# Datatec

Initiation of coverage

## Starting to unlock underlying value

IT services

2 November 2020

**Datatec is a global IT services and solutions provider, operating in over 50 countries through three divisions, Logicalis (IT services), Westcon International (technology distribution) and Analysys Mason (consultancy). Following a group reorganisation, all three divisions are now profitable and cash-generative, delivering a robust H121 on a constant currency basis, with Logicalis affected by currency weakness, offset by a strong performance from Westcon. Benefiting from technology trends (security, networking, cloud, unified communications), management expects revenue growth of 4–6% in the medium term driven by investment in software and services. Datatec trades at a substantial discount to its peers at an FY21e EV/EBITDA of 2.5x and P/E of 13.3x. In our opinion, this valuation reflects neither Datatec's recent transformation nor its future growth prospects.**

| Year end | Revenue (US$m) | PBT* (US$m) | EPS* (c) | DPS (c) | P/E (x) | Yield (%) |
|---|---|---|---|---|---|---|
| 02/19 | 4,332 | 65.7 | 3.0 | 0.00 | 45.8 | 0.0 |
| 02/20 | 4,305 | 79.1 | 10.6 | 7.00 | 12.8 | 5.2 |
| 02/21e | 4,258 | 67.0 | 10.1 | 3.44 | 13.3 | 2.5 |
| 02/22e | 4,419 | 84.6 | 16.4 | 5.46 | 8.7 | 3.9 |

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

## Factors driving improved performance

Despite the uncertain global outlook, Datatec continues to benefit from the streamlining of its operations and cost base. In addition to the transformation programme, a range of factors are driving Datatec's improved operating performance, including cost-cutting, investment in centralised systems and delivery platforms, together with an increased emphasis on software, services and annuity revenue streams as the group continues to invest in IT services.

## A resilient, profitable, global ICT business

Datatec is resilient, profitable, cash-generative and on an improving financial track. In H121, group sales fell 1% to US$2.03bn (2.8% rise in constant currency (cc)), with adjusted EBITDA of US$66.7m. Westcon sales rose 4% to US$1.30bn, with adj. EBITDA up 20% to US$23.0m. Logicalis sales fell by 10% to US$700m (1.9% fall cc), with currency weakness in Latin America offsetting stronger European demand. Logicalis adj. EBITDA fell 19% to US$45.2m (H120 benefited from a US$14m tax credit). Based on our forecasts, FY21 sees a moderate impact from COVID-19, but then a recovery in earnings in FY22/23, with EBITDA of US$189m in FY23.

## Valuation: Buy one get one free

Datatec currently trades on 0.08x FY21e EV/Revenue, 2.5x FY21e EV/EBITDA and a P/E of 13.3x. This low valuation, supported by our DCF, is backward-looking and does not reflect the transformation the business has achieved, its improving operational performance or its future growth prospects. A simple sum-of-the-parts analysis suggests that Datatec's current EV is well below our EV for Logicalis alone (c US$600m), with Westcon and Analysys Mason effectively thrown in for free. Management is focused on unlocking the group's underlying value.

| | |
|---|---|
| **Price** | **ZAR22.01** |
| **Market cap** | **ZAR4.4bn** |
| | ZAR16.28/US$ |
| Net debt (US$m) at 30 August 2020 | 73.2 |
| Shares in issue | 200.45m |
| Free float | 63.2% |
| Code | DTCJ |
| Primary exchange | Johannesburg |
| Secondary exchange | N/A |

### Share price performance


| % | 1m | 3m | 12m |
|---|---|---|---|
| Abs | (0.3) | (4.3) | (40.5) |
| Rel (local) | 4.7 | 3.4 | (35.7) |
| 52-week high/low | | ZAR37.30 | ZAR18.25 |

### 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

| | |
|---|---|
| FY21 results | May 2021 |
| AGM | July 2021 |

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

# Investment summary

Datatec is an international ICT solutions and services group, listed in Johannesburg and operating in more than 50 countries across North America, Latin America, EMEA and Asia-Pacific. The company has a 34-year history and employs more than 10,000 staff, serving more than 20,000 business customers around the world. Datatec has strong partnerships with leading global technology companies, such as IBM, Microsoft, HPE, Palo Alto, Fortinet, Oracle and Avaya and is one of five global gold partners to Cisco, which represents c 40% of group revenues. The group operates through three divisions, offering technology distribution (Westcon International – 61% of H121 revenues), IT services (Logicalis – 38% of H121 revenues) and consultancy (Analysys Mason – 1% of H121 revenues).

## Global, vertically integrated ICT solutions and services group

Management's vision is for Datatec to be a global leader in speciality, high-value ICT solutions through its distribution and integrated services businesses, in collaboration with leading vendor technology partners. At its simplest, a substantial part of Datatec's business is based around the supply and service of US technology to a global customer base. Its core strengths include:

- **Global presence**: Datatec is located in over 50 countries, with over 10,000 skilled employees and an experienced multinational management team.
- **Diversified business**: Datatec is comprised of three principal businesses (Westcon, Logicalis and Analysys Mason) that work at multiple points of the ICT supply chain but are operationally independent, providing diversified sources of income and unique growth opportunities.
- **Focus on growth segments**: over recent years, Datatec has been growing its software and IT services footprint. Datatec is focused in particular on high-value, fast growing sectors of the ICT market, including information security, networking, unified communications, cloud and data centre technologies.
- **Strong vendor and customer relationships:** the group has strong relationships with a wide range of leading technology vendors (including Cisco), as well as having a roster of over 22,000 business customers.

## Financials: Profitable H121

Following its delisting from AIM in 2017 and the subsequent 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 all three divisions now trading profitably.

Group revenues for H121 (to August 2020) fell 1% y-o-y to US$2.03bn (H120: US$2.06bn), with adjusted EBITDA down 5% y-o-y at US$66.7m (before US$5.9m of restructuring costs) (H120: US$70.0m). Westcon revenues rose 4% y-o-y to US$1.30bn (H120: US$1.25bn), with adjusted EBITDA up 20% y-o-y to US$23.0m (H120: US$19.1m), driven by strong cloud demand and remote access solutions. At the same time, Logicalis revenues fell by 10% y-o-y to US$700m (H120: US$780m), with currency weakness in Latin America more than offsetting a stronger European performance. Logicalis's adjusted EBITDA fell 19% to US$45.2m (H120: US$56.0m), although H120 benefited from a one-off tax credit of US$13.6m due to tax overpayments in Brazil. Stripping out this tax credit from H120, adjusted EBITDA would have improved by c 8% in H121. Highlighting Datatec's strong operating cash flow, net debt as at 31 August 2020 fell to US$73.2m (FY20: US$139.9m).

The impact of adverse currency movements is highlighted by the fact that, in constant currency terms, group revenues increased by 2.8% (vs reported 1.2% fall), with Logicalis revenues falling by 1.9% (vs reported 10.2% fall) and Westcon revenues rising by 5.4% (vs reported 4.0% rise).

## Outlook: Resilient FY21, further benefits expected FY21–22

While a deteriorating global economic environment may affect top-line growth in the short term, Datatec's high variable cost base and resilient business model should mitigate the impact on its underlying performance. Datatec is benefiting from the streamlining of its operations and cost base, with progressive margin improvement at Logicalis and improving profitability at Westcon. The full impact of Datatec's investment in its central IT platforms and services has yet to flow through, and with cost-cutting supporting the bottom line, further benefits are anticipated in FY21 and FY22.

In the short term, the group is benefiting from the surge in remote working, including business investment in security and communications. In the medium term, management's strategy is to grow software and services to more than 50% of group gross profits, up from 43% in FY20 (18% in FY11). Future growth is expected to be driven by increasing adoption of cloud services, providing opportunities in cloud-solution architecture, cloud migration and managed services and annuity services, with the cloud delivery of 'as-a-service' driving integration of hardware, software and services into bundled managed services.

Overall, we forecast a 1.1% fall in group revenue to US$4.26bn in FY21 (FY20: US$4.30bn) as COVID-19 affects global demand, followed by a bounce-back in FY22, with 3.8% annual growth taking group revenues to US$4.42bn. We then forecast revenue growth strengthening further in FY23, with revenues growing by 4.4% to US$4.61bn. We also forecast group EBITDA to rise from US$137m in FY21 to US$189m in FY23, with EBITDA margins rising from 3.2% to 4.1%. Improving profitability should drive strong cash generation with net operating cash flow of US$99m in FY21, rising to US$112m in FY23. We expect this to allow the group to return to paying a dividend of one-third of underlying EPS (uEPS) following the FY21 results, so we forecast a yield of 2.5% in FY21, rising to 6.4% in FY23.

## Valuation: Significant upside potential as value is unlocked

Datatec offers investors an opportunity to invest in a leading international ICT group that we believe is materially under-valued. Over the past few years, management has rationalised the business, as well as having invested in its central platforms and systems to better leverage the company's global footprint. With increased investment in IT services, management is also positioning Datatec to benefit from key technology trends that are likely to further enhance future growth, including information security, networking, unified communications, cloud and data centre technologies. These factors, together, should help support the group to deliver medium-term revenue growth of 4–6%.

Datatec continues to trade at a substantial discount to its (largely European and North American) peer group, trading on an FY21e P/E of 13.3x and an FY21e EV/EBITDA multiple of 2.5x. We are of the view that this low valuation is backward-looking and does not reflect the transformation of the business, its improving operational performance or its future growth prospects. This undervaluation is supported by our DCF analysis as well as a simple sum-of-the-parts analysis, which suggests that Datatec's EV is well below our EV for Logicalis alone (US$600m), with Westcon and Analysys Mason effectively thrown in for free (see page 20 for more details). This approach ignores any discount that investors might apply for Datatec's holding company structure, sovereign risk and emerging markets exposure.

## COVID-19 and sensitivities

In its H121 results, Datatec noted total COVID-19-related restructuring costs of US$5.9m, US$2.2m for Logicalis and US$3.7m for Westcon. Westcon also experienced increased freight costs due to COVID-19 (gross margins down from 11.0% in H120 to 10.3% in H121), with Logicalis suffering from the consequent weakening of emerging market currencies. As a global business, with c 33% of H121 EBITDA from emerging markets, Datatec remains exposed to emerging market currency fluctuations and economic volatility. As a supplier of largely US technology products to the global market, the prospect of an escalating US/China trade war will have consequences on end-user demand, some positive, some negative. With the group focused on the higher value, faster-growing products and services in the ICT supply chain, Datatec's product range is constantly evolving and subject to rapid technological change. The group is dependent on certain vendors, particularly Cisco, as well as to individual customers in specific regions. The weak global outlook due to the COVID-19 pandemic increases short-term business uncertainty.

# Company description

## Introduction

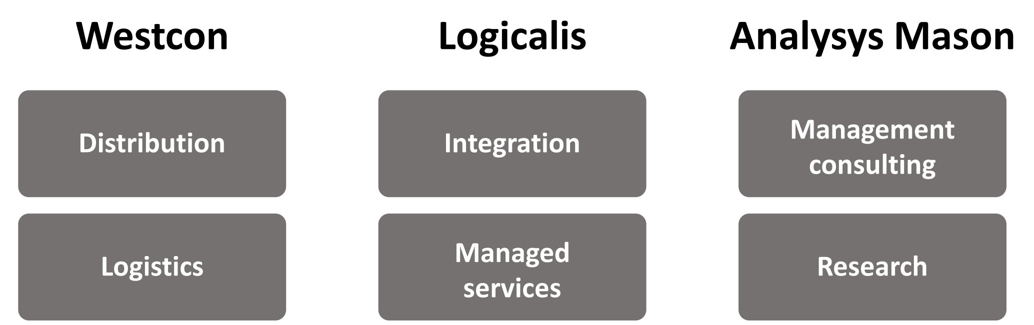
Datatec is a Johannesburg-listed international information and communication technology (ICT) solutions and services group, operating in more than 50 countries across six continents. The group has over 10,000 employees and over 20,000 corporate and public sector customers. Datatec also has partnerships with many of the leading US technology vendors, including Cisco, Microsoft, Palo Alto Networks, Avaya, Extreme, Juniper, Check Point, F5 and Symantec.

## Brief history

Datatec was founded in 1986 by Jens Montanana, the group CEO, and was listed on the Johannesburg Stock Exchange in December 1994. In 1997, the company began its international expansion and acquired UK-based IT firm Logical Networks, which later changed its name to Logicalis. In June 1998, Datatec acquired US distributor Westcon, for US$160m, and consolidated its distribution business under the Westcon brand. Datatec acquired communications consultancy Mason Communications in 1999 and UK-based telecommunications research and consultancy firm Analysys in 2004. Analysys was merged with Mason Communications to form Analysys Mason. In 2006, the company underwent a dual listing of its shares on AIM, which it subsequently cancelled in 2017, due to limited share liquidity. In FY18, Datatec sold the North and Latin American operations of Westcon-Comstor to SYNNEX, a US-based IT supply chain services company, for US$614m (including the subsequent earnout), as well as a 10% stake in Westcon International for US$30m.

## Divisional breakdown

**Exhibit 1: Datatec's core divisions**




Source: Edison Investment Research

Datatec operates through three divisions: Logicalis, providing IT services; Westcon International, offering technology distribution through two principal brands, Westcon and Comstor; and Analysys Mason, which provides management consultancy and financial services.

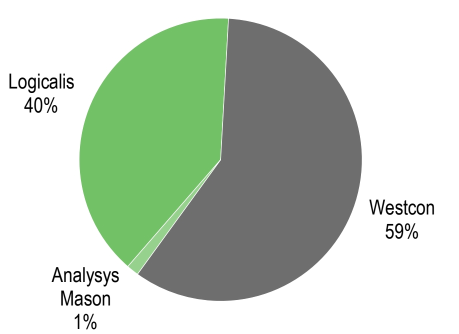
**Exhibit 2: FY20 divisional side-by-side comparison**

| US$m | Logicalis | Westcon | Analysys Mason | Group |
|---|---|---|---|---|
| Revenues | 1,700 | 2,545 | 60 | 4,305 |
| Gross profit | 441 | 276 | 25 | 742 |
| Margin | 25.9% | 10.8% | 41.3% | 17.2% |
| EBITDA* | 124 | 40 | 9 | 159 |
| Margin | 7.3% | 1.6% | 16.0% | 3.7% |
| Employees | 7,000+ | 3,000+ | 300+ | 10,000+ |

Source: Datatec. Note: *Divisional EBITDA breakdown excludes central costs.

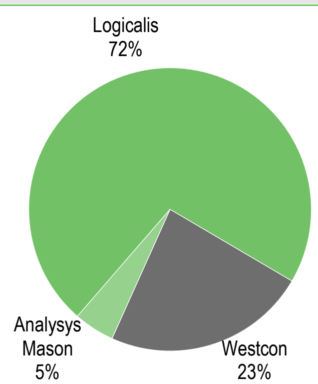
Westcon International represents the majority of revenues (c 59%) but, given its lower margins, only represented 37% of FY20 gross profit. Profit contribution is driven principally by Logicalis, providing 60% of gross profits and 72% of EBITDA in FY20, with a gross margin of 26% (vs 11% at Westcon) and EBITDA margins of 7% (vs 2% at Westcon). Although Analysys Mason may be an attractive business, it is relatively marginal in group terms, contributing 1% of revenues and 5% of EBITDA. All three divisions were materially profitable at the EBITDA level in FY20.

**Exhibit 3: FY20 revenue breakdown**




Source: Datatec

**Exhibit 4: FY20 EBITDA breakdown**




Source: Datatec. Note: EBITDA excludes central costs.

### Logicalis: Integration and managed services

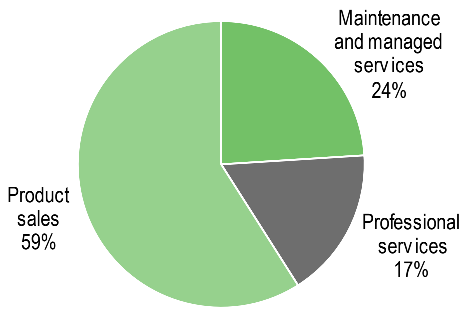
Logicalis is an international IT solutions provider, offering a suite of digital services to accelerate the digital transformation of its 10,000 global customers. It has over 7,000 employees, operating in 26 countries worldwide (Europe, North America, Latin America, Asia-Pacific and Africa), acting as a customer advocate, and a managed services and implementation partner for some of the world's leading technology companies, including Cisco, IBM, Microsoft, Oracle, HPE, NetApp and VMware. The division aims to be the leading ICT services and solutions partner to customers in its key markets around the world.

Logicalis drives digital enablement through services including:

- Independent, integrated multi-vendor solutions
- Lifecycle and managed services
- Cloud solutions

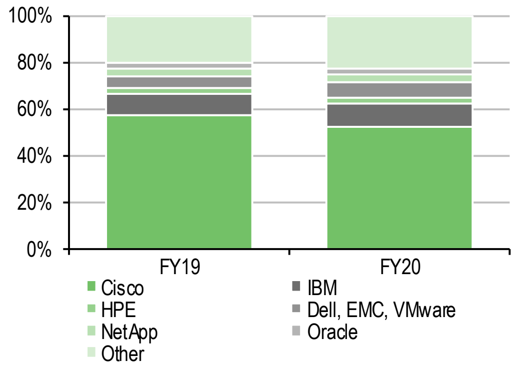
Management remains confident about the long-term prospects for the industry and Logicalis's positioning within it. As such, the business continues to develop its long-term capabilities within cloud, IoT, software, security, data management and intelligent networks as drivers of transformation and long-term value. Although technology will be even more firmly embedded in customers' operations following the COVID-19 pandemic, the impact of COVID-19 on Logicalis's short- to medium-term trading remains difficult to forecast, although emerging markets (and their currencies) are expected to remain volatile.

**Exhibit 5: Logicalis revenue by segment**




Source: Datatec

**Exhibit 6: Product revenue by vendor**




Source: Datatec

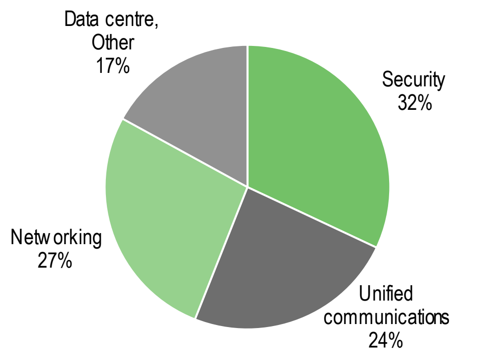
The majority of Logicalis's revenue in FY20 came from product sales (59% of revenues), with the remainder split between maintenance and managed services and professional services (design and implementation of technology solutions). Dissecting product sales further (59% of total Logicalis revenues), we can see that the majority of product sales revenues (52%) derived from Cisco products. To be clear, this means that c 30% (52% × 59%) of Logicalis revenues derive from Cisco product.

## Westcon International: Technology distribution

Westcon International is a technology distributor with over 3,000 employees, spread across 50 countries worldwide, with 18 logistics and staging facilities globally. The division works with over 11,000 partners, including a portfolio of market-leading vendors, such as Cisco, Palo Alto Networks, Avaya, Extreme, Juniper, Amazon Web Services, Check Point, F5 and Symantec. The business distributes technology solutions across cyber security, network infrastructure, unified communications products, data centre solutions and channel support services. The division markets itself under both Comstor (Cisco products) and Westcon (all other manufacturers) brands. Its ambition is to be the leading value-added distributor (offering packaged solutions, tailored to the individual customer's needs) for networking and cybersecurity vendors across Europe, the Middle East, Africa and Asia-Pacific.

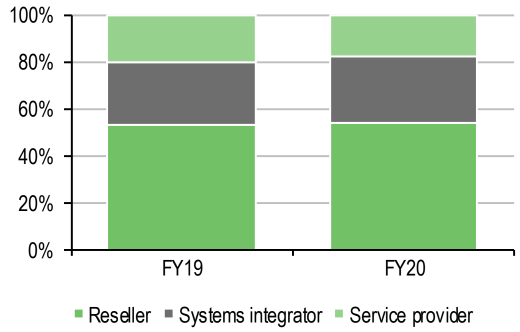
Westcon responded to the COVID-19 pandemic by implementing remote working and social distancing measures to protect its employees, but also ensuring continued support for its channel and vendor partners. Westcon's key logistics centres in the UK, Netherlands, Middle East, South Africa and Asia-Pacific all remained open, maintaining service levels, while ensuring staff welfare.

**Exhibit 7: Westcon revenue by category**




Source: Datatec

**Exhibit 8: Revenue by customer type**




Source: Datatec

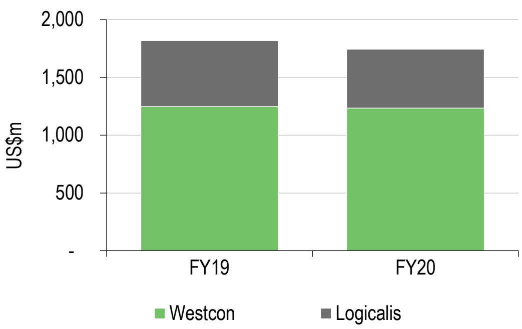
## Analysys Mason: Management consulting

Analysys Mason provides strategic advisory, modelling and market intelligence services in the networking and telecoms sectors. Its main consulting fields include strategy, transaction support, regulatory advice and market research in areas such as 5G and fibre, where Analysys Mason has deep domain expertise. Analysys Mason employs over 300 staff, operating from 16 offices across 10 countries internationally.

# Cisco: First among equals

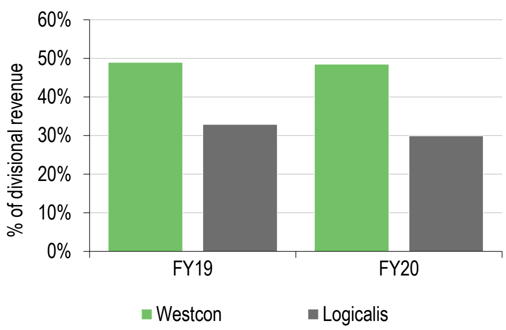
Datatec is dependent on certain vendors, none more so than Cisco, with a relationship going back over 20 years and whose products accounted for c 40% of FY20 revenues (FY19: 42%). Datatec's recent business transformation also mirrors a similar refocusing of Cisco's business around software and service-based annuity revenues, moving the focus away from pure hardware sales. In FY20, Cisco business represented c US$1.2bn of Westcon revenue (49% of divisional revenue) and US$0.5bn of Logicalis revenue (c 30% of divisional revenue), totalling US$1.7bn across the group.

**Exhibit 9: Group's Cisco product revenue**




Source: Datatec

**Exhibit 10: Divisional Cisco product revenue**




Source: Datatec

Westcon's business unit Comstor is solely focused on Cisco (with other manufacturers' products distributed under the Westcon brand), distributing the full suite of Cisco solutions to more than 100 countries globally. These include Cisco security (firewall, web and email threat detection for networks and mobile); Cisco collaboration (collaborative software); Cisco software (software licensing); Cisco data centre (data storage for mission-critical applications); Cisco enterprise networking (SME switching, wireless and routing solutions); and Cisco services (customer support for over 180 countries in 17 languages).

Logicalis has a strong relationship with Cisco, having obtained Global Gold status (Cisco's highest partner category) in FY18 (one of only five companies globally). A number of Logicalis employees are members of the elite DevNet 500, a group of engineers who qualified early for Cisco's innovation certification. In addition, Logicalis was awarded Cisco's Global IoT Industry Partner of the Year during FY20, with further multiple partner awards by country and region received on an annual basis.

The benefit of having a significant exposure to a given vendor is that customers are attracted to Datatec, knowing that the group offers the full suite of products and services and has the expertise to implement solutions of whatever size. In turn, the vendor rewards Datatec with discounts and incentives that improve with scale, and Datatec is also likely to receive privileged access to new products. The downside is that Datatec has, at least in part, aligned its business with Cisco's business, with sales dependent on Cisco's ability to continue to deliver a product range that is attractive to the end-user, delivers value and offers innovation.

Datatec's recent strategy initiatives mirror Cisco's own initiatives, including its increasing emphasis on software over hardware, with a particular focus on subscription revenues over one-off sales. However, management recognises Datatec's exposure to Cisco, actively looking to expand its non-Cisco business, in particular by further developing relationships with other strategic vendors such as Microsoft (Logicalis is a recognised Microsoft Azure Expert Managed Services Provider (MSP), one of only 65 firms globally), Palo Alto Networks, F5 and Check Point as well as more 'born-in-the-cloud' vendors.

## M&A strategy: Acquisition of specialist expertise

M&A is part of the Datatec story, with the group having been a serial acquiror of bolt-on businesses since it came to market, which have all been successfully integrated into the group. Small acquisitions are generally driven by the divisional management teams, with the strategic framework agreed centrally and central support provided where appropriate. The focus is typically on targets that deliver a particular skill set or sector-expertise, as well as a means to extend Datatec's global footprint into new markets.

Datatec is also an occasional seller of businesses, for example, the sale of Westcon Americas to SYNNEX in FY18, for US$614m (0.25x revenues, 8.6x EV/EBITDA). The sale was conducted as part of the restructuring of Westcon, improving the division's operating efficiency, crystallising value for shareholders and reducing the group's gearing. A potential IPO of Logicalis Latin America is another partial disposal under consideration.

### Recent acquisitions

Datatec completed four acquisitions in FY20, with a further two closing in H121.

**Kumulus, 6 August 2020** – Logicalis Latin America acquired a 30% stake in Kumulus, a Brazilian managed services and solutions specialist with 80 employees specialising in Microsoft cloud, data analytics and managed services.

**Allolio&Konrad, 1 April 2020** – Analysys Mason acquired Allolio&Konrad, a telecoms consultancy based in Bonn, Germany, for €7m in cash. The acquisition strengthens Analysys Mason's position in the strategic, digital transformation, IT transformation and performance consulting market, broadening its skills base to support the accelerating demand for 5G expertise.

**Cilnet, 2 September 2019** – Logicalis purchased a 70% interest in Communicações e Projectos Especiais S.A. (Cilnet) for US$8.8m (including US$2.3m deferred consideration). Cilnet is a Cisco systems integrator and managed services business in Portugal and increases Logicalis's Cisco technical expertise in the Iberian region.

**Orange Networks, 2 September 2019** – Logicalis acquired 100% of Orange Networks for US$2.9m (including US$0.6m deferred consideration), advancing Logicalis Germany to Microsoft Gold-Certified Partner status as well as enhancing its hybrid cloud offering.

**Mars Technologies, 30 June 2019** – Logicalis acquired Mars Technologies, a South African IT services business, for US$0.4m (including US$0.1m deferred purchase consideration), expanding Logicalis's South African managed services offering.

**Stelacon, 1 March 2019** – Analysys Mason acquired Stelacon, a Swedish consulting company, for US$2.6m (including US$1.2m of deferred consideration), building out Analysys Mason's Scandinavian presence.

**CNI, 8 October 2018** – Logicalis acquired Corporate Network Integration (CNI) for US$3.1m in cash. CNI is a Microsoft-certified gold partner based in Melbourne, Australia, bringing a full suite of Microsoft cloud service capabilities to Logicalis.

### Minorities: Principally Westcon International, Logicalis LatAm

With the disposal of Westcon Americas to SYNNEX Corporation (SYNNEX), a US-based competitor, in September 2017, SYNNEX acquired a 10% interest in Westcon International, with Datatec retaining a 90% shareholding. In June 2020, Datatec converted US$80m of inter-company loans to equity to strengthen the subsidiary's balance sheet and improve its credit rating. SYNNEX did not participate in the recapitalisation and, as such, its minority shareholding reduced from 10.0% to 7.9%.

Logicalis Latin America is currently held 65% by Logicalis and 35% by Promon, a Brazilian engineering firm. Datatec is exploring the possibility of a listing of Logicalis Latin America on the Brazilian stock exchange, the B3 SA – Brasil, Bolsa, Balcão (www.b3.com.br), involving both a primary and secondary share offering. Even after a potential IPO, it is envisaged that Logicalis would remain a majority shareholder, but with an increased minority.

In addition to the two principal minorities noted above, Westcon International has less material minorities in its Middle Eastern and African entities and Logicalis has other minority interests, eg Packet System Indonesia, Cilnet, Ituma and NubeliU. MIC held a 40% (black empowerment) stake in WestconSA in FY18 and FY19, but was replaced by Ascension Capital Partners as a minority in FY20.

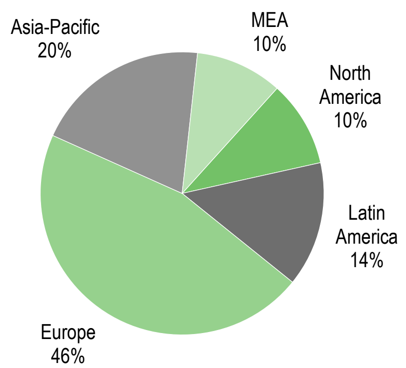
## Strategy: Investing in higher-margin services

Datatec is a diversified group with a global footprint, selling a wide range of IT products and solutions to clients predominantly in the enterprise and telecoms sectors.

The central group function provides leadership and sets the direction and strategy for each business, together with divisional management. The central function offers global orchestration (with execution left to the regional management teams), identifying potential areas for growth and supporting growth both organically and through acquisition by allocating capital and financing. The group targets profit growth, EBITDA margins and return on invested capital to drive financial returns.

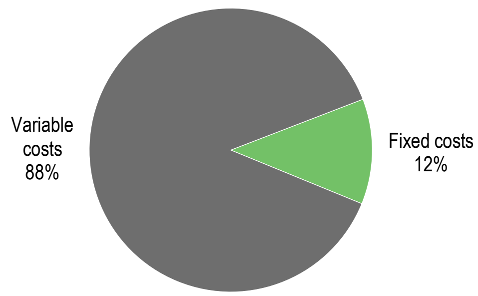
The group's decentralised operating model, extensive geographic footprint, positioning across the ICT value chain and strong vendor and customer relationships combine to create a resilient business with a low fixed cost base (c 88% variable costs). While having global scale, the group also retains the entrepreneurial culture, flexibility and resilience that some of its larger peers have lost.

**Exhibit 11: Broad geographic footprint (FY20 revenues)**




Source: Datatec

**Exhibit 12: Significantly variable cost base (FY20 results)**




Source: Datatec

Historically, management has targeted two principal strategic goals:

- Increasing focus on higher-margin software and services revenues, which have increased from c 18% of gross profit in FY11 to 43% in FY20. Management very much intends for this trend to remain in place, with a medium-term target for software and services to exceed 50% of total gross profits.
- Cost optimisation and profit recovery: between FY17 and FY20, management has focused on managing the group's cost base, with central costs carried disproportionately by Westcon Americas (exited in FY18) and a problematic BPO project and SAP implementation affecting revenues and the cost base. With the BPO reversal project and SAP implementation successfully completed, Westcon International made demonstrable progress in FY19, with materially improved EBITDA margins in FY20 and H121. We expect further progress from Westcon International in FY21–23.

The persistent impact of COVID-19 in FY21 creates real uncertainty with global outcomes difficult to predict and the threat of a global recession looming. However, in H121 Datatec demonstrated its ability to control costs in the COVID-19 environment, with l-f-l operating costs falling 10% to US$252m. The streamlining of the business which is now substantially complete, together with a focus on growth, places Datatec in a far stronger position than it has been in recent years.

The group's key strategic objectives include cost-cutting to help deliver better operational efficiency and improved margins, focused around balance sheet optimisation and working capital improvement. Management wants to improve overall quality of earnings and profit margins by driving revenue growth in Logicalis, with improved EBITDA and cash generation, as well as improving medium-term operating margin in Westcon International by further reducing central costs.

As part of its efforts to increase the proportion of software and services (to 50%+ of group gross profits), management intends to meet the growing demand from cloud computing, remote access solutions, software, virtualisation and cyber security. Management expects to develop the group's capabilities within cloud service delivery, both organically and by strategic acquisition.

Management will also continue to look for value realisation opportunities, including the mooted IPO of Logicalis LatAm.

# Market context: Global IT market

## Worldwide IT spending to decline 7.3% in 2020

Whereas at the start of the year (January 2020), Gartner forecast worldwide IT spending to reach US$3.9tn in 2020, an increase of 3.4% from 2019, its latest forecasts (July 2020) indicate IT spending of US$3.5tn in 2020, a decline of 7.3% from 2019. All segments of the market are expected to experience a decline in 2020, with spending on devices hardest hit following the temporary spike seen as part of companies' COVID-19 responses.

**Exhibit 13: Worldwide IT spending forecast**

| | 2019 spending (US$bn) | 2019 growth (%) | 2020 spending (US$bn) | 2020 growth (%) | 2021 spending (US$bn) | 2021 Growth (%) |
|---|---|---|---|---|---|---|
| Data Centre Systems | 210 | 0.6% | 188 | -10.3% | 200 | 6.2% |
| Enterprise Software | 477 | 11.7% | 450 | -5.7% | 483 | 7.4% |
| Devices | 712 | -0.3% | 597 | -16.1% | 611 | 2.4% |
| IT Services | 1,040 | 4.8% | 969 | -6.8% | 1,023 | 5.5% |
| Communications Services | 1,372 | -0.6% | 1,326 | -3.3% | 1,366 | 3.0% |
| Overall IT | 3,811 | 2.3% | 3,531 | -7.3% | 3,684 | 4.3% |

Source: Gartner (July 2020), www.gartner.com/en/newsroom/press-releases/2020-07-13-gartner-says-worldwide-it-spending-to-decline-7-point-3-percent-in-2020

With a backlog of IT projects and cash closely monitored, companies are expected to gravitate towards spending on subscription products and cloud services to reduce upfront costs, accelerating the digital transformation. This reflects a focus on business continuity related spending in 2020. However, once restrictions ease and the economy starts to recover, companies are expected to resume spending on more strategic IT projects. However, this pause will push growth out of 2020 and into 2021, so we expect to see falling global IT spending in 2020, with catch-up in 2021.

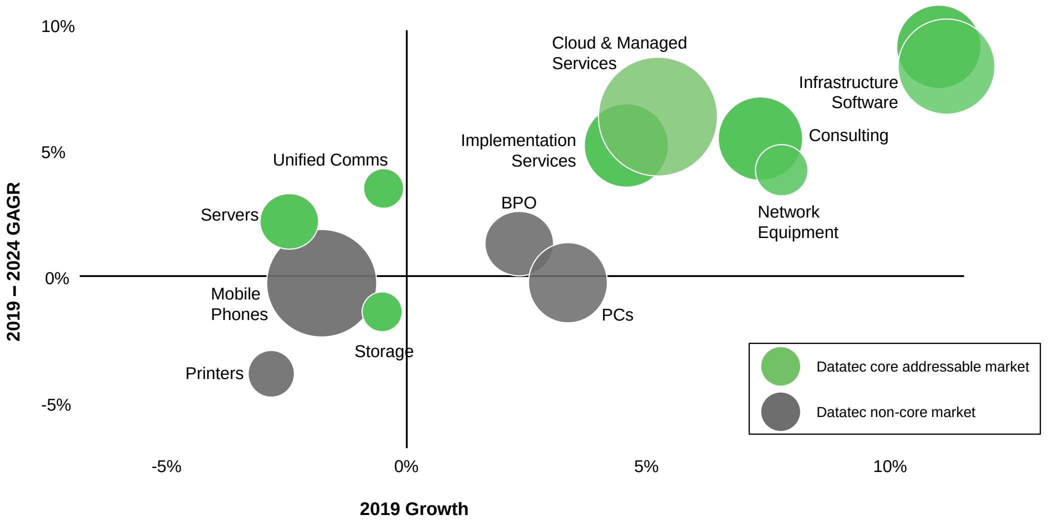
## Growth of cloud and 'as-a-service' offering

IT services providers play an important strategic role in the cloud/SaaS world, acting as service aggregators and brokers, identifying technology trends in a fragmented industry and influencing customer decision-making. In this environment, businesses need independent IT services specialists to integrate and manage complex multi-vendor cloud infrastructure solutions, including hybrid cloud deployments.

From a technology vendor's perspective, channel partners are an increasingly valuable conduit to aggregate fragmented customer segments (eg government, healthcare and education) and to manage credit, billing, add-on sales and renewals. IT services companies are also needed to support organisations embarking on digital transformation, ensuring the challenges of network security and governance are met.

## Key industry trends in the ICT market:

**Exhibit 14: Segmental estimates of growth in global IT spending**




Source: Datatec (based on multiple third party data sources and industry research)

Some of the principal drivers of IT spending include:

- **'As-a-service' (XaaS):** Among SMEs, only one in three (30%) adopt solutions in the cloud. With the spread of cloud services, IT investments are no longer characterised as capex (up-front cost), but as opex, with cost recognition corresponding to real-time usage. IT distributors and IT systems integrators are increasingly acting as aggregators of such contracts from multiple providers, reducing the impact on working capital and increasing the proportion of recurring revenues. 'As-a-service' models include cloud computing (IaaS, PaaS and SaaS), managed printing services and device-as-a-service.
- **Digital transformation**: investment in future technologies as businesses become increasingly tech-enabled. Opportunities include the internet of things (IoT), e-commerce in retail, electronic metering in utilities, agtech in agriculture and automation of logistics as well as increasing deployment of AI, particularly in customer service and customer-facing deployment.
- **Closing the gap on IT spending**: The major trends expected to drive future market growth are largely those that have been driving the B2B markets over the past decade (AI/ML, big data/analytics, blockchain, IoT, mobility and network security), and are expected to continue to drive growth through to at least 2023.

# Competition: Fragmented landscape

## Critical mass an advantage in a consolidating market

The global IT distribution market is constantly evolving and consolidating. Resellers prefer to deal with distributors that offer the widest range of products, encouraging distributors to build relationships with the highest possible number of vendors. However, vendors are reducing the number of distributors they work with to focus on a smaller number of specialist distributors able to showcase their full product line-up.

This has led to a polarised market, with many domestic or regional IT distributors struggling to survive in the market, alongside companies specialising in new verticals linked to innovative technologies and a smaller number of distributors benefiting from global scale.

As one of the nimbler global (particularly emerging market) groups, with a business encompassing IT services, distribution and management consulting, there is no single competitor to Datatec. Rather, each division has a unique set of international, regional and domestic competitors, which varies market by market and region by region.

Although we look at a broad range of comparators as part of our valuation exercise (Exhibits 26 to 28), key competitors by division are set out below.

**Exhibit 15: Divisional competitors in a fragmented market**

| | IT Services | IT distribution | Strategy consulting |
|---|---|---|---|
| Brand | LOGICALIS Architects of Change | Westcon Comstor Delivering Results Together | analysys mason |
| Competitive positioning | Global presence with focused solutions and services | Market leader in enterprise networking and security | Highly respected specialized TMT strategy consultants |
| Select competitors | e+, Insight, Bechtle, NTT Data, Computacenter | scansource, ALSO, Arrow, Synnex | Bain & Company, EY, BCG, McKinsey & Company |

Source: Datatec

Profiles of the principal competitors to Logicalis and Westcon are included in the appendix.

## Management team

The experience of Datatec's senior management team is detailed below:

**Stephen Davidson, Chairman:** Stephen was previously vice-chairman, investment banking, at WestLB Panmure and CEO and finance director of Telewest Communications. He has a first-class honours degree in mathematics and statistics from the University of Aberdeen.

**Jens Montanana, CEO:** Jens is the founder and CEO of Datatec Limited, established in 1986. Between 1989 and 1993, Jens served as managing director and vice-president of US Robotics (UK) Limited, a wholly owned subsidiary of US Robotics, Inc. which was acquired by 3Com in 1997. In 1993 he co-founded US start-up Xedia Corporation, which was subsequently sold to Lucent Corporation in 1999. Jens is also the non-executive chairman of AIM-listed Corero Network Security.

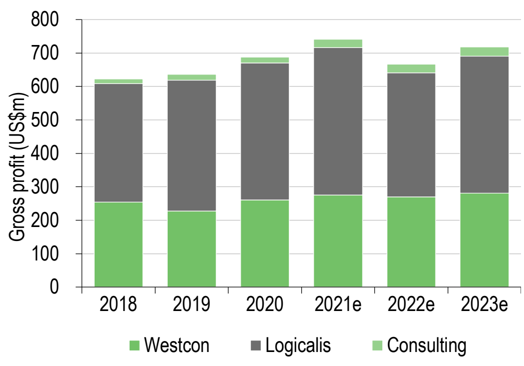
**Ivan Dittrich, CFO:** Ivan re-joined Datatec on 30 May 2016 from Vodacom, where he had been group CFO from 15 June 2012 to 31 July 2015. Prior to that, he held a number of senior executive positions at Datatec, including group CFO from May 2008 to June 2012, in a career that spanned 13 years. Ivan qualified as a chartered accountant (South Africa) at Deloitte South Africa and also worked for PricewaterhouseCoopers in London. He completed the Oxford Advanced Management and Leadership programme at Saïd Business School.

**Ekta Singh-Bushell, Senior Independent NED:** Ekta was COO, executive office at the Federal Reserve Bank of New York, and previously had a 17-year career in senior partner roles with EY, such as US innovation and digital strategy leader, where she led transformations across multiple industries affected by digital technology and information management advances. Ekta is a Certified Public Accountant (USA) and has a master of electrical engineering and computer science degree from the University of California, Berkeley, and a bachelor of engineering degree from the University of Poona, India.

## Financials

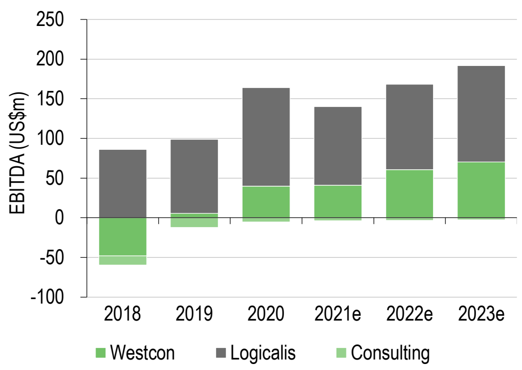
Despite an uncertain global outlook, Datatec continues to benefit from the streamlining of its operations and cost base, with further savings expected to flow through in FY21 and FY22. Looking ahead, improving profitability should drive strong cash generation and support an attractive dividend yield. In addition, management reconfirmed earlier in the year that it remains its intention to list Logicalis Latin America when market conditions permit.

Exhibit 16: Gross profit breakdown




Source: Datatec, Edison Investment Research

Exhibit 17: EBITDA breakdown




Source: Datatec, Edison Investment Research

## H121 interim results

Exhibit 18: Datatec Interim results summary

| Year end 29 February (US$m) | H120 | H220 | FY20 | H121 | l-f-l growth | H221e | FY21e | l-f-l growth |
|---|---|---|---|---|---|---|---|---|
| Revenue | 2,056.3 | 2,248.5 | 4,304.8 | 2,031.2 | -1.2% | 2,227.2 | 4,258.4 | -1.1% |
| Cost of Sales | (1,696.5) | (1,866.7) | (3,563.3) | (1,707.0) | 0.6% | (1,884.8) | (3,591.7) | 0.8% |
| Gross Profit | 359.8 | 381.8 | 741.6 | 324.2 | -9.9% | 342.5 | 666.7 | -10.1% |
| EBITDA | 70.0 | 88.6 | 158.7 | 60.7 | -13.3% | 75.8 | 136.5 | -13.9% |
| Normalised operating profit | 51.5 | 53.6 | 105.2 | 45.1 | -12.5% | 48.8 | 93.9 | -10.7% |
| Profit Before Tax (norm) | 43.2 | 35.9 | 79.1 | 32.1 | -25.6% | 34.9 | 67.0 | -15.2% |
| EPS – basic normalised (c) | 5.74 | 4.82 | 10.59 | 5.48 | -4.6% | 4.67 | 10.15 | -4.2% |
| EPS – company underlying uEPS* (c) | 5.25 | 4.63 | 9.90 | 3.88 | -26.2% | 6.44 | 10.33 | 4.4% |
| Gross Margin (%) | 17.5 | 17.0 | 17.2 | 16.0 | | 15.4 | 15.7 | |
| EBITDA Margin (%) | 3.4 | 3.9 | 3.7 | 3.0 | | 3.4 | 3.2 | |
| Normalised Operating Margin | 2.5 | 2.4 | 2.4 | 2.2 | | 2.2 | 2.2 | |
| Closing net debt/(cash) | 193.7 | 139.9 | 139.9 | 73.2 | | 126.9 | 126.9 | |

Source: Datatec, Edison Investment Research. Note: *Underlying earnings exclude impairments of goodwill and intangible assets, profit or loss on sale of investments and assets, amortisation of acquired intangible assets, unrealised foreign exchange movements, acquisition-related adjustments, fair value movements on acquisition-related financial instruments, restructuring costs relating to fundamental reorganisations, and the taxation effect on all of the aforementioned.

Group revenues for H121 were 1% lower at US$2.03bn (H120: US$2.06bn), with adjusted EBITDA down 5% y-o-y at US$66.7m (before US$5.9m of restructuring costs) (H120: US$70.0m). Westcon revenues rose 4% to US$1.30bn (H120: US$1.25bn), with adjusted EBITDA up 20% to US$23.0m (H120: US$19.1m), driven by strong cloud demand, remote access solutions, unified communications and enhanced network security. Logicalis revenues fell by 10% to US$700m (H120: US$780m), with currency weakness in Latin America more than offsetting a stronger European performance. Logicalis's adjusted EBITDA fell 19% to US$45.2m (H120: US$56.0m), although H120 benefited from a one-off tax credit for Logicalis Brazil of US$13.6m as a legal settlement relating to historically overpaid indirect taxes, as well as interest income of approximately US$7m in regard to those overpaid taxes. Stripping out this tax credit from the H120 figures, Logicalis adjusted EBITDA would have improved by c 8% in H121. Analysys Mason revenue rose to US$31.8m (H120: US$27.4m), with adjusted EBITDA of US$5.7m (H120: US$4.8m).

Operating costs for the two main divisions were down on the prior year with central costs at the group level of US$7.4m (FY20: US$15.3m). Highlighting Datatec's strong operating cash flow, net debt (including finance leases) as at 31 August 2020 fell to US$73.2m (FY20: US$139.9m). Excluding finance leases, the group had a net cash position of US$75.6m (FY20: net debt of US$10.4m).

In terms of the impact of COVID-19, in its H121 results Datatec noted total COVID-19-related restructuring costs of US$5.9m, US$2.2m for Logicalis and US$3.7m for Westcon. Westcon also experienced increased freight costs due to COVID-19 (gross margins fell from 11.0% in H120 to 10.3% in H121) and Logicalis suffering from the resultant weakening of emerging market currencies, notably Brazil, Mexico, Indonesia and South Africa.

The impact of adverse currency movements is highlighted by the fact that, in constant currency terms, group revenues increased by 2.8% (vs reported 1.2% fall), with Logicalis revenues falling by 1.9% (vs reported 10.2% fall) and Westcon revenues rising by 5.4% (vs reported 4.0% rise).

## Revenue estimates

Datatec provides a detailed divisional breakdown in its accounts, as well as geographic analysis. We have therefore built up our forecasts on a divisional basis, assuming a slowdown in revenues in FY21, before a return to growth in FY22.

Underlying our growth forecasts, we see revenue growth in the short term driven by strong cloud demand and demand for remote access solutions as businesses shift towards remote working. Cloud computing and remote access solutions are likely to remain longer-term drivers, with software, virtualisation and cybersecurity helping to drive underlying growth of 4–6%.

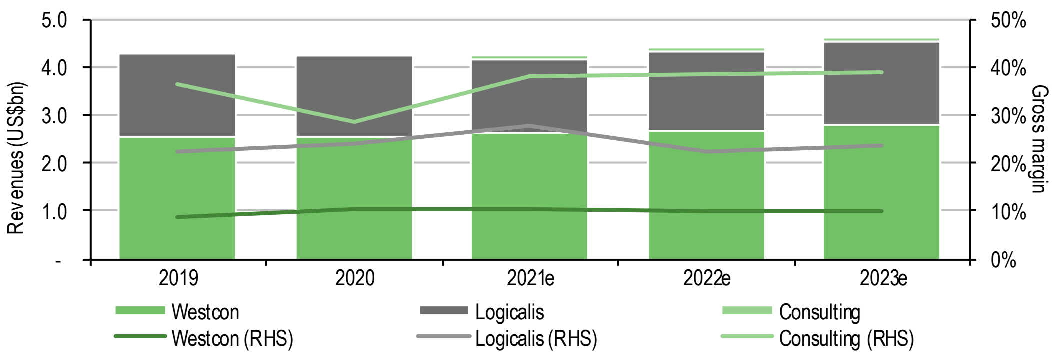
**For Logicalis**, with a 10% fall in H121 revenue, we have assumed a 7.5% drop in FY21 revenues to US$1.57bn from US$1.70bn in FY20. This assumes a continuing but moderating impact from COVID-19 through FY21. We then assume a bounce back, with what we expect to be a conservative 5% revenue growth in FY22 and FY23 – the middle of management's guidance of 4–6% underlying revenue growth. At the EBITDA level, we have assumed EBITDA margins dropping to 6.3% in FY21 (vs 6.5% in H121), strengthening to 7.0% in FY23. This feeds through to our EBITDA forecasts for Logicalis of US$99m in FY21, rising to US$121m in FY23.

**Looking at Westcon**, which has had a strong H121 as demand has held up well, we forecast 3% revenue growth in FY21 taking revenues to US$2.62bn, with 3% revenue growth in FY22 and 4% in FY23. In H121, revenue growth has come at the price of some loss in gross margins (10.3% forecast for FY21, the same as for H121). At the EBITDA level, we expect a similar outcome in FY21 as FY20 (US$41.1m vs US$40.0m), with EBITDA margin a shade below 1.6%. We then expect a pick-up in margin as growth is sustained, to 2.5% in FY23, delivering FY23 EBITDA of US$70.2m.

**Analysys Mason** has a had a very strong start to the year, delivering EBITDA of US$5.7m in H121 (H120: US$4.8m), off revenues up 16% from US$27.4m to US$31.8m. We have moderated growth somewhat in H220 so that FY21 is only up 8% on FY20 at US$64.6m, with 5% revenue growth in FY21 to US$67.8m and 6% in FY22 to US$71.9m.

At the group level, this leads to a fall in revenues of 1.1% in FY21 to US$4.26bn, reflecting the difficult global operating environment, particularly in emerging markets. Growth then rebounds to 3.8% in FY22, with revenues of US$4.42bn, and conservatively returning to the low-end of trend growth of 4-6% in FY23, with 4.4% revenue growth in FY23, leading to revenues of US$4.61bn. We have assumed central costs are held flat at US$15m in each of FY21–23 (FY20: US$15.3m).

**Exhibit 19: Divisional revenue and gross margin estimates**

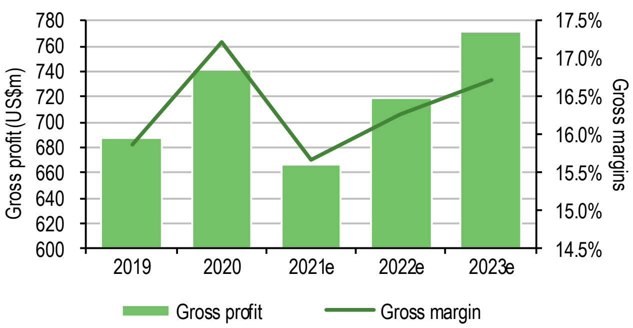



Source: Edison Investment Research

In terms of margins, management is continuing to cut costs at both Westcon and Logicalis. We have also referred to the group's low fixed cost base previously (c 88% variable costs in FY20), which means that although gross margin may be slightly compressed at 15.7% in FY21e (FY20: 17.2%), we then expect group gross margins to steadily improve in FY22 (16.3%) and FY23 (16.7%). Having seen a 10% cut in central costs in FY20, we expect EBITDA margins in both Logicalis (FY21–23: 6.3%, 6.5%, 7.0%) and Westcon (FY21–23: 1.6%, 2.3%, 2.5%) to continue to improve in FY22 and FY23, driving group EBITDA from US$137m in FY21 (FY20: US$159m), to US$165m in FY22 and US$189m in FY23.

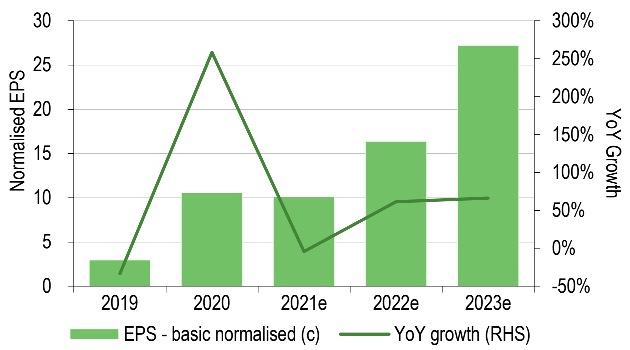
At the earnings level, this leads to a 4% fall in FY21 normalised EPS to 10.1 cents (FY20: 10.6 cents). Normalised EPS then rises materially in FY22 to 16.4 cents and 27.2 cents in FY23, with an assumption that the effective tax rate (54.4% in FY20) trends towards c 32% over the medium term. It is worth noting that the tax rate is unusually high due to the particular profit mix, with tax charges incurred on low profits or losses in certain jurisdictions as Datatec has not yet been able to book deferred tax assets against these losses. As at 31 August 2020 Datatec has estimated tax loss carry forwards of US$225m, with an estimated future tax benefit of US$50m, of which only US$20m has been recognised as a deferred tax asset. As profitability improves (especially in Westcon) the tax rate for the group is expected to reduce significantly. We note that in FY20 tax losses and other deferred taxes not recognised contributed 16pp to the effective tax rate, while foreign taxation rate differential added another 11pp. The statutory tax rate in South Africa is 28%.

**Exhibit 20: Gross profit forecasts**




Source: Datatec, Edison Investment Research

**Exhibit 21: Forecast adjusted EPS**




Source: Datatec, Edison Investment Research

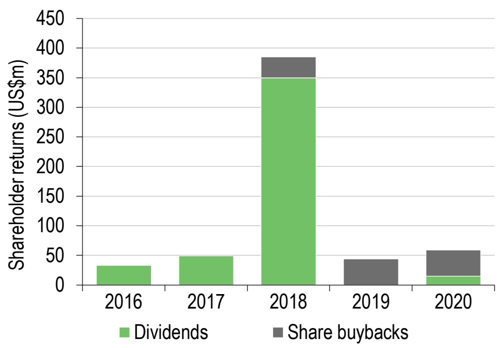
## Cash flow: Strong cash generation, dividend to return

Datatec is strongly cash-generative, with operating cash flow of US$178.6m in FY20, with the group benefiting from structural improvements in working capital, including cost-cutting and operational efficiencies as well as enhanced vendor incentives. These benefits have carried through to H121, together with the refinancing of the major facilities in Westcon Europe and Westcon Asia, as well as extended vendor payment terms, extending liquidity and helping bring net debt down to US$73.2m (FY20: US$140m). We forecast continuing strong operating cash flow of US$99–112m in FY21–23, however at a lower level than for FY20 since Westcon, as a distribution business, is highly working capital intensive and consumes cash as it grows (Logicalis is less working capital intensive and therefore more cash neutral through the cycle). The group had net debt of US$140m in FY20 and, with Datatec's strong cashflow generation, even allowing for an attractive dividend, we forecast net debt to fall steadily to US$103m in FY23, although recognising that the group's net debt fluctuates significantly throughout the year.

The group has historically paid a dividend of one-third of underlying earnings (uEPS is Datatec's normalised earnings), but as these were negative in FY18, no regular dividend was paid. In FY19, the board decided not to declare a dividend due to the low level of uEPS (6.6 cents) and in FY20, along with many other companies, management decided to suspend the dividend as a prudent measure to preserve cash until the extent of the COVID-19 pandemic became apparent. Nevertheless, the suspension of the dividend is a temporary measure and the company has signalled that it will consider an FY21 final dividend (payable in FY22) 'based on the full year results and the economic outlook at that time'. Historically, Datatec has paid a dividend of one-third of uEPS, so we forecast a yield of 2.5% in FY21, rising to 6.4% in FY23.

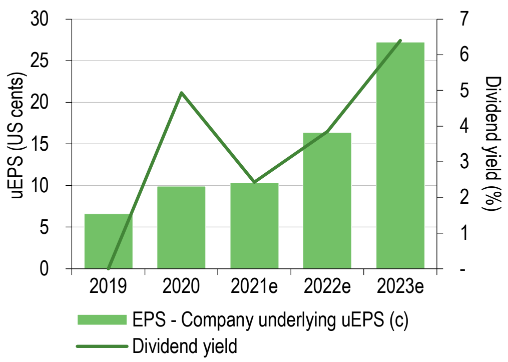
As well as the regular dividend, over the last three years Datatec has also committed to a share buyback programme, returning US$35m in FY18 and US$44m in each of FY19 and FY20. In addition, following the sale of Westcon Americas to SYNNEX, Datatec paid a special dividend of US$350m to shareholders in FY18, with a further smaller special dividend of US$15m in FY20.

**Exhibit 22: Historical shareholder returns**




Source: Datatec

**Exhibit 23: uEPS and dividend yield**




Source: Datatec, Edison Investment Research

## Balance sheet: Significant gearing capacity

As an IT distributor, Datatec has considerable short-term funding requirements, extending credit to end clients and resellers. This is reflected in Datatec's balance sheet, with high levels of debtors (US$1.11bn at FY20 year end) and creditors (US$1.26bn), as well as short-term borrowings of US$339m. Given this level of borrowing and assumed average utilisation of the facilities of 70–80% through the year, any interest rate savings the group can achieve through refinancing its facilities will be of considerable benefit to the bottom line.

In August, Westcon Europe 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. By our calculation, a 1% interest rate saving on this facility would benefit the bottom-line by around US$2m. Similarly, a new facility providing increased liquidity on reduced terms was signed by Westcon Asia.

Otherwise, the group has a sustainable and improving financial position, with net debt of US$73.2m at the end of H121 (with net debt falling at both Westcon and Logicalis), which, with net assets of US$633m, implies a group net debt to equity ratio of 12%. Interest cover (EBITDA/finance costs) has risen from 1.0x in FY18 to 3.9x in FY20. We expect this ratio to rise to 4.7x in FY21 and to continue rising to 6.7x in FY23. FY20 Net debt/EBITDA stood at 0.88x, falling to 0.39x in FY23.

## Valuation

We have looked at Datatec on the basis of peer valuations, considering each of the principal businesses separately, cross-referenced against a more fundamental group net present value (NPV) approach. Broadly speaking, Datatec's comparator universe has seen an uplift from the COVID-19 pandemic, enjoying further multiple expansion as investors perceive the sector as a relative safe haven.

### Valuation: NPV

Firstly, looking at the NPV of future cash flows, we have derived a core value of ZAR40.49 per share, 84% above the current share price of ZAR22.01. This valuation is based on an explicit forecast period of 2020–31, before adding a perpetuity calculation, and a WACC of 12.8%. We show the sensitivity to different WACC assumptions in Exhibit 25. Our key valuation assumptions are set out in the table below:

**Exhibit 24: Key NPV inputs**

| | |
|---|---|
| WACC | 12.8% |
| Terminal growth rate | 3.0% |
| Enterprise value (US$m) | 709.1 |
| Adjusted net debt, FY20 (US$m) | (139.9) |
| Minorities, FY20 (US$m) | (70.8) |
| Equity value (US$m) | 498.5 |
| Equity value per share (US$) | 2.49 |
| Equity value per share (ZAR) | 40.49 |

Source: Edison Investment Research

**Exhibit 25: NPV sensitivities (ZAR per share)**

| | Terminal growth rate | | | | | |
|---|---|---|---|---|---|---|
| | | 2.0% | 2.5% | 3.0% | 3.5% | 4.0% |
| WACC | 14.0% | 30.97 | 31.90 | 32.91 | 34.01 | 35.23 |
| | 13.0% | 36.30 | 37.51 | 38.84 | 40.31 | 41.94 |
| | 12.9% | 37.77 | 39.06 | 40.49 | 42.07 | 43.83 |
| | 12.0% | 42.77 | 44.37 | 46.16 | 48.15 | 50.39 |
| | 11.0% | 50.76 | 52.94 | 55.40 | 58.18 | 61.35 |

Source: Edison Investment Research

### Valuation: Separate global peer groups

In terms of Datatec's peer group, we have chosen to look at each of Datatec's three principal businesses as separate entities, identifying an international peer group for each given the group's global footprint and the lack of domestic peers.

First of all, we look at **Logicalis**, pulling together a group of competitors and peers, principally drawn from North America and Europe (Exhibit 26). Within this broader group, we focus on the subset of peers most directly comparable to Logicalis. These businesses have average FY1e gross margins of 30.0% and EBITDA margins of 6.2%, comparable to our FY21 estimates for Logicalis of 23.6% and 6.3% respectively. The core peer group trades on 0.5x FY1 and 0.5x FY2 sales and 8.2x FY1 and 7.0x FY2 EBITDA. Applying these multiples to Logicalis, would indicate an enterprise value of c US$754–810m. Factoring in the FY20 minorities, Datatec's 78% economic interest implies an average enterprise valuation to Datatec of US$600m, a significant uplift on Datatec's current group EV of US$344m.

**Exhibit 26: Logicalis peers – IT services companies**

| Name | Share price | Ccy | EV ($m) | Gross margin 1FY (%) | EBITDA margin 1FY (%) | EBIT margin 1FY (%) | EV/sales 1FY (x) | EV/sales 2FY (x) | EV/ EBITDA 1FY (x) | EV/ EBITDA 2FY (x) | P/E 1FY (x) | P/E 2FY (x) | Div yield 1FY (x) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| ***Atea*** | ***109.4*** | ***NOK*** | ***1,397*** | ***22.0*** | ***3.8*** | ***2.1*** | ***0.3*** | ***0.3*** | ***9.0*** | ***8.1*** | ***20.4*** | ***17.1*** | ***5.0*** |
| Bechtle | 149.1 | EUR | 7,775 | 14.4 | 6.2 | 4.6 | 1.2 | 1.1 | 18.9 | 17.2 | 33.9 | 30.1 | 0.8 |
| Cancom | 33.9 | EUR | 1,342 | 28.2 | 7.3 | 4.3 | 0.7 | 0.6 | 9.5 | 8.0 | 25.0 | 20.1 | 1.5 |
| CDW Corp | 120.95 | USD | 20,197 | 17.0 | 8.2 | 7.3 | 1.1 | 1.1 | 14.0 | 13.4 | 20.8 | 19.0 | 1.3 |
| ***Computacenter*** | ***2298*** | ***GBp*** | ***3,359*** | ***13.3*** | ***4.8*** | ***3.6*** | ***0.5*** | ***0.5*** | ***10.5*** | ***10.3*** | ***20.4*** | ***20.2*** | ***2.0*** |
| ***Econocom Group*** | ***1.784*** | ***EUR*** | ***974*** | ***21.0*** | ***6.0*** | ***4.0*** | ***0.3*** | ***0.3*** | ***4.9*** | ***4.4*** | ***6.3*** | ***5.8*** | ***5.4*** |
| ***ePlus*** | ***67.25*** | ***USD*** | ***866*** | ***25.3*** | ***6.9*** | ***6.8*** | ***0.6*** | ***0.6*** | ***8.5*** | ***7.6*** | ***12.9*** | ***11.7*** | ***0.0*** |
| ***Indra Sistemas*** | ***5.13*** | ***EUR*** | ***1,812*** | ***66.4*** | ***5.7*** | ***1.3*** | ***0.5*** | ***0.5*** | ***9.0*** | ***4.6*** | ***NM*** | ***7.4*** | ***0.7*** |
| ***Insight Enterprises*** | ***54.01*** | ***USD*** | ***2,178*** | ***15.2*** | ***3.9*** | ***3.5*** | ***0.3*** | ***0.3*** | ***6.8*** | ***5.9*** | ***9.7*** | ***8.5*** | ***NM*** |
| ***PC Connection*** | ***45.32*** | ***USD*** | ***1,018*** | ***16.1*** | ***3.7*** | ***3.1*** | ***0.4*** | ***0.4*** | ***10.8*** | ***9.3*** | ***20.3*** | ***16.5*** | ***NM*** |
| Softcat | 1135 | GBp | 2,824 | 21.7 | 8.4 | 8.2 | 1.9 | 1.7 | 22.1 | 20.8 | 29.1 | 27.4 | 2.4 |
| ***Sopra Steria Group*** | ***103.9*** | ***EUR*** | ***3,533*** | ***55.9*** | ***9.9*** | ***5.8*** | ***0.7*** | ***0.7*** | ***7.1*** | ***6.2*** | ***13.5*** | ***10.5*** | ***1.7*** |
| ***Sykes Enterprises*** | ***34.27*** | ***USD*** | ***1,279*** | ***35.2*** | ***10.8*** | ***8.1*** | ***0.8*** | ***0.7*** | ***7.1*** | ***6.7*** | ***14.0*** | ***12.7*** | ***NM*** |
| **Mean (all)** | | | | **27.1** | **6.6** | **4.8** | **0.7** | **0.7** | **11.8** | **10.5** | **18.8** | **15.9** | **2.1** |
| ***Mean (core comparator group – BOLD ITALIC)*** | | | | ***30.0*** | ***6.2*** | ***4.3*** | ***0.5*** | ***0.5*** | ***8.2*** | ***7.0*** | ***14.7*** | ***12.3*** | ***2.5*** |
| **Median (all)** | | | | **21.7** | **6.2** | **4.3** | **0.6** | **0.6** | **9.0** | **8.0** | **20.3** | **16.5** | **1.6** |

Source: Refinitiv data (priced at 30 October 2020)

In Exhibit 27 we set out the peer group for **Westcon International**, again principally drawn from North America and Europe. Within this broader group, we focus on a subset of core peers most directly comparable to Westcon. The average gross margin for Westcon's peers is 9.7%, with EBITDA margins of 3.3%, compared to our FY21 estimates for Westcon International of 10.3% and 1.6% respectively. Collectively, the peer group trades on 0.2x average FY1 and 0.2x average FY2 EV/sales and 6.8x FY1 and 5.9x FY2 EV/EBITDA. Applying these multiples to Westcon International would indicate an enterprise value of c US$619–627m based on the sales multiples but US$279–358m based on EBITDA, highlighting that Westcon International's EBITDA margins have scope to normalise further. Factoring in Datatec's 92% economic interest implies an average valuation to Datatec of c US$434m. However, irrespective of whether the valuation is driven off sales or EBITDA figures, Westcon International's standalone enterprise valuation still exceeds Datatec's current group EV of US$344m.

**Exhibit 27: Westcon International peers – IT distribution companies and resellers**

| Name | Share price | Ccy | EV ($m) | Gross margin 1FY (%) | EBITDA margin 1FY (%) | EBIT margin 1FY (%) | EV/sales 1FY (x) | EV/sales 2FY (x) | EV/ EBITDA 1FY (x) | EV/ EBITDA 2FY (x) | P/E 1FY (x) | P/E 2FY (x) | Div yield 1FY (x) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Also Holding | 207.5 | CHF | 3,043 | 5.9 | 1.9 | 1.5 | 0.2 | 0.2 | 11.7 | 10.8 | 20.9 | 18.0 | 1.8 |
| ***Arrow Electronics*** | ***77.5*** | ***USD*** | ***8,208*** | ***11.2*** | ***3.6*** | ***3.1*** | ***0.3*** | ***0.3*** | ***8.3*** | ***7.5*** | ***12.1*** | ***9.8*** | ***0.0*** |
| Avnet | 24.66 | USD | 3,316 | 11.7 | 2.2 | 1.6 | 0.2 | 0.2 | 8.6 | 6.7 | 14.6 | 9.5 | 3.4 |
| ***Esprinet*** | ***6.97*** | ***EUR*** | ***297*** | ***4.4*** | ***1.4*** | ***1.0*** | ***0.1*** | ***0.1*** | ***4.2*** | ***3.7*** | ***13.2*** | ***11.0*** | ***2.0*** |
| ***Scansource*** | ***19.99*** | ***USD*** | ***696*** | ***11.6*** | ***3.4*** | ***2.7*** | ***0.2*** | ***0.2*** | ***7.2*** | ***5.8*** | ***10.5*** | ***7.6*** | ***NM*** |
| ***SYNNEX Corp*** | ***132.2*** | ***USD*** | ***8,216*** | ***11.7*** | ***4.7*** | ***4.1*** | ***0.3*** | ***0.4*** | ***7.4*** | ***6.6*** | ***10.8*** | ***9.4*** | ***0.2*** |
| TESSCO Technologies | 6.23 | USD | 87 | 17.0 | -1.5 | -2.4 | 0.2 | 0.2 | NM | 22.3 | NM | NM | NM |
| Wesco International | 40.78 | USD | 6,865 | 19.3 | 4.8 | 4.0 | 0.6 | 0.4 | 11.9 | 7.9 | 8.3 | 6.7 | NM |
| WPG Holdings | 38.8 | TWD | 5,868 | 4.0 | 1.9 | 1.7 | 0.3 | 0.3 | 14.9 | 13.2 | 8.5 | 7.9 | 6.9 |
| **Mean (all)** | | | | **10.8** | **2.5** | **1.9** | **0.3** | **0.2** | **9.3** | **9.4** | **12.4** | **10.0** | **2.4** |
| ***Mean (core comparator group – BOLD ITALIC)*** | | | | ***9.7*** | ***3.3*** | ***2.7*** | ***0.2*** | ***0.2*** | ***6.8*** | ***5.9*** | ***11.6*** | ***9.5*** | ***0.7*** |
| **Median (all)** | | | | **11.6** | **2.2** | **1.7** | **0.2** | **0.2** | **8.5** | **7.5** | **11.4** | **9.5** | **1.9** |

Source: Refinitiv data (priced at 30 October 2020)

Finally, for completeness, we have looked at the peer group for **Analysys Mason** (Exhibit 28). By the nature of where the majority of consultancies are listed, the peer group is weighted towards North America over Europe. This represents a more diverse peer group than for Logicalis or Westcon International, but nevertheless points towards a consistent set of multiples, with average FY1 gross margins of 39.7% and EBITDA margins of 14.8%, with EV/sales multiples of 1.6x and

1.5x for FY1 and FY2, and average EV/EBITDA multiples of 11.5x and 10.6x for FY1 and FY2, respectively. Applying these multiples to Analysys Mason would indicate an enterprise value of c US$105–130m. Factoring in Datatec's 82% economic interest implies an average enterprise valuation to Datatec of c US$96m.

**Exhibit 28: Analysys Mason peers – IT distribution companies and resellers**

| Name | Share price | Ccy | EV ($m) | Gross margin 1FY (%) | EBITDA margin 1FY (%) | EBIT margin 1FY (%) | EV/sales 1FY (x) | EV/sales 2FY (x) | EV/ EBITDA 1FY (x) | EV/ EBITDA 2FY (x) | P/E 1FY (x) | P/E 2FY (x) | Div yield 1FY (x) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Accenture | 216.44 | USD | 134,660 | 31.5 | 18.4 | 14.9 | 2.9 | 2.7 | 15.7 | 14.6 | 26.9 | 24.4 | 1.6 |
| Atos | 57.58 | EUR | 9,830 | 41.1 | 13.9 | 8.1 | 0.7 | 0.7 | 5.4 | 5.1 | 8.1 | 7.7 | 2.4 |
| Booz Allen Hamilton | 75.31 | USD | 11,824 | 54.3 | 10.1 | 9.1 | 1.5 | 1.4 | 14.5 | 13.3 | 20.7 | 18.2 | 1.7 |
| Capgemini | 98.6 | EUR | 27,682 | 33.6 | 14.5 | 10.7 | 1.5 | 1.4 | 10.4 | 9.3 | 15.5 | 13.4 | 1.7 |
| FTI Consulting | 97.01 | USD | 3,562 | 32.4 | 13.4 | 11.7 | 1.4 | 1.3 | 10.8 | 8.9 | 17.2 | 14.7 | NM |
| Gartner | 118.28 | USD | 12,173 | 65.4 | 16.5 | 9.5 | 3.1 | 2.8 | 19.0 | 17.5 | 37.3 | 33.8 | 0.0 |
| Huron Consulting | 39.13 | USD | 1,143 | 28.9 | 9.3 | NM | 1.4 | 1.3 | 14.5 | 10.4 | 23.2 | 15.0 | NM |
| Wipro | 4.87 | USD | 21,667 | 30.1 | 22.2 | 18.2 | NM | NM | NM | NM | 20.7 | 19.4 | 1.1 |
| **Mean** | | | | **39.7** | **14.8** | **11.7** | **1.6** | **1.5** | **11.5** | **10.6** | **17.8** | **15.9** | **1.8** |
| **Median** | | | | **33.0** | **14.2** | **10.7** | **1.5** | **1.4** | **12.4** | **11.3** | **18.1** | **15.8** | **1.7** |

Source: Refinitiv data (priced 30 October 2020)

## Conclusions: Significant value locked-in

Pulling this all together, using the mean EV/sales and EV/EBITDA multiples of the core comparator groups from Exhibits 26–28, we can conclude that shareholders are not attributing anything like full value to the shares in the group's current structure, with Logicalis (or Westcon) alone worth more than the group enterprise value based on the above peer multiples. By our calculation (Exhibit 29), having adjusted the valuations for minority interests, applying a nominal 10x EV/EBITDA multiple for central costs and applying a somewhat subjective discount of 30% to allow for sovereign risk and the conglomerate structure, the implied sum-of-the-parts valuation is still substantially above Datatec's current share price.

**Exhibit 29: Sum-of-the-parts analysis**

| | Implied EV based on | | | | | | |
|---|---|---|---|---|---|---|---|
| **Enterprise value** | **Revenues** | | **EBITDA** | | **Economic interest** | **Mean EV** | **Per share** |
| **(US$m)** | **2021e** | **2022e** | **2021e** | **2022e** | | | |
| Logicalis | 762 | 763 | 810 | 754 | 78% | 600 | |
| Westcon | 619 | 627 | 279 | 358 | 92% | 434 | |
| Consulting | 106 | 105 | 130 | 126 | 82% | 96 | |
| Central costs | | | (150) | (150) | 100% | (150) | |
| | | | | | *Sum of the parts (EV)* | 979 | |
| | | | | | *FY20 net debt* | (140) | |
| | | | | | *SOTP – Equity value* | 839 | |
| | | | | | *Discount for: RSA sovereign risk, holding company risk* | 30% | |
| | | | | | *Adjusted equity value* | 587 | |
| | | | | | *Shares in issue (m)* | | 200.5 |
| | | | | | *SOTP value per share (US$)* | | 2.93 |
| | | | | | *SOTP value per share (ZAR)* | | 47.70 |
| | | | | | *Latest share price (ZAR)* | | 22.01 |
| | | | | | *Upside from latest share price* | | 117% |

Source: Edison Investment Research

Datatec's low relative valuation reflects the following risk factors: sovereign risk; emerging market exposure and currency risk; despite a 63% free float, limited liquidity with small lot sizes for institutional investors; a lack of immediate peers on the Johannesburg Stock Exchange, while most of its direct peers are listed in Europe or North America; a mixed (but improving) recent financial track record; high exposure to a single vendor (Cisco); and a conglomerate discount, potentially reflecting a lack of understanding of the group's business and overall strategy.

We expect management to try to reduce the valuation gap through a return to dividend payments, once COVID-19 related risks reduce, together with the IPO of Logicalis LatAm once market conditions improve. With a sustained improvement in financial performance, and consistent investor messaging, Datatec should be able to attract international investors and start to rebuild investor confidence. By positioning itself as an international investment story, we would expect the peer group discount to narrow, but full closure of the discount may require further simplification of the group's corporate structure.

## Sensitivities

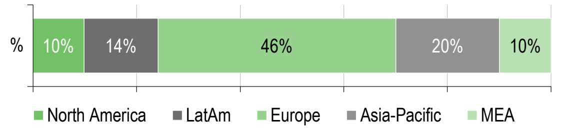
There are a number of factors that investors should bear in mind when considering investing in Datatec:

- **Foreign exchange risk:** Exchange rate volatility has a big impact on Datatec, especially in emerging markets. Other than the US dollar, the most significant currencies in which the group trades are the pound sterling, the euro, the Brazilian real, the Australian dollar and the South African rand. At its simplest, a substantial part of Datatec's business is based around the supply and service of US technology to a global customer base and therefore Datatec is a beneficiary of the weakening US dollar, with a strengthening US Dollar representing a headwind.
- **Key person exposure:** We believe that Datatec's share price and potentially its operations could be affected by the loss of key management, particularly Jens Montanana, founder and CEO of the business over the past 34 years. In mitigation, we note that decision-making is highly decentralised and that there has been a generational change within the group's divisional leadership in recent years.
- **COVID-19**: the COVID-19 virus represents an evolving scenario globally, which makes forecasting FY21 challenging. Given the uncertain global outlook, management has not issued forward guidance but remains focused on business optimisation, including cost and liquidity management.
- **The speed of technological change**: The group is focused on the higher value, faster growing products and services in the ICT supply chain. It is essential that management anticipates the impact of rapid technological change, a continuing feature of the sector.
- **The impact of a US/China trade war**: Any disruption to the global ICT supply chain could have consequences for Datatec. Further escalation in the US/China trade war, at the extreme potentially dividing the world into two spheres of influence, could disrupt supply as well as materially affect end-user demand, some of which will benefit Datatec.
- **Dependence on key vendors**: The group is dependent on certain vendors, particularly Cisco, whose products and services accounted for approximately 40% of the group's revenue. If any one of the group's principal vendors terminates, fails to renew or adversely changes its agreement with the group, it could harm the group's business and financial position.
- **Dependence on key customers:** The group's customer base is much larger than its vendor base but nevertheless includes large individual customers in specific regions (although none of these are material at the group level). Accordingly, the exposure to credit risk must be noted as a key risk of the business.

**Exhibit 30: Financial summary**

| US$'000s | 2017 | 2018 | 2019 | 2020 | 2021e | 2022e | 2023e |
|---|---|---|---|---|---|---|---|
| Year end 29 February | IFRS | IFRS | IFRS | IFRS | IFRS | IFRS | IFRS |
| **INCOME STATEMENT** | | | | | | | |
| Revenue | 3,861,991 | 3,923,715 | 4,332,381 | 4,304,845 | 4,258,432 | 4,418,935 | 4,613,564 |
| Cost of Sales | (3,239,701) | (3,287,670) | (3,644,637) | (3,563,267) | (3,591,726) | (3,707,908) | (3,850,250) |
| Gross Profit | 622,290 | 636,045 | 687,744 | 741,578 | 666,707 | 711,027 | 763,314 |
| EBITDA | 29,041 | 26,697 | 86,761 | 158,657 | 136,540 | 164,955 | 189,153 |
| Normalised operating profit | 954 | 24,765 | 89,727 | 105,157 | 93,877 | 110,399 | 135,957 |
| Amortisation of acquired intangibles | (10,171) | (11,299) | (10,217) | (11,297) | (10,000) | (8,000) | (7,915) |
| Exceptionals | (13,072) | (87,246) | (21,323) | (3,700) | (5,953) | (6) | (7) |
| Share-based payments | (1,000) | (6,198) | (9,764) | (7,623) | (7,623) | 0 | 0 |
| Reported operating profit | (23,289) | (79,978) | 48,423 | 82,537 | 70,301 | 102,393 | 128,036 |
| Net Interest | (13,821) | (18,403) | (22,577) | (25,874) | (26,850) | (25,774) | (25,695) |
| Joint ventures & associates (post tax) | (793) | (276) | (1,403) | (204) | 0 | 0 | 0 |
| Exceptionals | 6,114 | 305 | (228) | 2,029 | 0 | 0 | 0 |
| Profit Before Tax (norm) | (13,660) | 6,086 | 65,747 | 79,079 | 67,027 | 84,625 | 110,263 |
| Profit Before Tax (reported) | (31,789) | (98,352) | 24,215 | 58,488 | 43,451 | 76,619 | 102,341 |
| Reported tax | (21,242) | (18,465) | (20,959) | (31,809) | (25,633) | (38,307) | (40,934) |
| Profit After Tax (norm) | (22,788) | 7,031 | 8,840 | 36,071 | 27,484 | 42,315 | 66,160 |
| Profit After Tax (reported) | (53,031) | (116,817) | 3,256 | 26,679 | 17,818 | 38,312 | 61,407 |
| Minority interests | (7,711) | 2,568 | (1,816) | (13,772) | (7,146) | (9,468) | (11,558) |
| Discontinued operations | 63,780 | 159,608 | 11,694 | 1,332 | 0 | 0 | 0 |
| Net income (normalised) | (30,499) | 9,599 | 7,024 | 22,299 | 20,338 | 32,848 | 54,602 |
| Net income (reported) | 3,038 | 45,359 | 13,134 | 14,239 | 10,672 | 28,845 | 49,849 |
| Basic average number of shares outstanding (m) | | 210.6 | 216.3 | 237.8 | 210.5 | 200.5 | 200.5 |
| EPS - basic normalised (c) | (14.48) | 4.44 | 2.95 | 10.59 | 10.15 | 16.39 | 27.24 |
| EPS - diluted normalised (c) | (14.48) | 4.39 | 2.92 | 10.42 | 9.97 | 16.11 | 26.78 |
| EPS - basic reported (c) | 1.44 | 20.97 | 5.52 | 6.77 | 5.32 | 14.39 | 24.87 |
| EPS - Company underlying uEPS (c) | 10.99 | (5.62) | 6.61 | 9.90 | 10.33 | 16.38 | 27.23 |
| Dividend (c) | 4.00 | 165.00 | 0.00 | 7.00 | 3.44 | 5.46 | 9.08 |
| Revenue growth (%) | (40.2) | 1.6 | 10.4 | (0.6) | (1.1) | 3.8 | 4.4 |
| Gross Margin (%) | 16.1 | 16.2 | 15.9 | 17.2 | 15.7 | 16.1 | 16.5 |
| EBITDA Margin (%) | 0.8 | 0.7 | 2.0 | 3.7 | 3.2 | 3.7 | 4.1 |
| Normalised Operating Margin | 0.0 | 0.6 | 2.1 | 2.4 | 2.2 | 2.5 | 2.9 |
| BALANCE SHEET | | | | | | | |
| Fixed Assets | 786,361 | 417,370 | 437,786 | 512,598 | 498,859 | 489,797 | 483,229 |
| Intangible Assets | 591,114 | 269,647 | 284,877 | 291,279 | 288,060 | 285,338 | 281,198 |
| Tangible Assets | 73,742 | 59,731 | 60,306 | 43,300 | 44,578 | 46,856 | 50,184 |
| Right-of-use assets | 0 | 0 | 0 | 83,953 | 72,155 | 63,537 | 57,780 |
| Investments & other | 121,505 | 87,992 | 92,603 | 94,066 | 94,066 | 94,066 | 94,066 |
| Current Assets | 2,698,539 | 2,244,228 | 2,284,521 | 2,083,928 | 2,108,116 | 2,200,544 | 2,314,798 |
| Stocks | 438,503 | 238,537 | 332,256 | 253,271 | 255,294 | 273,711 | 294,767 |
| Debtors | 1,548,003 | 1,192,237 | 1,258,853 | 1,110,510 | 1,119,661 | 1,183,757 | 1,263,112 |
| Cash & cash equivalents | 345,634 | 476,242 | 344,400 | 347,189 | 360,203 | 370,118 | 383,961 |
| Other | 366,399 | 337,212 | 349,012 | 372,958 | 372,958 | 372,958 | 372,958 |
| Current Liabilities | (2,450,969) | (1,750,093) | (1,909,272) | (1,765,823) | (1,757,741) | (1,813,747) | (1,878,229) |
| Creditors | (1,720,391) | (1,199,384) | (1,358,928) | (1,259,013) | (1,250,931) | (1,306,937) | (1,371,419) |
| Tax and social security | (11,159) | (15,561) | (15,826) | (16,677) | (16,677) | (16,677) | (16,677) |
| Short term borrowings | (710,273) | (420,899) | (413,770) | (338,945) | (338,945) | (338,945) | (338,945) |
| Lease liabilities | 0 | 0 | 0 | (34,325) | (34,325) | (34,325) | (34,325) |
| Other | (9,146) | (114,249) | (120,748) | (116,863) | (116,863) | (116,863) | (116,863) |
| Long Term Liabilities | (127,056) | (120,685) | (100,805) | (187,610) | (187,610) | (187,610) | (187,610) |
| Long term borrowings | (31,902) | (61,723) | (31,383) | (18,638) | (18,638) | (18,638) | (18,638) |
| Lease liabilities | 0 | 0 | 0 | (95,148) | (95,148) | (95,148) | (95,148) |
| Other long term liabilities | (95,154) | (58,962) | (69,422) | (73,824) | (73,824) | (73,824) | (73,824) |
| Net Assets | 906,875 | 790,820 | 712,230 | 643,093 | 661,624 | 688,984 | 732,188 |
| Minority interests | (51,889) | (69,217) | (63,303) | (70,778) | (77,924) | (87,391) | (98,949) |
| Shareholders' equity | 854,986 | 721,603 | 648,927 | 572,315 | 583,700 | 601,593 | 633,238 |
| CASH FLOW | | | | | | | |
| Op Cash Flow before WC and tax | 43,113 | 120,141 | 117,848 | 169,980 | 150,116 | 164,961 | 189,160 |
| Working capital | (171,856) | (73,650) | (19,941) | 57,231 | (19,256) | (26,507) | (35,928) |
| Exceptional & other | 91,422 | (28,866) | (28,917) | (11,642) | (5,953) | (6) | (7) |
| Tax | (43,299) | (43,446) | (38,531) | (36,941) | (25,633) | (38,307) | (40,934) |
| Net operating cash flow | (80,620) | (25,821) | 30,459 | 178,628 | 99,274 | 100,141 | 112,291 |
| Capex | (61,453) | (48,715) | (36,886) | (28,036) | (32,500) | (33,500) | (34,550) |
| Acquisitions/disposals | 448 | (9,928) | (25,318) | (9,179) | 0 | 0 | 0 |
| Net interest | (25,264) | (24,784) | (22,434) | (30,972) | (26,850) | (25,774) | (25,695) |
| Equity financing | 0 | (34,629) | (43,881) | (51,683) | 0 | 0 | 0 |
| Dividends | (20,949) | (244,193) | (53) | (15,137) | (6,905) | (10,946) | (18,197) |
| Other | (12,097) | 771,221 | 1,991 | 20,019 | (20,000) | (20,000) | (20,000) |
| Net Cash Flow | (199,935) | 383,151 | (96,122) | 63,640 | 13,019 | 9,921 | 13,849 |
| Opening net debt/(cash) | 205,398 | 396,541 | 6,380 | 100,753 | 139,867 | 126,848 | 116,927 |
| FX | 11,917 | 4,099 | (15,116) | 3,099 | 0 | 0 | 0 |
| Other non-cash movements | (3,125) | 2,911 | 16,865 | (105,853) | 0 | 0 | 0 |
| Closing net debt/(cash) | 396,541 | 6,380 | 100,753 | 139,867 | 126,848 | 116,927 | 103,078 |

Source: Datatec accounts, Edison Investment Research

| Contact details | Revenue by geography |
|---|---|
| 3rd Floor, Sandown Chambers<br>Sandown Village<br>81 Maude Street<br>Sandown, 2031<br>South Africa<br>+27 11 233 1000<br>www.datatec.com |  |



**Management team**

| Chairman: Stephen Davidson | CEO: Jens Montanana |
|---|---|
| Stephen was previously Vice-chairman, investment banking, at WestLB Panmure and CEO and finance director of Telewest Communications plc. He has a first-class honours degree in mathematics and statistics from the University of Aberdeen. | Jens is the founder and CEO of Datatec Limited, established in 1986. Between 1989 and 1993, Jens served as managing director and vice-president of US Robotics (UK) Limited, a wholly owned subsidiary of US Robotics, Inc. which was acquired by 3Com in 1997. In 1993 he co-founded US start-up Xedia Corporation, which was subsequently sold to Lucent Corporation in 1999. Jens is also the non-executive chairman of AIM-listed Corero Network Security. |
| **CFO: Ivan Dittrich** | **Senior Independent NED: Ekta Singh-Bushell** |
| Ivan re-joined Datatec on 30 May 2016 from Vodacom, where he had been group CFO from 15 June 2012 to 31 July 2015. Prior to that, he held a number of senior executive positions at Datatec, including group CFO from May 2008 to June 2012, in a career that spanned 13 years. Ivan qualified as a chartered accountant (South Africa) at Deloitte South Africa and also worked for PricewaterhouseCoopers in London. He completed the Oxford Advanced Management and Leadership programme at Saïd Business School. | Ekta was COO, executive office at the Federal Reserve Bank of New York, and previously had a 17-year career in senior partner roles with EY, such as US innovation and digital strategy leader, where she led transformations across multiple industries affected by digital technology and information management advances. Ekta is a Certified Public Accountant (USA) and has a master of electrical engineering and computer science degree from the University of California, Berkeley, and a bachelor of engineering degree from the University of Poona, India. |

| Principal shareholders by manager | (%) |
|---|---|
| Prudential Investment Managers (ZA) | 15.32 |
| Sanlam Investment Management | 15.07 |
| PIC (ZA) | 13.64 |
| Montanana J | 12.90 |
| Kagiso Asset Management (Pty) Ltd (ZA) | 10.77 |
| Dimensional Fund Advisors | 5.93 |
| Mergence Investment Managers Pty Ltd (ZA) | 3.45 |
| The Vanguard Group Inc | 3.11 |

# Appendix

## IT middleman: The role of the IT distributor

With Westcon acting as an IT distributor, we wanted to clarify what the role involves and how sustainable the role of an IT 'middleman' is.

Distributors generally sit between vendor and reseller, with resellers then selling to the end-customer, forming an efficient and cost-effective supply chain. A distributor tends to act as a partner to the manufacturer and a strong distributor relationship can be ideal for manufacturers building a presence in a new market.

The distributor usually buys directly from the manufacturer, holds product inventory, provides after-sale services, and sells the product to resellers. With warehouses and facilities close to the end-user, the distributor is also well-placed to offer technical advice and training to customers, including educating resellers about new products on behalf of vendors, as well as providing procurement services. It is not feasible for a supplier to fulfil many thousands of small orders to customers around the world. Whereas the distributor, which buys in bulk from a manufacturer, can then aggregate and fulfil the manufacturer's inventory for them. Another important benefit provided by the distributor to end-users is the provision of finance and credit, acting as a credit intermediary for the supplier.

### Value proposition to IT vendors

- Market access, reach, coverage and channel building
- Import compliance and logistics
- Speed to market (for brands and new products)
- Commercial efficiency (lower service costs, reduced capital investment and working capital)
- Aggregation of products into complex multi-vendor solutions
- Provision of specialised services for different channels
- Offering credit line and credit collection capabilities

A reseller is generally less closely associated with the manufacturer, often buying product from distributors. Resellers do not typically hold inventory or provide after-sale services, selling direct to the end-user or wholesalers. For well-known manufacturers, a direct reseller relationship may be more profitable for the manufacturer because resellers tend not to develop the market for the product and therefore provide higher profit margins for the manufacturer.

### Value proposition to IT resellers

- Provider of end-to-end multi-vendor solutions (broader range and availability)
- One-stop-shop for product information and technical support
- No minimum quantities required to be a valued partner
- Outsourcing of warehousing and shipping
- Market and business intelligence
- Access to flexible financing programs and inventory management

## The role of the IT services company

IT services companies, such as Logicalis, provide a mix of IT consulting services, including IT outsourcing, managed services, cloud services and systems integration. This tends to be higher-margin work than that offered by the distributor, working directly with the client, independently sourcing technology from vendors and distributors to provide bespoke multi-vendor solutions to meet the client's needs.

An IT systems integrator is an independent business that offers solutions combining hardware, software, technology products from multiple vendors to deliver a customised implementation for its clients. A systems integrator assesses a client's business needs and defines the technical requirements for an IT system that meets those needs. This may involve designing or building a customised architecture or application and integrating it with new or existing hardware, packaged or custom software, and networking infrastructure. With the rise of cloud computing, the systems integrator is increasingly integrating on-premise IT systems with cloud-based applications and infrastructure.

To some degree, the roles of the systems integrator and reseller overlap. A value-added reseller (VAR) resells hardware and software products, providing IT consultancy services to create integrated solutions. A systems integrator may act as a VAR, reselling products to customers as part of a systems integration project. However, a systems integrator tends to have a more developed services capability, whereas a VAR will be more product-focused.

From the client's perspective, hiring a systems integrator to combine multiple subsystems into an integrated offering can also simplify contracting and vendor management for the client, who would otherwise need to purchase each subsystem separately, work with multiple vendors in parallel.

### Managed and cloud service solutions

Managed service providers (MSPs) are specialist IT service providers that take on responsibility for all or parts of a client's IT systems, as defined in a service level agreement (SLA), with the MSP providing monitoring, support, issue resolution and reporting. MSPs tend to charge a flat fee for delivery of their services, with the SLA defining precisely what services will be furnished, as well as metrics for measuring the success of these services.

Cloud computing has allowed MSPs to expand beyond the basic break/fix IT support, through the increasing adoption of cloud-based software as a service (SaaS) technologies, as well as infrastructure as a service (IaaS) and platform as a service(PaaS). These cloud capabilities mean that service delivery can be centralised and remote from the client, with far fewer (if any) resources required on-site at the client, allowing providers to operate far more efficiently, with a lower fixed cost base and scale at a far faster rate than the traditional managed IT services model.

## Competitor landscape

Brief profiles of the principal competitors to Logicalis and Westcon are set out below.

### Competitors of Logicalis

- **NTT Data (TYO: 9613, US$15.8bn)** is one of the world's largest IT services and systems integration companies, focused on local governments, financial and telecommunication sectors. It is listed in Tokyo and 54% owned by Nippon Telegraph and Telephone (NTT). The group acquired Datatec's closest peer and competitor, Dimension Data (listed in Johannesburg and London), for US$3.2bn in 2010.
- **Insight Enterprises (NASDAQ: NSIT, US$1.9bn)** is a US-based global provider of digital innovation, cloud and data centre transformation, connected workforce and supply chain optimisation solutions and services. Insight works with organisations (businesses, schools, government and healthcare) to define, architect, implement and manage their IT and digital transformation.
- **Bechtle (ETR: BC8, US$7.4bn)** is one of Europe's leading IT providers, with 75 systems integrators in Germany, Austria and Switzerland as well as 24 e-commerce subsidiaries in 14

European countries. Bechtle serves more than 70,000 customers from the industrial, trade, financial and public sectors with a comprehensive, vendor-neutral portfolio that covers all aspects of IT infrastructure and operation.

- **Computacenter (LSE: CCC, US$3.4bn)** is an IT reseller and leading independent provider of IT infrastructure services to large corporates, with operations centres across Europe, South Africa, Asia and the Americas. Computacenter manages customers' infrastructure, providing user support, supply chain management and IT strategy, serving a largely European-headquartered client base through an international partner network.

## Competitors of Westcon International

- **ScanSource (NASDAQ: SCSC, US$0.5bn)** is a leading global provider of technology products and solutions, operating as a technology distributor for its partners. Partners include value-added resellers, sales partners or agents, independent sales organisations and independent software vendors. Based out of South Carolina in the US, ScanSource has c 2,500 employees across 48 locations in North America, Latin America, and Europe.
- **Arrow Electronics (NYSE: ARW, US$6.0bn)** is a global supply chain partner to over 175,000 customers across sectors including transportation, medicine, industrial, telecommunication and consumer. Founded in 1935, Arrow works with organisations in over 336 locations and 80 countries to develop multi-vendor IT solutions, from cloud and data intelligence to security and IoT. Arrow has c 19,300 employees.
- **ALSO Holding (SIX: ALSN, US$2.9bn),** based in Switzerland, is active in 23 European countries, providing a range of 'on-premise' (transactional, acquisition of hardware and software), 'off premise', (consumptional, usage-based IT-as-a-service via the cloud) and hybrid solutions. ALSO offers 660 vendors of hardware, software and IT-services access to over 100,000 buyers, service providers and distributors. ALSO generated turnover of €10.7bn with around 4 000 employees in FY19.
- **SYNNEX Corporation (NYSE: SNX, US$6.8bn)** acquired Westcon Americas from Datatec in FY18. Headquartered in Fremont, CA, SYNNEX provides IT distribution and customer care outsourced services, operating in two business segments: Technology Solutions and Concentrix. Technology Solutions distributes c 30,000 technology products from c 400 established and emerging manufacturers, providing solutions to c 20,000 resellers and retail customers in the US, Canada and Japan. The SYNNEX Westcon-Comstor business operates in North and Latin America, operating under the SYNNEX Westcon and SYNNEX Comstor brands. Concentrix, with more than 225,000 associates operating in 40+ countries, offers business services solutions (direct sales, technical support, customer care, lead management, renewals management and back-office processing) to 650 customers globally.

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