

Singapore Company Guide

Silverlake Axis

Version 6 | Bloomberg: SILV SP | Reuters: SLVX.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

14 Feb 2020

BUY

Last Traded Price (13 Feb 2020): S\$0.37 (STI : 3,220.09)

Price Target 12-mth: S\$0.48 (30% upside) (Prev S\$0.57)

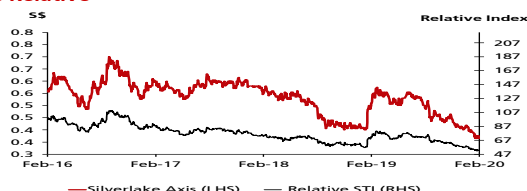
Analyst

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What's New

- 2QFY20 results in line; higher tax rate to be the norm
- Growth from recurring income segments offset weaker revenue from project related divisions
- Larger projects on hold, to be replaced by smaller ones
- Cut FY20-21F earnings by 8-13%; maintain BUY with a lower TP of S\$0.48

Price Relative



Forecasts and Valuation

FY Jun (RMm)	2018A	2019A	2020F	2021F
Revenue	542	681	700	733
EBITDA	167	277	311	332
Pre-tax Profit	147	285	261	302
Net Profit	134	246	186	213
Net Pft (Pre Ex.)	134	190	186	213
Net Pft Gth (Pre-ex) (%)	(84.2)	41.7	(2.4)	15.1
EPS (S cts)	1.67	3.05	2.31	2.65
EPS Pre Ex. (S cts)	1.67	2.36	2.31	2.65
EPS Gth Pre Ex (%)	(84)	42	(2)	15
Diluted EPS (S cts)	1.67	3.05	2.31	2.65
Net DPS (S cts)	2.92	1.81	1.38	1.59
BV Per Share (S cts)	6.50	7.36	8.18	9.29
PE (X)	22.2	12.1	16.0	13.9
PE Pre Ex. (X)	22.2	15.7	16.0	13.9
P/Cash Flow (X)	20.5	9.2	19.3	12.8
EV/EBITDA (X)	15.0	8.8	7.7	6.9
Net Div Yield (%)	7.9	4.9	3.7	4.3
P/Book Value (X)	5.7	5.0	4.5	4.0
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	16.0	44.0	29.7	30.4
Earnings Rev (%)		0	(13)	(8)
Consensus EPS (S cts):		N/A	2.65	2.78
Other Broker Recs:		B: 1	S: 0	H: 2

Source of all data on this page: Company, DBS Bank, Bloomberg Finance L.P

Healthy margins despite higher tax

Maintain BUY with lower S\$0.48 TP. We cut FY20-21F earnings for Silverlake (SAL) by 8-13% on higher tax rate assumption and lower project related revenue. Even though tax rate ahead is expected to be high at c.29%, net margin is still in excess of 20%. We continue to like Silverlake for its high recurring revenue proportion that forms at least 60% of total revenue, and high gross margins of c.60% with attractive yield of c.4%, on a 60% payout ratio.

Larger projects on hold, to be replaced by smaller ones. There is an increasing trend to spend on incremental enhancements as opposed to the larger one-off projects. Though the deal pipeline is healthy at c. RM1.5bn, the award of larger contracts in excess of RM100m has been slow. To close the gap, the group is targeting smaller contracts of c.RM10m each and these include digital contracts which are generally smaller in size. With these smaller contracts, orderbook backlog is maintained at close to RM300m.

Where we differ: We remain optimistic on SAL's business given its market leader position in the core banking solutions, and Insurtech.

Potential catalyst: Securing more and bigger value contracts.

Valuation:

Maintain BUY with lower TP of S\$0.48. We reduced our FY20F/21F earnings by 13%/8%, mainly on higher tax rate assumption and lower project related revenue. As such, our TP is reduced to S\$0.48 (vs S\$0.57 previously), still pegged to peers' average of 21x, and based on SAL's FY Jun 20F earnings.

Key Risks to Our View:

Slowdown in IT spending which could lead to lower orderbook; concerns on corporate governance issues.

At A Glance

Issued Capital (m shrs)	2,637
Mkt. Cap (S\$m/US\$m)	976 / 704
Major Shareholders (%)	
Goh Peng Ooi	66.5
Ntasian Discovery Master Fund	5.0
Free Float (%)	28.5
3m Avg. Daily Val (US\$m)	0.67
GIC Industry : Information Technology / Software & Services	



Live more, Bank less

WHAT'S NEW

2QFY20 results in line; higher tax rate to be the norm

2QFY20 results in line. Silverlake (SAL) reported 2QFY20 revenue of RM190.7m (+13% y-o-y, +16% q-o-q). Net profit of RM52.8m was down 22% y-o-y (+12% q-o-q) due to higher tax rate of 31% vs 17% in 1Q20 and 14% for FY19. 2QFY20 revenue and net profit accounted for 26% and 25% of our forecast respectively, and 49%/50% for 1HFY20, in line. DPS of 0.35cts was declared in 2QFY20, slightly lower than the 0.45cts in 2QFY19.

Higher tax rate to be the norm. Going forward, tax rate is expected to be in the high 20+%, due to the expiry of pioneer status of a Malaysian subsidiary effective 1QFY20, higher taxable income from certain subsidiaries as well as higher withholding tax on overseas revenue.

Growth from recurring income segments. Recurring revenue segments of maintenance, enhancement services and Software-as-a-Service (Insurtech) rose 5% to RM133.8m, and accounted for 70% of group revenue in 2QFY20. Insurance processing activities benefited from a new pricing structure introduced in key markets as well as additional revenue contribution from new productivity and analytics solutions.

Weaker revenue from project related divisions. Software licensing recorded higher revenue with contribution from new banking contracts whereas software project services recognised lower progressive revenue from ongoing implementation contracts secured in Malaysia and Hong Kong.

Sales of software and hardware products was strong, benefitting from new contracts secured, while credit and cards processing was weak following the termination of an outsourcing contract.

Revenue by business segment

Business segment	2QFY20 (RMm)	Y-o-Y (%)	Q-o-Q (%)
Software licensing	23.1	17	19
Software project services	13.6	-28	-30
Maintenance and enhancement services	123.7	4	10
Sale of software and hardware products	18.7	2802	1001
Credit and cards processing	1.5	-43	-5
Software-as-a-Service (Insurance)	10.1	24	4
TOTAL	190.7	13	16

Source: Company; DBS Bank

Lower gross margins due to product mix. Gross profit margin declined to 61% from 64% in 1QFY20 due to a change in revenue mix with a higher proportion of revenue recorded from lower margin segment such as the sale of software and hardware products.

Larger projects on hold, to be replaced by smaller ones. The deal pipeline remains healthy as Asian financial institutions and corporations continue to invest in Information Technology (IT) to improve their competitive edge. However, despite a healthy pipeline of c. RM1.5bn, the award of larger contracts in excess of RM100m has been slow. To close the gap, SAL is targeting smaller contracts of c.RM10m each and these include digital contracts which are generally smaller in size. There is an increasing spend on incremental enhancements as opposed to the larger one-off projects.

The group announced that it has secured two contracts to deliver innovative and transformative digital economy solutions and two license renewals and maintenance support contracts to two of its existing customers for 1HFY20. With these contracts, orderbook backlog is close to RM300m.

Cut FY20-21F earnings by 8-13%; maintain BUY with lower TP of S\$0.48. We reduced our FY20F/21F earnings by 13%/8%, mainly on higher tax rate assumption and lower project related revenue. We now assume tax rate of 29% for FY20F and FY21F, vs 14% in FY19. As such, our TP is reduced to S\$0.48 (vs S\$0.57 previously), still pegged to peers' average of 21x, and based on SAL's FY Jun 20F earnings.

Quarterly / Interim Income Statement (RMm)

FY Jun	2Q2019	1Q2020	2Q2020	% chg yoy	% chg qoq
Revenue	169	164	191	12.8	16.0
Cost of Goods Sold	(60.9)	(59.2)	(74.5)	22.3	25.8
Gross Profit	108	105	116	7.5	10.4
Other Oper. (Exp)/Inc	(20.8)	(42.1)	(33.1)	59.1	(21.4)
Operating Profit	87.3	63.1	83.1	(4.8)	31.7
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	-	-
Associates & JV Inc	(0.9)	0.97	0.42	nm	(56.3)
Net Interest (Exp)/Inc	(5.8)	(7.3)	(7.5)	(29.5)	(2.5)
Exceptional Gain/(Loss)	0.0	0.0	0.0	-	-
Pre-tax Profit	80.6	56.8	76.0	(5.7)	33.9
Tax	(13.0)	(9.6)	(23.2)	78.0	142.9
Minority Interest	0.0	0.00	0.01	nm	302.3
Net Profit	67.5	47.2	52.8	(21.8)	11.9
Net profit bef Except.	67.5	47.2	52.8	(21.8)	11.9
EBITDA	91.8	72.6	92.3	0.6	27.1
Margins (%)					
Gross Margins	63.9	64.0	60.9		
Opg Profit Margins	51.6	38.4	43.6		
Net Profit Margins	40.0	28.7	27.7		

Source of all data: Company, DBS Bank

CRITICAL DATA POINTS TO WATCH

Critical Factors

Contract wins

Orderbook has improved, with order backlog of close to RM300m currently, and with potential for more orders. Silverlake can leverage on its market leader position to secure more contracts as financial institutions upgrade/enhance their systems to avoid being rendered obsolete by the rising Fintech trend.

More orders could be in the pipeline, albeit smaller ones, as customers move to equip themselves with the technology to face the challenges of digital disruptions and to compete effectively in the digital economy ecosystem. This should lead to an improvement in project-related revenues (non-recurring revenue) going forward, while we project the maintenance and enhancement services and insurance software-as-a-service (recurring revenue) to expand at high single digit of about 8% to generate a healthy increase in recurring revenues.

Capital expenditure for financial institutions

Financial institutions were conservative in FY16/FY17 amid tough market conditions. This trend has reversed, as they beef up their systems to ride on the Fintech wave. Financial institutions are going through enhancements to avoid being rendered obsolete by the rising Fintech trend. Technology spending by Asian financial institutions and corporations improved in FY18 with increased expenditure on scalable and transformative technologies. Worldwide Fintech spending is expected to grow at a CAGR of 4.1% during the 2015 to 2020 period. We expect Silverlake to ride on the Fintech trend and project revenue growth of close to 10% for FY20F and FY21F.

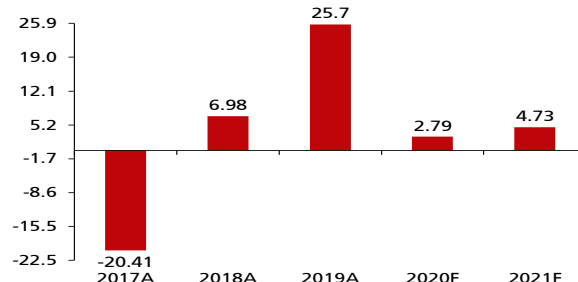
M&A to strengthen SAL as Fintech innovation accelerator

In the last 10 years, the group has undertaken seven acquisitions to broaden its suite of business enterprise software solutions and service offerings and strengthen its market position in new markets. However, we would prefer not to have any interested party transactions (IPT). In the past, IPT with Chairman Mr Goh's private companies have raised concerns on corporate governance issues.

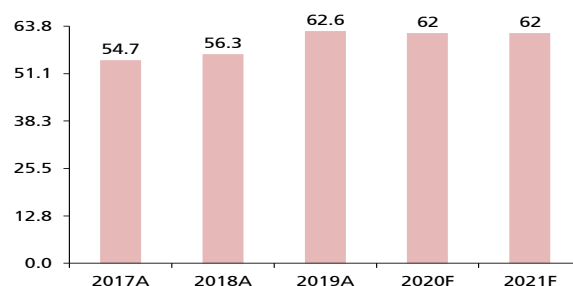
Scaling up as an Insurtech market leader

SAL's insurance arm, Merimen, generates high recurring income for the group. Going forward, Merimen's growth is expected to be driven by increased ecosystem participation and cross-selling opportunities. A continually changing regulatory and operational landscape in the insurance industry will provide opportunities to support growth for Merimen.

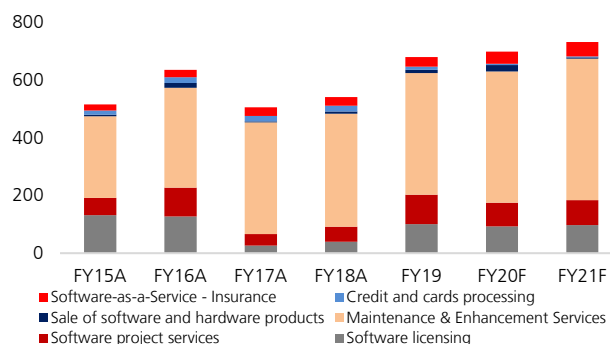
Revenue growth (%)



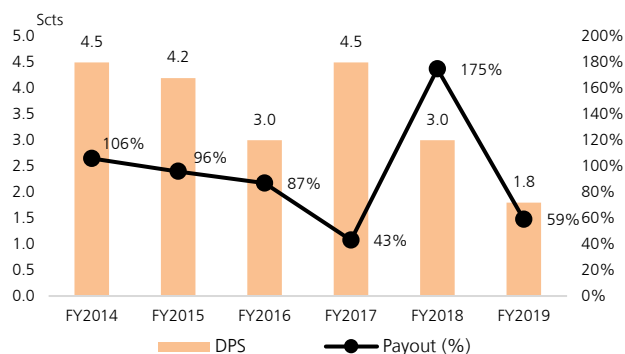
Gross Margins (%)



Revenue Breakdown By Segment



DPS and dividend payout ratio



Source: Company, DBS Bank

Appendix 1: A look at Company's listed history – what drives its share price?



Source: Company, Bloomberg Finance L.P.

Share price to move in tandem with contract wins

In the chart as shown above, new contracts secured and recognised in the financial year are represented by the red bar. These contracts are non-recurring in nature. Generally, the share price tends to move about one year ahead of new contracts booked as at the end of each financial year. Thus, the two arrows (as represented by each coloured pair) moved in the same direction but with about a one-year time lag, with the share price as the leading indicator. However, new contracts clinched staged a rebound in FY June 18 and is expected to increase further, but the share price has yet to rebound in the same quantum. It is still locked in a downtrend formed since FY June 2015.

Balance Sheet:

Healthy net cash level to support dividend payout. SAL's healthy net cash level has enabled the group to maintain an attractive dividend payout ratio of about 60%. We expect this trend to continue.

Share Price Drivers:**Growing project orderbook**

More orders could be in the pipeline, albeit smaller ones, as customers move to equip themselves with the technology to face the challenges of digital disruptions and to compete effectively in the digital economy ecosystem. This should lead to an improvement in project-related revenues going forward.

Potentially higher dividends

SAL's healthy net cash level has enabled the group to maintain an attractive dividend payout ratio of about 60%. We expect this trend to continue. This translates to dividend yield of c.4%. Furthermore, SAL has paid about half of the proceeds from the disposal of its stake in Global InfoTech (GIT) as dividend in FY18. SAL could potential pay a higher dividend when the remaining 8.3% stake in GIT is sold.

Key Risks:**Slowdown in IT spending which could lead to a lower orderbook**

A slowdown in this industry would lead to financial institutions cutting back on their spending on IT.

Concerns on corporate governance issues

Interested party transactions with Mr Goh's private companies over the past few years have raised concerns on corporate governance.

Exposure mainly in Asia

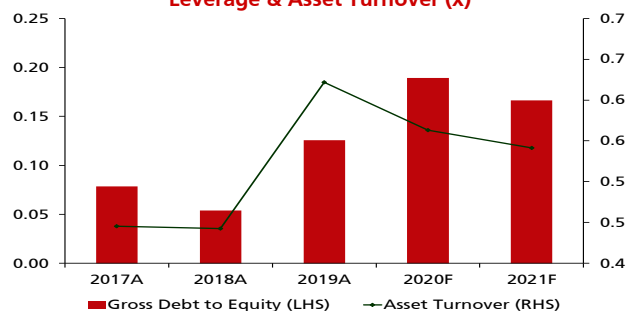
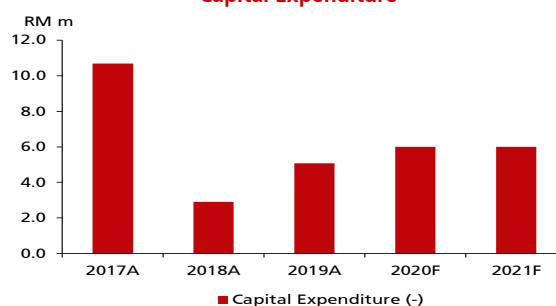
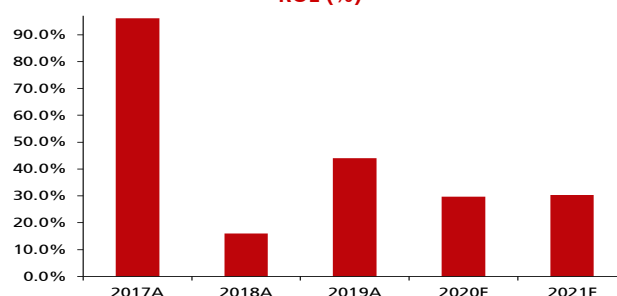
More than 90% of the total revenue is generated from Asia.

Environment, Social, Governance:

As a technology service provider, e-waste treatment is of utmost importance. SAL has established an E-waste Policy to facilitate its in-house e-waste management, to reduce operational cost and increase resource efficiency. Processes and procedures have been instituted and are being constantly reviewed and revised to ensure effective corporate governance.

Company Background

Silverlake Axis is the market leader in core banking software in ASEAN where it deploys its proprietary software to major organisations in banking, insurance, payments, retail and logistics industries. It is also an Insurtech market leader in providing collaborative and information exchange platform for the insurance industry.

Leverage & Asset Turnover (x)**Capital Expenditure****ROE (%)****Forward PE Band (x)****PB Band (x)**

Source: Company, DBS Bank

Key Assumptions

FY Jun	2017A	2018A	2019A	2020F	2021F
Revenue growth (%)	(20.4)	6.98	25.7	2.79	4.74
Gross Margins (%)	54.7	56.3	62.6	62.0	62.0

Segmental Breakdown

FY Jun	2017A	2018A	2019A	2020F	2021F
Revenues (RMm)					
Software Licensing	26.8	40.0	101	92.6	97.2
Software Project Services	389	51.8	103	82.3	86.4
Maintenance &	39.1	392	422	456	492
Sale of Software &	18.8	8.04	11.0	22.1	4.42
Others	3.43	19.6	11.0	5.49	2.75
Total	506	542	681	700	733

Income Statement (RMm)

FY Jun	2017A	2018A	2019A	2020F	2021F
Revenue	506	542	681	700	733
Cost of Goods Sold	(229)	(237)	(255)	(266)	(279)
Gross Profit	277	305	426	434	454
Other Opng (Exp)/Inc	675	(143)	(171)	(147)	(148)
Operating Profit	952	162	255	287	307
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	(7.7)	(15.9)	(1.7)	0.0	0.0
Net Interest (Exp)/Inc	2.80	1.51	(23.8)	(26.0)	(6.0)
Exceptional Gain/(Loss)	0.0	0.0	55.6	0.0	0.0
Pre-tax Profit	947	147	285	261	302
Tax	(101)	(13.1)	(39.2)	(75.8)	(87.2)
Minority Interest	0.0	0.0	0.01	0.0	0.0
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	846	134	246	186	213
Net Profit before Except.	846	134	190	186	213
EBITDA	963	167	277	311	332
Growth					
Revenue Gth (%)	(20.4)	7.0	25.7	2.8	4.7
EBITDA Gth (%)	205.1	(82.7)	65.9	12.4	6.5
Opg Profit Gth (%)	220.3	(83.0)	57.7	12.8	6.7
Net Profit Gth (Pre-ex) (%)	208.9	(84.2)	41.7	(2.4)	15.1
Margins & Ratio					
Gross Margins (%)	54.7	56.3	62.6	62.0	62.0
Opg Profit Margin (%)	188.1	29.8	37.4	41.1	41.8
Net Profit Margin (%)	167.1	24.7	36.1	26.5	29.1
ROAE (%)	96.1	16.0	44.0	29.7	30.4
ROA (%)	74.4	11.0	22.4	14.9	15.8
ROCE (%)	85.1	13.9	24.5	19.8	19.3
Div Payout Ratio (%)	43.0	175.0	59.3	60.0	60.0
Net Interest Cover (x)	NM	NM	10.7	11.1	51.1

Mainly due to impairment loss by joint venture entity, Silverlake HGH

Fair value adjustment for past acquisitions

Accounting adjustments tax reversal, disposal gain

High payout ratio in FY18 from proceeds of GIT sale

Source: Company, DBS Bank

Quarterly / Interim Income Statement (RMm)

FY Jun	2Q2019	3Q2019	4Q2019	1Q2020	2Q2020
Revenue	169	154	189	164	191
Cost of Goods Sold	(60.9)	(63.1)	(67.8)	(59.2)	(74.5)
Gross Profit	108	91.0	121	105	116
Other Oper. (Exp)/Inc	(20.8)	(23.8)	(39.4)	(42.1)	(33.1)
Operating Profit	87.3	67.2	82.1	63.1	83.1
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	(0.9)	(0.1)	(0.4)	0.97	0.42
Net Interest (Exp)/Inc	(5.8)	(6.2)	(6.0)	(7.3)	(7.5)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	80.6	60.9	75.7	56.8	76.0
Tax	(13.0)	(8.3)	(8.2)	(9.6)	(23.2)
Minority Interest	0.0	0.00	0.00	0.00	0.01
Net Profit	67.5	52.6	67.5	47.2	52.8
Net profit bef Except.	67.5	52.6	67.5	47.2	52.8
EBITDA	91.8	73.6	88.2	72.6	92.3

Growth

Revenue Gth (%)	1.4	(8.8)	22.8	(13.1)	16.0
EBITDA Gth (%)	16.5	(19.7)	19.8	(17.7)	27.1
Opg Profit Gth (%)	18.5	(23.0)	22.1	(23.1)	31.7
Net Profit Gth (Pre-ex) (%)	16.6	(22.0)	28.1	(30.0)	11.9

Margins

Gross Margins (%)	63.9	59.0	64.2	64.0	60.9
Opg Profit Margins (%)	51.6	43.6	43.3	38.4	43.6
Net Profit Margins (%)	40.0	34.2	35.6	28.7	27.7

Balance Sheet (RMm)

FY Jun	2017A	2018A	2019A	2020F	2021F
Net Fixed Assets	19.1	20.4	14.9	16.2	17.6
Invt in Associates & JVs	0.0	9.67	8.62	8.62	8.62
Other LT Assets	228	223	317	354	346
Cash & ST Invt	701	498	623	702	803
Inventory	0.0	0.0	0.97	0.0	0.0
Debtors	145	139	134	138	145
Other Current Assets	349	117	83.6	83.6	83.6
Total Assets	1,441	1,007	1,182	1,302	1,404
ST Debt	89.3	25.4	11.3	11.3	11.3
Creditor	66.3	68.0	70.7	18.5	19.3
Other Current Liab	79.7	115	140	197	208
LT Debt	1.60	2.93	63.1	113	113
Other LT Liabilities	46.5	272	305	305	305
Shareholder's Equity	1,158	523	592	658	747
Minority Interests	0.10	0.08	0.06	0.06	0.06
Total Cap. & Liab.	1,441	1,007	1,182	1,302	1,404
Non-Cash Wkg. Capital	348	72.4	7.94	6.24	0.50
Net Cash/(Debt)	610	470	549	577	679
Debtors Turn (avg days)	116.2	95.6	73.3	71.0	70.4
Creditors Turn (avg days)	100.1	113.7	109.7	67.2	27.1
Inventory Turn (avg days)	N/A	N/A	0.8	0.7	N/A
Asset Turnover (x)	0.4	0.4	0.6	0.6	0.5
Current Ratio (x)	5.1	3.6	3.8	4.1	4.3
Quick Ratio (x)	3.6	3.1	3.4	3.7	4.0
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	11.8	10.3	6.8	4.8	4.8
Z-Score (X)	5.9	6.4	5.9	5.9	5.9

Include software development expenditure, proprietary software and goodwill from acquisitions

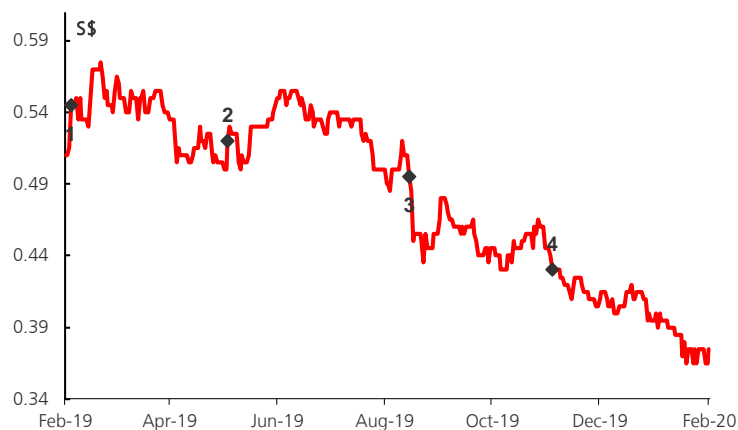
Source: Company, DBS Bank

Cash Flow Statement (RMm)

FY Jun	2017A	2018A	2019A	2020F	2021F
Pre-Tax Profit	947	147	285	261	301
Dep. & Amort.	18.3	21.3	24.0	24.0	24.0
Tax Paid	(101)	(20.0)	(40.2)	(75.8)	(87.2)
Assoc. & JV Inc/(loss)	7.70	15.9	1.72	0.0	0.0
Chg in Wkg.Cap.	(224)	271	58.5	(55.0)	(5.7)
Other Operating CF	(431)	(291)	(3.6)	0.0	0.0
Net Operating CF	217	145	325	155	232
Capital Exp.(net)	(10.7)	(2.9)	(5.1)	(6.0)	(6.0)
Other Invt.(net)	2.83	0.0	16.2	0.0	0.0
Invt in Assoc. & JV	0.0	(0.8)	(52.7)	0.0	0.0
Div from Assoc & JV	0.0	0.20	0.0	0.0	0.0
Other Investing CF	209	295	(30.2)	0.0	0.0
Net Investing CF	201	292	(71.7)	(6.0)	(6.0)
Div Paid	(237)	(387)	(152)	(120)	(124)
Chg in Gross Debt	11.6	127	37.1	50.0	0.0
Capital Issues	0.0	0.0	0.0	0.0	0.0
Other Financing CF	(17.5)	(305)	(17.9)	0.0	0.0
Net Financing CF	(243)	(564)	(133)	(69.9)	(124)
Currency Adjustments	20.4	11.2	17.7	0.0	0.0
Chg in Cash	196	(116)	138	78.6	102
Opg CFPS (S cts)	5.48	(1.6)	3.31	2.60	2.95
Free CFPS (S cts)	2.56	1.76	3.98	1.85	2.81

Source: Company, DBS Bank

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	15 Feb 19	0.55	0.62	BUY
2:	15 May 19	0.52	0.63	BUY
3:	26 Aug 19	0.50	0.60	BUY
4:	15 Nov 19	0.43	0.57	BUY

Note: Share price and Target price are adjusted for corporate actions.

Source: DBS Bank

Analyst: Lee Keng LING

DBS Bank recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

**Share price appreciation + dividends*

Completed Date: 14 Feb 2020 08:17:02 (SGT)

Dissemination Date: 14 Feb 2020 08:28:52 (SGT)

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