LGMS

Future-Proofing Its Operations

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OUTPERFORM ↔

Price:	**RM1.02**
Target Price:	**RM1.16** ↓

LGMS's 9MFY23 results disappointed. Its 9MFY23 core net profit fell 17% on increased headcount in preparation for future expansion. It is realigning its portfolio to optimise resources. We trim our FY23-24F net profit forecasts by 28% and 13%, respectively, lower our TP by 12% to RM1.16 (from RM1.32) but maintain our OUTPERFORM call.

Below expectations. LGMS's 9MFY23 earnings of RM7.5m (-16.7% YoY) came in below our expectations, accounting for only 53% of both our full-year forecast and the full-year consensus estimate. The variance against our forecast was mainly due to higher cost of sale which outpaced revenue growth.

Results' highlights. YoY, LGMS's 9MFY23 revenue was largely unchanged as it inched merely 1% lower. The weakness in the cyber risk management (-24%) segment and cyber threat response (-37%) segment was mostly offset by better showing from the cyber risk prevention (+12%), which makes up 76% of the group's revenue. However, the group recorded higher cost of sales which consisted of employee benefit expense (+28%) and IT expenses (+23%) which explains the compressed margin. As a result, its net profit trended 16.7% lower.

Preparing for future growth. We understand that the group is currently in its growth phase, where the incurred costs (i.e., increased headcount and IT resources) are imperative for future readiness. Therefore, quarterly evaluations may sometimes fail to present a clear picture. For example, the tepid revenue growth in the immediate term is transient, as the group has embarked on a journey to realign its portfolio, optimising resource allocation to achieve better revenue recognition in the future. Additionally, LGMS has introduced "StarSentry" (code name: Project Mars), a plug-and-play device that seamlessly connects to users' networks, autonomously analysing all connected devices for vulnerabilities. Tailored for SMEs seeking cost-effective and straightforward security solutions, this product is poised to contribute positively to the group, with a more meaningful impact in FY24. Consequently, we maintain a positive outlook on the company and the cybersecurity space it operates in.

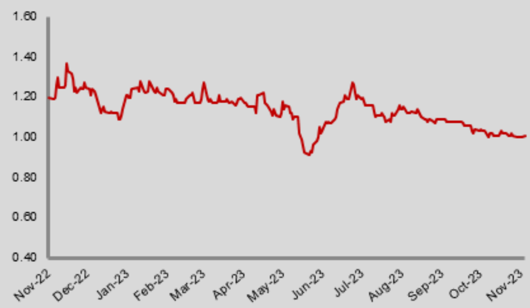
Forecasts. We cut our FY23-24F net profit forecasts by 28% and 13%, respectively.

Consequently, we trim our TP by 12% to **RM1.16** (from RM1.32) based on an unchanged 25x FY24F PER, in line with peers' forward mean. There is no adjustment to our TP based on ESG given a 3-star rating as appraised by us (see Page 4).

Investment thesis. We like LGMS for: (i) the high growth prospects of its core cybersecurity business given the under-penetrated local and regional cybersecurity markets, (ii) the deep moat around its business given the high barrier to entry created by the tough qualification process as a vendor, and (iii) new proprietary certification software which is expected to be the next earnings driver. Maintain **OUTPERFORM.**

Risks to our call include: (i) longer-than-expected gestation period for its regional expansions, (ii) economic downturn resulting in customer lowering budget allocated for cybersecurity, (iii) reluctance to spend on cybersecurity services due to the lack of knowledge and awareness in emerging countries, and (iv) failure to maintain the extensive list of accreditations due to potential loss of critical talent.

Share Price Performance



KLCI	1,448.0
YTD KLCI chg	-3.1%
YTD stock price chg	-9.7%

Stock Information

Shariah Compliant	Yes
Bloomberg Ticker	LGMS MK Equity
Market Cap (RM m)	465.1
Shares Outstanding	456.0
52-week range (H)	1.43
52-week range (L)	0.92
3-mth avg daily vol:	212,779
Free Float	42.7%
Beta	1.8

Major Shareholders

Fong Choong Fook	36.3%
Mitsui & Co Ltd	25.0%
Goh Soon Sei	10.8%

Summary Earnings Table

FY Dec (RM m)	2022A	2023F	2024F
Turnover	32.8	33.4	59.5
EBITDA	17.0	14.8	29.2
PBT	15.6	13.3	27.5
Core NP (CNP)	**12.6**	**10.2**	**21.1**
Consensus (NP)	-	14.2	24.2
Earnings Revision	-	-28%	-13%
EPS (sen)	2.8	2.2	4.6
EPS growth (%)	22.6	-19.4	106.8
NDPS (sen)	1.3	0.5	1.0
BVPS (RM)	0.18	0.21	0.25
Price/BV (x)	5.6	5.0	4.1
PER (x)	36.9	45.7	22.1
Net Gearing (x)	-	-	-
ROA (%)	13.8	9.7	16.0
ROE (%)	15.1	10.9	18.3
Dividend Yield (%)	1.3	0.5	1.0

Result Highlight

FYE Dec (RM m)	3Q FY23	2Q FY23	QoQ Chg	3Q FY22	YoY Chg	9M FY23	9M FY22	YoY Chg
Revenue	**8.4**	**9.0**	**-7.1%**	**7.8**	**6.7%**	**23.6**	**23.8**	**-1.0%**
GP	4.0	5.2	-22.5%	4.2	-5.8%	11.0	14.6	-24.6%
EBIT	3.1	4.9	-36.8%	4.2	-27.0%	10.2	11.4	-11.0%
PBT	3.1	4.9	-37.0%	4.2	-27.2%	10.1	11.4	-11.2%
Taxation	-0.8	-1.3	40.9%	-1.1	31.9%	-2.6	-3.1	15.4%
Net Profit (NP)	2.3	3.6	-35.6%	3.1	-25.5%	7.5	8.3	-9.6%
Core NP	**2.3**	**3.6**	**-35.6%**	**3.1**	**-25.5%**	**7.5**	**9.0**	**-16.7%**
EPS (sen)	0.5	0.8	-35.6%	0.7	-25.5%	1.6	2.0	-16.7%
DPS (sen)	0.0	0.5		0.0		0.5	1.3	
GP margin	47.7%	57.2%		54.1%		46.8%	61.5%	
EBIT margin	36.9%	54.3%		54.0%		43.2%	48.1%	
Pretax margin	36.6%	53.9%		53.6%		42.8%	47.8%	
CNP margin	27.5%	39.6%		39.4%		31.9%	37.9%	
Effective tax rate	-24.8%	-26.5%		-26.5%		-25.6%	-26.9%	

Source: Kenanga Research

Malaysian Technology Peers Comparison

Name	Rating	Last Price (RM)	Target Price (RM)	Upside (%)	Mkt Cap (RM'm)	Shariah Compliant	Current FYE	Core EPS (sen)		Core EPS Growth		PER (x) – Core Earnings		PBV (x)	ROE (%)	Net. Div. (sen)	Net. Div. Yld (%)
								1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.
D&O GREEN TECHNOLOGIES BHD	UP	3.59	2.30	-35.9%	4,445.5	Y	12/2023	3.7	7.0	-52.9%	89.7%	97.0	51.1	5.1	5.2%	0.6	0.2%
GHL SYSTEMS BHD	OP	0.750	0.980	30.7%	856.1	Y	12/2023	2.7	3.0	8.9%	13.4%	27.9	24.6	1.6	5.8%	0.0	0.0%
INARI AMERTRON BHD	OP	2.89	4.17	44.3%	10,822.5	Y	06/2024	10.4	12.4	20.5%	18.8%	27.7	23.3	4.1	14.9%	9.9	3.4%
JHM CONSOLIDATION BHD	MP	0.730	0.700	-4.1%	442.4	Y	12/2023	2.1	4.6	-43.5%	116.2%	34.1	15.7	1.3	4.1%	0.5	0.7%
KELINGTON GROUP BHD	OP	1.86	3.28	76.3%	1,199.3	Y	12/2023	14.1	15.6	63.2%	11.0%	13.2	11.9	3.9	32.8%	3.9	2.1%
KESM INDUSTRIES BHD	MP	6.90	7.06	2.3%	296.8	Y	07/2024	6.3	10.2	-44.9%	63.0%	111.6	66.7	0.8	0.8%	0.0	0.0%
LGMS BHD	OP	1.02	1.16	13.7%	465.1	Y	12/2023	2.2	4.6	-19.0%	106.9%	45.7	22.1	5.0	11.5%	0.0	0.0%
M'SIAN PACIFIC INDUSTRIES BHD	MP	27.00	27.20	0.7%	5,370.2	Y	06/2024	80.9	118.2	162.5%	46.1%	33.4	22.8	2.5	7.8%	35.0	1.3%
NATIONGATE HOLDINGS BHD	OP	1.31	1.70	29.8%	2,716.9	Y	12/2023	3.4	6.8	-16.6%	97.5%	38.1	19.3	9.2	27.2%	0.3	0.2%
OPPSTAR BHD	MP	1.29	1.82	41.1%	820.7	Y	03/2024	4.0	6.1	20.8%	50.8%	32.1	21.3	5.3	17.5%	1.0	0.8%
P.I.E. INDUSTRIAL BHD	OP	3.22	3.80	18.0%	1,236.6	Y	12/2023	17.7	21.1	-4.2%	19.5%	18.2	15.3	2.1	11.7%	7.0	2.2%
SKP RESOURCES BHD	MP	0.800	0.950	18.8%	1,242.1	Y	03/2024	6.3	7.1	-31.6%	12.5%	12.7	11.3	1.5	11.4%	3.2	4.0%
UNISEM (M) BHD	UP	3.38	2.00	-40.8%	5,452.2	Y	12/2023	4.7	10.0	-68.6%	111.6%	71.4	33.7	2.3	3.2%	6.0	1.8%
Simple Average										-6.7%	39.1%	32.6	23.5	3.4	11.8%		1.3%

Source: Kenanga Research

Stock ESG Ratings:

	Criterion	Rating				
GENERAL	Earnings Sustainability & Quality	★	★	★		
	Corporate Social Responsibility	★	★	★		
	Management/Workforce Diversity	★	★	★	☆	
	Accessibility & Transparency	★	★	★		
	Corruption-Free Pledge	★	★	★		
	Carbon-Neutral Initiatives	★	★	☆		
SPECIFIC	Occupational Health & Safety	★	★	★	★	
	Protection of Customer Data	★	★	★	★	
	Cybersecurity	★	★	★	★	
	Energy Efficiency	★	★	★		
	Digital Transformation	★	★	★		
	OVERALL	★	★	★		

☆ denotes half-star
★ -10% discount to TP
★★ -5% discount to TP
★★★ TP unchanged
★★★★ +5% premium to TP
★★★★★ +10% premium to TP

Stock Ratings are defined as follows:

Stock Recommendations

OUTPERFORM : A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM : A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM : A particular stock's Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT : A particular sector's Expected Total Return is MORE than 10%
NEUTRAL : A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT : A particular sector's Expected Total Return is LESS than -5%

******Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.***

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