Securities

AFFIN HWANG CAPITAL

Out think. Out perform.

Riding on education

Company Update

SCICOM (MSC)

SCIC MK
Sector: Trading/Services

RM 2.22 @ 15 Jun 2016

BUY (maintain)
Upside 18%

Price Target: RM2.62
Previous Target: RM2.58

Scicom's Education Malaysia Global Services (EMGS) contract continues to be a stable earnings driver as Malaysia increasingly becomes an attractive education destination. Another potential earnings driver is the extension of its e-government services to the region. Reaffirm BUY with a higher 12M target price of RM 2.62.

EMGS contract propels growth

The EMGS contract has been the main driver of Scicom's earnings which increased by 54% over the past two years. Moving forward, earnings are likely to continue to grow in line with the government's target to attract 200,000 international students by 2020 through the Economic Transformation Programme (ETP) and influx of new foreign university campus branches.

Evident margin expansion

Since the EMGS contract was awarded, Scicom's net profit margin has grown from 11% in FY13 to 22% as of 9MFY16. Apart from cost efficiencies on economies of scale, this has been due to the increase in offerings such as medical screening, issuance of iKad, student pass, multiple entry visa, and more recently, optional health insurance.

E-shop in the pipeline

Moving forward, the company plans to offer a variety of discounts and deals by tying up with partners through an e-commerce student store. This would indirectly leverage on the growing e-commerce market and earnings might be substantial depending on the take-up rate of the students.

Cambodian contract to open regional doors

Recall that one of Scicom's new contracts is a small project awarded by the World Bank involving phytosanitation in Cambodia. While contribution is minimal, it is likely to be the first of many more regional contracts.

Reaffirm BUY with a higher target price of RM2.62

Scicom continues to be an attractive e-government service play. We fine tune our EMGS assumptions and tweak our FY16-18 EPS forecasts by +0.2-3.9%, reaffirming BUY with a higher target price of RM2.62 based on an unchanged 20x PE and CY16E EPS. Risks to our recommendation include the loss of BPO customers and fewer-than-expected foreign students.

Earnings & Valuation Summary

FYE 30 June	2014	2015	2016E	2017E	2018E
Revenue (RMm)	160.1	176.8	209.2	233.8	255.8
EBITDA (RMm)	26.5	38.0	50.3	56.1	62.9
Pretax profit (RMm)	22.3	34.0	42.7	50.3	58.1
Net profit (RMm)	23.2	34.7	42.8	50.3	44.0
EPS (sen)	6.5	9.8	12.0	14.2	12.4
PER (x)	34.0	22.7	18.4	15.7	17.9
Core net profit (RMm)	21.9	33.8	42.8	50.3	44.0
Core EPS (sen)	6.2	9.5	12.0	14.2	12.4
Core EPS growth (%)	53.8	54.0	26.7	17.6	(12.5)
Core PER (x)	36.0	23.4	18.4	15.7	17.9
Net DPS (sen)	7.0	7.5	8.4	9.2	8.1
Dividend Yield (%)	3.2	3.4	3.8	4.1	3.6
EV/EBITDA (x)	30.5	21.4	15.9	13.9	12.2
Chg in EPS (%)			+0.2	+2.7	+3.9
Affin/Consensus (x)		-	-	-	-

Source: Company, Affin Hwang estimates

Price Performance

	1M	3M	12M
Absolute	-2.6%	-5.5%	6.7%
Rel to KLCI	-2.3%	-0.9%	13.8%

Stock Data

Issued shares (m)	355.5
Mkt cap (RMm)/(US$m)	789.1/192.4
Avg daily vol - 6mth (m)	0.4
52-wk range (RM)	1.59-2.45
Est free float	38.8%
BV per share (RM)	0.24
P/BV (x)	9.09
Net cash/ (debt) (RMm) (9M16)	36.56
ROE (2016E)	46.0%
Derivatives	Nil
Shariah Compliant	Yes

Key Shareholders

Leo Suresh Ariyanayakam	24.2%
Netinsat Asia Sdn Bhd	19.3%
Jaganath De Stse Sabapathy	5.3%

Source: Affin Hwang, Bloomberg

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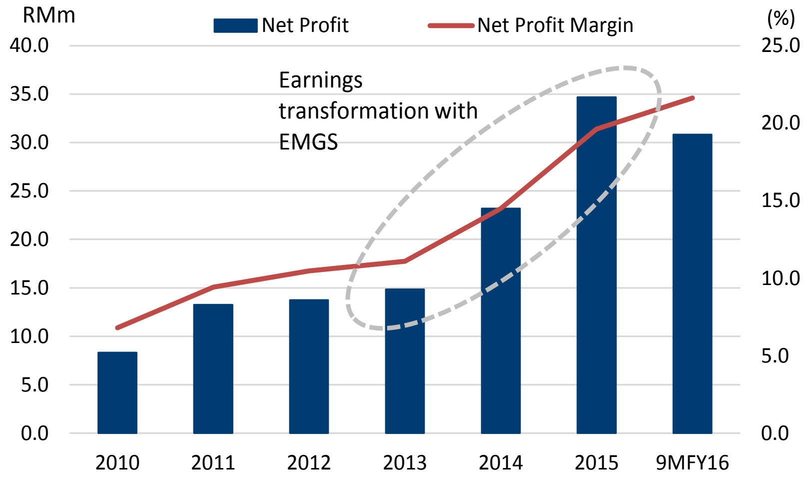
EMGS driving growth

Net profit increased by ~50% past two years

Recall that Scicom was awarded the EMGS contract in June 2012, which subsequently went live in 2013. In a nutshell, Scicom provides the backend engine to process all the visa applications of foreign students seeking to study in Malaysia. This has been the key instrument driving Scicom's earnings and we see that net profit has increased by a significant 50% over the past two years.

Fig 1: Net profit and margins on an upward trend



Source: Company, Affin Hwang

Malaysia increasingly attractive as education destination

According to the ETP, 54,728 applications from 147 countries were submitted through EMGS in 2014, a 68% increase from 2013. Of these, 47,564 Visa Approval Letters were issued, exceeding the target of 36,000 letters for 2014. The overall number of international students in Malaysia stood at 151,979 as of 2015, a 12% increase from 2014. We estimate that the number of visa applications received through the EMGS portal in 2015 is about a 20% increase from 2014 to ~65,600 students. Moving forward, we believe that growth will be sustained by the government's continued efforts to increase foreign student enrolments to its target of 200,000 by 2020. According to Mohd Yazid Abd Hamid, CEO of EMGS, Malaysia currently ranks as the 12th most preferred higher education destination among international students.

Fig 2: Number of international students increasing yoy

	2011	2012	2013	2014	2015
No. of visa applications received	39,548	43,410	32,679	54,728	65,674*
No. of international students enrolled	93,300	97,419	102,735	135,502	151,979

*Source: ETP, *Affin Hwang estimates*

Influx of new university branch campuses to attract foreign students

To date, four foreign branch campuses have been set up in Malaysia under the Education National Key Economic Areas (NKEA) initiative, namely Heriot-Watt University Malaysia (HWUM), Newcastle University of Medicine Malaysia (NUmed), University of Reading Malaysia (UoRM) and University of Southampton Malaysia (USMC); the latter three are situated in EduCity@Iskandar, an education-centric hub located in Iskandar, Johor, which also supports the government's agenda to drive international student enrolments. Currently, there are seven international education facilities in EduCity and the government plans to build stronger partnerships with the institutions to improve student lifestyle as well as increase its product offerings.

Fig 3: List of foreign education outfits in EduCity

Foreign Universities in EduCity@Iskandar	
1	Newcastle University Medicine Malaysia (NUMed)
2	Marlborough College Malaysia
3	University of Southampton Malaysia Campus (USMC)
4	University of Reading Malaysia (UoRM)
5	Raffles University Iskandar
6	Management Development Institute of Singapore
7	Netherlands Maritime Institute of Technology

Source: Iskandar Investment

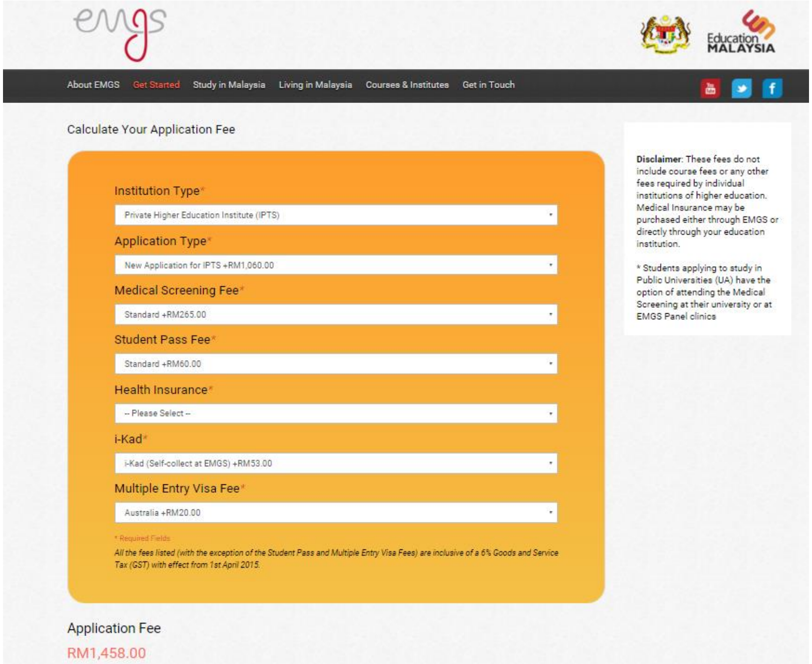
Xiamen University Malaysia already starting its first intake

The latest university to join the education scene and set up its Malaysian campus is Xiamen University (XMU). This is the first overseas campus of a Chinese university to be approved by the Chinese government, and shows the good bilateral ties between China and Malaysia. With an impressive 60ha campus in the making and part one of Phase One of the campus ready, XMU Malaysia had already started taking in students in February 2016 with a target of 500 students this year. The campus will be able to accommodate 5,000 students upon completion of Phase One (targeted within 10 years), and 10,000 students after Phase Two. Response has been good, with applications mainly from local Chinese students. According to Prof Dr Wang Rui Fang, president of XMU Malaysia, the target is to have two-thirds of its students from Southeast Asia and China.

Extension of EMGS services

While each student has to pay a mandatory visa application fee of RM1,000 regardless of whether the visa is approved or not, Scicom now offers various services to enhance and improve the application process. Among them are medical screening, the issuance of iKad, student pass, multiple entry visa as well as optional health insurance. Without taking into account the optional health insurance (packages costing RM400-4,000), this could effectively add more than 40% to the RM1,000 base fee.

Fig 4: EMGS online portal



Source: EMGS

Cost efficiencies improving margins

Given the increasing cost efficiencies due to economies of scale, we believe that the growth in the number of students and the extension of services have allowed Scicom to command better margins. Its net margin has seen an expansion since the award of the EMGS contract from 11% in FY13 to 22% as of 9MFY16.

E-commerce store in the pipeline

Moving forward, the company also plans to expand its services to offer a variety of discounts and offers by tying up with partners from the telecommunication, F&B, technology and retail segments through an e-commerce student store. While this will further facilitate the processes for foreign students to study in Malaysia, the e-store indirectly allows the company to capitalize on the growing and attractive e-commerce market. According to Pemandu, the e-commerce market in Malaysia is estimated to be at RM7bn in 2016 for both products and services and is expected to rise at an exponential rate with the increasing penetration of smartphones and other mobile devices. Therefore, net profit contributions could potentially be sizeable depending on the number of students using the e-store. Furthermore, Scicom has introduced the mobile app to enable students to check the status of their visa application and also display their two key identification documents - the iKad and insurance policy. The mobile app has been downloaded by about 20-30k students to date and will also encompass the e-commerce store offerings later on.

Cambodian contract likely to open up regional doors

Recall that Scicom had previously submitted a bid for a phytosanitation project for the Cambodian government by the World Bank. The tender has since been awarded to them and has gone live in June 2016.

Management has guided that in a full year, the project can earn about RM1m in revenue. While management has said that the project does not have a substantial impact on earnings, we gather that Scicom is also actively bidding for other regional contracts. We believe that the project is a stepping stone towards venturing into e-government contracts in regional markets such as Sri Lanka, Nepal and East Malaysia. Neighbouring countries could implement a similar scheme after seeing the success of the project due to Scicom's expertise and experience. Scicom already has existing offices in Colombo and Leo Ariyanayakam, Scicom's CEO, is Sri Lankan.

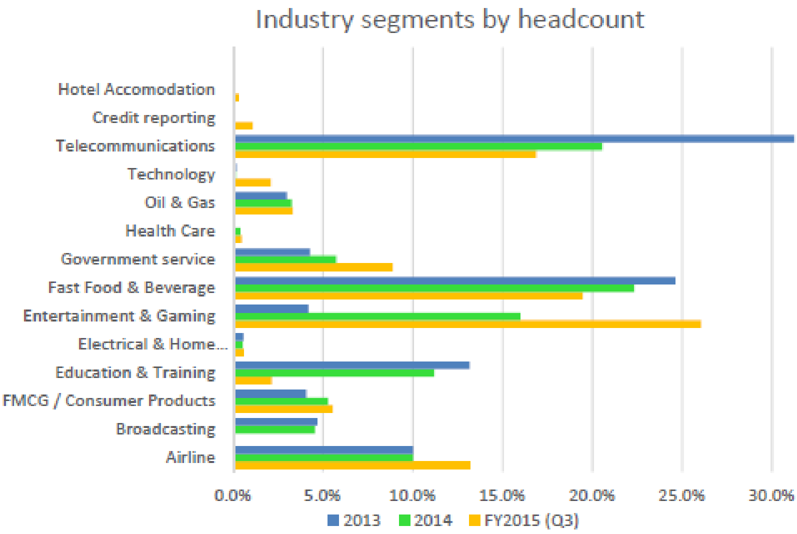
BPO segment running smoothly

Scicom's other main earnings contributor is the business process outsourcing segment (BPO). With a scalable and replicable business model, this segment continues to be a steady income generator.

Diversified client base

With 45 corporate clients and an international footprint covering 86 countries, Scicom's client base is diversified not only geographically but also by industry. Among the more notable corporate clients are McDonald's, Singtel and AirAsia. Looking at the headcount of the various industry segments, telecommunications used to be the largest segment but has since been overtaken by the entertainment and gaming industry due to ESL, a fast growing client with an increasing presence in China and which is now expanding to Thailand and Vietnam. More than 70% of Scicom's BPO revenue is derived from its overseas clients.

Fig 5: Largest segments of Entertaining & Gaming, Fast Food & Beverage and Telco



Source: Company

Dynamic and multinational workforce

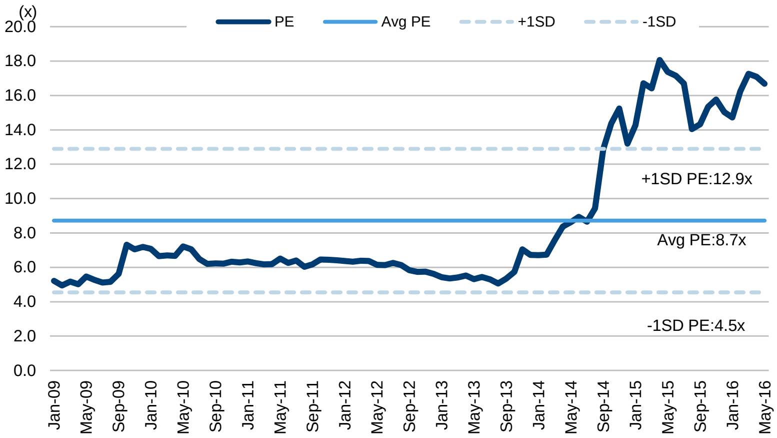
One of the key differentiating factors that separate Scicom from its international BPO competitors is its diverse workforce, which collectively speaks a total of 30 languages to cater to specific clients' needs.

Valuation and Recommendation

Trading below e-government service peer

Looking at Scicom's 12-month forward PE ratio chart, we can see that its PE has been trending upwards since the inception of the EMGS contract. The current PE stands at 18x which is above its 6-year average PE of 9x and its 3-year average of 12x, though still at a 40% discount to its local government services peer, MYEG (according to Bloomberg, forward PE of 30x).

Fig 6: Scicom's 12m forward PE ratio



Source: Company, Affin Hwang estimates

Peer comparison

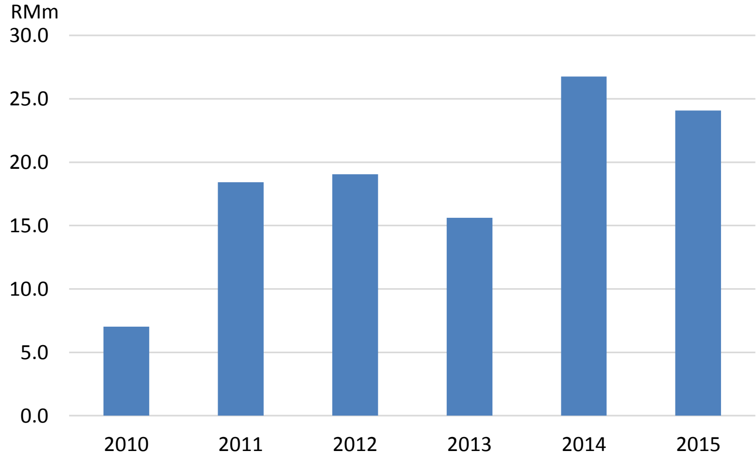
Stock	Ctry	Sh Pr (LMC)	Sh Pr (USD)	Mkt Cap (LMC m)	Mkt Cap (USD)	Year end	Core PE (x) CY16	Core PE (x) CY17	EPS growth (%) CY16	EPS growth (%) CY17	P/BV (x)	ROE (%) CY16	ROE (%) CY17	Net Div Yield (%) FY16	Net Div Yield (%) FY17
BPO															
Teletech	US	27.1	27.1	1,306	1,306	Dec	17.3	15.2	5.9	13.6	2.9	15.7	16.0	1.4	1.4
Sykes	US	29.9	29.9	1,273	1,273	Dec	15.9	14.2	0.7	11.5	1.8	n.a	n.a	n.a	n.a
Teleperformance	FR	75.9	85.3	4,343	4,881	Dec	17.6	16.0	17.6	9.9	2.5	13.0	13.1	1.8	2.0
WNS	US	29.9	29.9	1,533	1,533	Mar	15.5	14.4	3.9	7.1	3.8	17.0	17.4	-	-
E-Gov Services															
MYEG	MY	2.0	0.5	4,905	1,198	Jun	25.7	17.2	89.3	49.1	13.5	52.0	51.4	0.9	1.3
Scicom	MY	2.2	0.5	789	193	Jun	17.0	16.7	21.5	1.3	8.5	45.9	40.5	3.8	4.1
Simple Average							18.2	15.6	23.1	15.4	5.5	28.7	27.7	2.0	2.2

Source: Affin Hwang forecasts, pricing as of 16 June 2016

Strong financial footing

Due to the scalability of its operations, Scicom has always had an asset light model and has been in a net cash position since its listing. As of 9M16, it had net cash of RM36.6m and zero borrowings.

Fig 7: Consistently net cash



Source: Company, Affin Hwang

4Q historically strongest quarter

Scicom posted strong 9M16 results and we view it to be above expectations as 4Q has always been the strongest quarter, accounting for an average of 30% of core net profit for the past three years. We expect Scicom to post a strong set of 4QFY16 results.

Reiterate BUY rating with a higher TP of RM2.62

We revise our earnings forecasts by +0.2-3.9% for FY16-18 after fine tuning our EMGS assumptions on the number of students and fees per student, and accounting for the improvement in margins due to economies of scale. We expect core earnings to grow by 26.7% in FY16 and 17.6% in FY17. Scicom's MSC license, which allows it to be tax-exempt for 5 years, is expiring in 2017, which we believe would cause an earnings contraction of 12.5% in FY18. However, the tax effect would be a one-off and Scicom's tax expense would normalise in the years after. Moreover, the expansion in net margins should help mitigate this effect. We reiterate our BUY rating with a higher TP of RM2.62 based on an unchanged 20x CY16 EPS.

Key risks

Key downside risks include the loss of BPO customers and also fewer-than-expected foreign students to drive its EMGS business.

Scicom - Financial Summary

Profit & Loss Statement

FYE June (RMm)	2014	2015	2016E	2017E	2018E
Total revenue	**160.1**	**176.8**	**209.2**	**233.8**	**255.8**
Operating expenses	(133.6)	(138.8)	(158.9)	(177.7)	(192.9)
EBITDA	**26.5**	**38.0**	**50.3**	**56.1**	**62.9**
Depreciation	(5.7)	(5.5)	(8.0)	(6.5)	(5.8)
EBIT	20.8	32.5	42.3	49.6	57.2
Net interest income/(expense)	0.4	0.6	0.6	0.8	1.0
Associates' contribution	(0.1)	0.1	(0.1)	(0.1)	(0.1)
EI	1.3	0.9	-	-	-
Pretax profit	**22.3**	**34.0**	**42.7**	**50.3**	**58.1**
Tax	0.1	0.1	(0.4)	(0.5)	(14.5)
Minority interest	0.8	0.5	0.5	0.5	0.5
Net profit	**23.2**	**34.7**	**42.8**	**50.3**	**44.0**

Balance Sheet Statement

FYE June (RMm)	2014	2015	2016E	2017E	2018E
Fixed assets	12.0	16.5	13.5	12.0	11.3
Other long term assets	2.6	2.9	3.0	3.1	3.2
Total non-current assets	**14.5**	**19.5**	**16.6**	**15.2**	**14.5**
Cash and equivalents	26.8	24.1	38.0	53.3	66.1
Other recievables	6.3	6.9	6.9	6.9	6.9
Debtors	37.1	44.0	48.7	54.4	59.6
Other current assets	0.2	0.2	0.2	0.2	0.2
Total current assets	**70.4**	**75.1**	**93.8**	**114.8**	**132.7**
Creditors	13.0	14.2	17.2	19.2	21.0
Short term borrowings	-	-	-	-	-
Other current liabilities	-	-	-	-	-
Total current liabilities	**13.0**	**14.2**	**17.2**	**19.2**	**21.0**
Long term borrowings	-	-	-	-	-
Other long term liabilities	0.1	0.1	0.1	0.1	0.1
Total long term liabilities	**0.1**	**0.1**	**0.1**	**0.1**	**0.1**
Shareholders' Funds	**72.4**	**80.7**	**93.0**	**110.1**	**125.0**

Cash Flow Statement

FYE June (RMm)	2014	2015	2016E	2017E	2018E
EBIT	20.8	32.5	42.3	49.6	57.2
Depreciation & amortisation	5.7	5.5	8.0	6.5	5.8
Working capital changes	7.5	(7.1)	(1.8)	(3.7)	(3.3)
Cash tax paid	0.2	(0.1)	-	-	-
Others	1.6	2.5	0.4	0.6	(13.2)
Cashflow from operations	**35.7**	**33.3**	**48.9**	**53.0**	**46.4**
Capex	(4.2)	(10.0)	(5.0)	(5.0)	(5.0)
Acquisition of subsidaries	-	(0.4)	-	-	-
Others	0.1	0.0	-	-	-
Cash flow from investing	**(4.1)**	**(10.4)**	**(5.0)**	**(5.0)**	**(5.0)**
Debt raised/(repaid)	-	-	-	-	-
Equity raised/(repaid)	-	-	-	-	-
Net inct income/(expense)	(0.0)	-	-	-	-
Dividends paid	(20.7)	(25.5)	(30.0)	(32.7)	(28.6)
Others	0.2	(0.1)	-	-	-
Cash flow from financing	**(20.5)**	**(25.6)**	**(30.0)**	**(32.7)**	**(28.6)**
Free Cash Flow	**31.6**	**22.9**	**43.9**	**48.0**	**41.4**

Source: Company, Affin Hwang estimates

Key Financial Ratios and Margins

FYE June (RMm)	2014	2015	2016E	2017E	2018E
Growth					
Revenue (%)	19.6	10.4	18.3	11.8	9.4
EBITDA (%)	39.0	43.4	32.2	11.7	12.1
Core net profit (%)	53.8	54.0	26.7	17.6	(12.5)
Profitability					
EBITDA margin (%)	16.6	21.5	24.0	24.0	24.6
PBT margin (%)	13.9	19.3	20.4	21.5	22.7
Net profit margin (%)	14.5	19.6	20.5	21.5	17.2
Effective tax rate (%)	0.0	0.0	(0.0)	(0.0)	(0.3)
ROA (%)	27.3	36.7	38.8	38.7	29.9
Core ROE (%)	30.5	42.1	46.0	45.5	34.9
ROCE (%)	29.1	42.5	48.7	48.9	48.6
Dividend payout ratio (%)	107.2	76.8	70.0	65.0	65.0
Liquidity					
Current ratio (x)	9.1	5.4	5.3	5.5	6.0
Op. cash flow (RMm)	35.7	33.3	48.9	53.0	46.4
Free cashflow (RMm)	31.6	22.9	43.9	48.0	41.4
FCF/share (sen)	8.9	6.5	12.3	13.5	11.6
Asset management					
Debtors turnover (days)	84.6	90.7	85.0	85.0	85.0
Stock turnover (days)	2.0	3.0	4.0	5.0	6.0
Creditors turnover (days)	29.6	29.4	30.0	30.0	30.0
Capital structure					
Net Gearing (%)	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash
Interest Cover (x)	>100	NA	NA	NA	NA

Quarterly Profit & Loss

FYE June (RMm)	3Q15	4Q15	1Q16	2Q16	3Q16
Revenue	43.2	48.1	44.8	47.6	50.2
Operating expenses	(33.5)	(36.8)	(35.0)	(35.3)	(36.8)
EBITDA	9.7	11.3	9.8	12.3	13.4
Depreciation	(1.4)	(1.5)	(1.5)	(1.5)	(1.6)
EBIT	8.3	9.9	8.3	10.8	11.8
Net int income/(expense)	0.1	0.2	0.2	0.2	0.3
Associates' contribution	0.0	0.0	0.0	0.0	0.0
Exceptional items	0.5	0.3	1.1	(0.7)	(1.4)
Pretax profit	8.9	10.4	9.6	10.3	10.7
Tax	0.1	0.1	(0.0)	(0.0)	(0.0)
Minority interest	0.1	0.1	0.1	0.1	0.1
Net profit	9.2	10.6	9.7	10.3	10.8
Core net profit	8.7	10.3	8.6	11.1	12.1
Margins (%)					
EBITDA	22.4	23.6	21.9	25.9	26.7
PBT	20.7	21.6	21.5	21.6	21.3
Net profit	21.2	21.9	21.7	21.7	21.4

Equity Rating Structure and Definitions

BUY	Total return is expected to exceed +10% over a 12-month period
HOLD	Total return is expected to be between -5% and +10% over a 12-month period
SELL	Total return is expected to be below -5% over a 12-month period
NOT RATED	Affin Hwang Investment Bank Berhad does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation

The total expected return is defined as the percentage upside/downside to our target price plus the net dividend yield over the next 12 months.

OVERWEIGHT	Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months
NEUTRAL	Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months
UNDERWEIGHT	Industry, as defined by the analyst's coverage universe is expected to under-perform the KLCI benchmark over the next 12 months

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