

COMPANY UPDATE

4 March 2019

Scicom (MSC) Bhd

Price : RM1.29

Market Capitalization : RM459 mln

Market : Main Market

Sector : Trading & Services

Recommendation : Hold

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

Company update

We came away from Scicom's 2QFY19 results briefing, hosted by its CEO and investor relations manager, a little more positive on the company because the existing businesses are looking up. However, we are not hopeful on the prospects of its e-government bids.

BPO turning around. To our pleasant surprise, we gather that Scicom has secured sizeable new BPO contracts from existing and new customers. The company will require an additional 700 headcount by June 2019 from 2,500 in December 2018. This is despite headwinds the industry faces where customers are pushing for greater cost efficiencies using new channels of engagement such as online chat and email instead of phone conversation. Management cited an example where a client shifted a large number of headcount requirements to Scicom's Sri Lanka office where costs are half of Malaysia's. It is worth noting that BPO businesses carry lower margins than e-government revenues.

Education Malaysia Global Services (EMGS) has bottomed out. We understand that student numbers have bottomed out and should rise. Recall that the number of applications fell sharply after the government closed down numerous bogus colleges, which recruited students from two countries with the intention of staying as migrant workers. Student numbers in FY19 should exceed that of FY18, partly due to the low base in 4QFY8 when student numbers dropped prior to the general elections. The growth in foreign student inflow is largely driven by China, which has rose from number five three years ago to the largest contributor of students today.

Cambodia. Cambodia continues to elude Scicom. The Ministry of Finance (MoF) has been collecting visitor entry and exit fees through the International Air Transport Association (IATA). However, Cambodia's MOF is not channeling the funds to the Ministry of Tourism which to help fund its marketing expenses and the Cambodia Tourism Management System (CTM) proposed by Scicom.

Scicom has not incurred any capex in Cambodia but has spent an undisclosed sum on developing a system to enable the CTMS. We also gather that Scicom is not considering legal actions as it is proposing other e-government services in the country.

It appears that the government has taken Scicom's idea of taxing air travelers to generate funds but without using Scicom's system. This highlights the risks of doing business in emerging markets and how Scicom's risk profile increases when it moves out of Malaysia to emerging markets.

Other countries. We understand that Scicom has made proposals and submitted tenders in countries in South Asia, Africa and the Caribbean but has little to update. Its experience in Cambodia shows that contracts securing e-government contracts are a protracted process and even after getting the nod, it can potentially slip away.

Fuel subsidy solution. Malaysia's Ministry of Finance (MOF) has not adhered to any of the timeline for its request for proposal (RFP) to develop a solution to subsidise fuel for a targeted segment of the population. The company remarked that the MOF appears to be developing its own capabilities and does not appear to be looking to outsource part or all of the fuel subsidy scheme.

Recall that the MOF had issued an RFP from companies to develop, test, implement, study and operate a new system for the fuel subsidy. The government will choose the most competitive proposals, based on both cost and implementation. The media had reported that the government will carry out the

targeted RON95 fuel subsidy in stages by 2Q 2019, and to charge foreign vehicles substantially more. Budget 2019 had put aside RM2bn to subsidise owners of cars and motorcycles with engines below 1,500 cc and 125cc respectively RON95 petrol at 30sen per litre. The subsidy for car owners will be limited to 100 litres of petrol monthly, while motorcycle owners will get 40 litres monthly.

Lower dividends. Scicom's board has decided to pay out only what the company earns, which implies that the previous payouts of 2 sen/qtr for Q1-Q3 and 3 sen/qtr for Q4 are not sustainable unless business recovers substantially. Recall that Scicom dropped its DPS by 25% from 2 sen previously to 1.5 sen in 2QFY19. We maintain our forecast of 6 sen DPS. Based on our forecast, the company should generate 5-6 sen/share in free cashflow to equity.

Raising our forecast, maintain target price. We up our FY19 and 20 EPS estimates by 13% and 11% to reflect the more upbeat outlook for both BPO and EMGS divisions. However, our fair value remains unchanged at RM1.21 as we lower our fair multiple from 16.5x to 15x FY20 EPS to reflect a more muted probability of securing e-government contracts.

Forecast revision

Revised forecast (RMm)	FY19E	FY20E
Revenue	173.6	199.6
EBITDA	33.0	41.9
EBITDA margin	19.0%	21.0%
Core net profit	21.4	28.8
EPS (sen)	6.0	8.1
DPS (sen)	6.0	6.0

Previous forecast (RMm)	FY19E	FY20E
Revenue	157.0	184.5
EBITDA	29.8	38.4
EBITDA margin	19.0%	20.8%
Core net profit	18.9	26.1
EPS (sen)	5.3	7.3
DPS (sen)	6.0	6.0

% change	FY19E	FY20E
Revenue	10.5%	8.2%
EBITDA	10.5%	9.2%
EBITDA margin	0.0%	1.0%
Core net profit	12.8%	10.6%
EPS (sen)	12.8%	10.6%
DPS (sen)	0.0%	0.0%

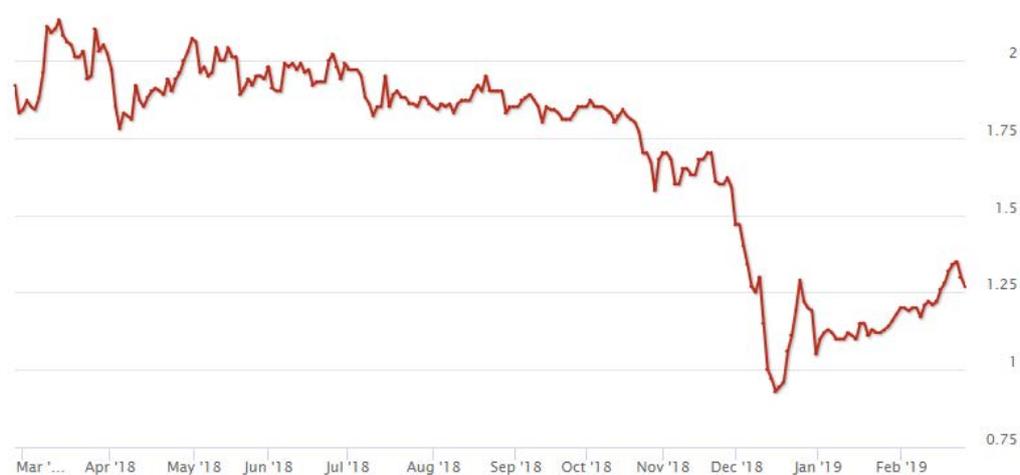
Recommendation

Maintain Hold. Despite the more optimistic outlook for its existing businesses, we maintain a Hold recommendation on Scicom because: 1) the BPO business continues to face headwinds from customer cost-cutting, 2) risks and delays associated with bidding for local and overseas e-government contracts. Scicom participates in tenders in emerging markets where political and market risks are higher than its current businesses. Even in Malaysia, the tender for MOF's fuel subsidy scheme appears to have stalled. 3) the current PE valuations of 21x and 16x for FY19 and FY20 and dividend yields of 4.7% are not compelling.

Key financials (FYE Jun)	FY17	FY18	FY19F	FY20F
Revenue (RMm)	199.5	165.3	173.6	199.6
EBITDA (RMm)	55.8	45.5	33.0	41.9
EBITDA margin	28.0%	27.5%	19.0%	21.0%
Core net profit (RMm)	44.8	31.6	21.4	28.8
FD EPS (sen)	12.6	8.9	6.0	8.1
% revision			12.8%	10.6%
FD EPS growth	7.1%	-23.9%	-35.7%	34.9%
DPS (sen)	9.0	9.0	6.0	6.0
Payout ratio	71.5%	101.2%	99.8%	74.0%
FCFE/share (sen)	10.9	12.3	5.2	6.2
Net cash (debt)/share (sen)	10.4	14.7	14.0	14.1

Key valuation metrics

P/E (X)	10.2	14.5	21.4	15.9
EV/EBITDA (X)	7.6	8.9	12.4	9.7
P/BV (X)	4.4	4.4	4.4	4.1
Dividend yield (%)	7.0%	7.0%	4.7%	4.7%
FCFE yield (%)	8.5%	9.5%	4.1%	4.8%
ROE (%)	45.2%	30.1%	20.4%	26.5%
ROAA (%)	39.7%	27.1%	18.1%	23.6%

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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