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Surfing IT stocks

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INFORMATION Technology (IT) stocks may very well be the future vogue. The signs are there. Only recently, as many as 100 companies have applied to be listed on the Malaysian Exchange of Securities Dealing and Automated Quotation Bhd (Mesdaq), Malaysia's answer to the National Association of Securities Dealers Automated Quotation (Nasdaq), the American exchange dominated by the world's leading IT companies.

Then there's the Multimedia Super Corridor (MSC) - Malaysia's unequivocal embracement of the information age. Physically located between the Kuala Lumpur City Centre (KLCC) at one end and the Kuala Lumpur International Airport (KLIA) at the other, the MSC measuring 50km by 15km is about the size of Singapore. It will be spearheaded by Cyberjaya, a 2000ha city development based on Silicon Valley urban standards. Located within the MSC is also Technology Park Malaysia (TPM), the vehicle to nurture R & D technological and management skills.

'With the nation on an information technology drive led by the government, the emergence of new IT-related stocks is inevitable,' says a locally-based analyst.

He may, in all probability, be right. Government expenditure on IT has been budgeted at levels unseen previously. Investment in IT-related programmes and projects to ministries and government agencies will total RM2.3 billion over the next five years. Over the next 10 years, the MSC and TPM are conservatively estimated to generate about RM50 billion in investment from both the public and private sectors.

However, some analysts think it might be a little premature for tech-investors to throw a wild party. 'Despite all the hype about IT, the performance of some IT-related companies on the Kuala Lumpur Stock Exchange (KLSE) is not up to mark. It's a wee bit early to uncork the champagne,' comments a foreign-based analyst.

IT-related stocks on the KLSE are Lityan Holdings Bhd, Fujitsu Systems Business Bhd, Dataprep Holdings, MCSB Systems Bhd, Measurex Bhd and Computer Systems Advisor Bhd (CSA) - all second boarders.

With the exception of Lityan and to a certain extent CSA and Fujitsu, the rest of the stocks are not as exciting as they are hoped to be.

Tan Fu-Mei, research analyst with Inter-Pacific Capital Sdn Bhd, says IT stocks have yet to fully win the interest of fund managers because they are still highly speculative at this point. 'Most of the stocks have small share base and are not liquid enough.' Perception of which stocks and how they will benefit from the country's IT thrust has further injected speculative elements. The speculation surrounds these stocks and their potential to get a piece of the MSC pie', says Tan. This explains their high price-earning (PE) ratio which at the time of writing ranges between 25x and 58x 1997 earnings.

Competition from within and without is intensifying as more new entrants come into the market. This will result in significant price reduction and profit margin loss, especially for companies inclined towards retailing of computers. Says the locally-based analyst, 'The retail business is extremely competitive and gross profit margins are usually less than 15%. During a price war it can drop to less than 5%.'

MCSB, Fujitsu and Dataprep have bled due to this. MCSB registered a 40% drop in revenue for the first half of financial year (FY) 1997, mainly owing to the discontinuation of its distribution business in China. 'This

is a big negative for the management, considering that China is one of the fastest growing personal computer (PC) market in the world,' says the locally-based analyst. Dataprep made a loss of RM12.9 million for first half FY97 compared with a profit of RM1.7 million for the corresponding period in 1996. Likewise, Fujitsu revenue has been on the decline over the last two years.

Analysts say it will take some time for IT stocks to have the same appeal banking and finance stocks had with fund managers in 1996. 'The appeal will come with improved liquidity and earnings,' says Tan.

Earnings potential in the business lies in the supply of innovative value-added IT services like software development as opposed to the pure supply of hardware. That's why Lityan, provider of IT solutions services like networking and systems integration, is a favourite among analysts. The locally-based analyst say margins for the more sophisticated IT retailing could be as high as 40%.

Lityan is a leader in data communications and IT and is considered one of the more focused IT stocks on the KLSE. Lityan with a PE of 25x 1997 earnings, according to Tan, 'has been more successful in catching the attention of fund managers as future income is assured by the MSC Telemedicine project and projects for the Melaka Hi-Tech Park.' Lityan's past profit margin has been good, averaging between 15% and 18%. Lityan is headed by executive chairman Rahmat Harun who holds the majority stake at 43%, with the Pilgrims Management and Fund Board holding 14% and the Employees Provident Fund (EPF), 5%.

The tables might be turning for Dataprep. Tan believes the disposal of its loss-making subsidiaries and the realigning of its business to higher value added IT services such as electronic commerce for the Kulim Hi-Tech Park is a positive move. The stock's strength currently lies in the strong presence Mirzan Mahathir. However, Mirzan is believed to have slightly reduced his stake in Dataprep.

New kids on the block are CSA and Measurex. CSA is one of the few local providers of effective Internet and Intranet solutions. Despite a tough year for IT firms, CSA managed to turn in a commendable RM15.4 million in pre-tax profit in FY December 1996, up 36% from FY95. Tan thinks the stock has a bright future. 'Unlike most IT firms, CSA is in the forefront with its potential tie-up with Sun Microsystems of the US to bring Sun's Java software innovations into the MSC.'

Java is a powerful computer language which enables programmers to write one piece of software that can run on many different systems - a technology expected to creep into every company's computers. Another push for the stock will come from its MSC status and possible tie-up with Telekom Malaysia to participate in the MSC.'

Measurex, manufacturer of hard disk drives, is a 40% associate of Goldtron Ltd of Singapore. Goldtron Ltd is an electronics and telecommunications firm listed on the Stock Exchange of Singapore. Sentiment on the stock is however hampered by a recent litigation by US-based Motorola Electronics against two of Goldtron's subsidiaries for infringing a Singapore telecommunications patent owned by Motorola. The case is likely to be the first patent infringement case to go on trial in Singapore under the new Singapore Patent Law.

Mesdaq, to be launched before the year's end, will facilitate the raising of capital for high-tech companies with great potential but no track record. Whether Mesdaq will plug the country into the IT era remains to be seen as analysts concur that a time frame is needed to capture certain issues.

First is the skilled labour shortage in the IT industry currently. By the year 2000, demand for IT graduates is expected to total 180,000

against 85,000 graduates in 1997. 'This could result in an expensive need to import skilled expatriates,' says the locally-based analyst. More importantly is the concern of whether there are enough venture capitalists to raise enough money to support the industry. The history of Silicon Valley shows back-up from venture capitalists is needed to kick-start IT firms.

There is also the problem of software piracy which is still rampant in Malaysia although statistics show the rate is declining. Software piracy has caused Malaysia's software industry to lose US\$80 million in 1995, up from US\$66 million in 1994 although the rate, according to a survey by Business Software Alliance (Singapore), showed a drop from 84% in 1994 to 77% in 1995. Software piracy rate is estimated to decline further to 70% in 1996.

Certain however are the massive opportunities the IT age will endow on the country. Says Tan, 'The potentials are definitely there, and we will see a lot of competition with IT firms aggressively shaping up for the MSC.'

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