

1QFY19 RESULTS UPDATE

26 November 2018

Scicom (MSC) Bhd

Price : RM1.61

Market Capitalization : RM572 mln

Market : Main Market

Sector : Trading & Services

Recommendation : Sell (downgraded)

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

FYE Jun (RMm)	1QFY19	4QFY18	qoq %	1QFY18	yoy %
Revenue	38.7	37.6	3%	45.8	-16%
Opex	(31.2)	(28.6)	9%	(32.3)	-4%
EBITDA	7.5	9.0	-17%	13.5	-45%
Depreciation	(1.6)	(1.8)	-9%	(2.0)	-17%
EBIT	5.9	7.3	-19%	11.6	-49%
Net interest	0.3	0.3	12%	0.2	22%
Forex/EI	0.2	(1.2)	-116%	(0.0)	-1137%
PBT	6.4	6.3	1%	11.8	-46%
Tax	(1.7)	(2.2)	-24%	(0.9)	91%
Tax rate	27.3%	29.4%		7.5%	
MI	(0.1)	(0.1)	-23%	(0.0)	14%
Net profit	4.6	4.0	15%	10.8	-57%
Core net profit	4.4	4.0	11%	10.9	-59%
EPS (sen)	1.2	1.5	-16%	3.1	-59%
DPS (sen)	2.0	3.0	-33%	2.0	0%
EBITDA margin	19.4%	24.0%		29.5%	
Core net profit margin	11.4%	13.9%		23.7%	

1QFY19 Results Review

- **Below expectation.** Scicom's performance continued to deteriorate. When annualized, 1QFY19 core net profit came in 62% below forecast on lower yoy revenue and margins. While revenue rose qoq, driven by the higher margin Education Malaysia Global Services (EMGS) business, margins were lower due to higher labour costs.
- **BPO and EMGS declined yoy.** FY18 revenue fell 16% yoy because of the loss of business outsourcing (BPO) clients and the reduction in the number of seats required. EMGS is still reeling from the closure of over 130 colleges over 2015-2017 with the continued decline in inbound students which affects. On a qoq basis, BPO revenue fell but EMGS revenues rose due to a 38% increase in the number of students processed.
- **Lower margin.** EBITDA margin fell 4.6%-pts qoq and 10.1%-pts yoy to 19.4%, the lowest since 1QFY15. This was due to higher costs where it took on 30 employees to build a complete border control system. Scicom expects to complete the development of this system by June 2019.
- **Dividends maintained.** As expected, it declared 2 sen in DPS (1QFY18 2sen, 4QFY18 3 sen), in line with our expectation.

Company update

Scicom hosted an investors' briefing in conjunction with the results release. The key points are:

Expect recovery in 2HFY19. Scicom expects both the EMGS and BPO businesses to turn around in 2H. It expects new BPO clients driving the recovery as revenue is under pressure from falling volumes and time spent per transaction for each customer. Scicom is now marketing itself globally by offering a cheaper service. Our view is that BPO companies are facing headwinds as the way which companies engage their customers are changing from traditional phone calls to social media and online chats. This reduces the number of headcount/seats required.

On the EMGS front, it is still reeling from the closure of over 130 colleges in 2017. Scicom expects the numbers to recover in 2HFY19.

Further delay in Cambodia. Following Cambodia's mid-term elections, a cabinet has yet been formed and therefore the Cambodia Tourism Management System (CTMS) has not yet been turned on. Apart from the Ministry of Tourism, other agencies are now vying for the revenues to be generated by the CTMS, which adds to the uncertainty over the start date.

Developing new products. Scicom took pains to explain the development work it is putting into solutions for governments:

- Identification management. This includes border control management services, advance passenger screening system, and biometric solutions.
- Fintech. This includes production authentication solutions and e-certificate of origin,
- Agriculture. ePhyto system to register exporters and issuance of transit permits.

Served with a lawsuit. On 5 Nov 2018, Scicom announced that its subsidiary has been named as a second defendant in a lawsuit by Tawasol Al-Sharq Marketing Services, which is seeking US\$0.4m (RM1.7m) in relation to alleged nonpayment after Scicom had ceased to procure Tawasol's services. Scicom explained Tawasol has no case against it as it was not invoiced for this service as Tawasol's commercial arrangement was with Nokia Asia, which is Scicom's client.

Cutting our forecast and target price. We lower our FY19 and FY20 EPS forecast by 50-67% as we assume: 1) zero contribution from Cambodian's Tourism Management System (CTMS) in FY19 and partial contribution in FY20 due to poor visibility as to when it will begin operations; and 2) higher costs from the intake of 30 engineers to develop its border control system. As a result, our target price is reduced to RM1.20 from RM2.36 based on 16.5x FY20 EPS. Our forecast of 9 sen DPS is maintained as management has no plans to revise it despite dividend payout exceeding earnings.

Recommendation

We downgrade Scicom to Sell on the back of the continued deterioration in its core businesses and delay in the CTMS. While the company has guided for a recovery in 2HFY19, we think its visibility is poor evidenced by the continued delay in onboarding new customers, and scaling back and cessation by existing customers. In addition, the commencement of the Cambodia's Ministry of Tourism, the operations is plagued by delays. Lastly, we appreciate the fact that the company is developing new solutions, but winning contracts from governments can be a tedious and slow process. Adding to the uncertainty is that most of them are from developing countries where political and policy risks are higher. Considering all the above, we believe there is further downside to stock price in the short term.

Key financials (FYE Jun)	FY17	FY18	FY19F	FY20F
Revenue (RMm)	199.5	165.3	157.0	184.5
EBITDA (RMm)	55.8	45.5	25.1	38.4
EBITDA margin	28.0%	27.5%	16.0%	20.8%
Core net profit (RMm)	44.8	31.6	15.3	25.8
FD EPS (sen)	12.6	8.9	4.3	7.3
% revision			-67.2%	-50.5%
FD EPS growth	7.1%	-23.9%	-53.9%	68.9%
DPS (sen)	9.0	9.0	9.0	9.0
Payout ratio	71.5%	101.2%	209.1%	123.8%
FCFE/share (sen)	10.9	12.3	4.6	5.3
Net cash (debt)/share (sen)	10.4	14.7	10.3	6.6

Key valuation metrics

P/E (X)	12.8	18.1	37.4	22.1
EV/EBITDA (X)	9.6	11.4	21.3	14.3
P/BV (X)	5.4	5.5	6.5	7.0
Dividend yield (%)	5.6%	5.6%	5.6%	5.6%
FCFE yield (%)	6.8%	7.7%	2.9%	3.3%
ROE (%)	45.2%	30.1%	15.8%	30.4%
ROAA (%)	39.7%	27.1%	13.9%	26.3%

Forecast revision

Revised forecast (RMm)	FY19E	FY20E
Revenue	157.0	184.5
EBITDA	25.1	38.4
EBITDA margin	16.0%	20.8%
Core net profit	15.3	25.8

Previous forecast (RMm)	FY19E	FY20E
Revenue	190.9	214.1
EBITDA	64.3	71.3
EBITDA margin	33.7%	33.3%
Core net profit	46.6	52.2

% change	FY19E	FY20E
Revenue	-17.8%	-13.8%
EBITDA	-60.9%	-46.1%
EBITDA margin	-52.5%	-37.5%
Core net profit	-67.2%	-50.5%

Scicom's last 12-month share price chart

Source: Bursa Marketplace

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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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