

DBS Group Research . Equity

15 Aug 2017

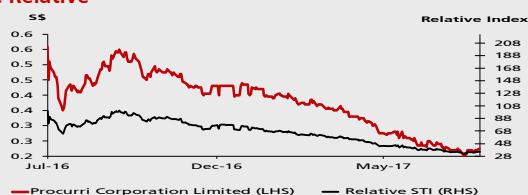
FULLY VALUED (Downgrade from HOLD)

Last Traded Price (14 Aug 2017): S\$0.225 (STI : 3,308.69)

Price Target 12-mth: S\$0.18 (-18% downside) (Prev S\$0.32)

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Sachin MITTAL +65 6682 3699 sachinmittal@dbs.com**What's New**

- 2Q17 loss of S\$1.67m was below expectations
- Overhang of high, growing administrative expenses
- Disappointed by acquisitions
- Downgrade to FULLY VALUED, revised TP of S\$0.18

Price Relative**Forecasts and Valuation**

FY Dec (\$\$ m)	2015A	2016A	2017F	2018F
Revenue	123	136	163	200
EBITDA	13.5	13.7	7.17	16.3
Pre-tax Profit	10.0	7.80	0.48	4.47
Net Profit	8.77	5.32	0.35	3.26
Net Pft (Pre Ex.)	8.77	6.26	0.35	3.26
Net Pft Gth (Pre-ex) (%)	168.7	(28.6)	(94.4)	825.3
EPS (S cts)	4.43	1.90	0.13	1.17
EPS Pre Ex. (S cts)	4.43	2.24	0.13	1.17
EPS Gth Pre Ex (%)	169	(50)	(94)	825
Diluted EPS (S cts)	4.43	1.89	0.13	1.16
Net DPS (S cts)	0.0	0.48	0.0	0.0
BV Per Share (S cts)	17.3	24.0	24.1	25.3
PE (X)	5.1	11.8	178.7	19.3
PE Pre Ex. (X)	5.1	10.1	178.7	19.3
P/Cash Flow (X)	9.1	nm	38.0	8.7
EV/EBITDA (X)	4.3	3.7	9.7	4.6
Net Div Yield (%)	0.0	2.1	0.0	0.0
P/Book Value (X)	1.3	0.9	0.9	0.9
Net Debt/Equity (X)	0.4	CASH	0.1	0.2
ROAE (%)	27.5	10.5	0.5	4.7
Earnings Rev (%)			(95)	(72)
Consensus EPS (S cts)			-	-
Other Broker Recs:		B: 0	S: 0	H: 1

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

Earnings visibility unclear

Disappointed by core organic business and acquisitions. We are disappointed by Procurri's core organic business (IT Distribution and Lifecycle Services) as the company struggles to replace revenue arising from the loss of a major customer. On the acquisitions front, we had expected ~S\$2m earnings contribution in FY17. However, due to cost issues related to EAF and Rockland JV coupled with slower than expected organic business, Procurri may be barely profitable in FY17F and any meaningful recovery is only possible in FY18F.

2Q17 loss of S\$1.67m was below expectations. Procurri saw a loss of S\$1.67m in 2Q17, bringing 1H17 loss to S\$1.51m, due to declining gross margins across both IT Distribution and Lifecycle Services, persistently high administrative costs amid accounting changes for revenue recognition. Revenue growth momentum has also slowed to 21% y-o-y (1Q17: 47% y-o-y) despite 1Q17 being a seasonally weak quarter.

Overhang of high, growing administrative expenses. We had previously highlighted persistently high administrative costs for the company which is an area of strong concern. In 2Q17, administrative expenses saw an increase of S\$5.9m to S\$12.3m (+88.1% y-o-y), compared against S\$9.8m in 1Q17 (+67.9%). We continue to be disappointed by the growing administrative expenses which grew S\$6.4m to S\$12.3m this quarter (+108.2%), mainly due to costs relating to EAF acquisition and Rockland. Staff costs, excluding EAF and Rockland, were S\$1.0m higher (+26.4% y-o-y) on higher headcount, in line with the increase seen in 1Q17. The remaining increase in administrative expenses is due to rental and maiden post-listing compliance costs.

Valuation:

Downgrade to FULLY VALUED with a revised TP of S\$0.18 based on a 5% discount to FY18F BV/share of S\$0.19 after accounting for value of intangibles on book. We switched from PE valuation methodology due to low earnings visibility.

Key Risks to Our View:

The company may be unable to demonstrate earnings execution and cost control. Further acquisitions at this point may jeopardise the ongoing transition and consolidation of previous acquisitions and JV.

At A Glance

Issued Capital (m shrs)	280
Mkt. Cap (S\$m/US\$m)	63.0 / 46.2
Major Shareholders (%)	
Declout	47.3
Irrucorp Pte Ltd	12.1
Free Float (%)	40.6
3m Avg. Daily Val (US\$m)	0.03
ICB Industry : Technology / Software & Computer Services	

WHAT'S NEW

2Q17 results a disappointment

2Q17 loss of S\$1.67m was below expectations. Procurri saw a loss of S\$1.67m in 2Q17, bringing 1H17 loss to S\$1.51m, due to declining gross margins across both IT Distribution and Lifecycle Services, and persistently high administrative costs amid accounting changes for revenue recognition.

Revenue growth momentum slowed to 21% y-o-y (1Q17: 47% y-o-y). Revenue growth momentum has also slowed to 21% y-o-y (1Q17: 47% y-o-y) despite 1Q17 being a seasonally weak quarter. According to management, revenue and earnings were partially affected (<10% impact on revenue, ~\$0.8m impact on NPAT) by a change in accounting practice for the maintenance service orderbook in the Americas where linear recognition of maintenance service contracts is now adopted, in contrast to previous upfront revenue recognition. Blended gross margins declined to 30.9% (1Q17: 33.6%). We note that margins in the Lifecycle management segment had declined from 55-80% in FY15 to 33.7% in 2Q17 due to high cost of sales and Procurri's pursuit of market share.

Overhang of high, growing administrative expenses. We had previously highlighted persistently high administrative costs for the company which is an area of strong concern. In 2Q17, administrative expenses saw an increase of S\$5.9m to S\$12.3m (+88.1% y-o-y), compared against S\$9.8m in 1Q17 (+67.9%). We continue to be disappointed by the growing administrative expenses which grew S\$6.4m to S\$12.3m this quarter

(+108.2%), mainly due to costs relating to EAF acquisition and Rockland. Staff costs, excluding EAF and Rockland, were S\$1.0m higher (+26.4% y-o-y) on higher headcount, in line with the increase seen in 1Q17. The remaining increase in administrative expenses is due to rental and maiden post-listing compliance costs.

Outlook

Needs to demonstrate better earnings execution. Delayed bottom-line contribution from acquisitions and cost escalations have lowered expectations for near-term profitability. We believe that the company needs to demonstrate better earnings execution to gain market confidence.

Transition phase. We note that the management expects the transitional phase to grow recurring revenue from Lifecycle Services to smoothen out in FY2018. Till then, we do not expect near-term upside in the company's financial performance.

Further delays in potential acquisitions expected. While the company continues to selectively prospect for acquisition targets, which in our opinion would be in the IT Asset Disposition business, we believe the company still requires some time to improve its current execution with the EAF acquisition and Rockland JV before taking on a new acquisition.

Quarterly / Interim Income Statement (S\$m)

FY Dec	2Q2016	1Q2017	2Q2017	% chg yoy	% chg qoq
Revenue	35.9	38.3	43.6	21.3	13.8
Cost of Goods Sold	(23.3)	(25.4)	(30.1)	29.5	18.4
Gross Profit	12.7	12.9	13.5	6.3	4.8
Other Oper. (Exp)/Inc	(8.0)	(12.7)	(14.8)	86.4	16.9
Operating Profit	4.73	0.19	(1.3)	nm	nm
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	-	-
Associates & JV Inc	0.0	0.0	0.0	-	-
Net Interest (Exp)/Inc	(0.2)	(0.2)	(0.2)	4.9	4.3
Exceptional Gain/(Loss)	(0.6)	0.0	0.0	nm	-
Pre-tax Profit	4.01	0.02	(1.5)	nm	nm
Tax	(1.1)	0.14	(0.2)	(83.9)	nm
Minority Interest	0.0	0.0	0.0	-	-
Net Profit	2.92	0.16	(1.7)	nm	nm
Net profit bef Except.	3.49	0.16	(1.7)	nm	nm
EBITDA	5.80	0.19	(1.3)	nm	nm
Margins (%)					
Gross Margins	35.3	33.6	30.9		
Opg Profit Margins	13.2	0.5	(3.1)		
Net Profit Margins	8.1	0.4	(3.8)		

Source of all data: Company, DBS Bank

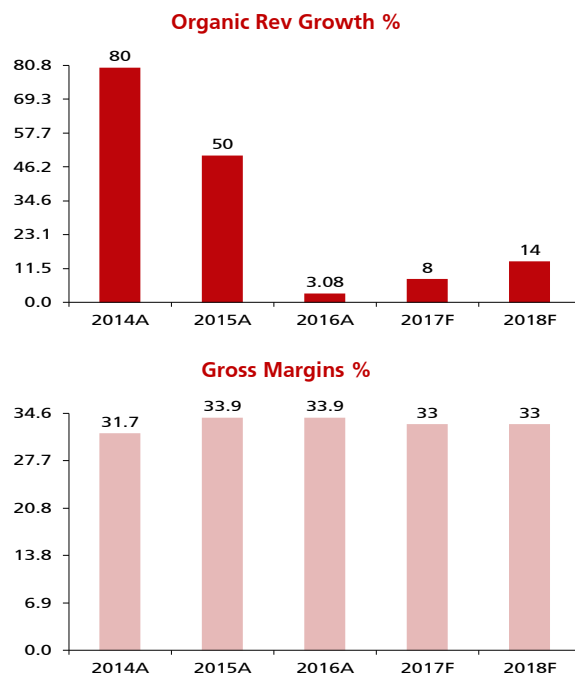
CRITICAL DATA POINTS TO WATCH

Critical Factors

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 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 rates 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 from 55-80% in FY15 to 33.7% in 2Q17 due to higher costs of sales and Procurri’s pursuit of market share. In addition, escalation in the administrative costs also has taken a toll on the bottom line.

Recent investments struggle with cost overruns. 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 [~\$1m]) while it achieved breakeven after the acquisition. Procurri has rights to 100% profits from the Congruity JV till end-2018 along with an option to buy the remaining equity stake (49%) by end-2018. However, recent cost overruns have affected Procurri’s bottom line and lowered expectations for near-term profitability.



Source: Company, DBS Bank

Balance Sheet:

During the year, Procurri increased its debt by S\$9.9m mainly due to increase in term loans and trade receivables factoring. While there is further headroom for more debt-funded acquisition, we do not think that it is appropriate given poor earnings visibility at this juncture.

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 ~20% of the total revenue 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 has resulted in lower expectations for near-term profitability. In line with this, we have revised down our profit expectations for FY17/FY18 due to poor earnings visibility. This should have a negative impact on Procurri's share price in the immediate term.

Key Risks:

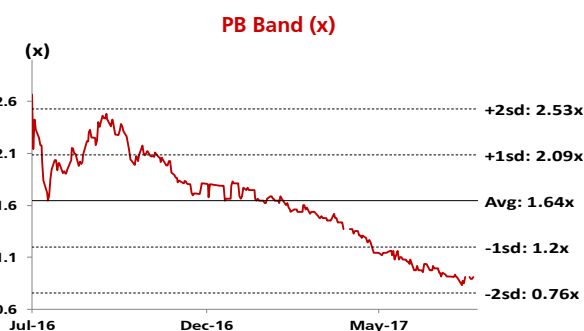
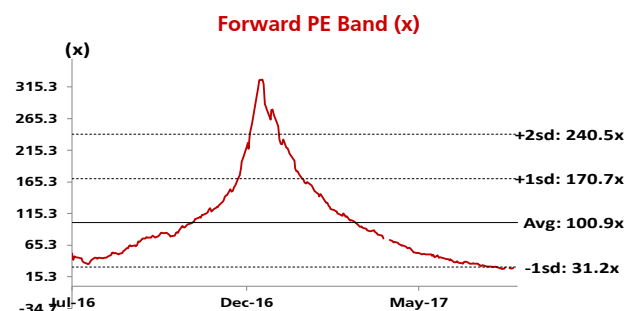
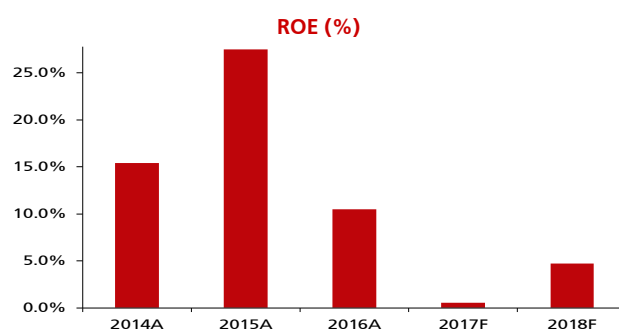
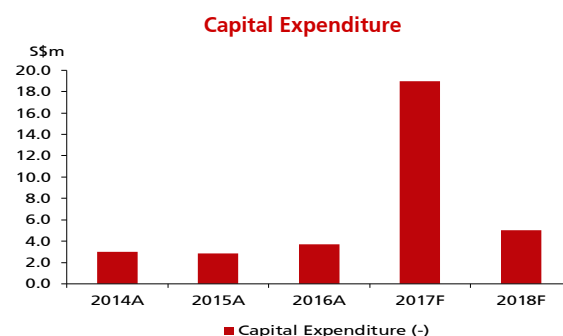
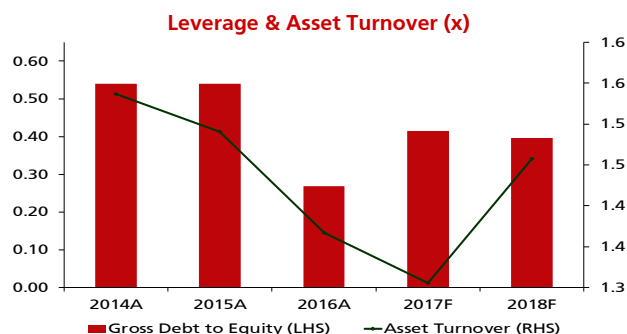
Fast-changing business environment. Rapid technological changes, evolving industry standards, and new product and service introductions may render Procurri's products and services obsolete.

Slower-than-expected improvement in recent acquisitions.

Management previously guided for 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

Procurri Corporation Limited

Key Assumptions

FY Dec	2014A	2015A	2016A	2017F	2018F
Organic Rev Growth %	80.0	50.0	3.08	8.00	14.0
Gross Margins %	31.7	33.9	33.9	33.0	33.0

Segmental Breakdown

FY Dec	2014A	2015A	2016A	2017F	2018F
Revenues (\$\$m)					
IT distribution	62.6	99.6	106	130	160
Lifecycle services	14.3	23.3	29.4	32.5	40.1
Others					
Total	76.9	123	136	163	200
Gross Profit (\$\$m)					
IT distribution	16.3	27.4	31.5	34.9	43.0
Lifecycle services	8.10	14.2	14.6	18.8	23.2
Others					
Total	24.4	41.6	46.0	53.7	66.1
Gross Margins (%)					
IT distribution	26.0	27.6	29.6	26.8	26.8
Lifecycle services	56.7	61.0	49.6	57.8	57.8
Others					
Total	31.7	33.9	33.9	33.0	33.0

Income Statement (\$\$m)

FY Dec	2014A	2015A	2016A	2017F	2018F
Revenue	76.9	123	136	163	200
Cost of Goods Sold	(52.5)	(81.2)	(89.7)	(109)	(134)
Gross Profit	24.4	41.6	46.0	53.7	66.1
Other Opng (Exp)/Inc	(20.3)	(31.9)	(38.1)	(53.5)	(61.9)
Operating Profit	4.03	9.69	7.99	0.21	4.27
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)	(0.7)	(0.8)
Exceptional Gain/(Loss)	(0.5)	0.0	(0.9)	0.0	0.0
Pre-tax Profit	4.01	10.0	7.80	0.48	4.47
Tax	(0.7)	(1.2)	(2.5)	(0.1)	(1.2)
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	0.35	3.26
Net Profit before Except.	3.26	8.77	6.26	0.35	3.26
EBITDA	7.24	13.5	13.7	7.17	16.3
Growth					
Revenue Gth (%)	170.8	59.7	10.5	19.8	23.2
EBITDA Gth (%)	164.2	86.0	2.0	(47.8)	127.4
Opg Profit Gth (%)	199.4	140.4	(17.5)	(97.3)	1,913.5
Net Profit Gth (Pre-ex) (%)	82.5	168.7	(28.6)	(94.4)	825.3
Margins & Ratio					
Gross Margins (%)	31.7	33.9	33.9	33.0	33.0
Opg Profit Margin (%)	5.2	7.9	5.9	0.1	2.1
Net Profit Margin (%)	3.6	7.1	3.9	0.2	1.6
ROAE (%)	15.4	27.5	10.5	0.5	4.7
ROA (%)	5.6	10.6	5.4	0.3	2.4
ROCE (%)	9.3	16.5	8.1	(0.4)	2.5
Div Payout Ratio (%)	0.0	0.0	25.0	0.0	0.0
Net Interest Cover (x)	7.9	23.1	14.2	0.3	5.3

Source: Company, DBS Bank

Quarterly / Interim Income Statement (\$\$m)

FY Dec	2Q2016	3Q2016	4Q2016	1Q2017	2Q2017
Revenue	35.9	31.9	41.9	38.3	43.6
Cost of Goods Sold	(23.3)	(20.4)	(28.1)	(25.4)	(30.1)
Gross Profit	12.7	11.5	13.9	12.9	13.5
Other Oper. (Exp)/Inc	(8.0)	(9.3)	(10.1)	(12.7)	(14.8)
Operating Profit	4.73	2.18	3.71	0.19	(1.3)
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)	(0.6)	(2.2)	0.0	0.0	0.0
Pre-tax Profit	4.01	(0.2)	3.52	0.02	(1.5)
Tax	(1.1)	0.0	(1.0)	0.14	(0.2)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Net Profit	2.92	(0.2)	2.48	0.16	(1.7)
Net profit bef Except.	3.49	2.00	2.48	0.16	(1.7)
EBITDA	5.80	3.32	3.71	0.19	(1.3)

Growth

Revenue Gth (%)	38.1	(11.4)	31.7	(8.7)	13.8
EBITDA Gth (%)	265.1	(42.8)	12.0	(95.0)	nm
Opg Profit Gth (%)	791.3	(53.9)	70.3	(95.0)	nm
Net Profit Gth (Pre-ex) (%)	(21,887.5)	(42.5)	24.0	(93.4)	nm

Margins

Gross Margins (%)	35.3	36.0	33.0	33.6	30.9
Opg Profit Margins (%)	13.2	6.8	8.9	0.5	(3.1)
Net Profit Margins (%)	8.1	(0.6)	5.9	0.4	(3.8)

Balance Sheet (\$\$m)

FY Dec	2014A	2015A	2016A	2017F	2018F
Net Fixed Assets	7.19	9.02	11.7	25.5	20.2
Invt in Associates & JVs	0.0	0.0	0.0	0.0	8.00
Other LT Assets	16.2	18.2	16.6	16.1	15.4
Cash & ST Invt	6.88	4.93	30.0	21.3	15.6
Inventory	7.65	11.2	15.6	12.6	15.6
Debtors	43.4	35.4	39.2	52.2	64.3
Other Current Assets	2.13	2.63	4.17	4.17	4.17
Total Assets	83.4	81.4	117	132	143
ST Debt	13.3	13.9	13.6	13.6	13.6
Creditor	33.0	25.0	24.7	29.9	36.8
Other Current Liab	2.59	3.04	4.49	3.58	4.66
LT Debt	3.29	4.65	4.48	14.5	14.5
Other LT Liabilities	0.44	0.50	2.76	2.76	2.76
Shareholder's Equity	29.6	34.2	67.3	67.6	70.9
Minority Interests	1.17	0.10	0.0	0.0	0.0
Total Cap. & Liab.	83.4	81.4	117	132	143
Non-Cash Wkg. Capital	17.6	21.1	29.9	35.5	42.5
Net Cash/(Debt)	(9.8)	(13.6)	11.9	(6.8)	(12.5)
Debtors Turn (avg days)	116.5	117.0	100.3	102.5	106.0
Creditors Turn (avg days)	136.6	135.4	106.3	96.6	98.7
Inventory Turn (avg days)	39.6	43.9	57.4	50.1	41.7
Asset Turnover (x)	1.5	1.5	1.4	1.3	1.5
Current Ratio (x)	1.2	1.3	2.1	1.9	1.8
Quick Ratio (x)	1.0	1.0	1.6	1.6	1.5
Net Debt/Equity (X)	0.3	0.4	CASH	0.1	0.2
Net Debt/Equity ex MI (X)	0.3	0.4	CASH	0.1	0.2
Capex to Debt (%)	17.9	15.5	20.4	67.6	17.8
Z-Score (X)	2.0	3.1	3.1	2.6	2.7

Source: Company, DBS Bank

Cash Flow Statement (S\$m)

FY Dec	2014A	2015A	2016A	2017F	2018F
Pre-Tax Profit	4.01	10.0	7.80	0.48	4.47
Dep. & Amort.	2.24	3.04	4.43	6.96	11.0
Tax Paid	0.27	(1.6)	(1.2)	(1.0)	(0.1)
Assoc. & JV Inc/(loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	(5.4)	(6.7)	(9.5)	(4.8)	(8.1)
Other Operating CF	1.43	0.18	(2.1)	0.0	0.0
Net Operating CF	2.57	4.90	(0.6)	1.66	7.27
Capital Exp.(net)	(3.0)	(2.9)	(3.7)	(19.0)	(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)	0.0	(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	(19.0)	(13.0)
Div Paid	0.0	0.0	0.0	(1.3)	0.0
Chg in Gross Debt	8.54	1.11	(1.3)	10.0	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	8.67	0.0
Currency Adjustments	0.0	0.06	0.0	0.0	0.0
Chg in Cash	4.94	(2.0)	25.1	(8.7)	(5.7)
Opg CFPS (S cts)	4.02	5.86	3.18	2.29	5.49
Free CFPS (S cts)	(0.2)	1.03	(1.5)	(6.2)	0.81

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
3:	23 Feb 17	0.40	0.40	HOLD
4:	15 May 17	0.28	0.32	HOLD

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

Source: DBS Bank

Analyst: Singapore Research Team

Sachin MITTAL

DBS Bank recommendations are based on 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: 15 Aug 2017 09:25:19 (SGT)

Dissemination Date: 15 Aug 2017 09:50:52 (SGT)

Sources for all charts and tables are DBS Bank unless otherwise specified.

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