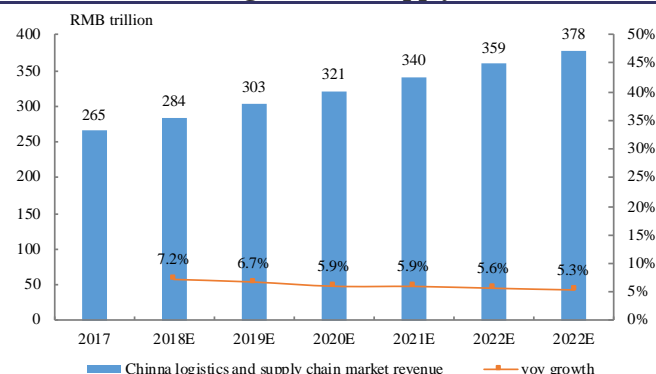
Revenue from China's logistics and supply chain service market has reached RMB303 trillion and is expected to grow stably in the next five years. According to Qianzhan, more than 90% of foreign-invested companies and a growing number of domestic companies in China have supply chain outsourcing needs in 2018. China's logistics and supply chain market is expected to grow at a CAGR of 7.36% to RMB378 trillion in 2023.

Chart 8. China logistics market revenue 2014-2018



Source: Qianzhan, Industrial Securities

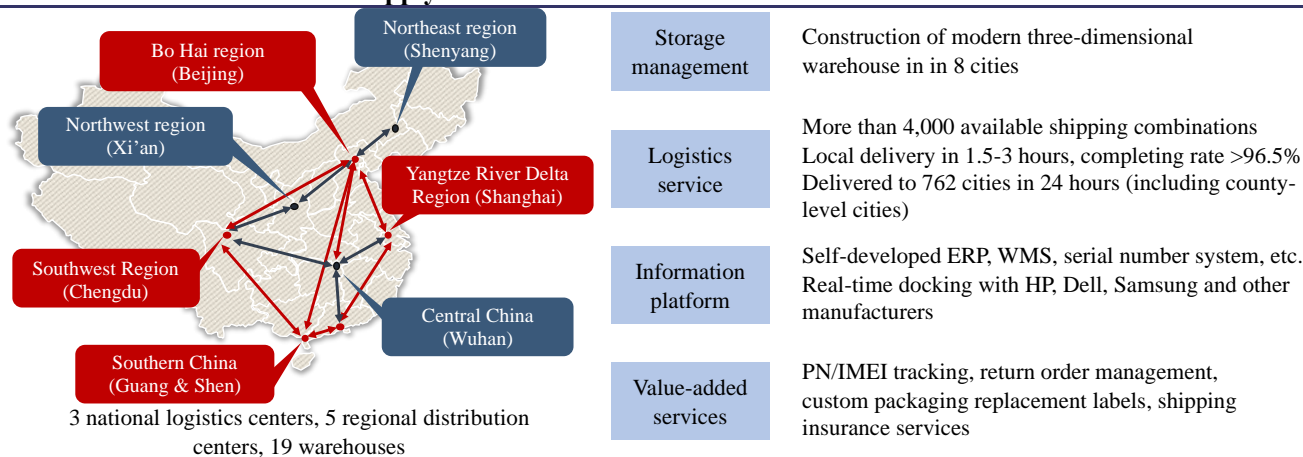
Chart 9. China logistics and supply chain forecast



Source: Qianzhan, Industrial Securities

With high-quality upstream and downstream resources, VSTECS developed both logistics and supply chain finance and established Chongqing VES Supply Chains in 2017. VES Supply Chains mainly provides more than 200 IT vendors with one-stop warehouse logistics services. This subsidiary independently develops enterprises and logistics management systems including ERP, WMS, TMS, BPS, and serial number systems. It also achieves system docking and real-time data transmission with vendors including HP, Dell, and Samsung, which enables efficient digital three-dimensional logistics services.

Chart 10. Overview of VES Supply Chain's Business

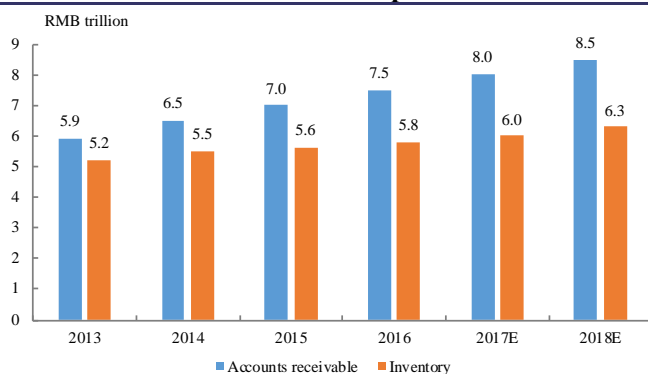


Source: the company, Industrial Securities

The company deepens its presence in supply chain finance service and improve the management of upstream and downstream resources through VST MC. Through this subsidiary, VSTECS holds a small loan license that makes the company's future development in supply chain finance expectable. The issuance of new small loan licenses is temporarily suspended after the Notice on the Immediate Suspension of the Granting of Online Small Loan Companies in 2017. According to an incomplete statistic, there are currently over 200 institutions holding small loan licenses. The demand for supply chain finance is driven up by industrial companies' increasing account receivable and inventories, and the supply for supply chain finance is limited

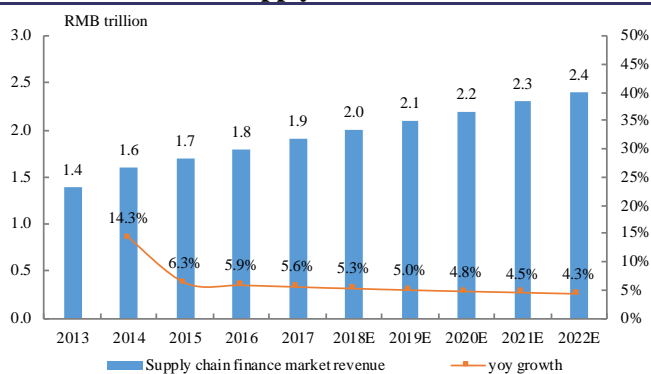
by the number of small loan licenses. We expect VSTECS to effectively leverage on its upstream and downstream resources to develop 2B finance services.

Chart 11. SME Industrial Companies' Current Asset



Source: Qianzhan, Industrial Securities

Chart 12. China Supply Chain Finance Market



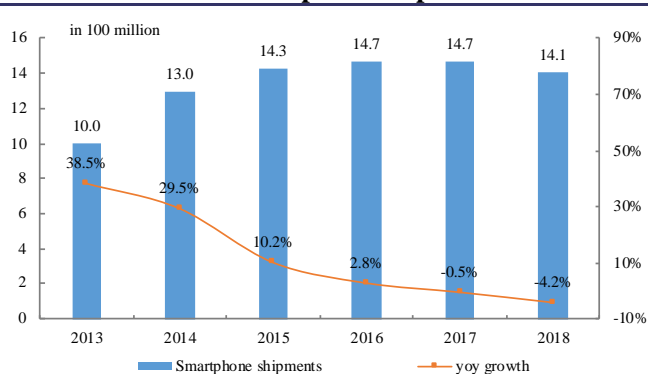
Source: Qianzhan, Industrial Securities

2.2 Mobile Terminal: Distribution of Emerging Technology Product and Expansion in Southeast Asia

2.1.1 Mobile Terminal: Smartphones and PCs under Pressure, Emerging Technology Products Drives Industry Growth

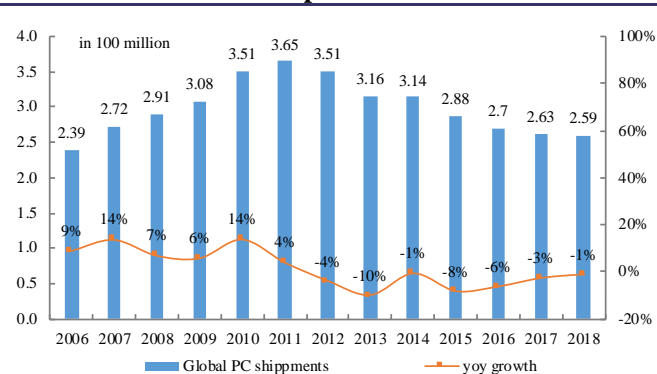
While the traditional mobile terminal distribution business is pressured by smartphones and PC shipment's downturn, distribution of emerging technology products opens up growth opportunities for VSTECS. With the demographic dividend era ending, the global smartphone market is almost saturated and becomes mainly driven by product upgrading. The global PC market declined less than the global smartphone market, but the shipments in China's PC market declined faster at 2.2% to 52.1 million. The main reasons for declination include: 1. Arise of alternative smart terminals, such as iPad. 2. Decline in consumers' disposable income and leisure time. 3. Decline in PC's attractiveness. Amongst the industry downturn, VSTECS faces pressure in smartphone and PC distribution but also takes up new growth opportunities brought by emerging technology products.

Chart 13. Global Smartphone shipments 2013-2018



Source: iResearch, Industrial Securities

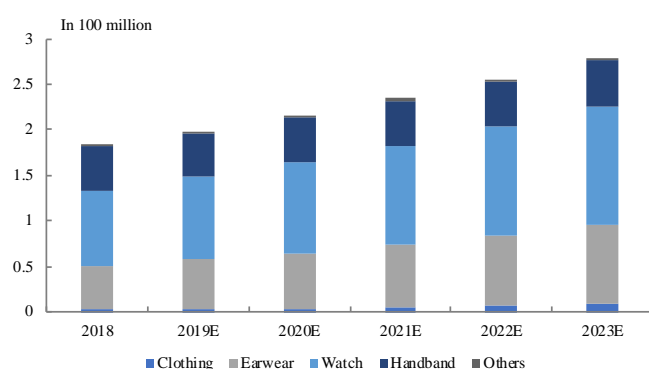
Chart 14. Global PC shipments 2012-2018



Source: Statista, Industrial Securities

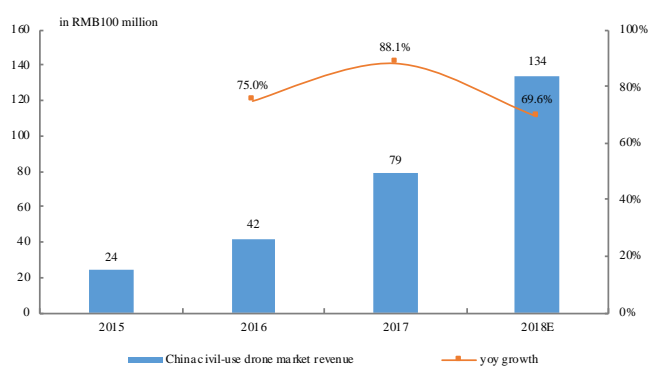
Distributing emerging technology products expands VSTECS's distribution SKU. The emerging technology mobile terminal market is growing rapidly, and smart watches performs especially well among wearable devices. Opposite to traditional mobile terminal, emerging technology products such as wearables and drones are growing rapidly in shipments. According to Gartner, wearables' shipments will grow at a CAGR of 8.9% from 198.5 million in 2019 to 279 million in 2023. Smart watches makes up the largest part of wearable products and are expected to grow at a CAGR of 9.7% from 900 million in 2019 (45.6% of the whole wearables market) to 1,300 million in 2023 (47.1%). The drone market has also been expanding robustly, growing at a CAGR of 77.4% from 2015 to around RMB13.4 billion 2018. The development of emerging technology mobile terminals brings new growth momentum to VSTECS's mobile terminal segment.

Chart 15. Smart wearable devices shipment forecast



Source: IDC, Industrial Securities

Chart 16. China civil-use drone market revenue



Source: ASKCI, Industrial Securities

2.2.2 Active Expansion to Emerging Technology Products and Stable Performance in Traditional Mobile Terminal Market

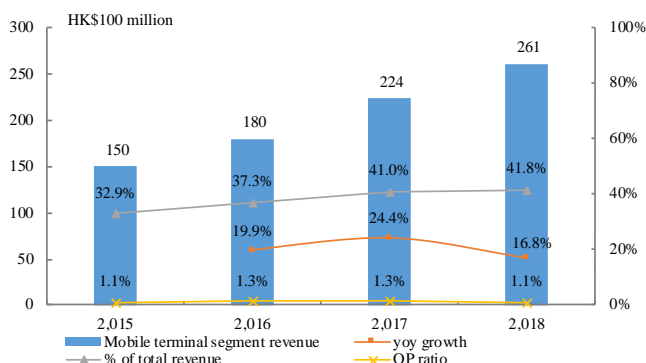
VSTECS cooperates with a large number of well-known vendors and is actively expanding its product line. By the end of 2018, VSTECS had established cooperation with more than 240 Fortune Global 500 companies, including HP, Apple, Lenovo, and Dell. The Company also leverages the mobile terminal industry's transition from PCs and smartphones to emerging technology products. VSTECS expanded into the gaming industry in 2014 (became the distributor of Microsoft's Xbox and Sony's PlayStation) and into the consumer electronics industry in 2015 (became the sole distributor of Huawei's wearables and DJI's photographed drones in China and Mi's MiPad in Southeast Asia). With rich upstream resources and the comprehensive distribution portfolio, VSTECS's biggest segment, mobile terminals, maintains a relatively fast growth rate and a relatively stable operating ratio.

Chart 17. Some of VSTECs's Upstream Vendors



Source: the company, Industrial Securities

Chart 18. Terminal Mobile Segment Revenue

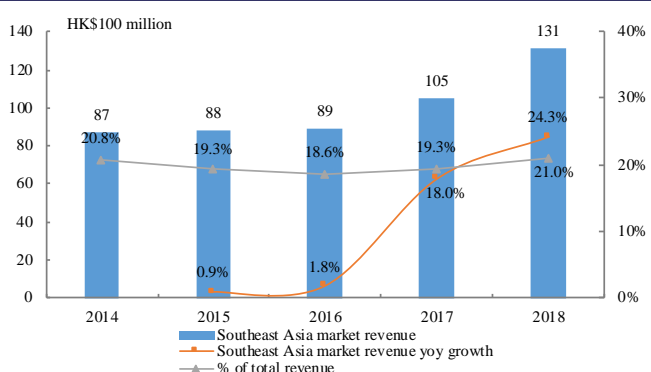


Source: the company, Industrial Securities

VSTECs deepens its presence in Southeast Asia to expand its distribution range.

The cooperation with Chinese IT vendors that want to acquire overseas market drives VSTECs's business in Southeast Asia. As China's vendors carry out their overseas O2O projects, the company's revenue in Southeast Asia grew 18%/21% in 2017/2018. In Oct 2016, the company cooperated with Mi to open Mi's first overseas retail store. After that, VSTECs also cooperates with local retail stores (such as Harvey Norman and Challenger) and Southeast's biggest e-commerce Lazada to provide Mi with exclusive online and offline distribution. Besides, the company also became the distributor of Huawei smart phone in China and Southeast Asia in 2015 and a strategic partner of Huawei to co-develop the Southeast Asia market in 2018. The company expands its business in Southeast Asia and further enhances its advantage of scale.

Chart 19. Geographic Distribution of Revenues



Source: the company, Industrial Securities

Chart 20. Mi's 1st Overseas Store in Singapore



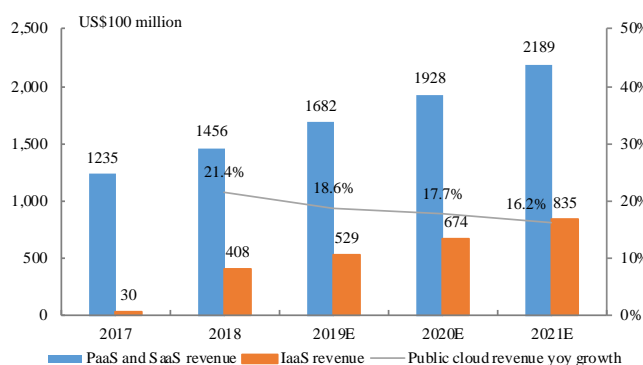
Source: Xueqiu, Industrial Securities

2.3 Cloud Computing and Big Data Analytics: Cooperates with Alibaba Cloud to Explore the New Market

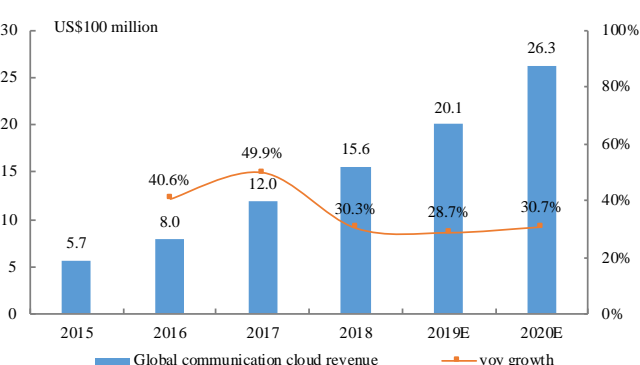
2.3.1 Cloud Computing: a Fast-growing RMB100 billion-level Market with Irreversible Expanding Trend

The cloud service market has exceeded RMB100 billion and is expanding rapidly.

According to Gartner, the global public cloud service market is expected to reach US\$221.1 billion in 2019, with the IaaS tier achieving the highest annual growth rate of 35.9%. The PaaS tier of global Internet communications cloud market has reached US\$1.56 billion in 2018, with a stable annual growth rate of around 30%.

Chart 21. 2017-2020 Global Public Cloud Market

Source: iResearch, Industrial Securities

Chart 22. PaaS of Global Communication Cloud

Source: iResearch, Industrial Securities

VSTECs has high know-how barrier on the 2B side, showing great value as a distributor. Because the product variety and product cognitive barrier is high in the cloud computing market, distributors play a major role in the sales of cloud computing products. After the professional training, salespeople of cloud computing products have professional knowledge and know-how barrier. Distributors show their value through outsourcing their salespeople and increasing cloud computing vendor's sales efficiency.

Table 3. Example of Cloud Service Salesperson Training

Training Session	Content Example
Current industry situation	How many players are there, and where is our company? Every cloud platform has hundreds of products, but the number of products that worth training for and promoting will not exceed 15. The description of each product should not be more than 200 words. The criteria for whether training is worthwhile for a product is whether it can bring great direct/indirect revenues.
General product knowledge	Use one sentence to explain whether this product replaces an old product or meets a new demand. Whether a salesperson should try hard to close a deal depends on the underlying product's direct profitability. Whether our company is competitive on this product. Which features should be talked about, and which ones should not be directly compared with our competitors.
Image building and value delivery	Training of sales talk. While speaking with client's CEO, talk more about comprehensible general trend. While speaking with client's CTO, talk about using the same budget to do more rather than cutting down budget. While speaking with client's operation-level staff, explain how cloud computing can make IT delivery faster and more stable, reducing their liability and pressure.
Stress competitors	Focus on our company's first-mover advantage. May avoid talking about our competitors' first-mover advantage, or even talk about second-mover advantages.
Successful cases	Use general comparison with the successful cases to build client's confidence.

Source: public information, Industrial Securities

2.3.2 ECSCloud Cooperates with Multiple Cloud Technology Company to Distribute Cloud Services

VSTECs's ECSCloud provides cloud computing, big data, and cloud information

security solutions. The company started to build its presence in the cloud service market in 2013 and started to focus on China's cloud services market in 2016, the latter marked by renaming one of its subsidiaries to "VST Yun'an". VST Yun'an cooperates with a number of leading cloud service providers, including Microsoft (Azure), Amazon (AWS), Vmware, and QingCloud. It also put forward the cloud service aggregation platform ECSCloud, on which users can find solutions such as cost analytics, infrastructure, and application services.

Chart 23. ECSCloud Platform Partners



Source: the company, Industrial Securities

Chart 24. Example of Using ECSCloud Platform



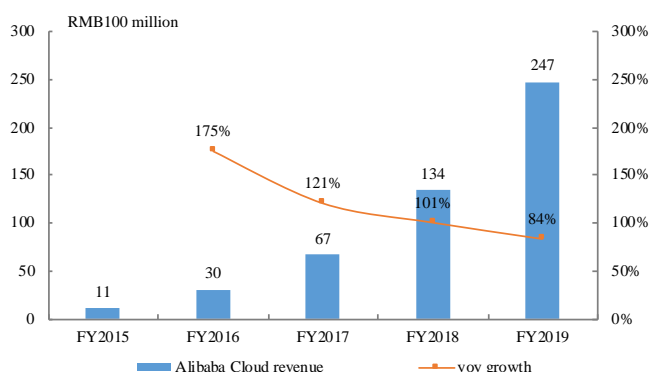
Source: the company, Industrial Securities

VSTECs establishes its industry barriers by building distribution or strategic partnerships with cloud service providers. The company's cloud service and big data analytics segment increased more than 50% in revenue in 2018. In Sep 2018, the company established strategic cooperation with JD Cloud with their business in Southeast Asia. Due to the deep cooperation between the company and cloud service providers and the increasing demand of cloud services, we expect the company's cloud service segment to grow considerably.

2.3.3 Alibaba Cloud: Major Growth Driver of Cloud Computing Segment in 2019

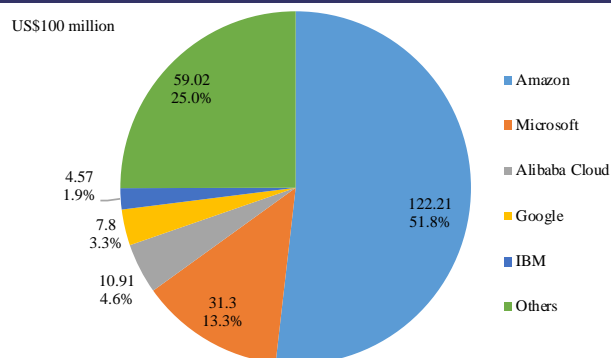
VSTECs became Alibaba Cloud's national distributor on 21 Mar 2019, and the distribution of Alibaba Cloud is expected to be the major driver of the company's growth in 2019. With its advanced technology, Alibaba Cloud ranked the first in Asia and the third globally by revenue in 2017. Alibaba Cloud's revenue grew 101%/84% in FY2018/FY2019 and reached RMB24.7 billion in Mar 2019, while its loss ratio narrowing to 5%. Compared with Amazon's AWS and Microsoft's Azure, Alibaba Cloud still lags in revenue and has great potential for improvement. We expect that distributing Alibaba Cloud will be VSTECs's new and major revenue driver in 2019 and the cloud computing and data analytics segment will increase 50% in revenue.

Chart 25. Alibaba Cloud’s Revenue Rapidly Rises



Source: Alibaba, Industrial Securities

Chart 26. Alibaba Cloud 2017 Revenue Ranked 3rd



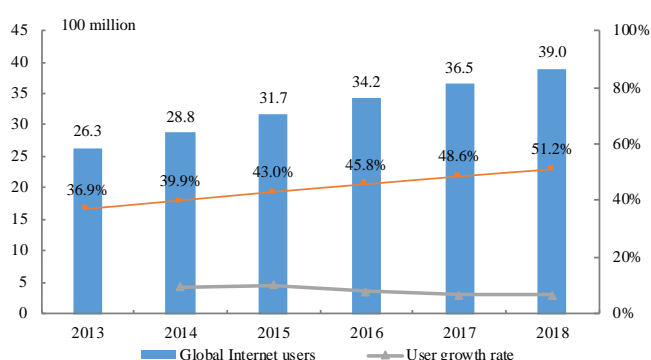
Source: Gartner, Industrial Securities

2.4 Network and Information Security

2.4.1 Industry: Rapid Growth Driven by High Demand for Network Security

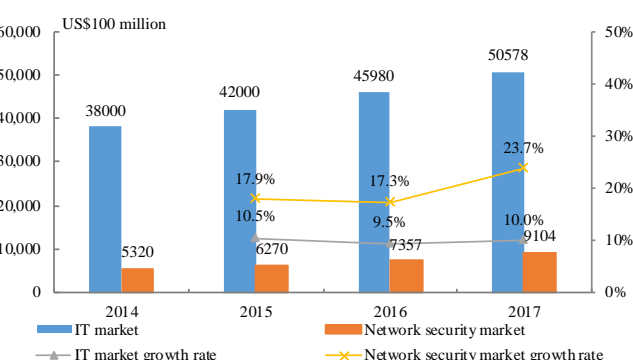
As Internet matures, the increasing awareness of Internet security becomes the main driver of the network security market. With the end of Internet demographic dividend, the Internet industry stopped brutal expansion and began to stabilize. Due to the increasing awareness of network security in recent years, the network security market is not expected to be limited by the end of Internet demographic dividend era. According to CCID Consulting, the global network security market’s scale was around US\$126.98 billion in 2018, of which China’s market accounted for US\$29.52 billion. China’s network security market is expected to grow faster than the global market to exceed US\$92.68 billion in 2021.

Chart 27. Global Network Security Market



Source: CCID Consulting, Industrial Securities

Chart 28. China’s Network Security Market



Source: CCID Consulting, Industrial Securities

2.4.2 VSTECS Cooperates with Leading Network Security Solution Providers

VSTECS’s deep connection with upstream IT service providers secured the company’s position in this industry. The company has strategic cooperation with the leading surveillance product and technology provider, Hikvision, and is also the sole distributor of 360’s enterprise products in China. VSTECS also cooperates with a

number of other network security providers to distribute security hardware and software required in big data and cloud computing, including Kaspersky, Cyberinc, Aerohive, and Mellanox. The company's network and information security revenue grew 5% to RMB8.802 billion in 2018, making up 14.1% of its total revenue.

VSTECS actively expands its network security business overseas and succeeds in the development in Southeast Asia. In 2012, the company used YITU's solutions to provide Singapore Police with high-precision facial recognition technology, increasing CCTV cameras' ability to detect criminal activities. The company also carried out the Bank Rakyat private cloud automation program in Malaysia with solutions from VMware Cloud Automation and NSX, which enables automotive application, deployment, and management of network security services in different environment and different application structures.

3. Competitors: Digital China, CHBM E-Link, HNA Technology, and Synnex

3.1 VSTECS is a Top-Notch APAC ICT Distributor

Digital China: China's largest ICT distributor by revenue, focusing on consumer electronics distribution and enterprise value-added services. DC Holdings, which was spun off from the former Lenovo Group, was independently listed in Hong Kong in 2001 (HK: 0861). DC Holdings spun off its IT distribution business in Aug 2015, which was back-door listed on A-shares through Shenxin Taifeng and was renamed Digital China. Digital China's total revenue reached RMB80.757 billion in 2018. Its main business included consumer electronics distribution (66.5% of total revenue) and enterprise value-added services (32.1%), and its cloud service reached RMB581 million with an annual growth of 187.4%.

CNBM E-Link: an important distributor of Huawei with little participation in cloud service distribution. China National Building Material E-Link Company Limited (CNBM E-Link) was established in Apr 2005, and its parent company is CNBM's subsidiary, China National Building Materials & Equipment Import & Export Corporation. CNBM E-link's enterprise ICT hardware and software products and services revenue reached RMB9.445 billion, accounting for 89.8% of total revenue. Huawei is an important upstream vendor of CNBM E-link, as CNBM E-Link signed a distribution agent agreement with Huawei in 2009 and has been a core distributor of Huawei's enterprise products for nine consecutive years. In 2017, CNBM E-Link became Huawei's first distributor with over 10 billion orders. CNBM E-Link's revenue from its cloud and digital services segment reached RMB479 million in 2018, accounting for only 3.7% of its total revenue.

HNA Technology: transforming to a technology company through acquisition of the world's largest IT distributor Ingram Micro; HNA Cloud Marketplace 2.0 yet to break-even. Founded in 1979 in California, Ingram Micro is an international IT

distributor operating in 52 countries and was acquired in 2015 by HNA Technology (formerly known as Tianhai Investment) of HNA Group. HNA Technology has since transformed into a technology company and reached RMB355.499 billion in revenue in 2018. It mainly operates in North America (40.1% of total revenue), Europe (29.0%), and APAC, Middle East, and Africa (25.1%). In Aug 2017, HNA Technology launched the “HNA Cloud Marketplace 2.0” program based on Ingram Micro’s Cloud Marketplace. By the end of 2018, the platform had listed more than 160 cloud service products from 66 vendors but had not yet achieved break-even. The revenue from HNA Cloud Marketplace has not been disclosed.

Synnex: APAC’s largest IT distributor by revenue, focusing on 3C and electronic component distribution. Synnex Technology International Corporation (Synnex) was established in 1998 and listed in Taiwan in 1995. Ranked by revenue in 2018, it was APAC’s largest and the world’s second largest IT distributor. Synnex’s revenue reached RMB86.196 million in 2018, of which 74.2% came from 3C products, 25.6% came from electronic components, and 0.1% came from maintenance services and others. In terms of geographical distribution. Around 80% of Synnex’s revenue comes from Taiwan, Mainland China, and Hong Kong.

3.2 Abundant Upstream and Downstream Resources and Advantageous Development in Southeast Asia

VSTECS has widespread downstream channels in APAC and fast-developing business in Southeast Asia. In terms of upstream vendors, CNBM E-Link mainly cooperates with Huawei, SAP, and Microsoft, while VSTECS and the three other competitors all cooperates with a large number of mainstream IT vendors. In terms of downstream channels, VSTECS has over 48,000 channel partners, exceeding its competitors which have disclosed this data. In terms of geographical distribution, VSTECS mainly operates in North and Southeast Asia. Its revenue in Southeast Asia grew 24% in 2018, twice the average industry growth rate.

Table 4. Operational Metric Comparison

	VSTECS	CNBM E-Link	Digital China	HNA Technology	Synnex
Upstream vendors	300+ mainstream partners, 240+ from 500 Fortune Global	Mainly: Huawei, SAP, Microsoft	300+ vendors	130+ well-known brands 1800+ vendors	300 leading brands
Downstream channels	48,000+ channels	8,000+ core channels	30,000+ channels	Not available	Not available
Staff	4000+ staffs in APAC	600+ value-added distribution staff (engineers > 60%) 938 staffs	1,100+ technical staffs 5,000+ staffs	32,000+ global staffs ~1000 Chinese staffs	5,796 global staffs 5,472 full-time staffs
Geographical distribution	North Asia 79% Southeast Asia 21%	Not available	Domestic 94% Overseas 6%	North America 40% Europe 29% APAC, Middle East, Africa 25% Latin America 6%	Taiwan 14% HK/Mainland China 67% New Zealand, Australia, Indonesia 18%

Source: the companies’ financial reports and public websites, Industrial Securities

3.3 Leading Level of ROE and Cloud Computing Service Revenue

VSTECS has low inventory turnover days, high cloud computing business revenue, and relatively high net profit ratio. VSTECS's lower than average inventory turnover days reflects an excellent operating efficiency and a relatively low inventory impairment risk. Its account receivable days and account payable days are slightly higher than the average level in this industry. In terms of scale, HNA Technology has the largest annual revenue of RMB335.5 billion, followed by Synnex and Digital China with revenues of over RMB80 billion. Although VSTECS's revenue is lower than the former three companies, its revenue from the cloud computing distribution is significantly higher than all competitors (except for HNA Technology, which has not disclosed the revenue from cloud services). VSTECS's net profit ratio is higher than the industry average, reflecting the improvement of the product portfolio and a higher bargaining power.

Table 5. Financial Comparison in 2018

	VSTECS	CNBM E-Link	Digital China	HNA Technology	Synnex
Stock ticker	0856.HK	834082.OC	000034.SZ	600751.SH	2347.TW
Inventory turnover days	31.27	41.87	30.39	33.77	37.62
AR turnover days	66.58	125.88	40.01	55.08	53.53
AP turnover days	53.56	12.86	25.72	59.34	33.94
Revenue (RMB100 million)	548.74	130.40	818.58	3354.99	861.96
Cloud service segment revenue (RMB100 million)	142.97	4.79	5.81	Not available	-
Net profit ratio	1.19%	1.66%	0.63%	0.06%	1.62%
Gross profit ratio	4.50%	8.58%	3.93%	6.43%	3.78%
Sales expense ratio	1.74%	2.34%	2.00%	1.14%	1.52%
Management expense ratio	0.95%	0.72%	0.32%	3.91%	0.63%
Finance expense ratio	0.37%	2.74%	0.59%	0.77%	0.02%
ROE	15.0%	15.0%	1.7%	0.45%	12.7%

Source: Wind, Bloomberg, Industrial Securities

Note: 1 HK\$ = 0.8782 RMB, 1TWD = 0.2249 RMB

4. Forecast and Valuation

4.1 Forecast Results

Table 6. Forecast of Each Business Segment

In million HK\$	2016	2017	2018	2019E	2020E	2021E
Components	13,632	13,243	11,287	9,933	9,138	8,590
yoy	-15%	-3%	-15%	-12%	-8%	-6%
Mobile terminals	17,978	22,357	26,114	29,509	32,459	35,381
yoy	20%	24%	17%	13%	10%	9%
Cloud computing and big data Analytics	9,394	10,558	16,279	24,094	31,322	37,586
yoy		12%	54%	48%	30%	20%
Network and information security	7,157	8,385	8,802	9,682	10,457	11,084
yoy		17%	5%	10%	8%	6%

Source: the company, Industrial Securities

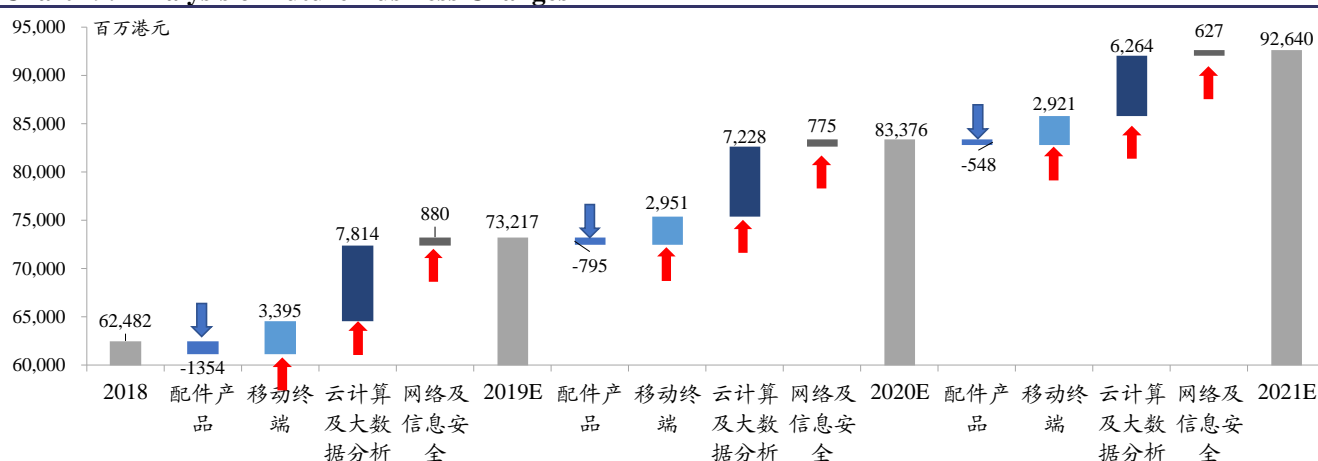
Forecast: we expect the company's total revenue to reach HK\$72.06 billion in 2019, with revenue from component segment reaching HK\$9.93 billion, mobile terminal

segment reaching HK\$30.03billion, cloud computing and big data [analytics] segment reaching HK\$24.42 billion, and network and information [safety] reaching HK\$9.68 billion. The expense ratios are expected to be relatively stable, and the operating profit is expected to reach HK\$1.42 billion in 2019.

Table 7. Forecast Results

In million HK\$	2016	2017	2018	2019E	2020E	2021E
Revenue	48,161	54,543	62,482	73,217	83,376	92,640
YoY	5.7%	13.3%	14.6%	17.2%	13.9%	11.1%
Gross Profit	1,857	2,347	2,810	3,366	3,875	4,352
Gross Profit Ratio	3.9%	4.3%	4.5%	4.6%	4.6%	4.7%
Sales and Distribution Expense	732	849	1,087	1,318	1,501	1,668
S&D Expense Ratio	1.5%	1.6%	1.7%	1.8%	1.8%	1.8%
Administration Expense	334	434	593	732	834	926
Administration Expense Ratio	0.7%	0.8%	0.9%	1.0%	1.0%	1.0%
Operating Profit	800	1,082	1,143	1,330	1,554	1,772
Operating Profit Ratio	1.7%	2.0%	1.8%	1.8%	1.9%	1.9%
Net Profit	552	716	741	854	999	1,142
Net Profit Ratio	1.1%	1.3%	1.2%	1.2%	1.2%	1.2%

Source: the company, Industrial Securities

Chart 29. Analysis of Future Business Changes

Source: the company, Industrial Securities

4.2 DCF Valuation: Initial Coverage Target Price: HK\$5.01/Share

We used the DCF valuation model to value VSTECS at HK\$5.02/share. The first stage FCFFs are calculated with cash flow information, the second stage FCFFs are calculated with a given annual growth rate, and the third stage FCFFs are expected to grow 2% annually. A WACC of 10% is used. According to calculations, VSTECS's FCFFs are discounted to HK\$5.01/share.

Table 8. VSTECS's FCFF Calculation (First Stage)

(In thousand HK\$)	2018	2019E	2020E	2021E	2022E	2023E
Revenue	62,481,961	73,216,631	83,375,519	92,640,316	102,915,955	114,970,129
EBIT	1,143,276	1,329,762	1,554,079	1,771,587	2,069,506	2,425,286
	<i>EBIT/Revenue</i>	1.83%	1.82%	1.86%	1.91%	2.01%
	+ <i>D&A</i>	35,253	35,253	35,253	35,253	35,253
EBITDA	1,178,529	1,365,015	1,589,332	1,806,840	2,104,759	2,460,539

	<i>EBITDA/Revenue</i>	1.89%	1.86%	1.91%	1.95%	2.05%	2.14%
-	Increase in WC	1,767,796	721,397	882,211	869,405	840,679	802,304
-	Capex	40,277	40,277	40,277	40,277	40,277	40,277
-	Tax expense	206,172	237,780	278,106	317,700	373,952	441,312
FCFF		-835,716	365,561	388,737	579,459	849,851	1,176,646

Source: the company, Industrial Securities

Table 9. VSTECS's FCFF Calculation (Second Stage)

Second Stage	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E	2031E	2032E	2033E
FCFF	951,833	1,056,534	1,162,188	1,266,785	1,368,127	1,463,896	1,551,730	1,613,799	1,662,213	1,712,080	1,746,321
yoy	12.00%	11.00%	10.00%	9.00%	8.00%	7.00%	6.00%	4.00%	3.00%	3.00%	2.00%

Source: Industrial Securities

Table 10. Result of VSTECS's DCF Valuation

FCFF Valuation	Discounted value (RMB1000)	% of value
First stage	1,836,356	13.42%
Second stage	6,520,609	47.64%
Third stage (terminal value)	5,330,207	38.94%
Enterprise value AEV	13,687,172	100.00%
- Minority interests		0.00%
- Net debt	6,405,364	46.80%
Value of equity	7,281,808	53.20%
Number of shares (in thousands)	1,453,342	
Value per share (HK\$)	5.01	

Source: Industrial Securities

Table 11. Sensitivity Test of VSTECS's DCF Valuation

WACC	Stable growth rate (g)								
	0.0%	0.5%	1.0%	1.5%	2.0%	2.5%	3.0%	3.5%	4.0%
7.50%	7.81	8.23	8.71	9.27	9.93	10.72	11.69	12.91	14.47
8.00%	6.90	7.24	7.63	8.08	8.61	9.23	9.97	10.88	12.01
8.50%	6.10	6.39	6.70	7.07	7.49	7.98	8.56	9.26	10.11
9.00%	5.40	5.64	5.90	6.20	6.54	6.94	7.40	7.94	8.60
9.50%	4.78	4.97	5.19	5.44	5.72	6.04	6.41	6.85	7.36
10.00%	4.22	4.39	4.57	4.78	5.01	5.27	5.58	5.92	6.33
10.50%	3.72	3.86	4.02	4.19	4.39	4.60	4.85	5.13	5.46
11.00%	3.27	3.39	3.52	3.67	3.83	4.01	4.22	4.45	4.72
11.50%	2.86	2.96	3.08	3.20	3.34	3.49	3.66	3.86	4.08
12.00%	2.49	2.58	2.68	2.78	2.90	3.03	3.17	3.33	3.51
12.50%	2.15	2.23	2.31	2.40	2.50	2.61	2.74	2.87	3.02

Source: Industrial Securities

5. Potential Risks

1. Unexpected macroeconomic growth
2. Industry competition intensified
3. Unexpected slow business progress
4. Uncollectible accounts risk

Appendix

Balance Sheet					Income Statement				
HK\$ million					HK\$ million				
FY	2018	2019E	2020E	2021E	FY	2018	2019E	2020E	2021E
Current Assets	22,062	24,707	27,432	30,022	Revenue	62,482	73,217	83,376	92,640
Inventory	6,103	6,398	7,191	7,914	Cost of Sales	-59,672	-69,850	-79,500	-88,288
Account Receivables	14,451	16,933	19,047	20,985	Gross Profit	2,810	3,366	3,875	4,352
Cash and Cash Equivalents	1,508	1,376	1,194	1,123	Other Gains, Net	14	14	14	14
Non-current Asset	1,815	1,858	1,901	1,944	S&D Expenses	-1,087	-1,318	-1,501	-1,668
PP&E	452	451	449	448	Administrative Expenses	-593	-732	-834	-926
Intangible Assets-Goodwill	320	320	320	320	Operating Profit	1,143	1,330	1,554	1,772
Interests in Associates	897	947	997	1,046	Finance Costs	-240	-282	-321	-356
Interests in Joint Venture	36	30	25	19	Share of Associates' Profits	50	50	50	50
Deferred Expenses	3	3	3	3	Share of a JV's Loss	-6	-6	-6	-6
Deferred Tax Assets	108	108	108	108	Profit before Taxation	947	1,092	1,277	1,459
Total Assets	23,877	26,565	29,334	31,966	Taxation	-206	-238	-278	-318
Current Liabilities					Profit for the Year	741	854	999	1,142
Trade and Other Payables	17,341	19,396	21,422	23,213	EPS (HK cents per share)	51.6	58.8	68.8	78.5
Contract Liabilities	10,895	12,951	14,976	16,767	Key Financial Ratio				
Borrowings	6	6	6	6	FY	2018	2019E	2020E	2021E
Taxation Payable	6,326	6,326	6,326	6,326	Growth				
Non-current Liabilities	113	113	113	113	Growth Rate of Revenue	14.6%	17.2%	13.9%	11.1%
Contract Liabilities	1,490	1,490	1,490	1,490	Growth Rate of Gross Profit	19.7%	19.8%	15.1%	12.3%
Deferred Income	4	1,196	1,196	1,196	Profitability				
Borrowings	1,455	1,455	1,455	1,455	Gross Margin Rate	4.5%	4.6%	4.6%	4.7%
Deferred Tax Liabilities	31	31	31	31	Net Profit Margin	1.2%	1.2%	1.2%	1.2%
Total Liabilities	18,831	20,886	22,911	24,703	ROE	15.0%	15.9%	16.5%	16.7%
Total Shareholders' Equity	5,047	5,679	6,422	7,264	ROA	3.3%	3.4%	3.6%	3.7%
Equity Shareholders of the Company	5,047	5,679	6,422	7,264	Solvency				
Minority Interest	0	0	0	0	Net Asset-liability Ratio	373.1%	367.8%	356.8%	340.1%
Total Liabilities and Equity	23,877	26,565	29,334	31,966	Asset-liability Ratio	78.9%	78.6%	78.1%	77.3%
					Current Ratio	1.27	1.27	1.28	1.29
					Quick Ratio	0.09	0.07	0.06	0.05
					Operation Capacity				
					Asset Turnover Ratio	261.7%	275.6%	284.2%	289.8%
					Inventory Turnover Ratio	10.96	12.17	12.17	12.17
					AR Turnover Ratio	5.09	5.09	5.16	5.21
					AP Turnover Ratio	6.16	6.08	5.98	5.93
					Stock Info				
					Revenue per Share (HK\$ cents)	51.6	58.8	68.8	78.5
					Net Asset per Share (HK\$)	3.5	3.9	4.4	5.0
					Valuation Ratio				
					P/E	9.8	8.5	7.3	6.4
					P/S	0.1	0.1	0.1	0.1
					P/B	1.4	1.3	1.1	1.0

Cash Flow Statement

FY	2018	2019E	2020E	2021E
Profit before Tax	947	1,092	1,277	1,459
Interest Expense	240	282	321	356
Depreciation of Fixed Assets	35	35	35	35
Change in Working Capitals	-1,768	-721	-882	-869
Cash Flows from Operating Activities	-852	398	421	611
Cash Flows from Investment Activities	-26	-26	-26	-26
Cash Flows from Financing Activities	662	-504	-577	-656
Net Change in Cash	-215	-132	-182	-71
Beginning Balance of Cash	1,981	1,508	1,376	1,194
Effect of Foreign Exchange Rate Changes	-258	0	0	0
Ending Balance of Cash	1,508	1,376	1,194	1,123

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Industry Investment Rating: When measuring the difference between the markup of the industry index and that of the market's benchmarks (HSI, Hang Seng Index) within twelve months after the release of the report, we define the terms as follows:

- Overweight: Industry performs better than that of the whole market;
- Neutral: Industry performs about the same as that of the whole market;
- Underweight: Industry performs worse than that of the whole market

Company Investment Rating: When measuring the difference between the markup of the company stock price and that of the market's benchmarks (HSI, Hang Seng Index) within twelve months after the release of this report, we define the terms as follows:

- Buy: With a markup more than 15% better than that of the market;
- Outperform: With a markup 5% to 15% better than that of the market;
- Neutral: With a markup less than 5% better or worse than that of the market;
- Underperform: With a markup more than 5% worse than that of the market

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