OSK

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Initiating Coverage

SEG International

Earnings to Double by FY12

BUY

Fair Value	RM2.23
Price	**RM1.945**

EDUCATION

SEGi is one of the largest private tertiary education providers in Malaysia by enrolment with 23k students onboard as of end-FY10.

Stock Statistics

Bloomberg Ticker		SYS MK
Share Capital (m)		535.6
Market Cap		1041.7
52 week H | L Price	2.07	0.75
3mth Avg Vol (000)		867.3
YTD Returns		81.9
Beta (x)		1.05

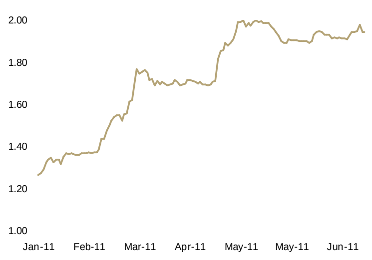
Major Shareholders (%)

Dato' Seri Clement Hii	32.2
Cerahsar	23.2
Segmen Entiti	6.8

Share Performance (%)

Month	Absolute	Relative
1m	2.4	100.8
3m	14.4	119.6
6m	63.7	214.3
12m	172.2	310.3

6-month Share Price Performance



SEG International (SEGi) is one of the largest private tertiary education providers in Malaysia by enrolment with 23k students in 6 campuses nationwide. Compared with its peers, SEGi has one of the widest range of courses covering commerce, creative arts, engineering, to healthcare and medical programs. It also enjoys better margins due to the introduction of its homegrown programs since 2008. We believe the growing thirst for tertiary education gives rise to boundless opportunities as SEGi introduces more new courses and better-yielding homegrown programs. Given the expected margin expansion on greater economies of scale and higher take-up of its homegrown courses amid a forecast enrolment growth of 20% p.a., we are modeling an earnings CAGR of about 50% over the next 2 years. Our Fair Value of RM2.23 is based on 18x FY12 PER. Initiate coverage with a BUY.

Vast underlying potential at home. Some 470k SPM and 700 STPM students leave school every year. Assuming a conservative 60% of these students go on to tertiary education, this represents an addressable market of close to 300k new students a year, or equivalent to RM4.5bn p.a (based on an average revenue of RM15k per student per year). As the nation progresses towards high income status as part of Malaysia's Vision 2020, we believe that rise of the medium- to high-income groups will propel demand for private tertiary education. Amid this scenario, SEGi is poised to grab a bigger piece of the pie given its diversified course offering.

Education as a major export. The Government plans to more than double the foreign student enrolment in local private institutions from 90k currently to 200k by 2020 by easing the application of student visas and providing working opportunities upon graduation. We believe this target is reasonably optimistic given Malaysia's key advantages, such as using English as the medium of teaching, affordable tuition fees, an increasing number of tie-ups with reputable foreign affiliates, and inexpensive cost of living. These provide the right climate for SEGi to boost the number of its international students, which stands at about 2k currently to a target 4k by FY12.

Aggressive expansion. We are targeting for SEGi's student base to expand at 20% p.a. over the next 2 years from 23k currently, riding on its reputation in providing local tertiary education and its presence in the region by associating itself with more foreign affiliates. Given that its facilities can accommodate up to 33k students versus the existing 23k whilst the take-up of its own programs continue to increase, we believe it is likely to sustain its superior gross margin of >70% in the last 3 years for FY11 and FY12. All in, we forecast for a solid earnings CAGR of 50% p.a. to RM92.6m by FY12**.**

FYE Dec	FY08	FY09	FY10	FY11f	FY12f
Revenue	127.4	166.4	217.6	279.8	359.3
Net Profit	7.3	10.0	43.1	78.0	92.6
% chg y-o-y	39.7	37.6	331.0	81.1	18.7
Consensus				67.2	84.6
EPS	1.0	1.3	5.8	10.4	12.4
DPS	0.3	0.4	7.2	5.2	6.2
Dividend yield (%)	0.2	0.2	3.7	2.7	3.2
ROE (%)	3.3	5.9	21.3	15.9	17.3
ROA (%)	2.4	4.6	16.4	14.0	14.8
PER (x)	200.3	145.5	33.8	18.6	15.7
BV/share	0.21	0.23	0.27	0.66	0.72
P/BV (x)	9.2	8.6	7.2	3.0	2.7
EV/EBITDA (x)	83.1	65.5	22.3	10.6	8.8

BACKGROUND

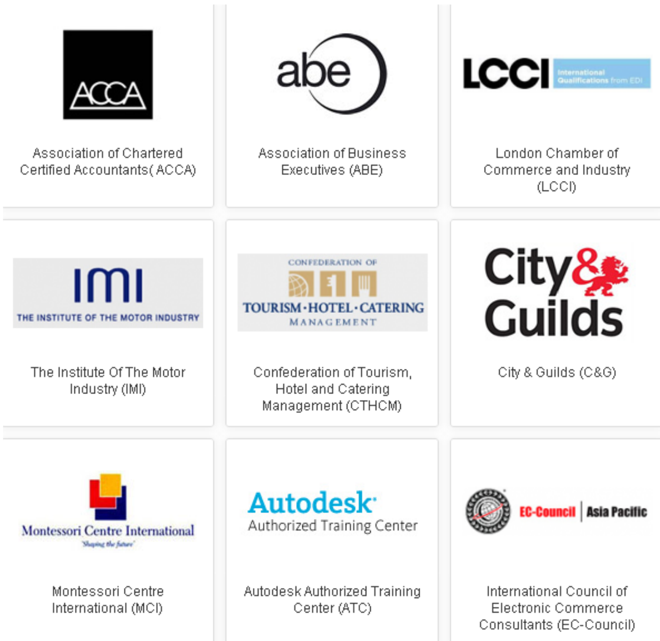
Largest listed education provider. Founded in 1977, SEGi is today Malaysia's largest listed private education group, with 23k students as of FY10. It provides professional, academic, technical and vocational educational courses as well as job placement consultancy services through its flagship SEGi University College in Kota Damansara and 5 SEGi College campuses nationwide. All in, the facilities have capacity for up to 33k students.

Figure 1: SEGi's Kota Damansara campus

Source: OSK Research, Company Data

Previously known as Systematic and PRIME. In the early 2000s, the group comprised 14 colleges and 6 training centers under the PRIME and Systematic brands, with core focus on professional courses such as ACCA, LCCI, ICSA and CIMA. The next phase of SEGi's growth came in 2006 when it streamlined its operations and consolidated into 6 large campuses, including its flagship campus in Kota Damansara that consists of on-campus residence halls, a sports & recreational complex, as well as state-of-the-art laboratories and learning facilities. After the consolidation, the campuses began to operate under a single brand name, later known as SEGi.

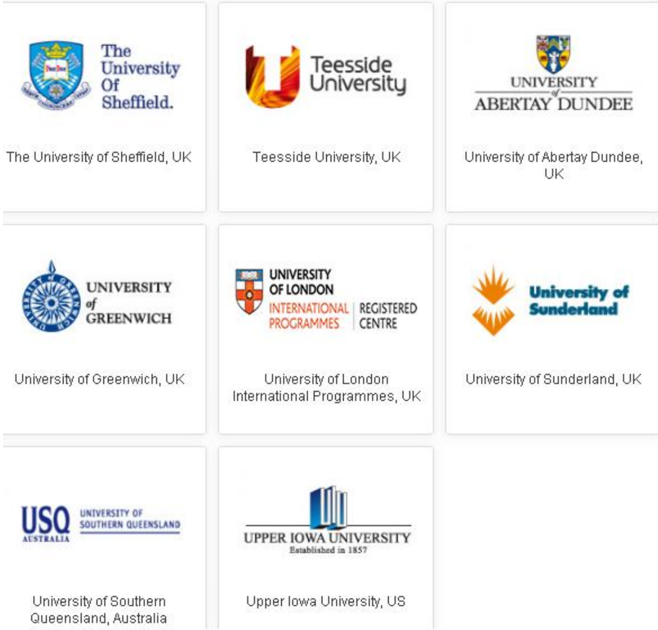
Figure 2: Professional bodies affiliated to SEGi



Source: OSK Research, Company Data

Status upgraded in 2008. SEGi received a boost when it was upgraded to University College status in June 2008. This enabled the group to introduce a suite of homegrown high margin programs. Today, SEGi is rolling out innovative and niche programs in the medical sciences, pharmacy, optometry and dentistry among others, and also looking to establish collaboration with more foreign education institutions. Leveraging on its strong reputation and growing regional presence, SEGi is also actively looking to expand the enrolment of foreign students, currently numbering 2k, to transform itself into a truly international tertiary education centre.

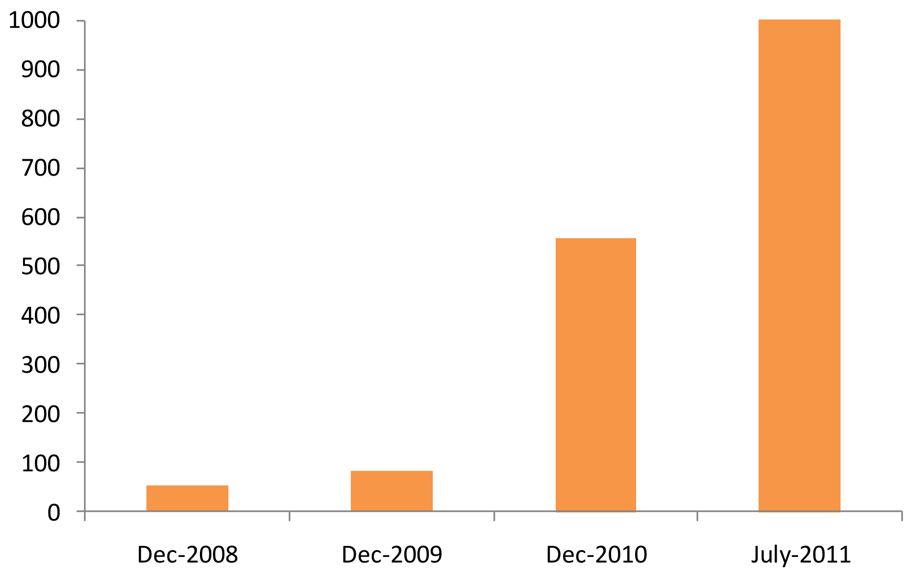
Figure 3: Foreign partners affiliated to SEGi



Source: OSK Research, Company Data

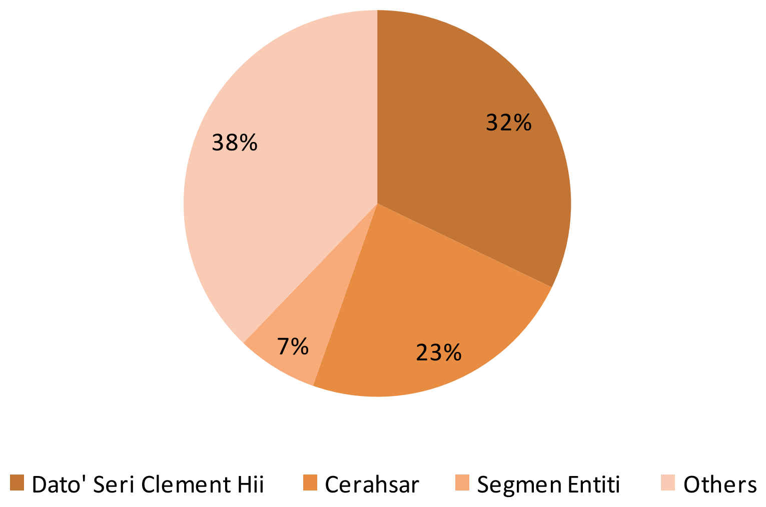
Market size swelled >20x since listing. Listed initially on the Second Board in 1995 with an initial market capitalization of RM40m, SEGi transferred its listing status to the Main Market (ex-Main Board) in 2004. Its market capitalization has jumped >20x over the last 15 years to RM1.0bn currently, buoyed by a core earnings CAGR of 18.4% since its listing. Its major shareholders include Dato' Seri Clement Hii Chii Kok with 32.5% equity interest, Cerahsar SB at 23.2%, and Segmen Entiti SB at 6.8%. Dato' Seri Hii emerged as the single largest substantial shareholder in SEGi upon doubling his stake over the last 12 months.

Figure 4: SEGi's market capitalization (RM m)



Source: OSK Research, Company Data

Figure 5: SEGi's shareholding structure as of FY10



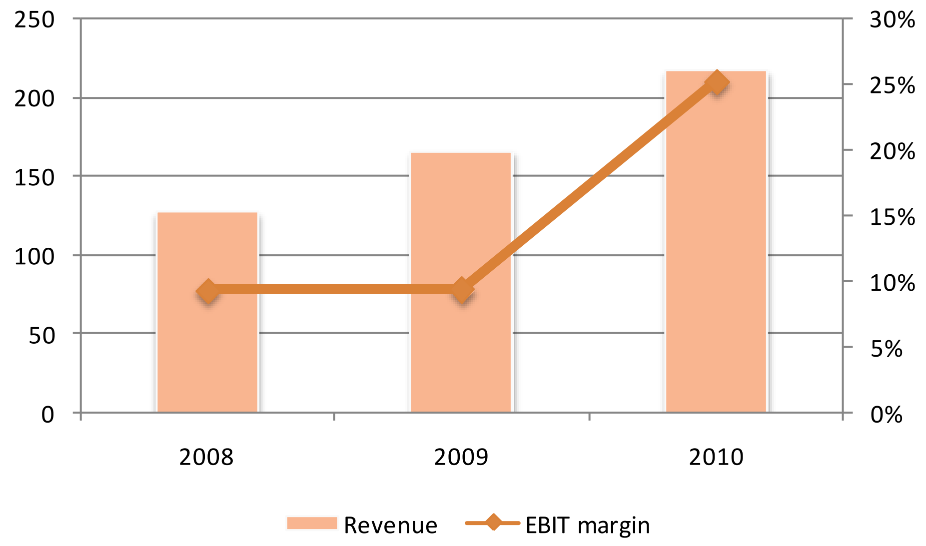
Source: OSK Research, Company Data

Management led by key promoter. The group's key management personnel include its single largest shareholder Dato' Sri Clement Hii Chii Kok as Group MD, assisted by Lee Kok Cheng as CEO and Hew Moi Lan as COO. Together, the trio has amassed over 60 years of experience in the education sector via various institutions.

FINANCIALS

Solid revenue CAGR of 58.8%. SEGi recorded sturdy topline CAGR of 58.8% over the last 3 years as student enrolment grew from 16k in 2007 to 23k as of end-FY10. In 2008, its flagship campus in Kota Damansara commenced operation, boosting SEGi's total capacity to 33k students. Given the improved economies of scale on better utilization of existing infrastructure and the introduction of homegrown programs after obtaining University College status, EBIT margin improved correspondingly from 9% to 25%. By the same token, core earnings jumped >6x to close FY10 at RM43.1m, the highest ever achieved since the group went public.

Figure 6: Revenue (RM m) and EBIT margin (%)



Source: OSK Research, Company Data

Diversified student composition. As of end-FY10, SEGi had about 23k students, of which 63% are enrolled in Business & Accounting, Nursing, Creative Arts & Design or Engineering courses. Some 12k students are currently registered under SEGi's homegrown Diploma or Degree programs, with the remainder pursuing its foreign partner programs and postgraduate studies. Since its Kota Damansara campus was upgraded to University College, it has garnered over 2.5k students under its own degree programs. In terms of financing, a significant 65% of its existing students are self-financed given their demographics, as they typically come from medium to high income households. Some 27% of the students is on PTPTN loans, with the rest on public or private scholarships.

Figure 7: Student composition by division

Courses by division	Proportion of total students
Business & Accounting	28%
Nursing	15%
Engineering	10%
Creative Arts & Design	10%
Others	37%

Source: OSK Research, Company Data

Campuses on sales-and-leaseback arrangement. SEGi worked out various sales-and-leaseback facilities to finance the development of its new campuses ease the burden on its balance sheet. Its Kota Damansara, Subang Jaya, and Seri Kembangan campuses are currently under lease arrangement with AmanahRaya REIT. Hence, its borrowings have been fairly manageable over the last 3 yrs and given the strong cash generation from this business, SEGi was sitting on a comfortable net cash pile of RM70m as of 1QFY11.

50% dividend payout policy. Early this year, SEGi's announced that the group would pay out at least 50% of its core net profit going forward. In FY10 alone, the company paid a final dividend of 7 sen per share on top of the special dividend of the 14 sen it paid in Jan 2011. The stock's dividend yield is a decent 3.7% for FY10 considering its aggressive growth.

Figure 8: Adjusted dividend payout according to share base in respective years

	2008	2009	2010
DPS (sen)	0.7	0.8	14.4
Yield (%)	0.2%	0.2%	3.7%
Dividend payout (%)	35%	31%	125%

Source: OSK Research, Company Data

INVESTMENT MERITS

Government embarks on more initiatives. Malaysia's literacy rate rose to >95% in 2009, with its youth literacy rate standing as high as 99%. Nonetheless, given the huge income disparity between the urban and rural areas, the secondary school enrolment ratio stands at a paltry <70%. In light of this, the Government proposed various initiatives to boost human capital development, having identified the education sector as the key engine propelling the nation into a high income economy by 2020. 13 Entry Point Projects (EPP) were identified with targets to raise the country's Gross National Income from RM27bn in 2009 to RM61bn by 2020. Covering early childcare to tertiary education, we believe these measures will boost Malaysia's image as a regional education center, which may in the long run draw a steady influx of foreign students to the country.

Figure 9: Various EPPs proposed by the Government

Entry Point Projects will expand education touchpoints by 2020

	Education NKEA Entry Point Projects	Education Touchpoints (Thousands) 2010	Target 2015	Target 2020
Rapid Scale-Up	1. Scaling up early child care and education centres	321	553	857
	2. Improving early child care and education training	1	13	25
	3. Scaling up international schools	19	37	75
	4. Expanding private teacher training	0	3	10
	5. Scaling up private skills training provision	55	96	110
	6. Expanding international distance learning	7	46	161
Concentration	7. Building an Islamic finance and business education DC	2	12	54
	8. Building a health services discipline cluster	55	90	150
	9. Building an advanced engineering discipline cluster	0	12	34
	10. Building a hospitality and tourism discipline cluster	17	35	43
	11. Launching EduCity @ Iskandar	3	16	16
Demand Generation	12. Championing Malaysia's international education brand	77	124	200
	13. Introducing public private partnerships in basic education	0	8	13

Source: OSK Research, etp.pemandu.gov.my

Vast potential in Malaysia. In 2010 alone, 192k students enrolled in public universities and colleges against 154k registered in private higher education institutions. With 500k students graduating from secondary schools every year, this translates into a tertiary education take-up rate of about 60% among school leavers (netting off the increase in foreign enrolment). We see plenty of room for improvement, buoyed by the growing medium- to high-income group, which would then drive expansion in the private education sector as the domestic household income increases in tandem with economic growth. As the cost of private tertiary education becomes increasingly affordable on larger economies of scale, we believe that more parents would be inclined to enroll their children in private varsities given their quality assurance and tie-ups with reputable foreign education partners.

Figure 10: No. of students in public and private varsities (in thousands)

	2009	2010
Entrants		
Public Institutions	153.5	167.2
Private Institutions	168.7	160.5
Others	59.2	62.9
Enrolment		
Public Institutions	437.4	462.8
Private Institutions	484.4	541.6
Others	128.9	129.7

Source: OSK Research, Ministry of Higher Education

Education as a major export. The Government plans to more than double the foreign student enrolment in local private institutions from 90k currently to 200k by 2020 by relaxing the application of student visas and providing work opportunities upon graduation. We believe the target is reasonably optimistic given the advantages that Malaysia enjoys over its regional counterparts such as: i) English is used as the medium of teaching, ii) affordable tuition fees averaging RM50k for a degree program, iii) increasing tie-ups with reputable foreign affiliates from UK and US, in particular, iv) inexpensive cost of living, and v) the presence of MNCs offering valuable working experience. Hence, we expect the number of SEGi's international students to increase from 2k currently to over 4k by FY12, with >50% of the total coming from rural and suburban areas in China, by leveraging on its tie-ups with various local partners.

Figure 11: Breakdown of foreign students by country of origin (in thousands)

	2009	2010
Iran	10.9	11.8
China	9.2	10.2
Indonesia	9.8	9.9
Nigeria	6.0	5.8
Yemen	4.9	5.9
Others	39.9	43.3

Source: OSK Research, Company Data

Aggressive expansion to drive earnings. We are targeting for SEGi's student population to expand at 20% p.a. over the next 2 years, riding on its reputation among its local education counterparts and penetration into the regional market by associating itself with more foreign affiliates. We continue to see opportunities in the local space as the tertiary education ratio would likely improve in tandem with Malaysia's economy. Although there were some concerns on the ballooning deficit in the National Higher Education Fund Corporation (PTPTN), we believe with the appointment of the Inland Revenue Board as a loan collection agent come Sept 2011 would ensure timely loan repayment going forward. Furthermore, students on PTPTN loans only make up about 27% of SEGi's overall students. All in, we are forecasting for an average growth rate of 50% p.a. at the core net profit level over the next 2 years.

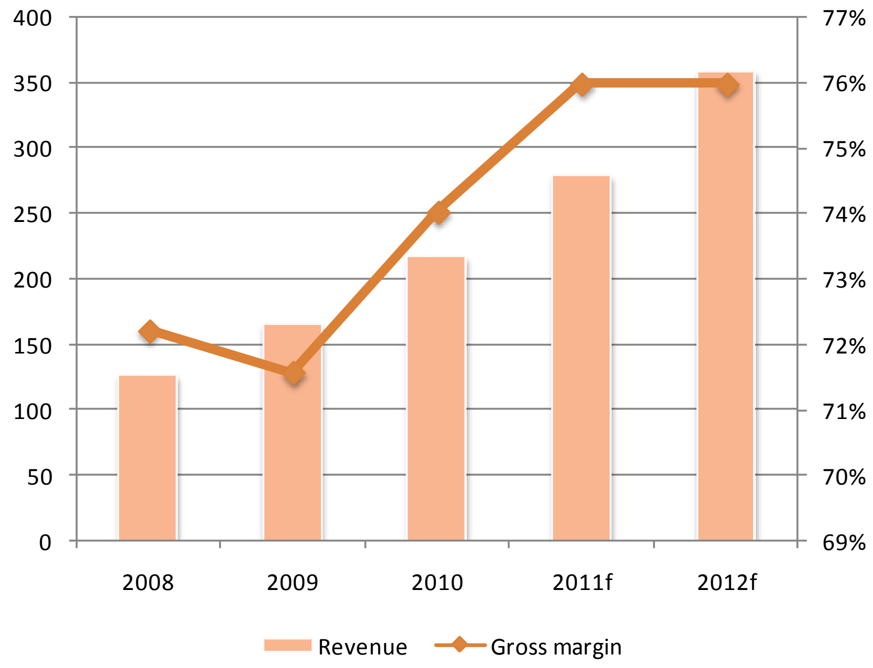
Figure 12: Composition of SEGi's student financing

Type of financing	Proportion of total students
Self-financing	64%
PTPTN	27%
EPF/Mara/Banks	9%

Source: OSK Research, Company Data

Sustaining superb margins in the near term. While we do not deny that pricing competition will continue to escalate, SEGi stands out for its strong reputation, established track record, diversified course offering and continuous rollout of its own programs. And given that its existing facilities can accommodate up to 33k students versus its current student population of 23k whilst the take-up of its own programs would likely increase, we believe that it is likely to be able to sustain the superior gross margin of >70% chalked up over the last 3 years for FY11 and FY12. While we expect its overhead expenses to go up on a higher headcount, other operating expenses are likely to maintain at current levels, with the lease and rental of premises and hostels being its second biggest cost component.

Figure 13: Revenue (RM m) vs GP margin (%)



Source: OSK Research, Company Data

A balance sheet-friendly light asset model. SEGi's existing facilities in Kota Damansara and Subang Jaya are under lease arrangement with AmanahRaya REIT while the proposed RM500m Perak campus will also be under a similar agreement. Hence, the group's capex on renovation, fittings and teaching equipment is likely stay at a minimal RM20m-RM30m p.a. With a net cash balance of RM70m sitting in its books, we believe funding would not be a significant issue. Hence, an upside to its dividend commitment of a minimum 50% payout is not unlikely, especially given the strong cash generation from its business.

Championing the development of early childcare education centre. In early 2011, SEGi is spearheading the establishment of early childcare education initiative as part of the Economic Transformation Program's EPP given its experience in the field. Although the implementation is long term in nature, we believe this could be a boon to SEGi's earnings over the long run if executed accordingly as a large number of today's pre-school teachers have yet to obtain the relevant qualifications due to a lack of guidelines. In the near term, we understand that SEGi would provide short training courses of 3 weeks' duration to pre-school teachers at its existing campuses at RM2k/pax. Having launched its first batch in Dec 2010 with 2k sign-ups, management is looking to roll out at least 2 batches this year targeting enrolment of 5k-6k, translating into an income stream of RM10m-RM12m a year.

VALUATION & RECOMMENDATION

Earnings CAGR of 50% over the next 2 years. We are modeling for SEGi to register a CAGR of about 50% at the core earnings level on sturdy growth in its student base, bolstered by the introduction of new courses and increasing contribution from international students (50% of the existing 2k is from China). EBIT margin is likely to continue to improve to close to 35% riding on increasing take-up of its homegrown programs, which stands at 45% currently, whilst capex is likely to stay at RM20m-RM30m p.a. given that its existing facilities have capacity for up to 33k students. All in, we are modeling for FY11 core earnings of RM78.0m, or a fully diluted EPS of 18.6 sen. Note that our calculations are based on the stock's fully diluted share base of 748.2m to include full conversion of its warrants, which are currently in-the-money, and the proposed share split of 2-for-1.

Figure 15: Peer comparison on FY11 forecasts

Listed entity	Market Cap (RM m)	Revenue (RM m)	EBIT margin (%)	Net profit (RM m)	P/E (x)	Yield (%)
HELP	363.6	120.0	24.3	20.7	17.5	0.9
Masterskill	774.7	349.2	38.8	110.4	7.0	7.1
SEGi	1,455.2*	279.8	34.9	78.0	18.6	2.7

**adjusted for full conversion of warrants*

Source: OSK Research, Company Data

BUY. We price SEGi at RM2.23 based on a 18x FY12 PER, or a 30% premium to our valuation for HELP given its larger earnings base and more aggressive growth. We like SEGi's superior margins on economies of scale, diversified courses offerings and asset-light model, with increasing news on the implementation of an early childcare education center likely to lift sentiment in the near term. Note that the stock would go ex-share split of 2-for-1 today. Hence, we initiate coverage with a BUY.

EARNINGS FORECAST

FYE Dec	FY08	FY09	FY10	FY11f	FY12f
Turnover	127.4	166.4	217.6	279.8	359.3
EBITDA	17.3	17.3	17.3	17.3	17.3
PBT	9.9	9.9	9.9	9.9	9.9
Net Profit	7.3	7.3	7.3	7.3	7.3
EPS	1.9	1.9	1.9	1.9	1.9
DPS	0.7	0.8	14.4	10.4	12.4
Margin					
EBITDA (%)	13.6	10.4	8.0	6.2	4.8
PBT (%)	7.8	5.9	4.5	3.5	2.8
Net Profit (%)	5.7	4.4	3.3	2.6	2.0
ROE (%)	3.3	5.9	21.3	25.8	26.5
ROA (%)	2.4	4.6	16.4	21.1	21.2
Balance Sheet					
Fixed Assets	125.7	134.5	140.9	168.0	211.2
Current Assets	88.2	84.5	122.2	201.1	225.7
Total Assets	213.9	219.0	263.1	369.1	436.9
Current Liabilities	45.2	34.7	46.2	47.9	59.3
Net Current Assets	43.0	49.8	76.0	153.2	166.4
LT Liabilities	9.7	14.4	13.3	17.3	27.3
Shareholders Funds	158.3	169.2	202.6	303.1	349.4
Net Gearing (%)	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash

OSK Research Guide to Investment Ratings

Buy: Share price may exceed 10% over the next 12 months

Trading Buy: Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain

Neutral: Share price may fall within the range of +/- 10% over the next 12 months

Take Profit: Target price has been attained. Look to accumulate at lower levels

Sell: Share price may fall by more than 10% over the next 12 months

Not Rated (NR): Stock is not within regular research coverage

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