

1QFY15 RESULTS UPDATE

12 June 2015

SMRT Holdings Berhad

Bursa / Bloomberg Code: 0117 / SMRT MK
Stock is Shariah-compliant.

Price : RM0.40

Market Capitalization : RM104.1 mln

Market : ACE Market

Sector : Technology

Recommendation : Buy

SMRT: 1QFY15 results

FYE Dec (RM mln)	Quarter-on-Quarter			Year-on-Year	
	1QFY15	4QFY14	% chg	1QFY14	% chg
Turnover	29.1	31.5	-7.6%	23.3	25.3%
Operating profit	2.7	0.5	425.1%	2.6	2.3%
Finance costs	(0.4)	(0.3)		(0.3)	
Pre-tax profit	2.2	0.2	1236.8%	2.3	-4.2%
Tax	(1.4)	(1.8)		(0.3)	
Minority Interest	0.0	0.2		(0.7)	
Net profit	0.8	(1.4)	nm	1.3	-39.5%
Reported EPS (sen)	0.3	(0.7)	nm	0.7	-50.7%
Op. profit margin	9.3%	1.6%		11.4%	
Pre-tax margin	7.6%	0.5%		10.0%	
Net profit margin	2.7%	-4.5%		5.6%	
Net assets/share (RM)	0.35				

1QFY15 Results Review

- SMRT reported a small RM0.8 mln net profit in 1QFY15 on the back of RM29.1 mln turnover. The results were below expectation as the earnings only made up less than 10% of our FY15 earnings estimate.
- 1QFY15 revenue was up 25% y-o-y due to improved contribution from the Group's Education as well as Consulting & Training businesses, offset by decline in the Technology segment. Profitability-wise (pre-consolidation adjustment), the Education business now contributes the bulk of SMRT's earnings, followed by the Consulting & Training activities where contracts such as the ELT and Pro-ELT (awarded by the MOE to train English Language teachers) are parked. The Technology, on the other hand, incurred a loss in the quarter under review due to lack of projects which resulted in the revenue being insufficient to cover overheads.
- With the acquisition of the 23%-stake in Masterskill Education Bhd (MEGB) having been completed on 20 March 2015, SMRT also recorded a small RM54,000 share of losses from its associate.
- The 1QFY15 net profit was further affected by i) acquisition-related expenses in excess of RM1 mln; ii) increased financing cost (+32% y-o-y); as well as iii) high effective tax rate at 63.1%. The acquisition expenses was related to its purchase of 23%-stake in MEGB. Meanwhile, the rise in financing cost was due to the jump in the Group's net borrowing from RM21.8 mln in December 2014 to RM45.2 mln in March 2015 as it had used borrowings to part finance the acquisition of MEGB. As for the high effective tax rate, we understand this was due to provisions of tax made for the profitable Education business while tax credits arising from loss-making division were not included at this juncture, to reflect prudent accounting practice. This 'mismatch' would eventually normalize in 4Q and the overall effective tax rate is expected to be at circa 30%.

- Sequentially, the results were an improvement over 4QFY14 where SMRT had recorded a net loss of RM1.4 mln then. To recap, the loss in the preceding quarter was mainly owing to an impairment of goodwill amounting to RM1.5 mln as well as a RM0.2 mln corporate exercise expenses.
- Having partly funded the 23%-stake of MEGB with borrowings, SMRT's net gearing has jumped to 0.5x as of March 2015 from 0.03x in December 2014.
- After reviewing the results and having considered the challenges ahead, we slash our FY15 earnings estimate to RM5.8 mln from RM11.2 mln, taking into consideration the following factors:- i) a further RM1mln acquisition-related cost to be expensed in the next quarter; ii) increase in financing cost given the higher borrowings; iii) forecasted lower contribution from the Technology sector given the market slowdown; and iv) expected share of losses from MEGB in FY15. Additionally, SMRT has not started charging the management fees on MEGB for supporting the latter in the turnaround exercise. The management fees, calculated on the basis of 5% of MEGB's revenue, are expected to commence only in 2HFY15.
- We reiterate our long term optimism on the Group's prospect but the next 12 to 18 months remain a challenging period as the team from SMRT races against time to turn around the operations at MEGB. The latter reported a net loss of RM3.4 mln in its 1QFY15 results. We believe MEGB will remain loss-making in FY15. We understand the team from SMRT is striving to return MEGB to the black by mid-2016. At present, there are about 2,000 students in MEGB's (now renamed) Asia Metropolitan University with a target 30% population growth to 2,600 by 2016.
- On SMRT's own core businesses, we expect its Education segment comprising the Cyberjaya University College of Medical Sciences (CUCMS) in Selangor to remain a star performer going forward. On the Consulting & Training division, management is currently in discussion with the authority on the extension and/or new contract for the ELT and Pro-ELT jobs. The existing ELT and Pro-ELT contracts are scheduled to complete by end of this year. As for Technology business, the earnings visibility is uncertain at this juncture given the market slowdown which may see companies hold back their IT spending.
- Having considered our assumptions of a turnaround of MEGB in FY16, coupled with continued growth at CUCMS and stable performance from Consulting & Training division, we estimate earnings to grow to RM10.8 mln in FY16 (vs. RM15 mln in our earlier forecast).
- No dividend was declared for the quarter under review.

Recommendation

We maintain our **Buy** recommendation on SMRT, but lower our fair value to **50 sen** (from 81 sen), after pegging a lower target PER multiple of 12x against our revised FY16 earnings. We remain positive on the Group's long term outlook. We like its focus on growing the education business that would provide stable and growing earnings. Nevertheless, its short term prospect is expected to be muted until MEGB's operations turn around, or that SMRT announces the winning of a high value contract either from the Consulting or Technology divisions. We opine the acquisition of MEGB is a short term pain that SMRT has to endure before it can reap the long term gains. We reckon the negative factors (such as acquiring a loss making education business and the resulting drag on SMRT's performance) have already been reflected in its share price. Further downside is likely limited at this juncture, in our opinion.

Per Share Data				P&L Summary					
FYE Dec	FY13	FY14	FY15e	FYE Dec (RM m ln)	FY12	FY13	FY14	FY15e	FY16f
Book Value (RM)	0.31	0.35	0.37	Revenue	61.4	52.4	121.9	130.9	140.2
Cash Flow (sen)	6.3	5.6	5.3	EBIT	10.4	10.5	13.2	12.7	16.3
Earnings (sen)	4.3	2.6	2.4	Net Int Exp	(0.4)	(0.2)	(1.4)	(2.1)	(2.1)
Net Dividend (sen)	0.5	0.5	0.5	Pre-tax Profit	10.0	10.3	11.8	8.3	14.4
Payout Ratio (%)	11.6%	19.6%	20.6%	Eff. Tax Rate	14.5%	19.7%	41.5%	30.0%	25.0%
PER (x)	9.3	15.7	16.5	Net Profit	8.5	8.2	5.5	5.8	10.8
P/Cash Flow (x)	6.3	7.1	7.5	EBIT Margin (%)	16.9%	20.0%	10.8%	9.7%	11.6%
P/Book Value (x)	1.3	1.1	1.1	Pre-tax Margin (%)	16.3%	19.6%	9.7%	6.4%	10.3%
Dividend Yield (%)	1.3%	1.3%	1.3%	Net Margin (%)	13.8%	15.7%	4.5%	4.5%	7.7%
ROE (%)	14.0%	7.3%	6.6%						
Net gearing (x)	cash	0.0	0.5						

SMRT's last 12-month share price chart



Source: Bloomberg

RATING GUIDE

BUY	Price appreciation expected to exceed 10% within the next 12 months
SELL	Price depreciation expected to exceed 10% within the next 12 months
HOLD	Price movement expected to be between -10% and +10% over the next 12 months from current level

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