

Datatec

H122 results

Attractive value play with upside potential

In H122 Datatec saw strong growth globally, with elevated demand for networking, cyber security and cloud infrastructure. The H122 results show good operational growth across the group, with a notably stronger performance from Westcon after its turnaround. Semiconductor supply-chain issues remain challenging, with the group seeing growing inventory levels and a building backlog of unfulfilled work. However, with technology trends continuing from H122, the outlook for H222 looks promising. Trading on 15.4x FY22 earnings and 3.6x FY22 EV/EBITDA, Datatec looks attractively priced, bolstered by the 512 ZAR cents (c 33 US cents) per share special dividend and with the results of management's ongoing strategic review as potential upside for 2022.

Year end	Revenue (US\$m)	PBT* (US\$m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
02/20	4,214	79.1	9.9	7.0	27.4	2.6
02/21	4,109	73.1	13.6	6.7	20.0	2.5
02/22e	4,514	84.6	17.6	40.3	15.4	14.8
02/23e	4,757	107.6	25.9	8.6	10.5	3.2

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

H122 results: Strong performance across the group

H122 group revenue rose 15% (against a weak comparator) to US\$2.26bn, with EBITDA up 24% to US\$75m and underlying EPS surging 113% to 8.3 US cents. By division, Logicalis showed 19% revenue growth to US\$823m. Despite EBITDA margin compression (5.7% in H122 vs 6.2% for H121) due to supply chain issues and backlog, Logicalis's EBITDA still rose 8% to US\$46.5m. Westcon's revenues rose 12% to US\$1.39bn, with its operational gearing meaning that EBITDA margins expanded to 2.2% in H122, driving its EBITDA up 62% to US\$31m. Analysys Mason saw a 37% increase in revenues to US\$43.6m, with EBITDA climbing 25% to US\$7.1m. Group net debt rose to US\$152.5m (FY21: US\$60.9m) as the business absorbs cash as it grows, and with elevated inventory levels.

Estimates revised upwards by c 5%

Following Datatec's strong H122 performance, we have upgraded our FY22 sales estimates by assuming each division matches its H122 revenues in H222, leading to group revenues of US\$4.51bn in FY22, an upward revision of c 5%. This then forms a base for future years, with c 5% top-line growth in FY23 and FY24, leading to revenues of US\$4.76bn and US\$5.03bn, respectively. We have raised EBITDA by c 4% to US\$169m in FY22 and US\$193 in FY23. With FY22 operating cashflow restrained by inventory build-up, we estimate closing net debt of US\$166m.

Valuation: Defensive growth with upside potential

With IT trends set to continue (Datatec's focus on networking, cyber security and cloud infrastructure looks set to support growth for some time to come) and trading on 15.4x revised FY22 earnings and 3.6x FY22 EV/EBITDA, Datatec looks attractively priced. The shares also offer the c 33 US cents per share special dividend together with potential upside from management's value realisation initiatives – quantified in our August note, [Strategic review to unlock embedded value](#) – which may lead to a crystallisation of value in 2022.

IT services

3 November 2021

Price **ZAR41.9**

Market cap **ZAR8.5bn**

ZAR15.42/US\$

Net debt (US\$m) at 31 August 2021 152.5

Shares in issue 203.2m

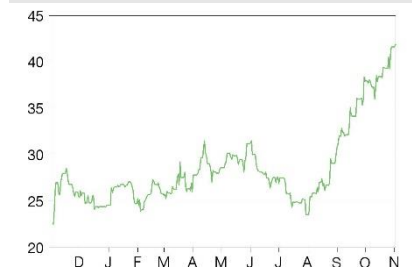
Free float 62%

Code DTCJ

Primary exchange Johannesburg

Secondary exchange N/A

Share price performance



%	1m	3m	12m
Abs	10.5	66.8	87.9
Rel (local)	3.8	69.4	45.9

52-week high/low ZAR41.9 ZAR22.5

Business description

Datatec is a South Africa-listed multinational ICT business, serving clients globally, predominantly in the networking and telecoms sectors. The group operates through three main divisions: Westcon International (distribution); Logicalis (IT services); and Analysys Mason (consulting).

Next events

FY22 results	May 2022
AGM	July 2022

Analysts

Richard Williamson	+44 (0)20 3077 5700
Katherine Thompson	+44 (0)20 3077 5730

tech@edisongroup.com

[Edison profile page](#)

**Datatec is a research client of
Edison Investment Research
Limited**

H122 results: Strong performance across the group

In H122, Datatec saw strong growth globally with elevated demand for networking, cyber security and cloud infrastructure, benefiting much of the industry. However, the global semiconductor shortage led to extended hardware lead times, restricting revenue growth and resulting in a significantly higher closing backlog for both Logicalis and Westcon. Without the effect of these supply issues, growth at both Logicalis and Westcon could have been even higher.

Despite this headwind, the H122 results show good operational growth across the group, with a notably stronger performance from Westcon after its turnaround. H122 group revenue rose 15% (against a relatively weak comparator at the start of the COVID-19 pandemic) to US\$2.26bn (H121: US\$1.96bn), with EBITDA up 24% to US\$75m (H121: US\$61m) and underlying EPS rising 113% to 8.3 US cents (H121: 3.9 US cents). Group central costs (including board and head office staff remuneration, consulting and audit fees) rose 23% y-o-y to US\$9.1m (H121: US\$7.4m), largely as a result of share-based payment charges, including LTIPs. As the business absorbs cash as it grows, as well as reflecting elevated inventory levels, group net debt at 31 August 2021 rose to US\$152.5m (FY21: US\$60.9m).

Exhibit 1: Interim results summary

US\$m	H121	H221	FY21	H122	H222e	FY22e
Revenue	1,963	2,147	4,109	2,257	2,257	4,514
Cost of Sales	(1,638)	(1,780)	(3,419)	(1,883)	(1,866)	(3,749)
Gross Profit	324	366	691	374	391	765
EBITDA	61	58	119	75	94	169
Reported operating profit	28	22	50	39	64	103
Profit before tax (reported)	15	10	25	25	51	76
EPS - Company underlying uEPS (c)	3.9	9.7	13.6	8.3	9.3	17.6
Gross Margin (%)	16.5	17.1	16.8	16.6	17.3	17.0
EBITDA Margin (%)	3.1	2.7	2.9	3.3	4.2	3.7
Closing net debt/(cash)	73	61	61	153	166	166

Source: Company accounts, Edison Investment Research

Special dividend of c 33 US cents per share

Following the sale of Westcon Americas to SYNnex in September 2017, Datatec made an inter-company loan to Westcon International to fund working capital as the business was restructured. During H122, Westcon International repaid the amounts outstanding (c US\$70m) to Datatec. This amount is to be paid to shareholders by way of a cash dividend with a scrip alternative. This special dividend equates to 512 ZAR cents (c 33 US cents) per share, payable to shareholders on the register at the close of business on 26 November 2021.

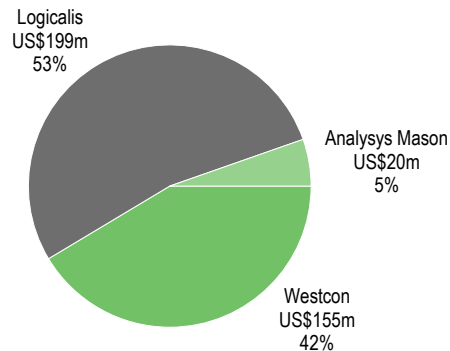
In addition to the special dividend, Datatec still expects to pay a final dividend for FY22 in line with its policy of ensuring that the dividend is covered 3x by uEPS.

Strategic review, developments not anticipated until 2022

As announced in August 2021, Datatec has engaged Lazard & Co. to assist with a strategic review of the group to address the persistent gap between Datatec's valuation and the perceived value of its underlying assets. As part of the strategic review, the board is considering a number of potential options, including private equity participation; joint ventures; international listings; divisional asset unbundling; and other value-creating structures. We quantified the size of the opportunity in our August note, [Strategic review to unlock embedded value](#), and look forward to an update on progress in 2022.

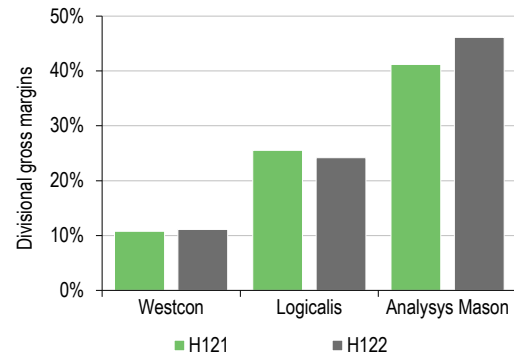
Divisional review: All segments delivering in H122

Exhibit 2: H122 gross profit by division



Source: Datatec

Exhibit 3: H122 vs H121 gross margins



Source: Datatec

Logicalis

Logicalis contributes the majority of Datatec's profitability and has the widest geographical spread. Datatec intends to continue to grow Logicalis globally, both organically and through M&A.

The global semiconductor shortage led to extended hardware lead times in H122, restricting revenue growth and resulting in a significantly higher closing backlog particularly in Latin America and EMEA. Despite this, Logicalis's revenue increased by 19% to US\$823m (H121: US\$693m). There was some margin compression, with a gross margin of 24.2% in H122 versus 25.5% in H121 and an EBITDA margin of 5.7% in H122 versus 6.2% for H121, due to the supply chain issues and growth in backlog. Despite this, Logicalis's gross profit still rose 13% to US\$199m (H121: US\$177m) and EBITDA rose 8% to US\$46.5m (H121: US\$43.0m).

Global trading uncertainties are expected to persist in the near future, with emerging market currencies and interest rates expected to remain volatile. Prospects within cloud, IoT, software, security, data management and intelligent networks for Logicalis remain attractive as Logicalis seeks to provide full lifecycle IT infrastructure solutions to its customers.

Westcon International

Westcon, Datatec's distribution business, accounts for 62% of group revenues. Following its restructuring in 2017/18, Westcon remains focused on improving profitability through revenue growth and margin expansion, coupled with tight cost control. As with Logicalis, Westcon's backlog also rose significantly in H122 due to semiconductor shortages and supply chain constraints.

In H122, Westcon's revenue increased by 12% to US\$1.4bn (H121: US\$1.2bn), particularly reflecting strong demand for networked cloud computing, remote access solutions for virtual office environments, unified collaboration and enhanced network security. Gross margins increased to 11.1% (H121: 10.8%) driving gross profit up 16% to US\$155m (H121: US\$134m). EBITDA increased by 61% to US\$31.0m (H1 FY21: US\$19.2m), as margins rose to 2.2% in H122 vs 1.9% in H121 with improving operating leverage.

We expect to see continued progress from Westcon in H222 and in the longer term, with growth supported by the unwinding of the backlog and margins by effective cost management.

Management Consulting

Datatec Financial Services has been moved under Westcon International, so Management Consulting now comprises Analysys Mason, which is focused on the convergence of telecoms and IT, driving digitisation, accelerated by the move to cloud computing. Although Analysys Mason is Datatec's smallest division, it remains important in the group context. Management is targeting

revenues of US\$100m within the next three years, with geographical expansion in North America and Asia-Pacific likely options.

Analysys Mason revenue increased by 37% to US\$43.6m (H121: US\$31.8m), with gross profit increasing by 53% to US\$20.1m (H121: US\$13.1m). Despite EBITDA margins decreasing to 16% compared to 18% in H121, EBITDA rose 25% to US\$7.1m (H121: US\$5.7m).

Outlook: More of the same in H222

In H122, Datatec benefited from pent-up demand around the world, with semiconductor shortages and the resulting supply chain issues acting as a brake on growth. These issues led to inventory build-up and significant growth in backlogs across the group. We expect a very similar set of dynamics to apply in H222, implying a continued strong performance across all divisions driven by continuing demand for software and services in networking, security and cloud infrastructure.

We do not envisage a solution to the semiconductor supply chain issues in FY22, but rather anticipate this issue will persist into FY23, with inventory build-up and backlog growth only starting to reverse in FY23.

Estimates: FY22/FY23 revised upwards, FY24 introduced

Exhibit 4: Revised estimates

Year end 28 February	2021		2022e		Y-o-y		2023e		Y-o-y		2024e		Y-o-y	
	Reported	Old	New	growth	Change	Old	New	growth	Change	New	growth	New	growth	
US\$m														
Revenue	4,109	4,317	4,514	10%	5%	4,548	4,757	5%	5%	5,029	6%			
Gross profit	691	727	765	11%	5%	775	816	7%	5%	871	7%			
EBITDA	119	163	169	43%	4%	185	193	14%	4%	215	12%			
Normalised operating profit	98	106	112	14%	6%	130	138	23%	6%	162	18%			
Profit before tax (norm)	73	79	85	16%	7%	102	108	27%	6%	131	21%			
Net income (normalised)	27	33	36	32%	7%	50	53	48%	4%	71	34%			
EPS - underlying (c)	13.6	16.5	17.6	30%	7%	24.9	25.9	47%	4%	34.8	34%			
Dividend (c)	6.7	5.5	40.3	501%	633%	8.3	8.6	(79)%	4%	11.6	34%			
Revenue growth (%)	(2.5)	5.0	9.8			5.4	5.4			5.7				
Gross margin (%)	16.8	16.8	17.0			17.0	17.1			17.3				
EBITDA margin (%)	2.9	3.8	3.7			4.1	4.0			4.3				
Normalised operating margin (%)	2.4	2.4	2.5			2.9	2.9			3.2				
Operating cash flow	173	95	84	(51)%	(11)%	100	131	55%	31%	178	36%			
Closing net debt/(cash)	61	84	166	173%	98%	113	166	(0)%	47%	125	(25)%			

Source: Datatec accounts, Edison Investment Research

We have made some small changes to our FY22 and FY23 estimates following Datatec's strong H122 performance and take the opportunity to introduce our FY24 estimates.

- **Revenues:** we have upgraded our FY22 sales estimates by assuming each division repeats its H122 revenues in H222, leading to group revenues of US\$4.51bn in FY22, an upward revision of c 5%. This forms a base for future years, with c 5% top-line growth in FY23 and FY24, leading to revenues of US\$4.76bn and US\$5.03bn, respectively. We have raised our EBITDA estimate by c 4% to US\$169m in FY22 and US\$193m in FY23.
- **Net debt:** we estimate closing net debt at 28 February 2022 of US\$166m, having factored in the US\$70m special dividend, together with an allowance for inventory build-up.
- **FY24:** we have also introduced our FY24 estimates, with revenue of US\$5.03bn, 5.7% growth over FY23. The assumed gross margin remains relatively stable at 17.3%, with the EBITDA margin ticking up to 4.3% as the group continues to deliver operating leverage. This leads to gross profit of US\$871m, with EBITDA of US\$215m and underlying EPS of 35 US cents.

Exhibit 5: Financial summary

28-February	US\$'000	2020	2021	2022e	2023e	2024e
		IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT						
Revenue		4,214,421	4,109,463	4,514,000	4,757,030	5,028,776
Cost of Sales		(3,472,843)	(3,418,926)	(3,748,700)	(3,941,430)	(4,157,507)
Gross Profit		741,578	690,537	765,300	815,601	871,269
EBITDA		158,657	118,632	169,200	192,607	215,235
Normalised operating profit		105,157	97,868	111,742	137,503	162,239
Amortisation of acquired intangibles		(11,297)	(8,635)	(8,586)	(8,046)	(7,279)
Exceptionals		(3,700)	(27,771)	(6)	(6)	0
Share-based payments		(7,623)	(11,493)	0	0	0
Reported operating profit		82,537	49,969	103,150	129,451	154,960
Net Interest		(25,874)	(25,692)	(27,097)	(29,900)	(31,729)
Joint ventures & associates (post tax)		(204)	908	0	0	0
Exceptionals		2,029	55	0	0	0
Profit Before Tax (norm)		79,079	73,084	84,646	107,603	130,510
Profit Before Tax (reported)		58,488	25,240	76,053	99,551	123,232
Reported tax		(31,809)	(19,540)	(34,224)	(39,821)	(43,131)
Profit After Tax (norm)		34,615	30,035	46,555	64,562	84,832
Profit After Tax (reported)		26,679	5,700	41,829	59,731	80,101
Minority interests		(13,772)	(3,103)	(10,989)	(11,899)	(14,119)
Discontinued operations		1,332	0	0	0	0
Net income (normalised)		20,843	26,932	35,566	52,663	70,713
Net income (reported)		14,239	2,597	30,840	47,832	65,982
Average number of shares outstanding (m)		210.5	198.6	201.8	203.2	203.2
EPS - normalised (c)		9.90	13.56	17.62	25.92	34.80
EPS - diluted normalised (c)		9.74	13.20	17.16	25.25	33.90
EPS - basic reported (c)		6.77	1.31	15.28	23.54	32.47
EPS - Company underlying uEPS (c)		9.90	13.56	17.62	25.92	34.80
Dividend (c)		7.00	6.71	40.33	8.64	11.60
Revenue growth (%)		(2.7)	(2.5)	9.8	5.4	5.7
Gross Margin (%)		17.6	16.8	17.0	17.1	17.3
EBITDA Margin (%)		3.8	2.9	3.7	4.0	4.3
Normalised Operating Margin		2.5	2.4	2.5	2.9	3.2
BALANCE SHEET						
Fixed Assets		512,598	554,690	586,356	620,633	657,790
Intangible Assets		291,279	314,486	333,525	349,507	363,128
Tangible Assets		43,300	39,987	39,469	41,600	46,255
Right-of-use assets		83,953	94,837	107,983	124,147	143,027
Investments & other		94,066	105,380	105,380	105,380	105,380
Current Assets		2,083,928	2,242,568	2,355,163	2,488,265	2,644,149
Stocks		253,271	242,005	292,707	307,755	294,285
Debtors		1,110,510	1,108,105	1,245,944	1,329,991	1,425,243
Cash & cash equivalents		347,189	488,632	411,607	444,426	517,223
Other		372,958	403,826	404,905	406,093	407,399
Current Liabilities		(1,765,823)	(1,980,013)	(2,174,777)	(2,285,960)	(2,411,522)
Creditors		(1,259,013)	(1,385,208)	(1,523,053)	(1,600,041)	(1,687,368)
Tax and social security		(16,677)	(16,596)	(16,596)	(16,596)	(16,596)
Short term borrowings		(338,945)	(392,877)	(431,552)	(454,786)	(480,766)
Lease liabilities		(34,325)	(36,398)	(39,981)	(42,134)	(44,540)
Other		(116,863)	(148,934)	(163,595)	(172,403)	(182,251)
Long Term Liabilities		(187,610)	(176,624)	(192,883)	(202,650)	(213,572)
Long term borrowings		(18,638)	(42,371)	(46,542)	(49,048)	(51,850)
Lease liabilities		(95,148)	(77,847)	(85,510)	(90,114)	(95,262)
Other long term liabilities		(73,824)	(56,406)	(60,830)	(63,488)	(66,460)
Net Assets		643,093	640,621	573,860	620,288	676,845
Minority interests		(70,778)	(57,465)	(68,454)	(80,353)	(94,472)
Shareholders equity		572,315	583,156	505,406	539,935	582,374
CASH FLOW						
Op Cash Flow before WC and tax		169,980	157,896	169,206	192,613	215,235
Working capital		57,231	79,903	(50,696)	(22,107)	5,546
Exceptional & other		(11,642)	(28,293)	(6)	(6)	0
Tax		(36,941)	(36,597)	(34,224)	(39,821)	(43,131)
Operating cash flow		178,628	172,909	84,280	130,679	177,650
Capex		(28,036)	(35,145)	(36,036)	(36,971)	(37,953)
Acquisitions/disposals		(9,179)	(3,694)	0	0	0
Net interest		(25,874)	(25,692)	(27,097)	(29,900)	(31,729)
Equity financing		(51,683)	(2,808)	0	0	0
Dividends		(15,137)	(4,905)	(81,934)	(17,553)	(23,571)
Other		20,019	1,880	(44,459)	(45,830)	(43,329)
Net Cash Flow		68,738	102,545	(105,246)	425	41,068
Opening net debt/(cash)		100,753	139,867	60,861	166,106	165,682
FX		(9,270)	(11,312)	0	0	0
Other non-cash movements		(98,582)	(12,227)	0	0	0
Closing net debt/(cash)		139,867	60,861	166,106	165,682	124,614

Source: Datatec accounts, Edison Investment Research

General disclaimer and copyright

This report has been commissioned by Datatec and prepared and issued by Edison, in consideration of a fee payable by Datatec. Edison Investment Research standard fees are £60,000 pa for the production and broad dissemination of a detailed note (Outlook) following by regular (typically quarterly) update notes. Fees are paid upfront in cash without recourse. Edison may seek additional fees for the provision of roadshows and related IR services for the client but does not get remunerated for any investment banking services. We never take payment in stock, options or warrants for any of our services.

Accuracy of content: All information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable, however we do not guarantee the accuracy or completeness of this report and have not sought for this information to be independently verified. Opinions contained in this report represent those of the research department of Edison at the time of publication. Forward-looking information or statements in this report contain information that is based on assumptions, forecasts of future results, estimates of amounts not yet determinable, and therefore involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of their subject matter to be materially different from current expectations.

Exclusion of Liability: To the fullest extent allowed by law, Edison shall not be liable for any direct, indirect or consequential losses, loss of profits, damages, costs or expenses incurred or suffered by you arising out of or in connection with the access to, use of or reliance on any information contained on this note.

No personalised advice: The information that we provide should not be construed in any manner whatsoever as, personalised advice. Also, the information provided by us should not be construed by any subscriber or prospective subscriber as Edison's solicitation to effect, or attempt to effect, any transaction in a security. The securities described in the report may not be eligible for sale in all jurisdictions or to certain categories of investors.

Investment in securities mentioned: Edison has a restrictive policy relating to personal dealing and conflicts of interest. Edison Group does not conduct any investment business and, accordingly, does not itself hold any positions in the securities mentioned in this report. However, the respective directors, officers, employees and contractors of Edison may have a position in any or related securities mentioned in this report, subject to Edison's policies on personal dealing and conflicts of interest.

Copyright: Copyright 2021 Edison Investment Research Limited (Edison).

Australia

Edison Investment Research Pty Ltd (Edison AU) is the Australian subsidiary of Edison. Edison AU is a Corporate Authorised Representative (1252501) of Crown Wealth Group Pty Ltd who holds an Australian Financial Services Licence (Number: 494274). This research is issued in Australia by Edison AU and any access to it, is intended only for 'wholesale clients' within the meaning of the Corporations Act 2001 of Australia. Any advice given by Edison AU is general advice only and does not take into account your personal circumstances, needs or objectives. You should, before acting on this advice, consider the appropriateness of the advice, having regard to your objectives, financial situation and needs. If our advice relates to the acquisition, or possible acquisition, of a particular financial product you should read any relevant Product Disclosure Statement or like instrument.

New Zealand

The research in this document is intended for New Zealand resident professional financial advisers or brokers (for use in their roles as financial advisers or brokers) and habitual investors who are 'wholesale clients' for the purpose of the Financial Advisers Act 2008 (FAA) (as described in sections 5(c) (1)(a), (b) and (c) of the FAA). This is not a solicitation or inducement to buy, sell, subscribe, or underwrite any securities mentioned or in the topic of this document. For the purpose of the FAA, the content of this report is of a general nature, is intended as a source of general information only and is not intended to constitute a recommendation or opinion in relation to acquiring or disposing (including refraining from acquiring or disposing) of securities. The distribution of this document is not a 'personalised service' and, to the extent that it contains any financial advice, is intended only as a 'class service' provided by Edison within the meaning of the FAA (i.e. without taking into account the particular financial situation or goals of any person). As such, it should not be relied upon in making an investment decision.

United Kingdom

This document is prepared and provided by Edison for information purposes only and should not be construed as an offer or solicitation for investment in any securities mentioned or in the topic of this document. A marketing communication under FCA Rules, this document has not been prepared in accordance with the legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research.

This Communication is being distributed in the United Kingdom and is directed only at (i) persons having professional experience in matters relating to investments, i.e. investment professionals within the meaning of Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005, as amended (the 'FPO') (ii) high net-worth companies, unincorporated associations or other bodies within the meaning of Article 49 of the FPO and (iii) persons to whom it is otherwise lawful to distribute it. The investment or investment activity to which this document relates is available only to such persons. It is not intended that this document be distributed or passed on, directly or indirectly, to any other class of persons and in any event and under no circumstances should persons of any other description rely on or act upon the contents of this document.

This Communication is being supplied to you solely for your information and may not be reproduced by, further distributed to or published in whole or in part by, any other person.

United States

Edison relies upon the 'publishers' exclusion' from the definition of investment adviser under Section 202(a)(11) of the Investment Advisers Act of 1940 and corresponding state securities laws. This report is a bona fide publication of general and regular circulation offering impersonal investment-related advice, not tailored to a specific investment portfolio or the needs of current and/or prospective subscribers. As such, Edison does not offer or provide personal advice and the research provided is for informational purposes only. No mention of a particular security in this report constitutes a recommendation to buy, sell or hold that or any security, or that any particular security, portfolio of securities, transaction or investment strategy is suitable for any specific person.

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
1185 Avenue of the Americas
3rd Floor, New York, NY 10036
United States of America

Sydney +61 (0)2 8249 8342
Level 4, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia