

April 27, 2019

## Tech Data Corporation: (TECD)

Nick Sapienza

**Sector:** Information Technology

**Industry:** Technology Hardware and Equipment

**Current Price:** \$106.62

**Target Price:** \$128.85

Tech Data Corporation operates as one of the world's largest technology distribution and solutions company. In addition to distributing more than 75,000 products from over 1000 manufacturers and publishers, Tech Data provides extensive pre-sale and post-sale training, service and support.

### BUY

Current Price: \$106.62

Target Price: \$128.85

Market Cap: 3.9B

Beta: 1.13

ROIC: 12%

WACC: 9%



### Thesis:

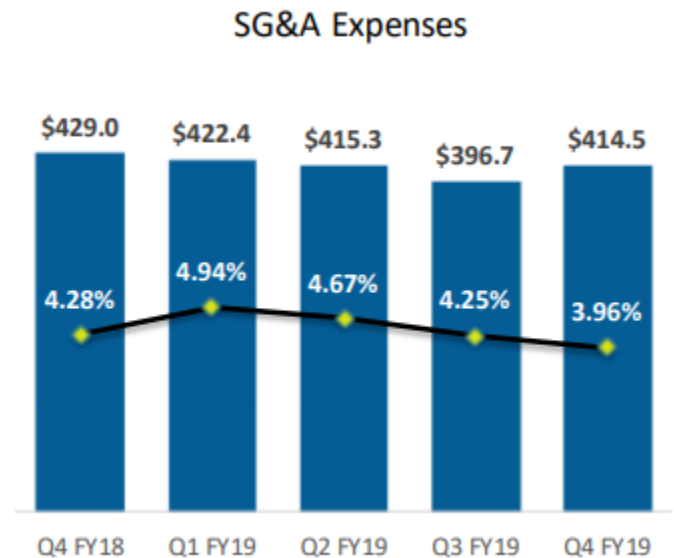
Tech Data Corporation (TECD) is very motivated to expand their current operations into next generation technologies such as Internet of Things, Cloud, and Security. The company is also looking to optimize their global footprint moving forward. TECD proved their ability to create value over time and they will continue this trend with their future strategy. For these reasons, I find that Tech Data is undervalued, and is a BUY at the current market price of \$106.62 per share.

### Catalysts:

- **Operating Margin Growth:** Although the guidance for TECD's FY2020 (Tech Data's fiscal year ends Jan. 31) was weak in terms of revenue growth in the low-single digits, they specified mid-single digit operating growth, which shows they plan to increase their operating margin.
- **Current Market Value:** Even with the low-single digit revenue guidance, TECD remains undervalued at their current market price. The stock price took a hit in 2018 like most tech stocks, but has not yet reached its intrinsic value. TECD management sees this as well, and have started a share-repurchasing plan.
- **Industry Potential:** With next-generation technology software such as Internet of Things and 5G coming in the near future, market leaders in technology sectors (Tech Data) are going to benefit.

## Expanding Margins:

Tech Data Corporation has been seeing a slowdown in revenue growth lately, which has caused its stock price to decline significantly in 2018. Although the year over year revenue growth from Q4 FY2018 to FY 2019 was only 4%, the revenue growth under a constant currency (if the exchange rate was more favorable) was closer to 8%. This shows that the company is still growing at a significant pace but has been impacted by temporary exchange rates. The stock has rebounded back to its original price at the start of 2018, but the future growth in margins is not priced in yet. In the last four quarters SG&A expenses have consistently declined from \$429 million to \$414 million, which shows that Tech Data's management team has improved the efficiency of the company's operations. Additionally, guidance for fiscal year 2020 shows revenue growth in the low-single digits while operating income is expected to grow at mid-single digits, again showing that management is attempting to increase Tech Data's margins. Not only will this have a direct impact on the current bottom line, once TECD begins to increase its revenue growth back to normal levels this change in margin is going to translate into huge gains in net income.



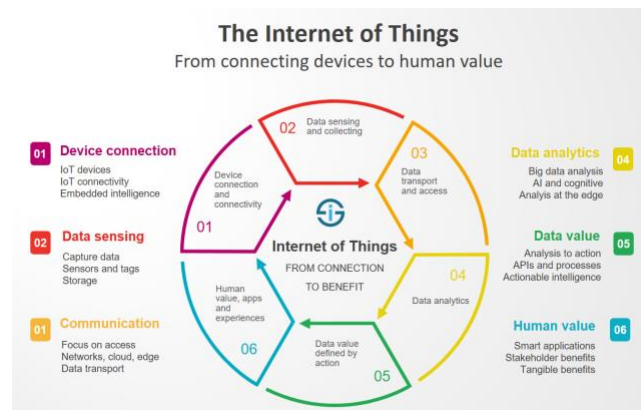
## Current Valuation:

The projected revenue growth for FY 2020 is very low compared to growth in the last 5 years. Many analysts and investors have priced this into their valuations, but the stock price is still currently trading below its intrinsic value. When adding in the factor of an expanding operating margin, the current market price could be as far as 20-30% below its intrinsic value. Revenue growth of 2% in FY 2020 and slowly increasing to a terminal growth rate of 2.5%, paired with a modest continuing period operating margin of only 2%, shows that through discounted cash flow valuation we find TECD to be trading close to \$20 below its intrinsic value. We can then conclude that either the operating margin expansion has not yet been priced in, or investors are using other valuation methods. Using other relative valuation techniques such as enterprise value to revenue (EV/Rev), Price to Earnings (P/E) and Price to Book Value (P/BV), we can still conclude that the company's stock is undervalued relative to its peers, even more so than if a discounted cash flow valuation is used. This means that investors simply are not pricing in the margin expansion, and are instead expecting a little to no growth future for Tech Data. Tech Data's management have noticed this undervaluation as well, and issued a share-repurchasing plan to take advantage of the low prices. This shows that even the people closest to the company's operations recognize that the stock is trading far below its intrinsic value. On March 7, 2019 the company authorized an increase of \$100 million to the repurchase plan. Fiscal year 2019 had a

total of \$107 million in share repurchases, and an additional \$193 million still remain under the current authorization.

## Industry Potential:

The technology sector has rebounded in the first quarter of 2019 as a whole, and Tech Data has followed. With innovative new products and software coming in the near future, Tech Data has a significant amount to gain from the success and growth of the technology industry. Tech Data has already started to invest in next-generation technology portfolios. They plan on continuing this by moving to higher value technologies such as cloud-based services, analytics and internet of things and next-generation security. These few groups of products/services are expected to drive the growth in the technology industry for at least the next few years. For example, the internet of things is the extension of internet connectivity into physical devices which creates possibilities for smart homes, smart security systems, and cashier-less stores such as the Amazon smart store. Integration of these products has already started but are expected to increase rapidly within the next few years. As a wholesaler of these products, it is clear that Tech Data Corporation is going to benefit



from the further integration, which will translate into higher revenues and profits.

## Global Optimization:

In addition to finding value in next-generation technologies, Tech Data has showed their interest in optimizing their global footprint. TECD is already one of the world's largest technology distributors, but they recognize that there are opportunities in other countries that they have not fully tapped into yet. Tech Data currently operates in more than 40 countries, and they plan on further geographic expansion within the next few



years. In 2016, they specified that they wanted to increase their allocation to 47% in the Americas, 50% in Europe and 3% in Asia Pacific. Currently, they have moved closer to 43%, 54%, and 3%, respectively. This shows that they still are working towards changing their global allocation and they have been successful thus far.

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## Risk Factors:

As with any company, Tech Data Corporation faces risk factors that could potentially divert the stock price away from the intrinsic value calculated. The main factors relating to their business include the following:

- **Economic Conditions:** TECD's ability to earn profit is much more challenging when sales slow from a down economy. Most of the technology that Tech Data is a wholesaler of can be considered a luxury in poor economic conditions, and therefore would make it difficult for the company to move their products.
  - **Competitors:** By reducing prices on vendor products that contribute most to Tech Data's profitability, competitors can take more market share. Customers are not required to purchase any specific amount from Tech Data, and as a result, they must be extremely flexible in determining when to reduce price to maintain market share and when to allow sales volumes to decline to maintain the quality of their profitability.
  - **Security Breaches:** Tech Data is heavily dependent on internal information and telecommunication systems. Any failure of these systems, including systems security breaches, data protection breaches or other cybersecurity attacks, may negatively affect their business and operations. As technology has increases for both corporations and individuals, security breaches and hackers are still highly relevant and dangerous especially to organizations that deal with the level of data that TECD deals with.
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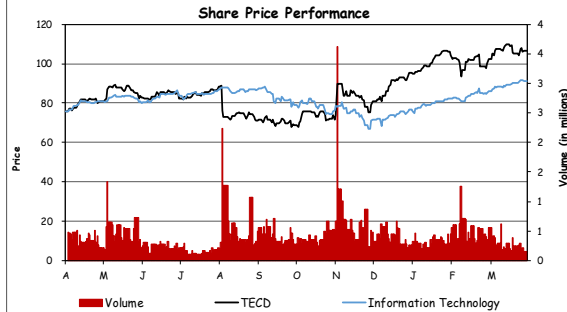
## Conclusion:

I believe that Tech Data Corporation is undervalued based on their operating margin growth prospects, current market price and analyst expectations, future capitalization of growth in the technology industry and their global optimization strategy. TECD's management has consistently showed that they are able to run their operations more efficiently and I expect that they will continue to expand their operation margins in the near future. Next-generation technology such as cloud services and the internet of things will provide a foundation for Tech Data to increase their revenues back to normal levels or possibly even higher. Tech Data is the market leader in their industry, and despite their low revenue growth expectations, they remain undervalued relative to both their own financials and their peer group. After an analysis of each of these factors, along with the potential risk factors, I believe that a BUY rating of TECD is justified at its current market price of \$106.62 per share.

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**CENTER FOR GLOBAL FINANCIAL STUDIES**
**TECD**
**Sunday, April 28, 2019**
**Page 1**

Tech Data Corporation	Symbol: TECD
Analyst	Nick Sapienza
Buy below	\$103.08
Sell above	\$150.06
Probability of Price Increase	99%
Last Price	\$106.62
Intrinsic Value	\$120.05
Target Dividends	\$0.00
Target Price	\$128.85


**Description**

Tech Data Corporation operates as one of the world's largest technology distribution and solutions company. In addition to distributing more than 75,000 products from over 1000 manufacturers and publishers, Tech Data provides extensive pre-sale and post-sale training, service and support.

Sector	Information Technology
Industry	Electronic Equipment, Instruments and Comp
Last Guidance	December 11, 2018
Next earnings date	May 29, 2019

**People**

Dutkowsky, Robert, Executive Chairman of the Board
Hume, Richard, CEO & Director
Dannewitz, Charles, Executive VP & CFO
Vetter, David, Executive VP & Chief Legal Officer
Zammit, Patrick, President of Europe
Rabinovitch, Michael, Senior VP, Chief Accounting Officer & Controller

**Top Competitors**

Arrow Electronics, Inc.	Anixter International Inc.
SYNNEX Corporation	Ingram Micro Inc.
Avnet, Inc.	Rexel S.A.
CDW Corporation	Insight Enterprises, Inc.
ScanSource, Inc.	Midwich Group Plc

**Market Statistics**

Market Capitalization (mil)	\$3,934.81
Last Price per share	\$106.62
52 week high	\$111.08
52-week low	\$66.93
Volatility	34.02%
Daily volume (mil)	0.16
Short interest	4.37%
Days to cover short interest	4.24
Beta	1.13

**Investment Thesis**
**AGING COMPANY BECOMING UNDERVALUED**

I am initiating coverage of Tech Data Corporation with a BUY at the current market price of \$106.62 and a target price of \$128.85. Tech Data Corporation operates as one of the world's largest technology distribution and solutions company. In addition to distributing more than 75,000 products from over 1000 manufacturers and publishers, Tech Data provides extensive pre-sale and post-sale training, service and support. The company is very motivated to expand their current operations into next generation technologies such as cloud services, internet of things and security. Tech Data has been steadily improving their margins, and despite their low revenue growth moving forward, the company is still undervalued.

**For the long:**
**1. Operating Margin Growth:**

Tech Data Corporation has been seeing a slowdown in revenue growth lately, which has caused its stock price to decline significantly in 2018. Although, the year over year revenue growth from Q4 FY2018 to FY 2019 was only 4%, the revenue growth under a constant currency was closer to 8%. Although the guidance for TECD's FY2020 (Tech Data's fiscal year ends Jan. 31) was weak in terms of revenue growth in the low-single digits, they specified mid-single digit operating growth, which shows they plan to increase their operating margin. Once TECD begins to increase its revenue growth back to normal levels this change in margin is going to translate into huge gains in net income.

**2. Current Market Value:**

The projected revenue growth for FY 2020 is very low compared to growth in the last 5 years. Many analysts and investors have priced this into their valuations, but the stock price is still currently trading below its intrinsic value. When adding in the factor of an expanding operating margin, the current market price could be as far as 20-30% below its intrinsic value. Revenue growth of 2% in FY 2020 and slowly increasing to a terminal growth rate of 2.5% paired with a modest continuing period operating margin of only 2%, shows that through discounted cash flow valuation we find TECD to be trading close to \$20 below its intrinsic value. This valuation does not factor in the possibility of future revenue growth above the terminal rate of 2.5%, which could drastically raise the value even higher.

**Industry Growth:**

The technology sector has rebounded in the first quarter of 2019 as a whole, and Tech Data has followed. With innovative new products and software coming in the near future, Tech Data has a significant amount to gain from the success and growth of the technology industry. Tech Data has already started to invest in next-generation technology portfolios. They plan on continuing this by moving to higher value technologies such as cloud based services, internet of things and next-generation security products.

**For the short:**
**1. Competitors and Product Mix:**

Given that Tech Data is a wholesaler of technology products, they have to continue to prove to both their vendors and customers that they provide a benefit to them that their competitors cannot provide. Additionally, if Tech Data Corp does not offer the right product mix to their customers based on future trends, they could see themselves losing large amounts of their business to competitors.

**Key Catalysts for price change:**

- Operating Margin Growth
- Current Market Value
- Industry Potential
- Global Optimization

**Valuation:**

My price target of \$128.85 is derived from a mix of discounted levered free cash flows and market multiples.

**Ownership**
**Change in Ownership ("Input"month)**

Shares outstanding (mil)	36.90	
Diluted shares outstanding (mil)	38.32	
Options and Warrants (Shares equivalent)	0.00	
% shares held by institutions	102%	"INPUT from BB"
% shares held by investments Managers	93%	"INPUT from BB"
% shares held by hedge funds	3.52%	"INPUT from BB"
% shares held by VC/PE firms	0.350%	"INPUT from BB"
% shares held by insiders	1.09%	-12.56%
Poison Pill Type	NONE	

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Page 2

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### Quarterly Earning Surprises (Actual Vs. Median Estimates)

Revenue	
1/31/2018	-5.29%
4/30/2018	4.69%
7/31/2018	1.63%
10/31/2018	4.68%
1/31/2019	-2.20%
Mean (Standard Error)	0.7% (0.99%)

### EBITDA

1/31/2018	-80.27%
4/30/2018	-39.18%
7/31/2018	-33.55%
10/31/2018	-4.54%
1/31/2019	-21.90%
Mean (Standard Error)	0.7% (7.11%)

Financials	TECD (LTM)	TECD Historical	Peers' Median (LTM)
<b>Profitability</b>			
Return on Capital	7.9%	8.62%	7.16%
Adjusted EBITDA Margin	1.5%	0.92%	3.08%
Return on Equity	12.3%	8.5%	12.6%
Adjusted Net margin	0.9%	0.8%	2.1%
<b>Invested Funds</b>			
Cash/Capital	16.3%	18.5%	6.4%
NWC/Capital	29.9%	73.8%	48.6%
Operating Assets/Capital	35.6%	0.5%	18.1%
Goodwill/Capital	18.2%	7.1%	26.5%
<b>Capital Structure</b>			
Total Debt/Market Cap.	0.49	0.33	0.50
Reported Cost of Borrowing	7.0%		5.0%
Cash Interest/Total Debt			3.6%
CGFS Credit Rating	BB		B
Credit Model Rating	bbb		bbb-
Probability of Default	0.05%		0.03%

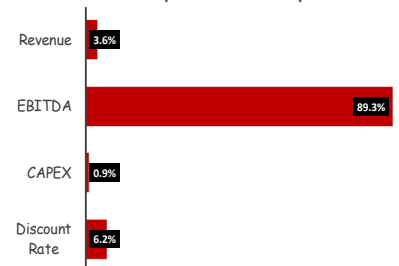
### Cost of Capital

	CGFS Credit Rating	Credit Model Rating	Probability of Default
Implied Cost of Borrowing (TECD)	5.2%	5.2%	5.2%
Implied Cost of Borrowing (Peers)	5.6%	5.8%	5.3%
Cost of New Debt Estimate	7.0%		
Market Risk Premium Estimate	6.9%		
Cost of Equity Estimate	13.9%		
WACC Estimate	13.9%		

### Valuation

DCF Valuation	Revenues	Net Margin	LFCF	Ke	ROE	Price Per Share
Base Year (Actual)	\$37,238.95	1%	\$4.15	13.93%	12.31%	\$116.42
year 1	\$37,994.85	1%	\$392.85	13.93%	15.62%	\$121.98
year 2	\$38,789.00	1%	\$456.98	13.93%	14.01%	\$126.97
year 3	\$39,617.41	1%	\$470.04	13.93%	11.95%	\$132.34
year 4	\$40,481.56	1%	\$477.15	13.93%	10.47%	\$138.31
year 5	\$41,382.99	1%	\$479.96	13.93%	9.35%	\$145.04
year 6	\$42,323.34	1%	\$480.64	13.93%	8.47%	\$152.70
year 7	\$43,304.33	1%	\$480.61	13.93%	7.77%	\$161.44
year 8	\$44,327.78	1%	\$478.60	13.93%	7.17%	\$171.44
year 9	\$45,395.60	1%	\$477.14	13.93%	6.67%	\$182.86
year 10	\$46,509.81	1%	\$478.54	13.93%	6.28%	\$195.82
year 11	\$47,672.56	1%	\$483.28	13.93%	5.97%	\$210.27
year 12	\$48,864.37	1%	\$516.90	13.93%	6.02%	\$225.88
year 13	\$50,085.98	1%	\$548.18	13.93%	6.02%	\$242.85
year 14	\$51,338.13	1%	\$577.52	13.93%	5.99%	\$261.42
year 15	\$52,621.59	1%	\$607.99	13.93%	5.95%	\$297.83
Continuing Period	\$53,937.13	3%	\$1,211.19	13.93%	13.93%	
Relative Valuation	Asset Based Valuation					
Multiple	EV/Rev (FW)	EV/EBITDA (FW)	P/BV (TTM)	P/E (FW)	Recovery Rate	100%
Median (Peers)	0.4x	7.8x	1.4x	10.0x	Capital	\$4,827.28
Base	Revenue (NTM)	EBITDA (NTM)	Book Value (LTM)	Net Income (NTM)	Intangibles	\$1,843.85
TECD	\$38,184.14	\$502.78	\$3,063.09	\$502.78	Claims	\$1,933.08
Implied EV	\$14,154.10	\$3,945.84				
Total Net Claims	\$750.95	\$750.95				
Implied EQ	\$13,403.15	\$3,194.89	\$4,136.22	\$5,031.58		\$1,050.35
Valuation Summary						
Model	Intrinsic Value		Target Price		Weight	
DCF Valuation	\$116.42		\$121.98		80.00%	
EV/Rev (FW)	\$349.80		\$398.52		5.00%	
EV/EBITDA (FW)	\$83.38		\$94.99		10.00%	
P/BV (TTM)	\$107.95		\$122.98		5.00%	
P/E (FW)	\$131.31		\$149.61		0.00%	
Asset Based Valuation	\$27.41		\$31.23		0.00%	
Price per Share	\$124.36		\$133.16		100%	

### Sensitivity Attribution Analysis



### Intrinsic Value Distribution--Probability (Upside)=99%

