

COMPANY UPDATE

23 May 2018

Scicom (MSC) Bhd

Bursa / Bloomberg Code: 0099 / SCIC MK
Stock is Shariah-compliant.

Price : RM1.89

Market Capitalization : RM672 mln

Market : Main Market

Sector : Trading & Services

Recommendation : Buy

Company update

Scicom held an investors' briefing to review its 3QFY18 results and to address concerns about the Education Malaysia Global Services (EMGS) contract it has with the Government of Malaysia. It was chaired by its CEO and head of investor relations.

EMGS contract. To assuage concerns over its contract with EMGS, Scicom explained that it was one of 8 bidders for the EMGS contract in a tender by the then Ministry of Higher Education (MOHE). Pemandu (a government agency tasked with transforming the economy and government) had earlier conducted an impact study for MOHE on how to increase foreign students in Malaysia. MOHE had established EMGS and called for a tender to set up and operate the system. Scicom believed it won the competitive tender based on merit because it was the only tenderer that:

- 1) offered a revenue share model which allows the government to generate revenue to promote Malaysia's higher education overseas.
- 2) reduced the processing fee, which fell from between RM4,000 and RM12,000 charged by colleges to RM1,000. Its solution also reduced the processing time from between 3 to 6 months to less than 14 days.
- 3) offered a private finance initiative (PFI) model which spared the government from any upfront spending.

Based on the above, Scicom feels that its contract with EMGS is unlikely to be reviewed by the new government nor has it been invited by the government to be questioned. This comes at a time when the government is scrutinising any lopsided contracts undertaken by the previous administration. Scicom declined to reveal the remaining tenure of the contract but added that it has "some time to go" and has an option for 5 more years after the expiry.

New government, new opportunities? With the new Malaysian government, Scicom is hopeful of securing projects from the government. i.e. to win on merit.

Perfect storm. Scicom said it faced the perfect storm in 2QFY18 which resulted in the disappointing results: 1) potential customers held back due to political uncertainties ahead of the 14th General Election, 2) it lost some clients, while others scaled back requirements. It noted a large Philippine-based client substantially reducing its BPO needs, and 3) student numbers were impacted by the closure of colleges. Over the past 12 months, the company had reduced its headcount by 25% to 1,600 currently.

Foreign student numbers should recover. After falling for the last 4 quarters, Scicom indicated that the number of students processed should recover in the current quarter vs the previous one. The government has closed 50 (out of a total of 500) private higher learning institutions in Malaysia which were found to be heavily recruiting none bona fide students from two undisclosed countries. They entered as students to eventually seek employment. Encouragingly, total students excluding those from these two countries have risen 8% year-to-date.

BPO revenues should stabilise. Scicom revealed that it is on the verge of securing several new business process outsourcing (BPO) contracts, largely from Chinese companies, which require between 500 and 700 people. This is a substantial figure relative to its current headcount of 1,600.

Cambodia to launch soon. In Cambodia, its system is scheduled for completion end-June and will be officially launched in mid-July. It will be operated by its fully-owned Cambodian subsidiary and subjected to a 20% corporate tax and 10% withholding tax.

Comments

EMGS should withstand scrutiny. We believe the EMGS contract should withstand any review by the new administration given that 1) it was awarded based on a competitive tender, 2) it helps the government generate revenues, and 3) provides the government a tool to screen applicants. In the worst case (and unlikely) scenario where EMGS ceases, Scicom is entitled to a compensation.

Looking forward. We are more positive on Scicom on: 1) the revelation of new customers, albeit amidst a structural decline in the BPO industry, 2) higher qoq student applications, although to some extent driven by seasonality. Lastly, Cambodia should begin maiden contribution in July.

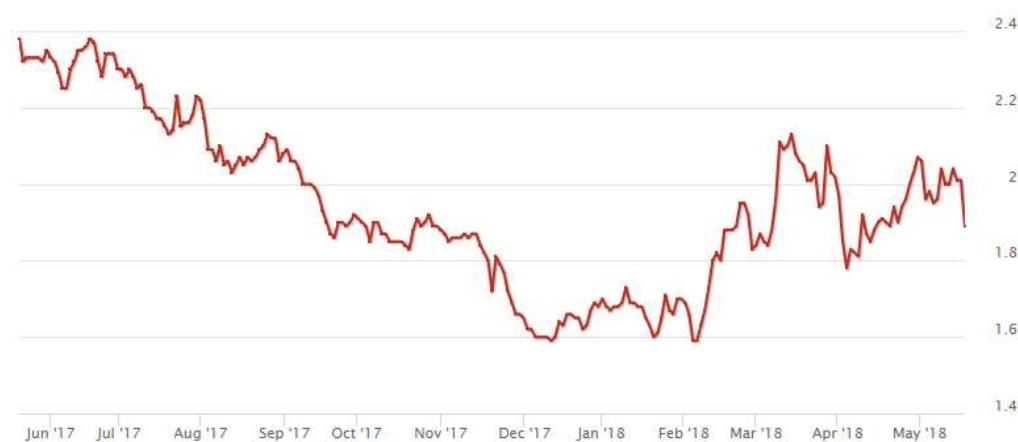
Recommendation

We maintain a Buy recommendation on Scicom as we believe the contract from Cambodia's Ministry of Tourism and gradual recovery of its BPO business should catalyse the stock. The Cambodian contract should drive earnings and help diversify Scicom's revenue away from the ailing BPO division and EMGS. Lastly, its dividend yield of 4.8% is attractive, backed up by a FCFE yield of 6-7%.

Key financials (FYE Jun)	FY16	FY17	FY18F	FY19F
Revenue (RMm)	196.3	199.5	166.2	190.9
EBITDA (RMm)	49.3	51.5	45.5	64.3
EBITDA margin	25.1%	25.8%	27.4%	33.7%
Core net profit (RMm)	41.3	44.8	36.3	48.1
FD EPS (sen)	11.6	12.6	10.2	13.5
% revision			0.0%	0.0%
FD EPS growth	20.3%	7.1%	-17.0%	32.5%
DPS (sen)	9.0	9.0	9.0	9.0
Payout ratio	77.5%	71.5%	88.2%	66.5%
FCFE/share (sen)	11.6	10.3	13.1	11.6
Net cash (debt)/share (sen)	10.4	10.4	14.5	17.2

Key valuation metrics				
P/E (X)	16.3	15.0	18.5	14.0
EV/EBITDA (X)	12.9	12.3	13.6	9.5
P/BV (X)	7.3	6.4	6.1	5.3
Dividend yield (%)	4.8%	4.8%	4.8%	4.8%
FCFE yield (%)	6.2%	5.5%	6.9%	6.2%
ROE (%)	47.7%	45.2%	33.8%	40.9%
ROAA (%)	40.3%	39.7%	30.9%	37.7%

Scicom's last 12-month share price chart



Source: Bursa Marketplace

Analyst:
Kelvin Goh
 kelvingoh@zjresearch.com
 03-2032 2328

RATING GUIDE

BUY	Price appreciation expected to exceed 15% within the next 12 months
SELL	Price depreciation expected to exceed 15% within the next 12 months
HOLD	Price movement expected to be between -15% and +15% over the next 12 months from current level

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ZJ Advisory Sdn Bhd (Co No: 645449-V)
(An investment adviser licensed by the Securities Commission)
Suite 27, 27th Floor, Sunway Tower,
No 86, Jalan Ampang, 50450 Kuala Lumpur
Tel (603) 2032 2328 Facsimile (603) 2032 1328
