

Singapore Company Focus

OKP Holdings

Bloomberg: OKP SP EQUITY | Reuters: OKPH.SI

Refer to important disclosures at the end of this

DBS Group Research . Equity

2 May 2013

FULLY VALUED S\$0.51 STI : 3,368.18

(Downgrade from HOLD)

Price Target : 12-Month S\$ 0.405 (Prev S\$ 0.49)

Reason for Report : 1Q13 Results, Earnings/Rec/TP downgrade

Potential Catalyst: Thomson line MRT project wins

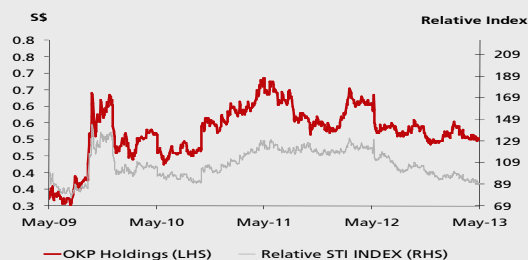
DBSV vs Consensus: Below consensus

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Price Relative



Forecasts and Valuation

FY Dec (\$\$ m)	2011A	2012A	2013F	2014F
Revenue	110	104	146	165
EBITDA	35	20	16	16
Pre-tax Profit	32	15	12	12
Net Profit	27	12	10	10
Net Pft (Pre Ex.)	27	14	10	10
EPS (S cts)	9.0	4.0	3.4	3.3
EPS Pre Ex. (S cts)	9.0	4.5	3.4	3.3
EPS Gth (%)	39	(56)	(16)	(3)
EPS Gth Pre Ex (%)	39	(50)	(25)	(3)
Diluted EPS (S cts)	9.0	4.0	3.4	3.3
Net DPS (S cts)	3.0	1.5	3.0	3.0
BV Per Share (S cts)	28.9	31.2	31.6	31.9
PE (X)	5.6	12.6	15.0	15.5
PE Pre Ex. (X)	5.6	11.2	15.0	15.5
P/Cash Flow (X)	27.0	nm	7.6	29.8
EV/EBITDA (X)	1.6	5.2	6.1	6.8
Net Div Yield (%)	5.9	3.0	5.9	5.9
P/Book Value (X)	1.7	1.6	1.6	1.6
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	33.8	13.4	10.7	10.3

Earnings Rev (%)		(44.1)	(50.6)
Consensus EPS (S cts):		5.2	5.7
Other Broker Recs:	B: 1	S: 0	H: 2

ICB Industry : Industrials

ICB Sector: Construction & Materials

Principal Business: OKP Holdings Limited is involved in the construction and maintenance of roads in Singapore.

Source of all data: Company, DBS Vickers, Bloomberg Finance L.P

Margin crush

- Revenue slightly below, net profit disappoints on significantly lower gross margins
- Cost increase is structural, expect lower margins going forward
- Cut FY13F/FY14F earnings by 44%/51%, gross margin assumption reduced to 17.5%
- Downgrade to FULLY VALUED, TP lowered to S\$0.405

Weak 1Q13 earnings, dragged by lower gross margins. OKP's 1Q13 earnings of S\$2.4m (-22% y-o-y) was below our forecast and made up 13% of our full year estimates. Revenue of S\$32m (+28% y-o-y) was slightly below our forecasts as order wins trailed projections. Gross margin declined to 15% from 22.4% in FY12 mainly due to higher wages and subcontracting costs.

Gross margin decline was a key disappointment. The decline in gross margin was due to direct labour cost increases to project engineers as well as higher subcontracting cost due to a rising raw material and labour cost environment. We estimate that subcontracting costs could have doubled in 1Q13 from FY12 as the subcontracting component as a proportion of cost of sales has now increased. We believe that the increase in these cost items is structural to the construction industry and that lower gross margins (c. 15% vs >20% in FY12) will likely sustain going forward. Due to shortages, salary increases for engineers are likely to impact from 2Q13.

Cut FY13F/FY14F earnings by 44%/51%. We factor lower gross margins of 17.5% (from 23%) which results in FY13F/14F earnings cuts of 44%/51%. We lower our revenue estimates slightly to account for poor order wins in 1Q13. Otherwise, OKP's order book remains healthy at S\$393.5m, lasting till 2015. OKP is also tendering for Thomson Line MRT project packages which can potentially boost the order book if successful.

Downgrade to Fully Valued, TP reduced to S\$0.405. Our S\$0.405 TP is based on 1) 6x FY13F PE for its recurring business valued at S\$0.235 per share; and 2) S\$0.17 per share surplus net cash. Prefer Pan United and Tat Hong for Singapore construction plays.

At A Glance

Issued Capital (m shrs)	308
Mkt. Cap (S\$m/US\$m)	156 / 126
Major Shareholders	
Kim Peow Investment (%)	54.7
China Sonangol (%)	14.0
Free Float (%)	31.3
Avg. Daily Vol. ('000)	175

Revenue slightly below, earnings disappointed by weak gross margins

Weak 1Q13 results, dragged by lower gross margins. OKP's 1Q13 earnings shrank 22% y-o-y to S\$2.4m, below our forecast. 1Q13 earnings made up 13% of our initial S\$18.6m full year estimate. Revenue for the quarter grew by 28% y-o-y to S\$32m, driven by both construction and maintenance segments. Gross margin was the key disappointment, declining to 15% from 22.4% in FY12 mainly due to higher wages and subcontracting costs. 1Q13 has been slow for OKP as project wins stood at S\$16.9m, well below our S\$30m project win assumption for the quarter.

Gross margin disappoints on higher labour and subcontracting costs. The surprise in this set of results was the collapse in gross margins. Gross margin declined 7.4ppts to 15% from above 20% between 1Q12 to 4Q12. This decline was due to higher labour and subcontracting costs. Higher labour costs were more a function of project engineers' wage increases rather than higher foreign worker levy. There was also higher subcontracting cost incurred for construction projects, as subcontractors require higher pricing to justify workers' wages and raw material prices. We estimate that subcontracting costs could have doubled in 1Q13 from FY12 now that subcontracting component has increased to 30-40% of cost of sales from 20% in 2012.

Cost increase is structural, expect lower margins going forward

Higher costs faced by industry is structural. We believe that margin compression from wage increases and subcontracting services is structural and specific to the construction industry. On the skilled labour front, there is a shortage of engineers in the market and contractors will have to pay more to engage them, while lower end foreign labour continues to face higher foreign worker levies.

Lower margins to stay. According to OKP, salary increase for engineers is likely to flow in 2Q13 as it has yet to complete the wage adjustment process. Salaries of its engineers are expected to increase by another 5-10% in 2Q13. We believe our current gross margin assumption of 23% for FY13F is on the high side now that subcontracting costs and direct wages have increased.

Lower FY13F/FY14F earnings by 44%/51%

Slow start in 1Q13. OKP had a slow start in 1Q13, winning only Maintenance segment contracts for dredging services in Sungei Api Api and improvement to roadside drains at Joo Chiat worth S\$16.9m. There were no project wins for the Construction segment.

No significant change in revenue projections. Order book remains healthy at S\$393.5m lasting till 2015. There are sufficient projects which OKP is currently working on that will underpin revenue recognition for FY13F. We expect revenue recognition for FY13F to gain momentum going forward as activity of existing construction projects pick up pace. OKP is also one of the applicants to submit bids for the Thomson Line MRT packages. A successful outcome for the construction of one of these packages could boost its order book and revenue growth beyond FY14F significantly.

Lower gross margin assumption to 21%, FY13F/FY14F earnings cut by 44%/51%. We expect gross margins to be lower going forward, due to structural changes in the cost structure. We believe subcontracting costs will remain high for the time being, and engineer shortage continues to persist. Wage increases for OKP's engineers will continue into 2Q13. As such we are lowering our gross margin assumption from 23% to 17.5%. This results in earnings cuts of 21-22% for FY13F/FY14F earnings.

Downgrade to FULLY VALUED

Downgrade to Fully Valued, TP lowered to S\$0.405. We value OKP using SOTP based on 1) 6x FY13F PE for its recurring business valued at S\$0.235 per share (from S\$0.36); and 2) net cash of S\$0.17 per share (unchanged). We derive a lower TP of S\$.405. Our revised TP of OKP represents a potential downside of 19.8% for the stock. Downgrade to from HOLD to Fully Valued.

SOTP valuation of OKP

S\$ per share	Old	New
Recurring business based on FY13F earnings	0.36	0.235
Net cash	0.13	0.17
TP (S\$)	0.49	0.405

Source: DBS Vickers

Results Summary and Comparison

FY Dec (m)	1Q12	4Q12	1Q13	YoY Chg	QoQ Chg
Sales	25.0	27.5	32.0	28%	17%
Cost of Goods Sold	(19.7)	(21.4)	(27.2)	38%	27%
Gross Profit	5.2	6.0	4.8	-8%	-20%
Other Operating Income	0.7	1.1	0.3	-60%	-73%
<i>Distribution Costs</i>	0.0	0.0	0.0		
<i>Administration Expenses</i>	(2.2)	(2.8)	(2.4)	8%	-16%
<i>R & D and other expenses</i>	(0.1)	(0.1)	0.0	nm	nm
Other Operating Expenses	(2.3)	(2.9)	(2.4)	2%	-18%
EBIT	3.7	4.2	2.8	-25%	-35%
Non-Operating Income	0.0	0.0	0.0		
Interest Income	0.0	0.0	0.0		
Interest Expense	(0.0)	(0.0)	(0.0)	-33%	nm
Share of Associates' or JV Income	0.0	(0.0)	0.0		nm
Exceptional Gains/(Losses)	0.0	0.0	0.0		
Pretax Profit	3.6	4.2	2.7	-25%	-35%
Tax	(0.6)	(0.2)	(0.4)	-38%	50%
Minority Interests	0.0	(0.2)	0.0	nm	nm
Net Profit	3.1	3.8	2.4	-22%	-37%
Margins (%)					
Gross Margin	21.0	21.9	15.1		
SGA % Sales	9.3	10.6	7.5		
EBITDA Margin	17.4	16.7	10.3		
EBIT Margin	14.7	15.3	8.6		
Pre-tax Margin	14.6	15.3	8.5		
Net Margin	12.2	13.8	7.4		

Source: Company, DBS Vickers

Valuation Summary

Recurring business	Net profit forecast			Value	Reference
	FY12	FY13F	PE (x)		
Based on blended FY12/13F estimates	12.4	10	7.0	72.7	
Weighted avg share capital (m)				308.4	
Value of OKP's recurring business (S\$)				0.235	(1)
Net Cash (S\$ m)	52.5	59			
Net Cash per share (S\$)	0.17	0.19			
Net Cash per share as at 1Q13 (S\$)				0.17	(2)
Target price for OKP (S\$)				0.405	(1) + (2)

Source: Company, DBS Vickers

OKP Holdings

Key Assumptions

FY Dec	2010A	2011A	2012A	2013F	2014F
New orders won	166.5	152.3	137.4	116.9	130.0

Segmental Breakdown

FY Dec	2010A	2011A	2012A	2013F	2014F
Revenues (\$\$ m)					
Construction	116	90	92	120	152
Maintenance	24	20	13	26	13
Total	140	110	104	146	165
Gross Profit (\$\$ m)					
Construction	23	36	21	22	26
Maintenance	7	7	3	4	2
Total	29	43	23	25	28
Gross Profit Margins					
Construction	19.8	40.2	22.6	18.0	17.0
Maintenance	27.4	35.3	21.3	15.0	14.5
Total	21.1	39.3	22.4	17.5	16.8

Lowered after project wins slowed in 1Q13. No new projects in Construction segment.

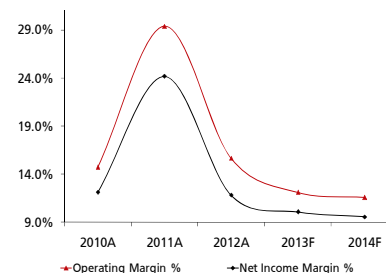
Fewer maintenance contract wins assumption as we expect more construction projects to be rolled out going forward

Lowered after 1Q13 gross profit margin disappointment.

Income Statement (\$\$ m)

FY Dec	2010A	2011A	2012A	2013F	2014F
Revenue	140	110	104	146	165
Cost of Goods Sold	(110)	(67)	(81)	(120)	(138)
Gross Profit	29	43	23	25	28
Other Opng (Exp)/Inc	(9)	(11)	(7)	(13)	(16)
Operating Profit	21	32	16	12	12
Other Non Opg (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	0	0	0	0	0
Net Interest (Exp)/Inc	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	(2)	0	0
Pre-tax Profit	20	32	15	12	12
Tax	(4)	(6)	(2)	(2)	(2)
Minority Interest	0	0	0	0	0
Preference Dividend	0	0	0	0	0
Net Profit	17	27	12	10	10
Net Profit before Except.	17	27	14	10	10
EBITDA	23	35	20	16	16
Growth					
Revenue Gth (%)	7.6	(21.5)	(4.9)	39.6	13.4
EBITDA Gth (%)	18.5	50.9	(44.2)	(18.9)	(1.7)
Opg Profit Gth (%)	19.1	56.7	(49.3)	(23.7)	(2.2)
Net Profit Gth (%)	17.4	56.7	(53.4)	(16.0)	(3.0)
Margins & Ratio					
Gross Margins (%)	21.1	39.3	22.4	17.5	16.8
Opg Profit Margin (%)	14.7	29.4	15.7	8.6	7.4
Net Profit Margin (%)	12.1	24.2	11.8	7.1	6.1
ROAE (%)	26.5	33.8	13.4	10.7	10.3
ROA (%)	12.3	17.6	8.7	6.6	6.2
ROCE (%)	25.5	33.0	14.7	10.5	10.1
Div Payout Ratio (%)	78.4	34.5	37.4	89.1	91.9
Net Interest Cover (x)	136.4	283.0	183.8	197.8	150.3

Margins Trend



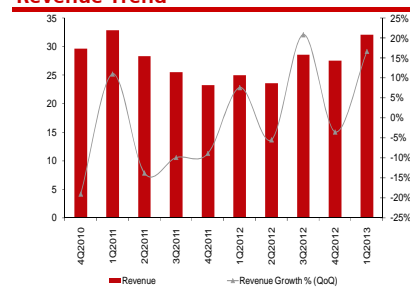
Declining margin. Subcontracting costs and wages for engineers have increased.

Source: Company, DBS Vickers

Quarterly / Interim Income Statement (\$\$ m)

FY Dec	1Q2012	2Q2012	3Q2012	4Q2012	1Q2013
Revenue	25	24	28	27	32
Cost of Goods Sold	(20)	(18)	(22)	(21)	(27)
Gross Profit	5	6	6	6	5
Other Oper. (Exp)/Inc	(2)	(2)	(2)	(2)	(2)
Operating Profit	4	4	5	4	3
Other Non Opg (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	0	0	0	0	0
Net Interest (Exp)/Inc	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	(2)	0	0
Pre-tax Profit	4	4	3	4	3
Tax	(1)	(1)	(1)	0	0
Minority Interest	0	0	0	0	0
Net Profit	3	3	2	4	2
Net profit bef Except.	3	3	4	4	2
EBITDA	4	5	6	5	3

Revenue Trend



Growth

Revenue Gth (%)	7.6	(5.5)	20.8	(3.6)	16.6
EBITDA Gth (%)	(65.1)	5.1	24.4	(19.3)	(27.6)
Opg Profit Gth (%)	(68.4)	4.3	22.3	(9.8)	(34.7)
Net Profit Gth (%)	(68.0)	1.0	(21.2)	56.0	(37.4)

Margins

Gross Margins (%)	21.0	24.3	22.6	21.9	15.1
Opg Profit Margins (%)	14.7	16.2	16.4	15.3	8.6
Net Profit Margins (%)	12.2	13.1	8.5	13.8	7.4

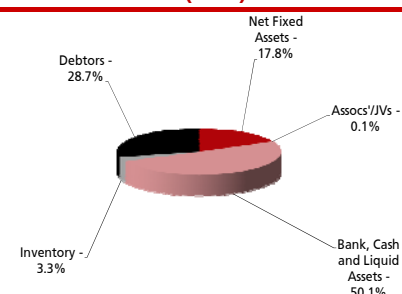
Lower gross margins.
Affected by subcontracting
and direct labour costs for
engineers.

Balance Sheet (\$\$ m)

FY Dec	2010A	2011A	2012A	2013F	2014F
Net Fixed Assets	17	19	19	21	22
Invt in Associates & JVs	0	0	0	0	0
Other LT Assets	5	6	29	29	29
Cash & ST Invt	100	93	54	60	51
Inventory	3	2	4	5	6
Debtors	28	29	31	60	41
Other Current Assets	0	0	1	1	1
Total Assets	153	148	138	176	150
ST Debt	1	1	1	1	1
Creditor	60	35	19	56	27
Other Current Liab	21	23	20	20	22
LT Debt	1	0	1	1	1
Other LT Liabilities	0	1	1	1	1
Shareholder's Equity	69	88	96	97	98
Minority Interests	0	0	0	0	0
Total Cap. & Liab.	153	148	138	176	150
Non-Cash Wkg. Capital	(51)	(27)	(3)	(10)	(2)
Net Cash/(Debt)	98	91	53	59	50
Debtors Turn (avg days)	71.3	96.2	105.4	113.7	111.1
Creditors Turn (avg days)	167.3	274.3	126.5	116.8	113.0
Inventory Turn (avg days)	7.8	13.8	13.5	13.6	14.8
Asset Turnover (x)	1.0	0.7	0.7	0.9	1.0
Current Ratio (x)	1.6	2.1	2.3	1.7	2.0
Quick Ratio (x)	1.6	2.1	2.2	1.6	1.9
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	311.1	376.5	293.7	343.9	343.9
Z-Score (X)	NA	3.8	4.3	3.8	3.7

Source: Company, DBS Vickers

Asset Breakdown (2012)



1Q13 net cash is
S\$0.17.

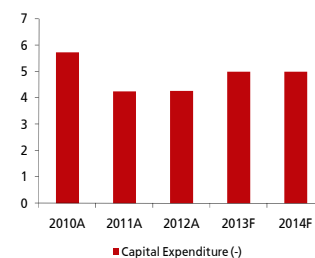
OKP Holdings

Cash Flow Statement (\$\$ m)

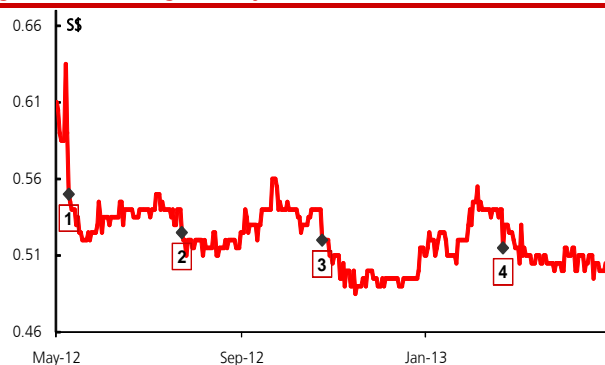
FY Dec	2010A	2011A	2012A	2013F	2014F
Pre-Tax Profit	20	32	15	12	12
Dep. & Amort.	3	3	3	4	4
Tax Paid	(3)	(3)	(5)	(2)	(2)
Assoc. & JV Inc/(loss)	0	0	0	0	0
Chg in Wkg.Cap.	19	(26)	(19)	7	(8)
Other Operating CF	0	0	(1)	0	0
Net Operating CF	39	6	(7)	20	5
Capital Exp.(net)	(6)	(4)	(4)	(5)	(5)
Other Invt.(net)	0	(1)	(20)	0	0
Invt in Assoc. & JV	0	0	0	0	0
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	(2)	0	0	0	0
Net Investing CF	(8)	(5)	(25)	(5)	(5)
Div Paid	(11)	(15)	(6)	(9)	(9)
Chg in Gross Debt	(1)	(1)	(1)	0	0
Capital Issues	4	8	0	0	0
Other Financing CF	(1)	0	0	0	0
Net Financing CF	(9)	(8)	(7)	(9)	(9)
Currency Adjustments	0	0	0	0	0
Chg in Cash	22	(8)	(38)	6	(9)
Opg CFPS (S cts)	7.8	10.7	4.0	4.4	4.4
Free CFPS (S cts)	12.8	0.4	(3.7)	5.0	0.1

Source: Company, DBS Vickers

Capital Expenditure



Target Price & Ratings History



S.No.	Date	Closing Price	Target Price	Rating
1:	09 May 12	0.55	0.65	Hold
2:	23 Jul 12	0.53	0.54	Hold
3:	24 Oct 12	0.52	0.49	Hold
4:	21 Feb 13	0.52	0.49	Hold

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

Source: DBS Vickers