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OKP Holdings
Post result briefing takeaways

OKP SP
BUY; TP: **S$0.98**

Price @23/02/11: S$0.59
52-week range (SGD): 0.42 – 0.62
Market cap – S$147m

Recommendation – maintain BUY

- **Maintain BUY.** Management of OKP gave a post-result briefing yesterday after the group announced a record FY10 net profit of S$17m (+17% yoy). Our estimates are unchanged and target price remains at S$0.98, peg 10x CY12 earnings, below the mid-cycle valuation, and discount to bigger peers who re-rated upon awards of overseas contracts.
- We **like OKP for its high projects visibility** in the public sector, and its strong potential overseas expansion story. OKP is a prime candidate to government infrastructural spending and the stock offers excellent value trading at 5.9x CY12 P/E against its 3-year core earnings CAGR forecast of 23.9%.
- **Our above consensus estimates reflect OKP's higher order book and robust margin.** Further upside to our earnings estimates could emerge with potential catalyst of the possible overseas projects.
- **Fresh order wins** from public and private sector civil engineering projects will be the primary growth drivers that fuel sustainable earnings growth. In our view, immediate re-rating catalysts are likely to come from stronger than expected order momentum, strong margins from recently awarded road-raising works that will bring the group to another record profits and higher dividend payout.

Points from the briefing

- **Levy and CPF impact are not going to hurt the margins in a negative way.** Management stated that since the group has already been prudent with cost management, the gradual increase in foreign workers levies till 2013 is less severe than what most investors think.
- First, as 20% of work force the group employs falling into the higher skill tier (which has lesser levy impact), the immediate reaction to engage the remaining work force for training to qualify them into this category. Secondly, like the rest of their peers in the industry, new tenders for projects would definitely reflect the higher cost structure going forward.
- The net effect, according to OKP's internal budgeting would only put an additional 1.6% rise to its cost of works. As a matter of fact, due to OKP's stellar project management skill and tighter cost controls, gross margin has climbed to 21% (18% in FY09).
- We noted that OKP has embarked on more complex projects that commanded better margins compared to the past, the margin buffer for these projects it undertaking now and those in the pipeline have also gotten fatter. All these will serve to more than mitigate the gradual cost escalation (should there be any) coming from labour costs.
- Management reiterates its focus on its traditional core business of construction and maintenance activities. OKP will leverage its track record and financial strength to participate in tenders for larger and more complex civil engineering projects in order to generate higher profitability. OKP will also extend its civil engineering capabilities to the oil and gas sector. Sustainable earnings growth will be primarily driven by fresh order wins, particularly opportunities arising from Downtown Lines awards.
- Possibly, OKP could team up with its substantial shareholders, China Sonangol, for possible property development project in Singapore. Recap: Last December, OKP secured a S$83.5m contract award from China Sonangol for the construction of luxury Angullia Park condominium in Orchard Road.
- **In the worst case scenario, if OKP could not secure any new tender (though not likely), its current S$310m order book can last till FY2014.** OKP's total gross order book stands at a healthy S$309.9m based on secured civil engineering and construction contracts, with projects stretching up to 2014. We estimated a conservative S$150-180m new order to add on the order book to replace the equivalent amount of orders to be delivered in FY11.
- **Obviously, more cash is good.** We believe with the expansive balance sheet and free cash flow built up by the group, it is natural for the group to branch out into various business segments that will ensure long term sustainable earnings.
- … **Earnings diversification into other high value projects is better.** While the group is able to leverage on its strengths and expertise to tender for larger and more complex civil engineering projects in order to generate higher profitability, it is paramount to diversify and explore suitable opportunities to regionalise the group's core business and reduce its reliance on a single source of revenue. Management has said that there is intention to beef up its property development capability, thereby fortifying its already rock-solid income quality.
- **Enhancing shareholders value is still the focus.** If the above mentions do not manifest, investors should be expecting those generous dividends to continue. Management has stated clearly that it is the board's intention to continue enhances shareholders value. In the latest set of result, OKP declared a special dividend of 2Scts in addition to a final dividend of 2Scts. With interim DPS of 1Scts, total payout from earnings amounted to 77%. This works out to a dividend yield of 8.3% based on yesterday's closing share price of S$0.59.
- **70% of market cap backed by net cash of S$100m.** OKP's NTA stood at 25.3 Scts/share. The group continued to build up its balance sheet, and the current net cash pile of the group swelled to S$100m, implying that 70% of the market cap of the group is backed by cash, a testament of the group's cash generative strength.
- **Potential business opportunities overseas.** We believe overseas ventures will serve to broaden and invigorate OKP's income base and underpin longer term profitability. We think that the group would eventually make its foray to overseas market, which would mean higher margins due to the higher premium that the group required for outside Singapore projects.

Financial summary

FYE Dec	**2009**	**2010**	**2011F**	**2012F**	**2013F**
Revenue (S$ m)	130.0	139.9	185.7	220.4	262.9
EBITDA (S$ m)	19.8	23.4	28.8	35.6	44.3
EBITDA margins (%)	15.2	16.7	15.5	16.2	16.9
Pretax profit (S$ m)	17.1	20.4	25.1	32.5	42.0
Net profit (S$ m)	**14.4**	**17.0**	**20.7**	**26.4**	**33.7**
EPS (cts)	6.1	6.5	7.8	9.9	12.7
EPS growth (%)	-4%	7%	20%	28%	27%
P/E (x)	9.7	9.1	7.6	5.9	4.6
Core EPS (cts)	6.1	6.5	7.8	9.6	11.9
Core EPS growth (%)	-4%	7%	20%	23%	24%
Core P/E (x)	9.7	9.1	7.6	6.2	4.9
FD EPS (cts)	5.4	5.9	7.1	8.7	10.9
FD P/E (x)	10.9	10.0	8.3	6.8	5.3
Gross DPS (cts)	2.0	5.0	5.0	5.0	5.3
Dividend yield (%)	3.4%	8.5%	8.5%	8.5%	8.9%
P/NTA (x)	2.5	2.6	2.3	1.9	1.5
ROE (%)	24.5%	27.4%	29.8%	31.7%	32.3%
Net gearing (%)	nil	nil	nil	nil	nil
Net cash per share (S$)	0.3	0.4	0.4	0.4	0.5
P/CF (x)	8.3	7.8	6.5	5.1	4.1
EV/EBITDA (x)	3.2	2.7	2.2	1.7	1.4
% change in EPS estimates			0.0%	0.0%	0.0%

Source: Company, CIMB Research