SEG International

Rising to the occasion

OUTPERFORM↔

Price: RM1.80

Target Price: RM2.41 ↑

We visited SEGi's management for an update and came back feeling confident in the company's future prospects as we did all the while. From more positive information gathered from management, we have tweaked our forecasts upward slightly, which saw an increase in our target price for the stock to RM2.41 now from RM2.35 previously. Our BUY call conviction on SEGi is reaffirmed, pegging its new fair value at the stock's mid PER band of 14.5x on our FY12 EPS forecast of RM0.17. We believe SEGI deserves to trade back to at least its mid-range PER valuation band given the fact that its earnings would be growing almost at a CAGR of 38% over the next two years (FY12/FY13). In addition, SEGI to us is the top play in the defensive yet growing education sector. With the growing popularity of its homegrown and foreign programmes, its student base is rising healthily and in turn, this is raising the company's earnings margin rapidly (net profit margin is expected to rise to 33.5% in FY13 from 25.1% in FY11). Its healthy balance sheet meanwhile allows SEGI to easily fund the current expansion of its campus to cater for this rising student enrolment and at the same time, possibly making ad hoc acquisitions of other learning institutions to further boost its strong student growth rate. The company has a 50% dividend payout policy and this means the stock will pay a good 4.6% dividend yield return in FY12. Together with the strong 34.6% capital upside for the stock to our fair value, SEGI offers a possible total return of a strong 39% from its current level. We continue to favour and believe in Segi's strong growth prospect and its results-oriented management. BUY at market.

Upward tweak. We have tweaked our FY11 and FY12 forecasts upward (full year FY11 result due out next month) to reflect the adjusted total students and average revenue per student (ARPS) for both years as guided by management in our recent visit. Following the revision, we have cut our FY11 net profit forecast to RM68.5m but raised our FY12 net profit to RM104.78m (-2.2% and +2.2% rise) respectively, giving a strong 2-year forward CAGR growth of 38% (FY11 to FY13).

Growing margins. SEGi's EBITDA and net profit margins are expected to be on a rapidly increasing trend going forward for the following reasons: i) higher margin from the newer courses introduced since FY10 ii) higher margin on a total basis from its popular business courses and iii) higher year-on-year student fees. We are expecting the bottom line margin to increase from an estimated 25.1% in FY11 to 33.5% in FY13.

New Vietnam contribution. SEGi has signed an MOU with the Vietnamese government to provide various technical and skill-based courses to 10,000 trainees over a period of three years beginning FY12, which will mainly be supported by the Vietnamese government. SEGi expects to generate an additional 8% income from this project from FY12 onwards.

Healthy balance sheet. As at 9MFY11, SEGi's total borrowings stood at less than RM6m against a cash pile of RM58.4m, even after taking into account its more than 50% dividend payout last year.

New dividend player. Moving forward, we are projecting a prudent 50% dividend payout based on the company's new dividend policy despite an estimated 170% payout rate last year (based on our estimated FY11 earnings). This would translate to a dividend yield of 10.8% and 4.6% for FY11 and FY12 respectively at the closing market price of RM1.80. With the new policy in place, and growing earnings, SEGi could start to attract income-seeking funds as well.

STOCK DATA

Bloomberg Ticker	SYS MK Equity	YTD price chg	-0.0%
Market Cap	1,005.9	YTD KLCI chg	-0.7%
Issued shares	558.8	Beta	1.0
52-week range (H)	2.09		
52-week range (L)	1.36	**Major Shareholders**	
3-mth avg daily	420.335	HII CHII KOK	28.4%
Free Float	45.1%	CERAHSAR SDN	20.5%
Altman Z-score	9.9	SEGMEN	6.0%

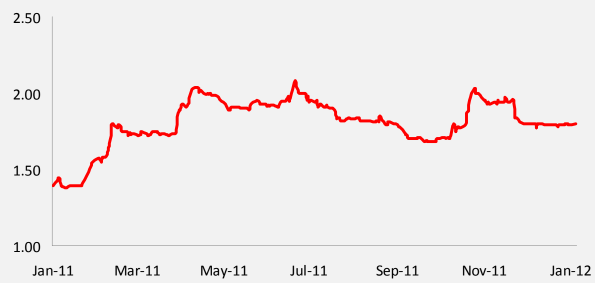
AT A GLANCE — **SEG INTERNATIONAL**

Target Price	**RM2.41**	**UPGRADE**
Valuation:	14.5× to its FY12 partially diluted EPS	
Current Price:	RM1.79	
Report Reason:	FY11 result preview	
Action:	**OUTPERFORM**	**MAINTAIN**
Reason:	Fundamentals intact with bright earnings prospects.	
Basis of call:	We continue to like SEGi for its turnaround in profitability, student growth, collaborations and exposure with foreign markets. Furthermore we like the low risk nature of the education sector coupled with SEGi's healthy balance sheet to finance future growth.	
Catalyst:		

FYE 31Dec RMm	**2010A**	**2011F**	**2012F**
Turnover	217.52	273.00	346.50
Core Net Profit (NP)	**43.06**	**68.49**	**107.05**
Consensus (Core NP)		**75.17**	**103.83**
Earnings Revision:		-2.2%	+2.2%

Earnings Revision Rationale: We have tweaked up total student count for FY12 to include foreign skill-based courses from Vietnam.

SHARE PRICE CHART



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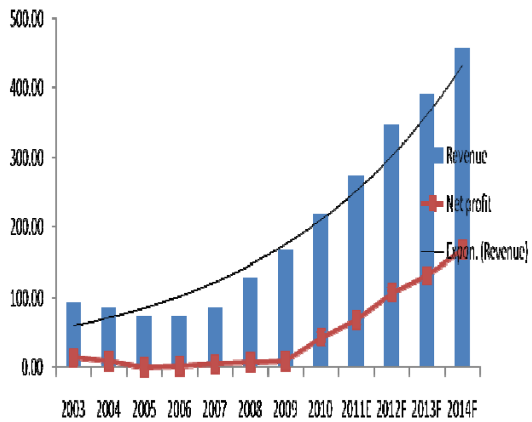
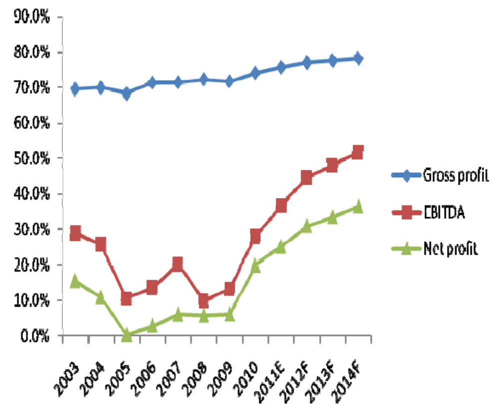
Slight earnings revision. We have tweaked FY11 estimates (full year result due next month) and FY12 forecast, to reflect the adjusted total students and ARPS for both years as guided by management in our recent visit. Given such, our revised estimate and forecast for FY11 and FY12 are RM273.0m and RM346.5m vs RM276.9m and RM341.5m as previously stated. Following the revision, we are expecting FY11 and FY12 bottom line to adjust accordingly to RM68.5m and RM104.78m representing a 3 year CAGR of 111.2% and 120.2% from RM70m and RM104.8m as previously stated. The revised EPS is increased by RM0.003 to RM0.166.

Handsome margins to continue. In 2009, there was a significant jump in SEGi's EBITDA and net profit margins and we are expecting it to be on an increasing trend moving forward for the following reasons: i) a higher margin coming from the newer courses introduced since FY10 such as medicine, optometry, pharmacy, dental surgery and engineering; ii) higher margin on a total basis from its popular business courses not forgetting the introduction of its DBA course (Doctorate in Business Administration) in FY10; and iii) higher year on year student fees. Even after assuming a prudent 5% increase in its ARPS for this year, we are expecting its bottom line margin to at least increase from an estimated 25.1% in FY11 to 30.9% in FY12.

Revenue and Net profit (in RM'm)



SEGi's margins



Good financial strength. As at 9MFY11, SEGi's total borrowings stood at less than RM6m which is just a fraction of its expected cash pile of RM58.4m even after taking into account more than 50% paid out last year. Its healthy cash pile coupled with its net cash position since FY08 indicates the company's capacity and financial strength to finance future growth or even possible acquisitions.

What to expect for FY12. SEGi was appointed by the Malaysian government as the project leader to promote skill based training to the international market as part of the ETP initiative. Following the government's call, SEGi signed an MOU with the Vietnamese government to provide various technical and skill based courses to 10,000 trainees over a period of three years beginning FY12 which will mainly be supported by the Vietnamese government. SEGi expects to generate an additional 8% income from this project from FY12 onwards.

Ipoh campus to balloon earnings after FY14. SEGi should see its earnings balloon in FY14 once its Ipoh campus is opened to students. The campus which has the capacity to house about 8000 students (an additional 25% of total students expected for FY12) is expected to breakeven within a year. The campus will be sold and leased back. No additional capex is expected for this year; hence depreciation charge is expected to stay flat ranging between RM5m – RM10m.

Nursing and allied healthcare slightly hit. The National Higher Education Fund (PTPTN) decision to cut loans end of last year was barely a hit to SEGi's middle to upper middle income group of students (Masterskill >90% dependent) since >70% of its students are self funded and the balance 30% are only partially dependent on the loan. Furthermore the cut only applies to student's expenses, while education and tuition fees loans remain. However its nursing and healthcare courses were slightly hit ad is expected to moving forward are expected to get a slight hit due to the higher entry requirement set by the Malaysian government for nurses sometime last year. Unlike Masterskill, SEGi's diversified courses ranging from health science, engineering, business, design, architecture, art etc mitigates this concern.

New dividend player. Moving forward we are projecting a prudent 50% dividend payout based on the company's dividend policy albeit an estimated 170% pay out last year alone (based on our estimated FY11 earnings). That would translate to a dividend yield of 10.8% and 4.6% for FY11 and FY12 respectively at the closing market price of RM1.79. With the new policy in place, and growing earnings year on year, SEGi would be a new dividend play stock.

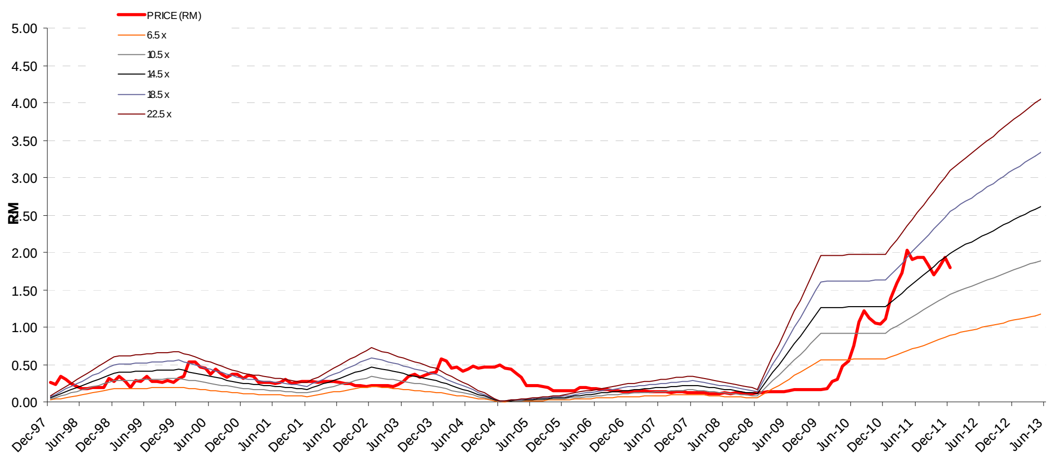
Upping up a notch. SEGi is currently trading at a PE of 20.9x for FY10. We are calling a buy on SEGi valuing the company at RM2.41 tagging a mid PE band of 14.5x with FY12 EPS of RM0.166. We believe the PE pegged to its valuation is fair on the basis of the following reasons; i) low exposure to PTPTN's new decision to cut loans unlike Masterskill ii) its education quality, hence entrusted by the Malaysian government to lead the vocational training programme for foreign trainees and early childhood and children education; iii) healthy balance sheet allowing for immediate funding for expansion of its campus to meet the growing popularity of its homegrown and twinning programmes in or even ad hoc acquisitions if deem necessary iv) continuously developing new programmes to meet local and foreign market demands (11% of its students are foreigners); and v) impressive dividend policy of >50% pay out without hampering immediate cash demand. Looking at a new earnings norm moving forward, the fair value offers a healthy 34.6% upside for the stock.

Valuation

PE Band	14.5x
FY 12 EPS (sen)	16.64
Target Price	**RM2.41**
Potential upside	34.6%

Source: Kenanga Research/ Bloomberg

Forward PER Band



Source: Kenanga Research

Earnings Estimates

FYE 31 Dec (RMm)	2008A	2009A	2010A	2011E	2012F	2013F
Turnover	127.32	166.26	217.52	273.00	346.50	391.00
EBIT	6.87	15.55	52.67	92.26	144.70	176.36
Pretax profit	9.88	14.61	54.31	93.16	145.61	178.23
Net Profit	7.27	10.02	43.06	68.49	107.05	131.04
EBIT margin	5.4%	9.4%	24.2%	33.8%	41.8%	45.1%
Pretax margin	7.8%	8.8%	25.0%	34.1%	42.0%	45.6%
Effective tax rate	25.9%	29.9%	20.4%	25.0%	25.0%	25.0%
Net margin	5.7%	6.0%	19.8%	25.1%	30.9%	33.5%
Growth ratios						
Turnover	47.6%	30.6%	30.8%	25.5%	26.9%	12.8%
EBIT	-47.7%	126.2%	238.7%	75.2%	56.8%	21.9%
Pretax profit	298.7%	47.8%	271.9%	71.5%	56.3%	22.4%
Net profit	40.9%	37.9%	329.6%	59.1%	56.3%	22.4%
ROE	4.7%	6.1%	23.2%	36.0%	52.3%	49.6%
ROA	2.8%	4.6%	17.9%	26.7%	37.5%	36.4%
Net Gearing (x)	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash
Per share data (based on partially diluted share base)						
EPS (sen)	1.46	2.01	8.57	11.45	16.64	19.03
EPS growth	40.9%	37.9%	326.5%	33.6%	45.3%	14.4%
PER (x)	122.9	89.1	20.9	15.6	10.8	9.4
Net DPS (sen)	0.37	0.47	3.44	19.41	8.32	9.52
Net Div. Yield	0.2%	0.3%	1.9%	10.8%	4.6%	5.3%
Book Value/share (RM)	0.33	0.35	0.41	0.32	0.40	0.48
P/BV (x)	5.3	5.2	4.4	5.7	4.5	3.7
NTA/share (RM)	0.27	0.29	0.36	0.27	0.35	0.44
P/NTA (x)	6.5	6.1	5.0	6.6	5.1	4.1

Source: Kenanga Research, Bloomberg

Balance Sheet

FYE 31 Dec (RMm)	2008A	2009A	2010A	2011E	2012F	2013F
Non Current Assets	125.67	134.53	140.89	153.07	171.15	177.60
Current Assets	88.24	84.52	122.15	96.89	149.74	220.68
Total Assets	213.91	219.06	263.04	249.96	320.89	398.29
Current Liabilities	45.23	34.70	46.24	63.13	78.39	87.62
Non Current Liabilities	9.73	14.37	13.32	6.44	6.44	6.44
Shareholders' Fund	158.32	169.16	202.58	178.11	231.63	297.15
Minority Interest	0.62	0.84	0.90	2.28	4.43	7.07
Equity & Liabilities	213.91	219.06	263.04	249.96	320.89	398.29

Source: Kenanga Research, Bloomberg

Cash Flow

FYE 31 Dec (RMm)	2008A	2009A	2010A	2011E	2012F	2013F
Cash From Operating Activities	27.43	29.64	66.56	111.50	124.24	146.61
Less: Capital Expenditures	(11.09)	(19.19)	(9.99)	(21.07)	(28.03)	(17.64)
Free Operating Cash Flow	16.33	10.45	56.57	90.43	96.21	128.97
Cash From Investing Activities	68.14	(12.12)	(9.75)	(20.22)	(28.03)	(17.64)
Cash From Financing Activities	(45.06)	(28.00)	(14.88)	(111.67)	(52.61)	(63.64)
Net Changes in Cash	50.51	(10.48)	41.93	(20.39)	43.59	65.33

Source: Kenanga Research, Bloomberg

Stock Ratings are defined as follows:

Stock Recommendations

OUTPERFORM : A particular stock's Expected Total Return is MORE than 10%
(An approximation to the 5-year annualised Total Return of FBMKLCI of 10.2%)
MARKET PERFORM : A particular stock's Expected Total Return is WITHIN the range of 3% to 10%
UNDERPERFORM : A particular stock's Expected Total Return is LESS than 3%
(An approximation to the 12-month Fixed Deposit Rate of 3.15% as a proxy to Risk-Free Rate)

Sector Recommendations***

OVERWEIGHT : A particular stock's Expected Total Return is MORE than 10%
(An approximation to the 5-year annualised Total Return of FBMKLCI of 10.2%)
NEUTRAL : A particular stock's Expected Total Return is WITHIN the range of 3% to 10%
UNDERWEIGHT : A particular stock's Expected Total Return is LESS than 3%
(An approximation to the 12-month Fixed Deposit Rate of 3.15% as a proxy to Risk-Free Rate)

*******Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.***

Published and printed by:

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