

Datatec

IT services
5 August 2020

Benefiting from operating leverage

Datatec is a global IT services group that has successfully operated a buy-and-build model throughout its 34-year history. The group operates in over 50 countries and is a global partner to Cisco, which represents c 40% of group revenues. After a challenging past few years, having finally bedded down a group-wide SAP implementation, the streamlined business returned to profitability in FY19, with both its major divisions, Westcon and Logicalis, profitable in FY20. In its latest trading update, cost-cutting led to improved year-on-year EBITDA, despite a slight fall in year-on-year revenues. Supported by a weakening US dollar and positive operating leverage, if this trend continues it will demonstrate the resilience of the business.

Positive trading update (four months to 30 June 2020)

In a four-month trading update, management noted that, although group revenues were slightly down on the same period in FY19, EBITDA was improved through reduced operating costs. Westcon International (technology distribution) reported strong demand for networked cloud computing and remote access solutions, while Logicalis (IT services) reported 'much improved' EBITDA despite lower revenue, driven mainly by strength in demand from Europe and the US. Given the uncertain global outlook, management has not issued forward guidance but remains focused on business optimisation, including cost and liquidity management.

Streamlined group benefiting from operating leverage

Following the restructuring of Westcon and the sale of Westcon Americas for US\$614m in FY18 (0.25x revenues, 8.6x EV/EBITDA), a streamlined group returned to profitability in FY19, with both Westcon and Logicalis profitable in FY20. Since then, despite the uncertain global outlook, Datatec continues to benefit from the streamlining of its operations and cost base. For example, Westcon Europe recently signed a new €275m three-year committed banking facility at a 'much reduced rate', replacing its existing credit line due to expire in June 2021. The new facility will meaningfully reduce interest costs, directly adding to the bottom line.

Valuation: Cheap by all measures

In the absence of consensus estimates, we focus on historical numbers in this note, pending publication of our own forecasts. Datatec currently trades on 0.09x FY20 EV/Revenue, 2.5x FY20 EV/EBITDA and a P/E of 13.3x adjusted EPS. We would highlight that this backward-looking valuation gives no weight to the potential for increased demand from the acceleration of the digital transformation, the growth of cloud computing, remote access solutions, security and unified communications.

Historical financials						
Year end	Revenue (US\$m)	EBITDA (US\$m)	Adj EPS (c)	DPS* (c)	P/E (x)	Yield (%)
02/17	3,862	29.0	11.0	4.0	12.0	3.0
02/18	3,924	26.7	(17.2)	165.0	N/A	125.4
02/19	4,332	86.8	6.6	0.0	19.9	N/A
02/20	4,305	158.7	9.9	7.0	13.3	5.3

Source: Datatec. Note: *DPS includes dividends and special dividends.

Price ZAR22.88
Market cap ZAR4.6bn
 ZAR17.38/US\$

Share price graph



Share details

Code DTCJ
 Listing Johannesburg
 Shares in issue 200.5m

Business description

Datatec is a South Africa-based 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).

Bull

- Operational performance aligned with key technology trends, including internet-based networking, security and cloud solutions.
- Long-term track record of value creation (based on total shareholder return (TSR), including special dividends).
- Trades at a steep discount to global peer group.

Bear

- Illiquid shares with little-known equity story.
- Complexity of group holding structure can be difficult for new investors to understand.
- Superficially unattractive share price history conceals more compelling TSR story.

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