

Consistent growth has built a world class operator now accelerating a funded expansion

Recommendation: Buy

Investment Rationale

- Servcorp offers international Serviced and Virtual Office solutions. Founded in 1978, it now runs a network of prime CBD locations in Australia, New Zealand, Japan, China, South-East Asia, India, Europe and Middle East.
- Its office and IT solutions enable any size of company to enjoy the corporate presence, IT, infrastructure and support of a multinational, without the associated overhead. A Servcorp Smart Office® is a fully managed corporate office suite in a landmark CBD building. It includes a dedicated, local receptionist, access to a worldwide network of meeting rooms, secretarial support on hand and exclusive access to an online portfolio of business services and tools.
- A Servcorp Virtual Office® gives clients access to the presence, facilities and services of a Smart Office®, whilst they work from home or another location. There are compelling reasons to focus on and fast-track growth.

World class expertise has reached maturity at a highly opportune time

ServCorp operated 67 offices in 22 cities globally at 30 June 2009, with five more committed. Of these offices, 18 were in Australia, 18 in Japan, 6 in China, 4 each in France and Singapore, 3 each in UAE, Thailand and NZ, 2 each in Qatar, Belgium, HK and Malaysia. Committed floors will add access to the UK (one just opened), USA, Saudi Arabia and Bahrain.

Revenue in FY09 was \$229m, net profit \$34m, doubled in four years from \$124m and \$17m respectively: Net cash \$84m. In FY05 Servcorp operated 55 floors in 40 cities. Growth has been strong, with revenue ahead of floors due to efficient use and marketing, and profits will now grow ahead of both.

This will now continue at much accelerated rates, for three reasons.

- One, Servcorp has developed its Virtual Office IT systems over twenty years and it has a unique offering with totally integrated online control, billing and administration. The Virtual Office provides more effective working support from a smaller footprint, with phone, internet & IT solutions at the cutting edge at margins well above the Smart Office. Servcorp grew its virtual packages in June '05 to '09 from 10,000 to 20,000. It plans for 40,000 in three years time.
- Two, trends to work online and globally are intensifying. In the face of carbon reduction, travel costs will rise and both Servcorp models are gaining, Virtual even more than Smart. Servcorp competition is way behind with legacy technologies and will fall further back if it attempts mergers.
- Three, global office markets offer the cheapest rent deals for years, particularly in the US. So, Servcorp raised \$77m in October at \$4.00. Servcorp is on a roll, setting up Virtual Office floors on 10-year leases across the US and globally with the A\$-US\$ rate helping. It will open 13 locations in FY10, and plans 35-45 by FY11. It takes time to find, lease, staff and open an office and 9-12 months to break-even, so growth will be hockey-stick. The larger number of 'immature' floors in the build-up phase will hold back profits but, looking ahead, margins should expand strongly. Servcorp has the management, technology, funds and model. EBIT was 70% of equity plus debt in FY09. Return on investment is very fast.

The window is now—for compelling growth!

Recommendation

While Servcorp warned at its November capital raising of the 'material negative impact on profitability until the new floors reach maturity', it has a great opportunity to secure leases on very attractive terms, particularly with the A\$. In addition, its systems and IT platform are fully scalable, robust and able to accommodate the aggressive expansion plans. We see this as an excellent time to buy internet-related global growth with proven management. Buy.

Snapshot

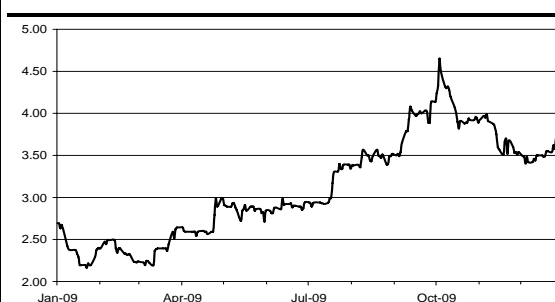
Last Price	\$3.74
Market Cap.	\$368 million
52 Week High	\$4.70
52 Week Low	\$216.4
Sector	Real Estate & ICT Operation & Office Services

Investment Fundamentals

Year-end June	FY08A	FY09A	FY10E	FY11E
NPAT (\$m)	33.8	34.1	11.3	23.1
EPS (c)	41.2	42.6	12.5	23.0
EPS Growth (%)	28.3	3.4	-70.7	84.0
PE Ratio (x)	9.1	8.8	29.9	16.3
DPS (c)	19.6	24.9	10.0	10.5
Franking (%)	100	100	100	100
Dividend Yield (%)	5.2	6.7	2.7	2.8

Source: Intersuisse estimates

Price Chart



Business Description

Servcorp Limited (SRV) provides executive serviced and virtual offices and IT, communications and secretarial services to companies and individuals both in Australia and overseas. Since listing in December 1999, SRV has grown revenues from \$60m to \$228m and NPAT from \$6.9m to \$34.1m. Return on equity has been around 23.5% over the last four years. Expansion has been organic and focused, to build its expertise and serviced office network internationally and to develop ICT (information and communication technology) considered to be far ahead of competitors and affording complete virtual office capability. SRV has successfully implemented the Virtual Office model in a number of locations—there are more than 14 SRV locations that have over 500 virtual packages. SRV is implementing an expansion plan which will target on opening more than 100 new floors over the next 3 to 4 years, the vast majority of which will focus on the Virtual Office model. A large number of sites and locations have been identified, a few now open. See the informative website www.servcorp.net

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