Singapore Company Guide

Procurri Corporation Limited

Version 2 | Bloomberg: PROC SP | Reuters: PROC.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

23 Feb 2017

HOLD (Downgrade from BUY)

Last Traded Price (22 Feb 2017): S$0.41 (STI : 3,122.20)
Price Target 12-mth: S$0.40 (-1% downside) (Prev S$0.56)

Potential Catalyst: New aquisitions
Where we differ: FY17F EPS below consensus

Analyst
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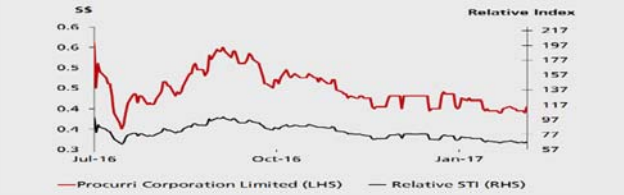
What's New

- **4Q16 net profit of S$2.5m (-48% y-o-y) was below expectations due to higher administrative costs and tax**
- **Expect delays in acquisition contributions to profitability**
- **Downgrade to HOLD with a revised TP of S$0.40**

Price Relative



Forecasts and Valuation

FY Dec (S$ m)	2015A	2016A	2017F	2018F
Revenue	123	136	170	197
EBITDA	13.5	13.7	20.0	24.9
Pre-tax Profit	10.0	7.80	13.5	17.1
Net Profit	8.77	5.32	10.1	13.7
Net Pft (Pre Ex.)	8.77	6.26	10.1	13.7
Net Pft Gth (Pre-ex) (%)	168.7	(28.6)	61.3	35.6
EPS (S cts)	4.43	1.90	3.61	4.89
EPS Pre Ex. (S cts)	4.43	2.24	3.61	4.89
EPS Gth Pre Ex (%)	169	(50)	61	36
Diluted EPS (S cts)	4.43	1.89	3.58	4.86
Net DPS (S cts)	0.0	0.48	0.90	1.22
BV Per Share (S cts)	17.3	24.0	26.7	30.4
PE (X)	9.1	21.3	11.2	8.3
PE Pre Ex. (X)	9.1	18.1	11.2	8.3
P/Cash Flow (X)	16.3	nm	5.3	6.8
EV/EBITDA (X)	7.0	7.4	5.2	4.1
Net Div Yield (%)	0.0	1.2	2.2	3.0
P/Book Value (X)	2.3	1.7	1.5	1.3
Net Debt/Equity (X)	0.4	CASH	CASH	CASH
ROAE (%)	27.5	10.5	14.2	17.1
Earnings Rev (%):			(23)	(13)
Consensus EPS (S cts):		3.20	5.00	5.90
Other Broker Recs:		B: 1	S: 0	H: 0

Source of all data on this page: Company, DBS Bank, Bloomberg Finance L.P

Higher costs and tax impact profitability

Procurri offers 16% earnings CAGR over FY15-18F. Procurri is among the few companies globally that offer both hardware resale and independent maintenance services, also reflected in its healthy gross margins of over 33%. Procurri offers a 16% earnings CAGR over FY15-18F aided by acquisitions. However, the company needs to demonstrate better execution to gain market trust and trade at a superior PE multiple in our view.

Earnings miss due to cost escalations and higher tax. Excluding one-offs, 4Q16 net profit of S$2.5m (-48% y-o-y) was 35% below expectations mainly due to cost escalations. Admin costs increased 49% y-o-y due to higher headcounts in Asia to support expansion plans, coupled with higher listing and amortisation expenses. Overprovision of deferred tax assets in 4Q16 also resulted in the tax bill jumping in the quarter.

Lower FY16 profit base and higher tax rate lead to 23% cut in FY17F earnings. Corporate tax rate is expected to remain high ~25% in the future due to expiry of tax incentives in Singapore. Key growth driver is expected to be ~S$2m earnings contribution in FY17 from recent joint venture with Congruity. Another recent acquisition, EAF may contribute negligible profit in FY17 as the company achieves breakeven in 1Q17. In line with this, we have revised down our profit expectations for FY17/FY18 by 23%/13%.

Valuation:

Downgrade to HOLD with a revised TP of S$0.40 due the lower FY17F EPS. We have pegged Procurri's TP at 11x FY17F PE based on the average PE of comparable companies.

Key Risks to Our View:

Further delay in potential acquisitions as we project these to contribute S$3m profit in FY18F.

At A Glance

Issued Capital (m shrs)	280
Mkt. Cap (Sm/USm)	113 / 80.3
Major Shareholders (%)	
Declout	47.3
Irrucorp Pte Ltd	12.1
Free Float (%)	40.6
3m Avg. Daily Val (US$m)	0.05

ICB Industry : Technology / Software & Computer Services

ed: TH / sa:JC, PY

WHAT'S NEW

Cost escalations hurt profits

Revenue supported by new acquisitions: Revenue of S$41.9m (+28% y-o-y, +32% q-o-q) was in line with our expectations. IT distribution segment revenues saw a bump in 4Q16 largely due to the acquisition of EAF and improvement in the APAC region. In addition, Lifecycle segment revenues saw improvement due to better performance in EMEA and Americas. However, the segment's margins retreated due to increased cost of sales as Procurri looked to improve market share.

Earnings miss due to cost escalations: Net profit of S$2.5m (-48% y-o-y) was below expectations mainly due to the cost escalations. Admin costs increased 49% y-o-y due to higher headcounts in Asia to support Procurri's expansion plans. Cost increases related to the recent listing and higher amortisation of intangibles from previous acquisitions also contributed towards a lower bottom line. Overprovision of deferred tax assets in 4Q16 also resulted in the tax bill jumping in the most recent quarter.

Quarterly / Interim Income Statement (S$m)

FY Dec	4Q2015	3Q2016	4Q2016	% chg yoy	% chg qoq
Revenue	32.8	31.9	41.9	27.9	31.7
Cost of Goods Sold	(19.0)	(20.4)	(28.1)	47.7	37.7
Gross Profit	**13.8**	**11.5**	**13.9**	**0.5**	**20.9**
Other Oper. (Exp)/Inc	(8.8)	(9.3)	(10.1)	15.0	9.3
Operating Profit	**4.97**	**2.18**	**3.71**	**(25.2)**	**70.3**
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	nm	nm
Associates & JV Inc	0.0	0.0	0.0	nm	nm
Net Interest (Exp)/Inc	(0.2)	(0.2)	(0.2)	(13.8)	(11.2)
Exceptional Gain/(Loss)	0.0	(2.2)	0.0	nm	nm
Pre-tax Profit	**4.79**	**(0.2)**	**3.52**	**(26.6)**	**nm**
Tax	0.02	0.0	(1.0)	nm	nm
Minority Interest	0.0	0.0	0.0	nm	nm
Net Profit	**4.81**	**(0.2)**	**2.48**	**(48.4)**	**nm**
Net profit bef Except.	4.81	2.00	2.48	(48.4)	24.0
EBITDA	5.58	3.32	3.71	(33.4)	12.0
Margins (%)					
Gross Margins	42.0	36.0	33.0		
Opg Profit Margins	15.1	6.8	8.9		
Net Profit Margins	14.7	(0.6)	5.9		

Source of all data: Company, DBS Bank

CRITICAL DATA POINTS TO WATCH

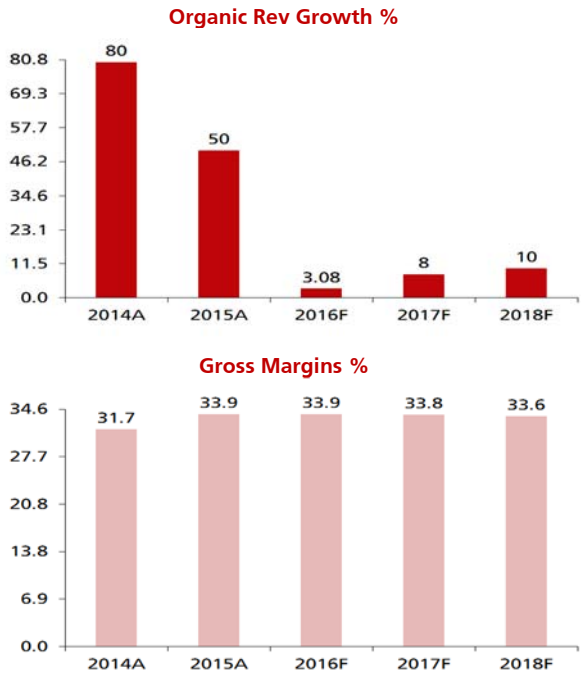
Earnings Drivers:

Operating in high-growth segments. Hardware Resale, Independent IT Maintenance and IT Asset Disposition segments are set to post high growth, according to third-party research firm, Frost & Sullivan. The Hardware Resale segment, a key contributor to Procurri's top line, is set to grow at a CAGR of 16.9% from 2015-2020 to reach US$34.8bn by 2020. Independent IT Maintenance is set to outpace the overall IT maintenance market with a CAGR of 15.7% over the next five years. Currently, the Americas and Europe are the largest markets for all three segments. However, Frost & Sullivan expects Asia-Pacific to grow at the highest rate in the next five years due to higher rate of growth of outsourced data centre industry in countries such as Singapore, Australia, Japan, Indonesia, India and China, and higher adoption of services in Asia-Pacific, which have been experiencing comparatively lower adoption compared to Americas and Europe thus far.

Margin contraction could hurt FY17 profit improvement. With Procurri investing to expand operations in Asia as well as looking to gain market share in the US and European markets, we may see segmental margins taking a hit in the near term. For example, margins in the Lifecycle management segment had declined to below 50% in 4Q16 from 55-80% in FY15 due to Procurri's pursuit of market share. In addition, escalation in the administrative costs also has taken a toll on the bottom line.

Recent investments to lead to a decent growth in FY17. We do not expect significant upside for Procurri's bottom line from the recent investments (post IPO) in EAF group and JV with Congruity. EAF group is expected to have limited profitability in FY17 (reported FY15 net loss of £581,000 (~S$1m) while it achieved breakeven after the acquisition. The JV with Congruity in FY17 may contribute ~S$2m in earnings in our estimate as Procurri has rights to 100% profits from the venture till end-2018 along with an option to buy the remaining equity stake (49%) by end-2018.

Potential acquisitions to aid growth. Even with the S$15.5m investment in the JV in early 2017, the company would have sufficient headroom for new acquisitions, in our view. Procurri is looking to grow its higher-margin Lifecycle services business in US and Europe and the management has been quite keen to acquire more companies (similar to EAF group) to grow its global footprint. As a result, profitable acquisitions and driving their growth could have a significant positive impact on Procurri's bottom line post FY17.



Source: Company, DBS Bank

Balance Sheet:
During its recent IPO, Procurri raised S$34.8m, out of which only S$8.9m had been utilised as at end-FY16. We expect the balance and debt to fund the JV with Congruity in early FY17. However, even with the investment, the company will have a net debt/EBITDA(FY17F) of 0.2x, indicating plenty of room for dividend payout and further investments.

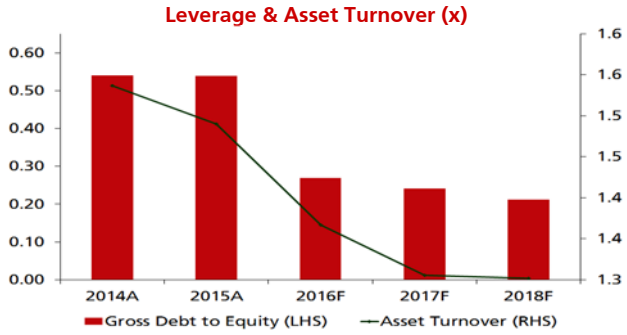
Share Price Drivers:
Rising portion of independent maintenance services. Independent Maintenance services business is not lumpy like Hardware Resale business and also commands much better gross margins. Maintenance services (major part of Lifecycle services segment) comprised 19% of the total revenue in 9M16 and the market may re-rate Procurri as this business increases its contribution further.

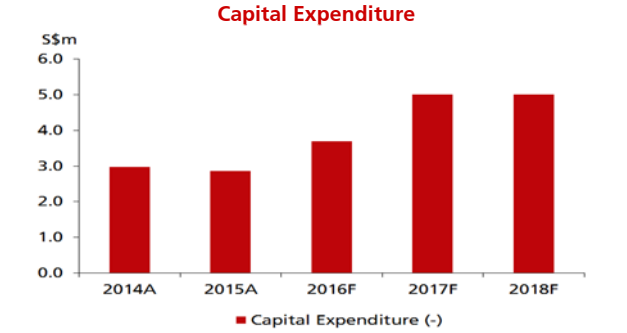
Delayed bottom-line contribution from acquisitions to temper market expectations. Despite the strong growth expected in the medium term, the delayed bottom-line contribution from acquisitions and cost escalations have resulted in lower expectations for near-term profitability. In line with this, we have revised down our profit expectations for FY17/FY18 by 24%/14%. This should have a negative impact on Procurri's share price in the immediate term.

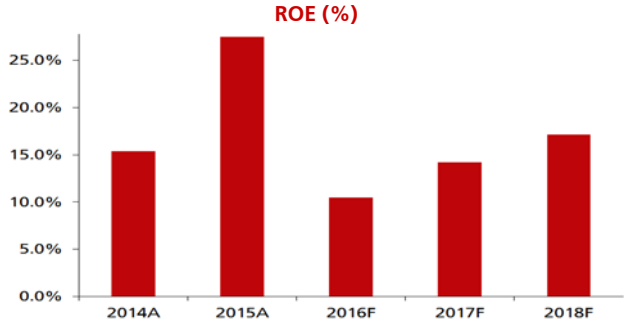
Key Risks:
Fast-changing business environment. Rapid technological changes, evolving industry standards, and new product and service introductions may render Procurri's products and services obsolete.

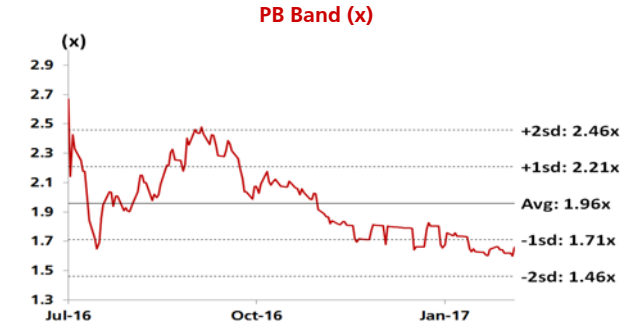
Slower-than-expected improvement in recent acquisitions. We expect recent acquisitions to provide ~S$3m contributions to profitability by end-FY18. If this is not met, it could result in a re-rating of Procurri due to missed expectations.

Company Background
Procurri is a global provider of pre-owned data centre equipment and independent maintenance services.









Source: Company, DBS Bank

Key Assumptions

FY Dec	2014A	2015A	2016F	2017F	2018F
Organic Rev Growth %	80.0	50.0	3.08	8.00	10.0
Gross Margins %	31.7	33.9	33.9	33.8	33.6

Segmental Breakdown

FY Dec	2014A	2015A	2016F	2017F	2018F
Revenues (S$m)					
IT distribution	62.6	99.6	106	136	157
Lifecycle services	14.3	23.3	29.4	33.9	39.3
Total	76.9	123	136	170	197
Operating profit (S$m)					
IT distribution	16.3	27.4	31.5	37.3	42.9
Lifecycle services	8.10	14.2	14.6	20.1	23.1
Total	24.4	41.6	46.0	57.3	66.0
Operating profit Margins					
IT distribution	26.0	27.6	29.6	27.4	27.3
Lifecycle services	56.7	61.0	49.6	59.1	58.8
Total	31.7	33.9	33.9	33.8	33.6

Income Statement (S$m)

FY Dec	2014A	2015A	2016F	2017F	2018F
Revenue	76.9	123	136	170	197
Cost of Goods Sold	(52.5)	(81.2)	(89.7)	(112)	(131)
Gross Profit	24.4	41.6	46.0	57.3	66.0
Other Opng (Exp)/Inc	(20.3)	(31.9)	(38.1)	(44.3)	(49.4)
Operating Profit	4.03	9.69	7.99	13.0	16.7
Other Non Opg (Exp)/Inc	0.97	0.73	1.31	1.00	1.00
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(0.5)	(0.4)	(0.6)	(0.6)	(0.6)
Exceptional Gain/(Loss)	(0.5)	0.0	(0.9)	0.0	0.0
Pre-tax Profit	4.01	10.0	7.80	13.5	17.1
Tax	(0.7)	(1.2)	(2.5)	(3.4)	(3.4)
Minority Interest	(0.5)	0.0	0.0	0.0	0.0
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	2.79	8.77	5.32	10.1	13.7
Net Profit before Except.	3.26	8.77	6.26	10.1	13.7
EBITDA	7.24	13.5	13.7	20.0	24.9
Growth					
Revenue Gth (%)	170.8	59.7	10.5	25.0	15.9
EBITDA Gth (%)	164.2	86.0	2.0	45.6	24.6
Opg Profit Gth (%)	199.4	140.4	(17.5)	63.0	28.0
Net Profit Gth (Pre-ex) (%)	82.5	168.7	(28.6)	61.3	35.6
Margins & Ratio					
Gross Margins (%)	31.7	33.9	33.9	33.8	33.6
Opg Profit Margin (%)	5.2	7.9	5.9	7.7	8.5
Net Profit Margin (%)	3.6	7.1	3.9	6.0	7.0
ROAE (%)	15.4	27.5	10.5	14.2	17.1
ROA (%)	5.6	10.6	5.4	7.8	9.1
ROCE (%)	9.3	16.5	8.1	10.4	13.0
Div Payout Ratio (%)	0.0	0.0	25.0	25.0	25.0
Net Interest Cover (x)	7.9	23.1	14.2	23.1	29.6

Higher admin costs

Margin recovery due to growth

Source: Company, DBS Bank

Quarterly / Interim Income Statement (S$m)

FY Dec	4Q2015	1Q2016	2Q2016	3Q2016	4Q2016
Revenue	32.8	26.0	35.9	31.9	41.9
Cost of Goods Sold	(19.0)	(18.0)	(23.3)	(20.4)	(28.1)
Gross Profit	**13.8**	**8.06**	**12.7**	**11.5**	**13.9**
Other Oper. (Exp)/Inc	(8.8)	(7.5)	(8.0)	(9.3)	(10.1)
Operating Profit	**4.97**	**0.53**	**4.73**	**2.18**	**3.71**
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)
Exceptional Gain/(Loss)	0.0	0.11	(0.6)	(2.2)	0.0
Pre-tax Profit	**4.79**	**0.45**	**4.01**	**(0.2)**	**3.52**
Tax	0.02	(0.4)	(1.1)	0.0	(1.0)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Net Profit	**4.81**	**0.10**	**2.92**	**(0.2)**	**2.48**
Net profit bef Except.	4.81	0.0	3.49	2.00	2.48
EBITDA	5.58	1.59	5.80	3.32	3.71
Growth					
Revenue Gth (%)	(2.3)	(20.6)	38.1	(11.4)	31.7
EBITDA Gth (%)	118.4	(71.5)	265.1	(42.8)	12.0
Opg Profit Gth (%)	94.4	(89.3)	791.3	(53.9)	70.3
Net Profit Gth (Pre-ex) (%)	144.9	nm	nm	(42.5)	24.0
Margins					
Gross Margins (%)	42.0	31.0	35.3	36.0	33.0
Opg Profit Margins (%)	15.1	2.0	13.2	6.8	8.9
Net Profit Margins (%)	14.7	0.4	8.1	(0.6)	5.9

Higher admin costs hurt profits

Balance Sheet (S$m)

FY Dec	2014A	2015A	2016F	2017F	2018F
Net Fixed Assets	7.19	9.02	11.7	11.5	10.0
Invts in Associates & JVs	0.0	0.0	0.0	15.5	23.5
Other LT Assets	16.2	18.2	16.6	15.8	15.0
Cash & ST Invts	6.88	4.93	30.0	28.3	28.6
Inventory	7.65	11.2	15.6	13.0	15.1
Debtors	43.4	35.4	39.2	54.4	63.1
Other Current Assets	2.13	2.63	4.17	4.17	4.17
Total Assets	**83.4**	**81.4**	**117**	**143**	**159**
ST Debt	13.3	13.9	13.6	13.6	13.6
Creditor	33.0	25.0	24.7	40.1	46.6
Other Current Liab	2.59	3.04	4.49	6.82	6.87
LT Debt	3.29	4.65	4.48	4.48	4.48
Other LT Liabilities	0.44	0.50	2.76	2.76	2.76
Shareholder's Equity	29.6	34.2	67.3	74.8	85.1
Minority Interests	1.17	0.10	0.0	0.0	0.0
Total Cap. & Liab.	**83.4**	**81.4**	**117**	**143**	**159**
Non-Cash Wkg. Capital	17.6	21.1	29.9	24.7	28.8
Net Cash/(Debt)	(9.8)	(13.6)	11.9	10.2	10.5
Debtors Turn (avg days)	116.5	117.0	100.3	100.7	109.0
Creditors Turn (avg days)	136.6	135.4	106.3	111.1	128.3
Inventory Turn (avg days)	39.6	43.9	57.4	49.2	41.6
Asset Turnover (x)	1.5	1.5	1.4	1.3	1.3
Current Ratio (x)	1.2	1.3	2.1	1.6	1.7
Quick Ratio (x)	1.0	1.0	1.6	1.4	1.4
Net Debt/Equity (X)	0.3	0.4	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	0.3	0.4	CASH	CASH	CASH
Capex to Debt (%)	17.9	15.5	20.4	27.6	27.6
Z-Score (X)	2.3	3.4	3.0	3.0	3.0

Net cash position following IPO

Source: Company, DBS Bank

Cash Flow Statement (S$m)

FY Dec	2014A	2015A	2016F	2017F	2018F
Pre-Tax Profit	4.01	10.0	7.80	13.5	17.1
Dep. & Amort.	2.24	3.04	4.43	5.96	7.24
Tax Paid	0.27	(1.6)	(1.2)	(1.0)	(3.4)
Assoc. & JV Inc/(loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	(5.4)	(6.7)	(9.5)	2.87	(4.3)
Other Operating CF	1.43	0.18	(2.1)	0.0	0.0
Net Operating CF	**2.57**	**4.90**	**(0.6)**	**21.3**	**16.7**
Capital Exp.(net)	(3.0)	(2.9)	(3.7)	(5.0)	(5.0)
Other Invts.(net)	0.0	0.0	(3.0)	0.0	0.0
Invts in Assoc. & JV	(12.4)	0.10	(2.0)	(15.5)	(8.0)
Div from Assoc & JV	0.0	0.0	0.0	0.0	0.0
Other Investing CF	(5.7)	(5.8)	9.03	0.0	0.0
Net Investing CF	**(21.1)**	**(8.6)**	**0.34**	**(20.5)**	**(13.0)**
Div Paid	0.0	0.0	0.0	(2.5)	(3.4)
Chg in Gross Debt	8.54	1.11	(1.3)	0.0	0.0
Capital Issues	17.2	3.66	38.6	0.0	0.0
Other Financing CF	(2.2)	(3.1)	(11.9)	0.0	0.0
Net Financing CF	**23.5**	**1.67**	**25.4**	**(2.5)**	**(3.4)**
Currency Adjustments	0.0	0.06	0.0	0.0	0.0
Chg in Cash	4.94	(2.0)	25.1	(1.8)	0.31
Opg CFPS (S cts)	4.02	5.86	3.18	6.57	7.49
Free CFPS (S cts)	(0.2)	1.03	(1.5)	5.81	4.19

Further investments likely

Source: Company, DBS Bank

Target Price & Ratings History

S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	16 Sep 16	0.52	0.67	BUY
2:	11 Nov 16	0.47	0.56	BUY

***Note**: Share price and Target price are adjusted for corporate actions.*

Source: DBS Bank
Analyst: Sachin MITTAL

DBS Bank recommendations are based an Absolute Total Return* Rating system, defined as follows:
STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)
BUY (>15% total return over the next 12 months for small caps, >10% for large caps)
HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)
FULLY VALUED (negative total return i.e. > -10% over the next 12 months)
SELL (negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame)

Share price appreciation + dividends

Completed Date: 23 Feb 2017 10:06:13 (SGT)
Dissemination Date: 23 Feb 2017 11:13:58 (SGT)

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