

2 March 2023

Technology | IT Services

Scicom (SCIC MK)

Not Rated

Creating a Holistic Customer Experience

- MYR1.56 FV based on 15x CY23F P/E.** Recent recovery in earnings margin is expected to persist in the near-term, in tandem with strong growth of customer service and wide advancements in digital services. Scicom's gov-tech business is expected to benefit from an increase in China students' applications to study in Malaysia. The company also has uninterrupted profits since its IPO, and a high ROE business (c.30% in FY23F). It has a forecasted FY23 dividend yield of c.7.5%, coupled with an ex-cash P/E of merely c.9x, to make it a compelling investment.
- Scalable operating model.** Scicom's diversified client-base creates a natural hedge against the unpredictability of the industry's growth and cycle. Maintaining in-house IP and developed solutions enable the group to be independent and cost-effective without relying on third-party software suppliers. Scicom has upped its game by providing higher-value operation services or omnichannel solutions, rather than the conventional customer care services. This has shown to improve its earnings margin. It provides multi-lingual channels to solve complex customer issues on time and hence, ensuring customer satisfaction. These value-adds can be difficult and costly for businesses to replicate and hence enhance client stickiness.
- Benefit from geopolitical tension.** Reasonable pricing, coupled with vast experience (>20 years), provide the company with a firm footing to compete in both the local and foreign markets. Recent global geopolitical tension has opened up more opportunities for Asia's business process outsourcing (BPO) players to capture a larger market share in developed countries.
- China border reopening a boon for gov-tech.** Scicom provides back-end solutions for the Malaysian Government's one-stop visa centre for foreign students under the Education Malaysia Global Services (EMGS) programme. This segment contributed c.25% of Scicom's FY22 sales. The Government continues efforts to attract international students from the region with a 3-year CAGR target of 71%. China has consistently been the largest tertiary education market for EMGS (>40% of students pa), and is set to recover strongly after the country's borders reopened.
- Undemanding valuation.** Coupled with its net cash position and uninterrupted profitability since 2006, we believe its current valuation of c.12x P/E is undemanding vs its direct peer – Teleperformance (TLPFF US, Not Rated) – now trading at c.23x of trailing P/E, especially with Scicom's higher profit margins and healthier balance sheet. In line with the average 2-year forward P/E of local software space, we ascribe a P/E of 15x on its CY23F earnings to derive a fair value of MYR1.56. A decent dividend yield of more than 7% is another plus point. Key risks include: i) The inability to secure new contracts; ii) non-renewal of EMGS concession; iii) a drop in the number of foreign students studying in Malaysia; and iv) scarce human capital & limited brand presence.

Fair Value (Return): MYR1.56 (36.7%)
 Price: MYR1.14
 Market Cap: USD91.4m
 Avg Daily Turnover (MYR/USD): 0.26m/0.06m

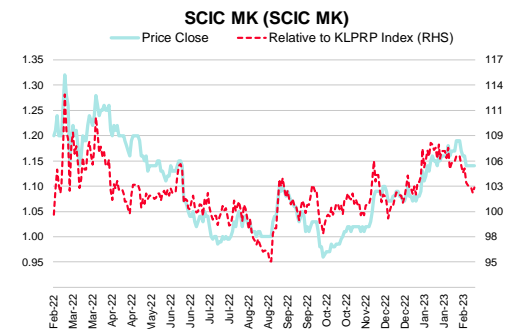
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	5.6	0.0	11.8	12.9	(7.3)
Relative	(0.9)	(3.6)	2.0	7.6	(2.9)
52-wk Price low/high (MYR)	0.96 – 1.32				



Source: Bloomberg

Forecasts and Valuation	Jun-21	Jun-22	Jun-23F	Jun-24F	Jun-25F
Total turnover (MYRm)	216	265	295	322	351
Recurring net profit (MYRm)	26	31	35	39	43
Recurring net profit growth (%)	17.1	21.8	11.2	11.1	11.6
Recurring P/E (x)	15.69	12.88	11.58	10.42	9.34
P/B (x)	3.7	3.6	3.4	3.1	2.8
P/CF (x)	8.50	8.07	10.91	7.64	7.22
Dividend Yield (%)	5.3	6.1	7.0	7.0	7.0
EV/EBITDA (x)	7.31	5.89	5.38	4.71	4.03
Return on average equity (%)	24.4	28.3	29.9	31.0	31.4
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash

Source: Company data, RHB

Note:

Small cap stocks are defined as companies with a market capitalisation of less than USD0.5bn.

Financial Exhibits

Asia	Financial summary (MYR)	Jun-21	Jun-22	Jun-23F	Jun-24F	Jun-25F
Malaysia	Recurring EPS	0.07	0.09	0.10	0.11	0.12
Technology	DPS	0.06	0.07	0.08	0.08	0.08
Scicom	BVPS	0.31	0.32	0.34	0.37	0.41
SCIC MK	Return on average equity (%)	24.4	28.3	29.9	31.0	31.4
Buy						
	Valuation metrics	Jun-21	Jun-22	Jun-23F	Jun-24F	Jun-25F
Valuation basis	Recurring P/E (x)	15.69	12.88	11.58	10.42	9.34
15x P/E on its CY23 earnings	P/B (x)	3.7	3.6	3.4	3.1	2.8
	FCF Yield (%)	7.5	10.2	9.2	13.1	13.9
Key drivers	Dividend Yield (%)	5.3	6.1	7.0	7.0	7.0
i. Adaptable operating model;	EV/EBITDA (x)	7.31	5.89	5.38	4.71	4.03
ii. BPO business to sustain growth;	EV/EBIT (x)	10.83	8.35	7.61	6.50	5.42
iii. Gov-tech business to benefit from China border reopening;						
iv. Undemanding valuation.						
	Income statement (MYRm)	Jun-21	Jun-22	Jun-23F	Jun-24F	Jun-25F
Key risks	Total turnover	216	265	295	322	351
i. Inability to secure new contracts;	Gross profit	216	265	295	322	351
ii. Non-renewal of EMGS concession;	EBITDA	51	62	67	71	76
iii. Drop in number of foreign students in Malaysia;	Depreciation and amortisation	(17)	(18)	(20)	(20)	(20)
iv. Scarce human capital.	Operating profit	34	44	47	52	57
	Net interest	(1)	(2)	(1)	(0)	1
Company Profile	Pre-tax profit	33	42	46	51	57
Scicom is an industry leader in BPO services and integrated digital solutions. It offers education services as well.	Taxation	(8)	(11)	(11)	(12)	(14)
	Reported net profit	26	31	35	39	43
	Recurring net profit	26	31	35	39	43
	Cash flow (MYRm)	Jun-21	Jun-22	Jun-23F	Jun-24F	Jun-25F
	Change in working capital	(12.6)	3.7	(2.7)	(18.6)	(5.8)
	Cash flow from operations	47.7	50.2	37.1	53.1	56.1
	Capex	(17.2)	(8.7)	0.0	0.0	0.0
	Cash flow from investing activities	(18.6)	3.0	0.0	0.0	0.0
	Dividends paid	(19.5)	(23.1)	(28.4)	(28.4)	(28.4)
	Cash flow from financing activities	(30.1)	(33.8)	(29.6)	(28.9)	(27.9)
	Cash at beginning of period	29.1	30.0	36.8	44.4	68.6
	Net change in cash	(1.0)	19.3	7.5	24.2	28.2
	Ending balance cash	28.1	49.4	44.4	68.6	96.8
	Balance sheet (MYRm)	Jun-21	Jun-22	Jun-23F	Jun-24F	Jun-25F
	Total cash and equivalents	30	37	44	69	97
	Tangible fixed assets	60	52	32	13	(7)
	Total investments	0	0	(0)	(0)	(0)
	Total assets	166	165	173	185	201
	Total liabilities	59	53	54	56	57
	Total equity	107	112	119	129	144
	Total liabilities & equity	166	165	173	185	201
	Key metrics	Jun-21	Jun-22	Jun-23F	Jun-24F	Jun-25F
	Revenue growth (%)	19.2	22.6	11.1	9.2	9.2
	Recurrent EPS growth (%)	17.1	21.8	11.2	11.1	11.6
	Gross margin (%)	100.0	100.0	100.0	100.0	100.0
	Operating EBITDA margin (%)	23.6	23.5	22.7	22.1	21.7
	Net profit margin (%)	11.9	11.9	11.9	12.1	12.3
	Dividend payout ratio (%)	82.6	79.1	81.3	73.1	65.5
	Capex/sales (%)	7.9	3.3	0.0	0.0	0.0
	Interest cover (x)	19.3	19.0	24.0	28.3	29.0

Source: Company data, RHB

Investment Thesis

Scalable operating model. Scicom serves over 40 customers from multiple industries, including telecommunication, hospitality, airlines, e-commerce, education, and E&E. As it does not depend on a single industry or customer, the client-base diversity creates a natural hedge for the company. Having its own IP and in-house developed solution allows it to be independent and cost-effective without relying on any third-party software supplier.

Moving up the value chain. The company moved up the value chain by creating new customer offerings. It started providing higher-value operations services (such as social media support, text support, fulfilment, and robotic automation) to move away from the conventional customer care offerings. The updates are believed to influence the higher earnings' margin. With its wider range of services, Scicom is seen as delivering a one-stop digital business operation to its clients.

We believe clients appoint Scicom to provide customer care service due to the latter's turnkey efficiency in saving time and resources by lowering average handling time and increasing first-call resolution. This ensures complex customer issues can be solved quickly, hence improving customer satisfaction and loyalty. It also provides clients the flexibility to quickly scale their operations for long-term growth or seasonal surges. The company's forte is in helping clients retain customers, create a holistic customer experience, and indirectly increase market share.

Scicom's strength also lies with its multi-lingual employees, who are able to serve customers from multiple countries. The company provides training not just prior, but even after an employee has started working with a particular client or brand. Since it is costly and time-consuming for a client to train their own employees to attain the skills and experience of a Scicom customer service staff, the latter has good prospects to enhance stickiness with customers, and this bodes well for the group's income.

Asian edge. Scicom's multi-lingual advantage, reasonable pricing, and the experience gained from operating for more than two decades, provides it a firm position in the Asian market and an upper-hand over regional competitors with higher costs. Recent geopolitical tension has also created more opportunities for Asian BPO players to capture a larger global market share as businesses seek affordable alternatives to the European providers (Scicom's main competitors).

The company is working doubly hard to strengthen its position with existing clients and grow its market share in developed countries. This is because Scicom's cost advantages (as compared to its peers) in the addressable foreign market makes its pricing extremely competitive while sustaining its margin at the same time.

Sustainable growth of its BPO services. As Scicom usually signs 1-2 years' contracts with clients, we believe the recent strong growth in the top line is sustainable in the near term. According to Grandview Research, the global BPO market is expected to grow from USD261.9bn in 2022 to USD525.2bn in 2030, which indicates an 8-year CAGR of 9.1%. The customer services segment (accounts for c.30% of total BPO market) is expected to remain dominant, due to the increasing number of companies across the globe that are outsourcing customer service and technical support.

Welcoming foreign students. Scicom first ventured into the e-government segment in 2012, through the provision of back-end solutions for the Malaysian Government's one-stop visa centre for foreign students under the EMGS programme. The multi-year concession enables the company to receive an undisclosed percentage from every MYR1,000 paid by a foreign student to the Government to apply for a visa. This segment contributed c.25% to its FY22 sales.

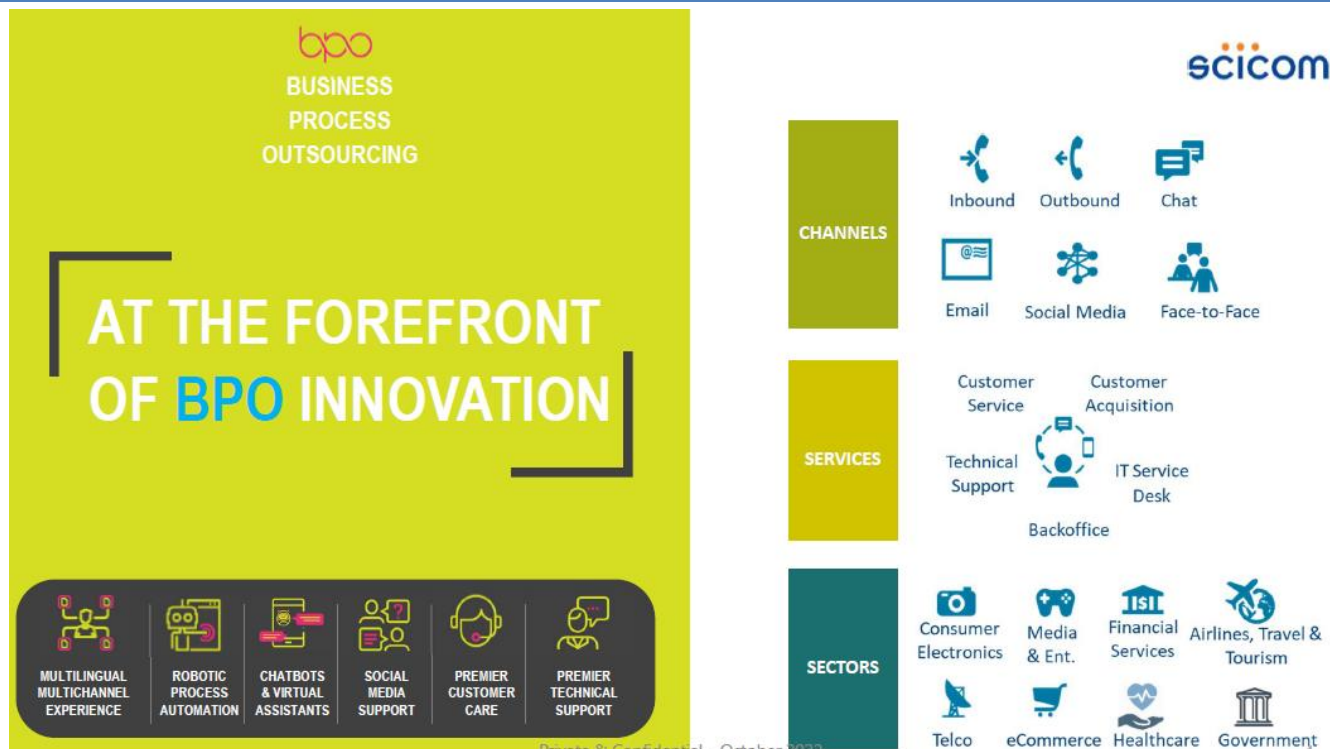
According to EMGS, it has met the immediate target to receive 50,000 new international student applications in 2022, which translates to a 27.5%-increase over 2021's total. The number is also more than pre-Covid's annual number of applicants. The five countries with highest number of student arrivals in 2022 were China, Indonesia, Bangladesh, India, and Nigeria. The Government is working towards reaching a target of attracting 250,000 students in 2025. Henceforth, we expect Scicom to benefit from the overall increase in the applications from foreign students, especially from China, which provided 43% of the total enrolment last year.

Undemanding valuation. Scicom delivered year-after-year of uninterrupted profit since its listing in 2006, thanks to a diverse customer-base, high retention of customers, competitive advantage over its peers, and strong demand growth of customer service. The group has also consistently paid dividends every year since its IPO. In the past four years, Scicom's dividend payout ratio ranged between 79.1% and 96.7%. Coupled with its net cash position of MYR112.1m, we believe the current valuation of c.12x P/E is undemanding when

compared with its direct competitor – Teleperformance, now trading at c.23x P/E. In our view, the gap between Scicom and Teleperformance is steep, especially with its higher profit margins and healthier balance sheet (as shown in Figure 3).

As shown in the peer table, the average 2-year forward P/E of the local software provider players stand at c.15.3x. In line with the current average of software companies, we ascribe a P/E of 15x on its CY23F earnings to derive a fair value of MYR1.56. A decent dividend yield of more than 7% is another plus point. Especially in the current high interest rate environment, a value stock like Scicom deserves a relook from its current ex-cash P/E of merely c.9.4x.

Figure 1: Revenue by location



Source: Company

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Figure 2: Peer table

Company	Country	FYE	Mkt cap (USDm)	Price		P/E (x)		Div. yld (%)	ROE (%)	EV/ EBITDA	NP Growth (%)		PEG
				28-Feb-22 (Local currency)	Actual	1-yr fwd	2-yr fwd				1-yr fwd	2-yr fwd	
SCICOM (MSC)	MA	06/2023	90.3	1.14	12.1	12.3	11.5	6.4	29.1	6.3	-1.6	7.4	1.6
Local peers													
KRONOLOGI ASIA	MA	01/2023	80.0	0.50	14.1	18.9	15.3		5.3		-25.4	23.0	0.7
RAMSSOL GROUP	MA	12/2022	19.7	0.36	20.7	14.0	11.0		12.1	11.3	47.7	27.7	0.4
CENSOF HOLDINGS	MA	03/2023	30.8	0.25	6.9								
RADIANT GLOBALTECH	MA	12/2022	42.1	0.36	24.9								
MY EG SERVICES	MA	12/2022	1190.8	0.72	13.1	14.2	13.1	2.5	24.3	12.0	-7.7	8.5	1.5
AGMO HOLDINGS	MA	03/2023	51.8	0.72	32.1								
N2N CONNECT	MA	12/2022	61.0	0.49	15.2	21.3	18.7	3.1	4.8	4.6	-28.8	14.1	1.3
AWANBIRU TECHNOLOGY	MA	06/2023	58.8	0.34	56.4	-174.6	58.2		-0.8	158.6	-132.3	-399.7	na
EXCEL FORCE MSC	MA	06/2023	46.1	0.37	15.7								
Mkt. cap weighted avg.			936.4		15.8	6.9	15.3	2.5	21.2	18.1	-14.0	-7.2	1.4
Simple avg.			191.9		22.9	-21.2	23.3	2.8	9.2	46.6	-29.3	-65.3	1.0
International peers													
ACCENTURE	IR	08/2023	175089.9	265.55	25.5	23.9	22.0	1.6	32.2	14.3	6.4	8.9	2.5
TELEPERFORMANCE	FR	12/2022	15372.7	246.00	22.6	16.3	14.7	1.7	160.0	9.2	39.1	11.0	1.3
Mkt cap weighted avg			162198.7		25.2	23.3	21.4	1.6	42.5	13.9	9.0	9.0	2.4
Simple Avg.			95231.3		24.0	20.1	18.3	1.7	96.1	11.7	22.7	10.0	1.9

Source: Bloomberg, RHB

Figure 3: Operating metrics

Company	Revenue 3-year CAGR	Net profit 3-year CAGR	Gross profit margin	EBITDA margin	Net profit margin	Net gearing (latest)
SCICOM (MSC)	17.0%	-0.8%	#VALUE!	23.5%	11.9%	Net Cash
Local peers						
KRONOLOGI ASIA	23.6%	13.1%	20.5%	15.4%	7.7%	Net Cash
RAMSSOL GROUP	30.5%	187.0%	56.1%	17.1%	15.0%	Net Cash
CENSOF HOLDINGS	5.3%	-226.5%	40.1%	26.4%	16.8%	Net Cash
RADIANT GLOBALTECH	31.1%	35.4%	35.9%	10.3%	5.3%	Net Cash
MY EG SERVICES	19.4%	25.7%	67.4%	58.2%	61.2%	6.0
AGMO HOLDINGS			44.7%	42.7%	40.8%	Net Cash
N2N CONNECT	-1.6%	10.2%	68.3%	34.2%	17.1%	Net Cash
AWANBIRU TECHNOLOGY	-23.7%	84.4%	30.7%	8.7%	4.9%	Net Cash
EXCEL FORCE MSC	17.6%	22.3%	69.0%	55.5%	32.6%	Net Cash
Mkt. cap weighted avg.	17.0%	23.9%	60.7%	49.2%	48.9%	
Simple avg.	12.8%	19.0%	48.1%	29.8%	22.4%	
International peers						
ACCENTURE PLC-CL A	14.5%	19.2%	32.0%	19.8%	11.2%	Net Cash
TELEPERFORMANCE	22.5%	27.4%		18.2%	7.9%	69.1
Mkt. cap weighted avg.	15.2%	19.9%	32.0%	19.7%	10.9%	
Simple avg.	18.5%	23.3%	32.0%	19.0%	9.5%	

Source: Bloomberg, RHB

Company Overview

Scicom was listed on Main Market Bursa Malaysia in 2005. It is an industry leader in BPO services and integrated digital solution. It offers innovative digital services in the areas of customer lifecycle management, digital, and gov-tech. The company also provides education services, including corporate and youth training programmes. It has operations in many countries, including Malaysia, Singapore, China, the Philippines, Thailand, Hong Kong, United Kingdom, Indonesia, India, Cambodia, and Sri Lanka.

Its business segments can be divided into:

- i. **Business process outsourcing (99.9% of FY22 revenue).** The BPO segment contributed most of the group's revenue. It provides unique end-to-end digital and customer services, deploying recognised integrated and forward thinking solutions. This segment comprises:
 - a. **Customer lifecycle management** offers premier customer care, technical support, customer acquisition, and sales as well as back-office support with multilingual and omnichannel solutions. It has experience in serving multiple industries like airlines, financial services, telecommunications, e-commerce, healthcare, and government agencies;
 - b. **Gov-tech** (e-Government) solution focuses on enhancing public sector operations, and projecting a simple, efficient, and transparent governance. It delivers services to improve data collection and analytics collection tools, and equip the decision makers with a more comprehensive information. In addition, its technology platform also emphasises on improving the user experience for government services. The integrated solutions delivered include International Student Management System, Border Control and Intelligence Solutions, Medical Screening Solutions, and E-Visa implementation;
 - c. **Digital** is a division that specialises in designing and implementing cutting-edge digital commerce solutions by integrating customer experience technology, data, analytics, and intelligent automation. Its strength lies in the creation of a direct-to-customer channel, which enables it to meet customers' digital expectations. This division focuses on two main areas – healthcare technology and e-commerce. Healthcare technology has successfully developed platforms for electronic health record and revenue cycle management. Both integrated solutions facilitate clinics and hospital to digitalise their operations effectively and efficiently. The e-commerce technology delivers an end-to-end solution for online shopping, including complete E-commerce strategy and engine development, mobile apps strategy and development, payment gateway services, catalog and inventory management, web and social analytics, and the order processing and fulfilment;
- ii. **Education segment (0.1% of FY22 revenue).** Scicom's education segment focuses on upskilling and enhancing employees' workplace-learning. It enables the workforce to build vital skills required to succeed in the global and digital worlds. It has developed exclusive Learning Management System (LMS), e-learning training courses, bespoke corporate training solutions, and a variety of course creation – from instructional design, to content, and to production. It is also collaborating with the Malaysian government in developing programmes to accelerate digitalisation and improve the skills of the B40-group workforce.

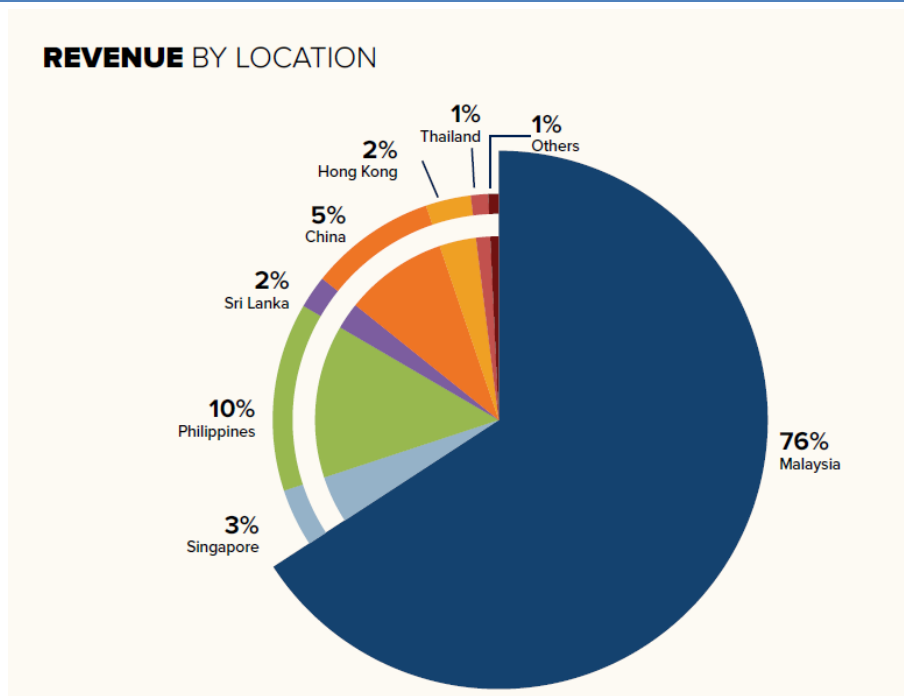
Scicom is led by an experienced management team. CEO Dato' Sri Leo Suresh Ariyanayakam is responsible for overseeing the overall operational function of the group. Kelvin Loke Cheong Hian, the CFO, has over 20 years of accounting experience. They are supported by the senior management team, comprising individuals with outstanding professional qualifications and over 10 years' of experience in their respective fields.

Figure 4: Group structure



Source: Company

Figure 5: Revenue by location



Source: Company

Key Risks

Inability to secure new contracts. Most of Scicom's contracts last one to two years, leaving it with a six-month window to ramp up on the existing deals. If the company does not secure enough contracts, it faces the risk of a drop in revenue. That said, Scicom should be able to mitigate risks through its wide customer base from various sectors.

Non-renewal of EMGS concession. The e-Government portion currently makes up about 20-25% of Scicom's annual income. Although the contract is considerably long-term, we cannot eliminate the slightest chance of a possible revocation. In the event that the contract is terminated, Scicom will lose out a sizable portion of its revenue and profit. However, we think that the probability is low as the Government will have to replace Scicom with another vendor that has the capability to take over, and risking possible disruption of the EMGS during the interim.

A lower number of international students could dampen Scicom's income from the e-government segment. We understand it gets a portion of the visa processing fee, so the income is positively correlated to the number of foreign students coming to Malaysia.

Scarce human capital. In this industry, professionals with high competency is needed for the company's daily operation. Consequently, the scarcity in human capital is anticipated in tandem with the rising demand on technology and digital solutions in the market. This is especially true following the pandemic outbreak, as businesses transition into a digital environment. Scicom has to satisfy the demand while keeping up with the rapidly-changing technology and improve the operational efficiency in order to retain market competitiveness. One of the risk management applied to enhance the employees' competencies is via structured-development programmes and performance-management process, where action plans to address employees' development needs are executed timely.

Limited brand presence and recognition. When the market is familiar with certain products or services, potential clients will tend to choose a more well-known company instead of others. It is cognisant that brand presence and recognition associated to the products and services are very crucial to determine the business' success. Therefore, the group continues to expand its brand presence and recognition in its BPO, gov-tech, digital, and education segments regionally and globally through enhancement of digital footprints.

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Buy:	Share price may exceed 10% over the next 12 months
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Take Profit:	Target price has been attained. Look to accumulate at lower levels
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