

ARB Bhd

(7181 | ARBB MK) Technology | software

Non-Rated

Quantum leap in earnings with ERP and IOT

Fair Value : RM0.51

INVESTMENT HIGHLIGHTS

- **Diversification from timber business to ERP and IOT provides ARB with quantum leap in earnings**
- **Company's large pool of clientele consists of underserved SMEs as well as GLCs**
- **Leveraging on unique partnership model to roll out IT software and platforms and to ensure customer stickiness**
- **Cash-rich balance sheet further supported by on-going conversion of irredeemable convertible preference shares**
- **We ascribe ARB with a fair value of RM0.51**


Company background. ARB Bhd started off in the timber business. Subsequently, it diversified into the provision of IT services, especially in the field of enterprise resource planning (ERP) and internet of things (IOT) solutions.

Fruitful diversification. Subsequent to the diversification, ARB's financial performance has improved tremendously. This is mainly attributable to the existing low adoption rate of Small and Medium Enterprise (SMEs) business digitalisation and Government-linked Companies in South East Asia. As seen in the company's 2019 financial performance, both the revenue and earnings grew by more than five folds. Moving forward, we expect the earnings growth prospect to remain exciting.

Unique ERP business model. Moving away from the traditional ERP pricing model, ARB's unique business proposition includes the setup of a joint venture (JV) company with its partner. Under this arrangement, ARB will provide the necessary investments required to set up the ERP platform while the partners need only to impart their business know-how. Nonetheless, we understand that in the initial years both parties have agreed to plough back the entire profits for reinvestment purposes.

Strong cash position. In order to implement the ERP business model, having a healthy cash reserve is important. In this regard, ARB's FY19 cash level has grown significantly to RM27.6m. This is achieved via the profit-making IT business as well as cash injection from its main shareholder through the conversion of ICPS. Thus, we do not expect any dividend payments in the foreseeable term as new cash generated will be reinvested for future expansion.

Business risk. We have identified three main risks associated with ARB's key businesses. These include: (i) risks of new entrants; (ii) exposure to the industry the partner operates in and; (iii) risk of obsolescence.

Fair value. We value ARB at **RM0.51**, premised on pegging FY21F EPS of 11.9sen against forward PER of 4.3x. The premium multiple reflects the company's high-yielding diversification strategy to the IT business from timber business previously. 

RETURN STATISTICS

Price @ 15 th June 2020 (RM)	0.285
Expected share price return (%)	+78.9
Expected dividend yield (%)	+0.0
Expected total return (%)	+78.9

SHARE PRICE CHART



Share price performance (%)	Absolute	Relative
1 month	-19.7	-24.8
3 months	96.6	65.0
12 months	-36.0	-30.0

KEY STATISTICS

FBM KLCI	1,498.83
Syariah compliant	Yes
Issue shares (m)	289.81
Estimated free float (%)	83.83
Market Capitalisation (RM'm)	101.41
52-wk price range (RM)	0.09– 0.51
Beta vs FBM KLCI (x)	1.88
Monthly velocity (%)	11.02
Monthly volatility (%)	49.08
3-mth average daily volume (m)	18.89
3-mth average daily value (RM'm)	5.93
Top Shareholders (%)	
Dato Liew Kok Leong	6.50
Caravan Capita Management LLC*	5.20
Aspirasi Puspita Sdn Bhd	3.79

*Held indirectly through MIRI strategic Emerging Markets Fund LP and Kenneth Raining Foundation

KEY INVESTMENT THESIS

New lease of life. ARB Bhd was principally involved in the timber business. However, the local timber business has been plagued with tough operating environments with respect to the long-term supply and sustainability, causing the company to be in a loss-making position. In view of this, in 2H2018 the company had diversified into the provision of IT solutions and services, particularly in the field of ERP and IOT. Both ERP and IOT had been identified due to the strong potential it offers, especially to small and medium enterprises (SME). At present, the adoption rate of ERP and IOT solutions amongst SME and GLC is relatively low mainly due to the large initial investment costs and lack of technical know-how. We understand that only large-sized organisations are more inclined to incorporate ERP and IOT solutions into the businesses. Thus, this presents a huge opportunity for ARB to enter. The Malaysian Government is also encouraging the adoption of ERP and IOT as seen in the announcement of the smart cities initiatives and National Policy on Industry 4.0. Furthermore, the advent of 5G will further act as a catalyst for the proliferation of ERP and IOT solutions.

Figure 1: Business milestones since diversification into IT services and platform

Timeline	Segment	Project
January 2019	ERP	Memorandum of understanding (MOU) with Yes's Comm. Enterprise Sdn Bhd (YESS) to provide to ERP System Integrated Solutions ("SIS") to YESS 5 retails outlet, integrating the SIS with YESS daily operation, optimising YESS supply chain which is worth RM20.0m per year.
March 2019	IOT	Joint venture agreement (JV agreement) with Perkasa Selalu Sdn Bhd to develop an intelligence modern lifestyle project located at the city of Daerah Kuala Selangor on a joint venture basis worth RM78.0m.
May 2019	IOT	Secured a green project with an indirect wholly owned subsidiary of University Sains Malaysia to install, operate and manage solar PV system at USM Faculty of Engineering.
May 2019	IOT	Business contract with IJ Ventures Sdn Bhd to carry out IOT systems, engineering, procurement, commissioning and management (SEPCM) for a proposed residential development comprising 130 units of single-storey terrace houses in Perak which is worth RM18.0m.
May 2019	IOT	Accepted Letter of Award from Ageson Berhad for IOT SEPCM project for 260 units of serviced apartments in Shah Alam worth RM60.4m.
July 2019	IOT	Memorandum of agreement (MOA) with Shuifa IoT Tech. Co., Ltd ("SITC") to form a strategic partnership to carry out the project in relation to smart household water filtration system that can be supplied to the public and for individual households to enjoy safer and healthier water source for daily use (Smart Household Water Filtration Project) worth RM600m.
July 2019	IOT	MOA with Hangzhou Mayam IoT Tech. Co., Ltd to form a strategic partnership in the deployment of smart water meters that can be deployed by water authorities in Malaysia to measure, collect and analyse real-time water consumption information and data, including water leakages, water pressure, date and time of water consumed by households (Smart Water Metering Project).
August 2019	ERP	Business contract with Tatan Land Co., Ltd to provide customized ERP system and SIS in Cambodia which is worth USD20.0m per year.
December 2019	ERP	JV agreement with Orange Social Media Sdn Bhd to set up a JV company to form a strategic partnership to undertake the development and implementation of an ERP system platform.
May 2020	IOT	Business partnership agreement with Beijing Kuangshi Technology Co. Ltd. (Megvii) to collaborate and explore on business opportunities in the area of artificial intelligence ("AI") facial recognition application and relevant algorithm technology in the IOT field in Malaysia.
June 2020	ERP	Business partnership agreement to explore and undertake projects in relation to enterprise application software solutions and related IT consultancy services and outsourcing partnership agreement on the enterprise applications software solution on project basis with Databook Pte Ltd.

Source: Company, MIDFR

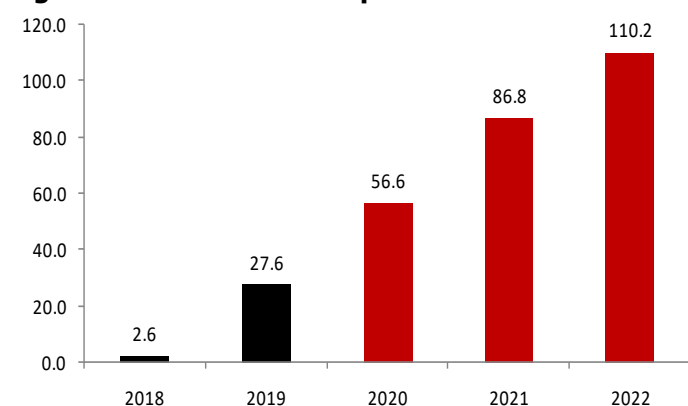
Unlocking the potential of IOT. The company's venture into the IOT realm is primarily due to the huge opportunity the segment presents. The IOT market is expected to grow by leaps and bounds as it brings about the betterment of work processes via automation and artificial intelligence. This will lead to a reduction in the costs of operations as well as time saving benefits. Moreover, the data generated can also be used to further understand the operations. In this regard, the company offers end-to-end customised solution to suit the different requirements of the partners and their businesses. To maintain its competitiveness, the company constantly exploits the latest cutting-edge technologies available.

A unique ERP business model. ARB implements a unique business model whereby it seeks to form a JV company with its target partner, where ARB will have the major controlling interest. Under the JV arrangement, the partner will provide the business know-how, while ARB will implement and periodically update its ERP solutions. The differentiating factor that makes this business model unique lies with the part where ARB will fully bear the cost of setting up the ERP solutions. Traditionally, SMEs are reluctant (or unable) to provide an upfront hefty investment on the implementation of ERP. Thus, this arrangement will entice prospective SMEs to form a JV agreement with the company. Under the JV agreement, both ARB and its JV partner are entitled to a share of profit from the JV. However, we are made to understand that in the initial years of the venture, the profits earned will be plough back for reinvestment purposes. We opine that this arrangement creates a 'win-win situation' whereby both parties will be able to focus on their respective field of expertise.

Cash generative business. The diversification into technology services has since been able to generate remarkable returns to the company which has successfully reversed its previously loss-making position. This was mainly supported by the management's aggressive marketing efforts to secure various business partners as well as the double-digit profit margin that the IT business currently commands. Being an MSC Malaysia Status Company, ARB is also eligible for 100% tax exemption on their statutory income. Moreover, the high-yielding business venture has also averted the company from the need to secure borrowings which would only add-on to the cost of doing business.

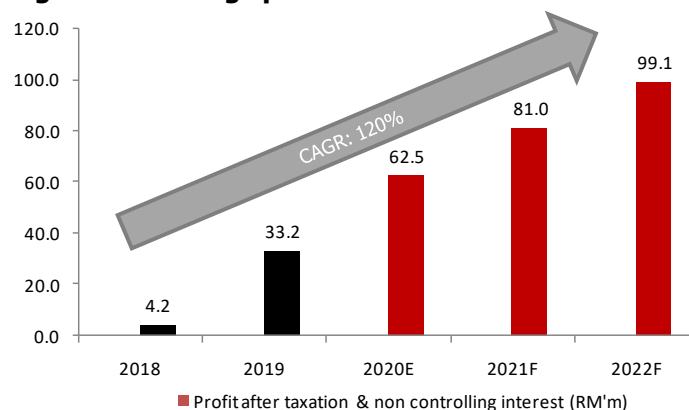
Solid financial position. To support its unique ERP business model, having a healthy level of cash reserve is vital. As at end December 2019, which is approximately one year after the company has diversified into the provision of IT solutions, its cash reserve has improved considerably to RM27.6m from RM2.5m as at end of 2018. The improvement on cash reserve was mainly attributable to the cash generating capability as explained above. In addition, there is also cash injection from its main shareholder via the conversion of irredeemable convertible preference share (ICPS). In this regard, we have assumed a more aggressive, front-loaded conversion on the outstanding ICPS (785.5m shares as at end 2019) before tapering off in the later years. We view that this is in-line with the company's plan to grow the business rapidly given its nascent business stage. On a separate note, given that ARB is currently on a rapid growth phase, we do not expect any dividend payments in the foreseeable term.

Figure 2: Cash and cash equivalents



Source: Company, MIDFR

Figure 3: Earnings performance chart



Source: Company, MIDFR

EARNINGS PERFORMANCE

Earnings growth momentum to carry on. ARB decided to venture into the provision of IT solutions and services in June 2018. Premised on this, the company has returned to profitability in 3QFY18. Fast forward, 2019 represents the first full year whereby the IT business takes centre stage while the timber business is being wound down as at the end of 2019. In FY19, revenue grew by more than five folds to RM102.6m, primarily from the rendering of IT services. Coupled with a healthier profit margins, ARB's earnings increased by +684.6%yoy to RM33.2m as compared to FY18 profit of RM4.2m. Taking cue from its 2019 business milestones, we believe that the company will maintain its effort to expand its IT business aggressively. This will translate into remarkable revenue growth and thus, earnings growth prospects in the foreseeable term.


KEY BUSINESS RISK

Risk of new entrants. The business model advocated by ARB is comparatively enticing for competitors to replicate, especially so should the latter have prior experience in the software solution business and possess sufficient capital. On top of this, ARB would need to constantly stay relevant and to be able to meet the ever-evolving needs of its partners. Nonetheless, we view that the ARB would have the first-mover advantage to secure its clientele base. This would in-turn serve as a reference project for its prospective partners.

Exposure to the partners' industry. Due to its unique revenue-sharing business model, we view that ARB's well-being is also tied to the industry that the partner is in. This risk however, could be partially mitigated by being selective in the type of industry of its prospective partners. In this regard, we understand that ARB seeks to partner both SME with more than 10 years of track record as well as GLC that have yet to embrace digitalisation. Note that the large organisations realm is predominantly dominated by the Big Three namely Oracle, SAP and Microsoft.

Risk of technology obsolescence. The company's business revolves around the provision of IT software and platforms. This mean it is expose to the fast pace of technology change. Thus, it is imperative that the company continues to keep abreast and embrace the latest advancements and innovations in the technology sector. With the healthy cash level that the company possesses, we view that it has the required financial capability to maintain its competitive edge. In addition, we believe that the company would have also done the necessary cost benefit analysis.

VALUATION

Fair value. We are attaching a fair value of **RM0.51** to ARB Bhd. This is derived from pegging FY21F EPS of 11.9sen to forward PER of 4.3x. The applied target PER is the company's one standard deviation premium to its the two-year historical average PER of 2.6x. We view that the higher valuation multiple attached is justifiable given the company's high-yielding diversification strategy into the IT business from the timber business previously. 

INVESTMENT STATISTICS

Financial year ending 31st December (in RM'm, unless otherwise stated)	2018	2019	2020E	2021F	2022F
Revenue	15.3	102.6	285.8	361.6	443.2
EBITDA	4.8	33.3	63.0	82.5	102.1
Operating profit	4.3	32.8	61.8	79.7	97.0
Profit before taxation	4.3	33.0	62.2	80.6	98.6
Profit after taxation & non-controlling interest	4.2	33.2	62.5	81.0	99.1
PATANCI growth (%)	n.a.	684.6	88.4	29.5	22.3
EPS (sen)	6.3	10.1	11.9	11.9	11.8
PER (X)	4.5	2.8	2.4	2.4	2.4

Source: Company, MIDFR

*Forecasted EPS from FY20 onwards are affected by the on-going conversions of ICPS

SUMMARY FINANCIAL STATEMENT

Statement of Profit or Loss (RMm)	2018	2019	2020E	2021F	2022F
Revenue	15.3	102.6	285.8	361.6	443.2
EBITDA	4.8	33.3	63.0	82.5	102.1
Operating profit	4.3	32.8	61.8	79.7	97.0
Profit before tax	4.3	33.0	62.2	80.6	98.6
Taxation	0.0	-0.2	-0.4	-0.5	-0.7
Minority Interest (MI)	0.0	-0.4	-0.7	-0.9	-1.1
Profit after tax & MI	4.2	33.2	62.5	81.0	99.1
EPS(sen)	6.3	10.1	11.9	11.9	11.8
Operating profit margin (%)	28.1	32.0	21.6	22.0	21.9
Profit before tax margin (%)	27.9	32.2	21.8	22.3	22.2
Profit after tax & MI margin (%)	27.7	32.3	21.9	22.4	22.4

Statement of Cash Flows (RMm)	2018	2019	2020E	2021F	2022F
Profit before taxation	4.3	33.0	62.2	80.6	98.6
Depreciation & amortisation	0.5	0.5	1.2	2.8	5.1
Interest income	0.0	0.3	(0.5)	(1.0)	(1.6)
Interest expense	0.0	0.0	0.1	0.1	0.1
Others	(0.1)	(7.9)	(2.0)	(1.6)	(1.6)
OP/(L) before changes in WC	4.6	25.9	61.0	80.9	100.6
Changes in WC	(3.8)	(38.4)	(28.5)	(19.4)	(20.8)
Income Tax	(0.1)	0.3	(0.4)	(0.5)	(0.7)
Net interest received	(0.0)	0.2	0.5	1.0	1.6
Cash flow from Operations	0.6	(12.0)	32.6	62.0	80.7
Capital expenditure	(0.0)	(15.4)	(42.9)	(63.3)	(88.6)
Others	0.1	0.3	0.0	0.0	0.0
Cash flow from investments	0.1	(15.1)	(42.9)	(63.3)	(88.6)
ICPS	0.0	42.3	39.3	31.4	31.4
Others	0.8	10.0	0.0	0.0	0.0
Cash flow from financing	0.8	52.3	39.3	31.4	31.4
Net Cash Change	1.5	25.1	29.0	30.1	23.4
Beginning cash	1.1	2.5	27.6	56.6	86.8
Ending Cash	2.5	27.6	56.6	86.8	110.2

Source: Company, MIDFR

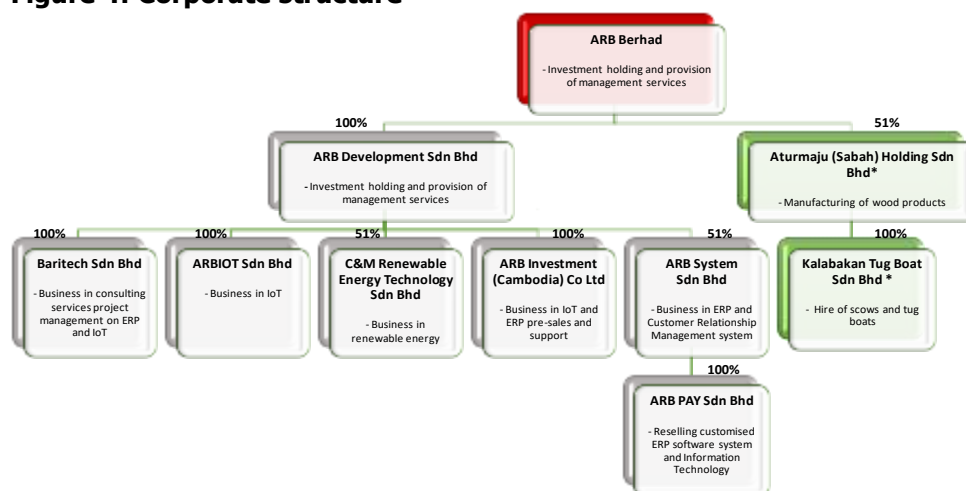
Statement of Financial Position (RMm)	2018	2019	2020E	2021F	2022F
<i>Non current assets</i>					
PPE	11.7	18.4	60.1	120.5	204.1
Others	0.0	32.9	32.9	32.9	32.9
<i>Current assets</i>					
Inventories	0.0	0.0	0.0	0.0	0.0
Receivables	10.1	45.1	75.3	95.3	116.8
Others	0.4	3.0	3.0	3.0	3.0
Cash	2.6	27.6	56.6	86.8	110.2
Total assets	24.8	127.0	227.9	338.4	466.9
Share capital	15.7	60.3	99.5	131.0	162.4
ICPS conversion	0.0	7.9	5.9	4.3	2.7
Other reserves	0.0	0.9	0.9	0.9	0.9
Retained profits	7.7	40.8	103.4	184.4	283.5
Non-controlling interest	0.0	9.6	8.9	8.0	6.8
Total equity	23.4	119.4	218.6	328.5	456.3
<i>Non current liabilities</i>					
Lease liabilities	0.0	0.4	0.4	0.4	0.4
Deferred tax liabilities	0.0	6.1	6.1	6.1	6.1
<i>Current liabilities</i>					
Payables	1.2	0.8	2.5	3.1	3.8
Others	0.2	0.3	0.3	0.3	0.3
Total Liabilities	1.4	7.6	9.3	9.9	10.6
Total equity & liabilities	24.8	127.0	227.9	338.4	466.9

Ratios	2018	2019	2020E	2021F	2022F
Profitability ratios (%)					
ROE	18.1	30.2	29.8	25.3	22.0
ROA	17.1	26.1	27.4	23.9	21.2
Liquidity ratios (x)					
Current ratio	9.6	68.3	48.1	54.0	56.0
Cash ratio	1.9	24.9	20.2	25.3	26.8
Growth Ratios (%)					
Revenue	33.6	572.8	178.4	26.5	22.6
Profit after tax & MI	n.m.	684.6	88.4	29.5	22.3

APPENDICES

Company background. Predominantly, the company is in the timber processing business. However, being aware of the challenging industry the company is in, it commenced its diversification into the IT business to provide IT solutions and services. ARB currently develops customised ERP systems to cater to its strategic partners' needs. In addition, it also provides a complete solution for the integration of internet of things (IOT) systems and devices from designing to project deployment which also includes provision of re-energy solutions.

Figure 4: Corporate structure



Source: Company, MIDFR

Internet of Things. Internet of things refers to a network of physical objects such as vehicles, machines, home appliances to name a few, that have sensor and application program interface attached to connect and exchange data over the internet. In the realm of IOT, the company focuses on three main segments i.e. smart home, smart building and smart water supply management solutions. In addition, the company also aims to play a part in supporting the case for environmental sustainability. This is done through partnerships with like-minded organisations to build re-energy solutions for a more sustainable future.

Figure 5: IOT offerings

	
Smart home	Smart building
<ul style="list-style-type: none"> ➤ Design smart home solutions which can integrate a range of electrical appliances, centralized control and remote monitoring accessible via mobile devices and Windows operating system. ➤ Provision of comprehensive professional electrical wire installation and home data network with safe and restorable smart home system design. ➤ Offer smart home products and integration services that connect kitchen, closet or office to the smart home network and integrate it flawlessly with other smart home appliances. 	<ul style="list-style-type: none"> ➤ Provision of a complete solution with full turnkey deployment from designing, installation, testing, pre-commissioning and commissioning of various IOT systems and devices as well as integration of automated systems for smart building, including installation of wire and wireless and mechatronic works. ➤ Provision of IOT system, engineering, procurement, commissioning and management to property developer and contractor



Smart water supply management solutions

- Offer software and hardware, data management and analytics tools.
- Integrate, configure, perform pre-commissioning as well as testing of smart water meter system.
- Provide insights for customer care and billing, analysis, operations and maintenance.



Re-energy solutions

- **Grid Management System (GMS).** Formulation of smart grid strategies and system planning (design), construction (C&S), project management (M&E), control operations, maintenance and more.
- **Hybrid Energy Management.** Provision of solutions that combine primary solar power from a PV system with another secondary power generating energy source such as diesel generators, fuel cells, battery storage system to name a few.
- **Solar Energy Distribution.** Provision of software and hardware solutions for solar photovoltaic (PV) system.

Source: Company, MIDFR

Enterprise Resource Planning. ERP refers to the integration of a company's various core processes into a single system. This core processes encompass, but not limited to, finance, human resource, manufacturing, supply chain, services and procurement.

Figure 6: ERP offerings



Enterprise resource planning solution

- Design and develop ERP systems, including customisation on system dashboards for the business owner's ease of reference.
- Develop and implement ERP platforms for outlet management as well as allow business owners to connect more efficiently with the customers.
- Installation, troubleshooting and provision of support to ERP solutions.
- Customizing ERP features to include vast range of applications and modules to cater to specific industries or businesses.

Source: Company, MIDFR

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

STOCK RECOMMENDATIONS

BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <10% over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.

SECTOR RECOMMENDATIONS

POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.