

OKP Holdings Limited

Growing Company Showing Deep Value

OKP Holdings Limited's (OKP) FY10 PATMI came in at S\$17.0m, which was higher than expected due to the execution of higher margin orders. The combination of OKP's bidding efforts and strong order book gives us great comfort that FY11 will be another record year for OKP. Additional earnings kickers will stem from the successful award of at least one Downtown Line 3 contract and any well-selected property development project. OKP shows deep value trading at just 3.1x FY10 P/E on an ex-cash basis. Maintain Increase Exposure call based on an intrinsic value of S\$0.930 (previous close: S\$0.575).

Key Developments:

FY11F growth put in place: OKP's current gross order book stood at S\$309.9m, of which four projects worth a total of S\$154.5m were awarded in the 2H of FY10 and will proceed at full pace in 2011. We estimate that OKP's order book will contribute about S\$130.0m of revenue in FY11F. We counted five LTA projects that OKP has bid for, of which the results have yet to be announced. We are confident that OKP will continue to show growth in FY11.

Potential earnings kicker: OKP's prospects will be further boosted by the successful tender of at least one Downtown Line 3 contract. We understand that OKP has been pre-qualified for the entire line and is bidding for more than one contract.

Property development to raise value add: We see this as a move by the company to capture value upstream and to capitalize on market upswings while thriving on civil engineering in slower times. Accordingly, the management is adopting a prudent approach and progress will depend on the profitability of available opportunities.

Huge war chest: OKP has accumulated cash of S\$100.1m (S\$0.376 per share) as of end FY10 to fund its growth plans and future dividends. OKP is paying a total of 5 S cents of dividends for FY10, working out to an attractive yield of 8.7%. OKP is trading at just 3.1x FY10 earnings ex-cash, suggesting much value to be uncovered.

Increase Exposure

- Intrinsic Value S\$0.930
- Prev Close S\$0.575

Main Activities

OKP Holdings Limited is a civil engineering company specializing in road and expressway construction. It has also diversified into the oil and gas infrastructure sector and had formed a JV to enter the African market in 2009.

Financial Highlights

(Y/E Dec) S\$ m	FY09	FY10	FY11F
Revenue	130.0	139.9	160.8
Gross Profit	23.4	29.5	32.2
Earnings	14.4	17.0	19.3
EPS (S cts)	6.1	6.5	6.8

Source: Company, SIAS Research

Key ratios (FY11F)

PER	8.0
P/BV	2.1
Return on Common Equity	26.7%
Return on Assets	13.4%
Gross Debt to Common Equity	2.4%
Current ratio	1.9

Source: SIAS Research

Indexed Price Chart

Green (FSSTI)

White (OKP)



Source: Bloomberg

52wks High-Low S\$0.620 /S\$0.420

Number of Shares 266.4m

Market Capitalization S\$153.2m

Analyst:

Liu Jinshu, Investment Analyst

jinshu@siasresearch.com

Tel: 6227 2107

What to Expect Next

High revenue visibility: OKP's order book excluding the CTE widening project due for completion in end 2011 works out to S\$190.6m (S\$309.9m less S\$119.3m). The S\$119.3m CTE project will continue to support earnings in 2011, while the S\$83.5m Angullia Park project has already commenced and will enter full pace operations in 2Q 2011.

Bidding pipeline is in place: We traced at least five LTA civil engineering tenders that OKP is bidding for. They include work to build the Sentosa Gateway Tunnel, widening of sections of the PIE and the construction of a road interchange. The award of at least one of these contracts will strengthen our positive outlook on the company.

Gunning for value – prudent tender participation: Some of these projects seem to be more complex than usual and should be worth more than S\$50m. Some of them will draw upon OKP's expertise in expressway works or lead to the development of new capabilities, e.g. sub-terrain works. As much as OKP is actively looking at existing tenders, we like how the company is being prudent in its approach and selecting projects of attractive risk/reward profiles. This avoids a race to the bottom and defends margins.

Figure 1: Order Book Analysis

No	Brief Description	Start Date	Est. End Date	Contract Value
1	Widening of CTE	30-Jan-09	29-Dec-11	119.3
2	Tuas View Extension, Phase 1	10-Mar-10	09-Jun-11	5.2
3	Ad hoc repairs and upgrading of roads I	03-May-10	02-Aug-13	19.4
4	Ad hoc repairs and upgrading of roads II	03-May-10	02-Aug-13	14.9
5	Desilting of Bukit Timah Diversion Canal	26-Jul-10	25-Oct-11	6.0
6	Cleantech Park Phase 1	19-Oct-10	18-Jun-12	14.5
7	Orchard Road – Road raising works	01-Nov-10	31-May-11	22.0
8	Angullia Park Development	22-Dec-10	22-Apr-13	83.5
9	Widening of Old Choa Chua Kang Road	14-Feb-11	13-Feb-14	28.5

** Revenue from the construction of the Angullia Park development will not be recognized in OKP's income statement. OKP will recognize its share of profits from the Forte Builder JV instead. However, we present this contract as part of OKP's order book to acknowledge its positive impact on OKP's earnings.*

Source: Company Announcements, LTA website, SIAS Research

Figure 2: Existing Tenders (Non-MRT)

Tender Ref	Description	Publication Date	Tender Close	No of Bids
ER368	Interchange at TPE/Sengkang West Road /Seletar Aerospace Way	15-Jul-10	28-Oct-10	7
ER296	Construction and Completion of Sentosa Gateway Tunnel from Telok Blangah Road to Keppel Road/Kampong Bahru Road/Lower Delta Road and Associated Road Widening Work along Lower Delta Road	29-Oct-10	24-Jan-11	5
ER371	Widening of Pan Island Expressway (PIE) from Clementi Avenue 6 to Bukit Timah Expressway (BKE)	04-Nov-10	27-Jan-11	8
ER343	Widening of PIE from BKE to Adam Road	04-Nov-10	25-Jan-11	8
ER373	Construction of Covered Linkways and Cover to Pedestrian Overhead Bridges	26-Nov-10	20-Dec-10	9

This list is not exhaustive. Bids for URA, PUB projects are not included.

Source: LTA website, SIAS Research

Mega developments to be earnings kicker: We view the successful award of any Downtown Line 3 contract as a bonus that will drive earnings higher. Thus far, the lists of bidders for seven contracts related to the construction of stations and associated tunnels along the Downtown Line 3 are out. Operationally, OKP has set up a project team to pursue MRT projects and has also informally tied down with partners on potential JV arrangements.

In 2012, we will see preparation and bidding commence for the North South Expressway - construction is slated to start in 2013. The North South Expressway will be a good opportunity for OKP to deploy its competency in road building.

Property development – a new frontier: This is a new area to OKP to grow beyond civil engineering and deepen its relationship with partners such as China Sonangol – which as a substantial shareholder will want to see OKP perform well. Given its current portfolio, developments in this area will not affect contract wins in the public construction sector. However, the management pointed out that they are not rushing to acquire land and will only consider projects that show value.

We expect the impact of recent worker levy and CPF increments on OKP to be muted as OKP has been focusing on higher margin projects. This consistent move up the value chain will buffer against cost inflation (estimated to be just less than 2% of project costs).

Results Overview

Margin expansion drove growth: OKP's FY10 net attributable profit grew by 17.7% to S\$17.0m, which was slightly higher than our forecast of S\$16.6m, as a result of higher margin orders and tight cost control.

Figure 3: Results Analysis

S\$m	FY10			FY10	FY09	Chg (%)
	Actual	Forecast	Variance (%)			
Revenue	139.9	145.3	-3.7%	139.9	130.0	7.6%
Gross Profit	29.5	26.3	12.1%	29.5	23.4	26.0%
EBIT	19.7	20.4	-3.4%	19.7	15.8	24.7%
PATMI	17.0	16.6	2.1%	17.0	14.4	17.7%
			% pts			% pts
Gross Margin	21.1%	18.1%	3.0%	21.1%	18.0%	3.1%
EBIT Margin	14.1%	14.0%	0.0%	14.1%	12.2%	1.9%
Net Margin	12.1%	11.4%	0.7%	12.1%	11.1%	1.0%

Source: SIAS Research

4Q decline in revenue not a cause for concern: Revenue in 4Q FY10 was S\$7.0m lower than that in 3Q FY10, which led full year revenue to decline by 3.7%. We see this as a timing issue. OKP has a huge order book. On a quarter-to-quarter basis, revenue may be affected by the ramp up of projects. Revenue recognition typically picks up some time after a project commences when work activity gains full pace.

Excellent balance sheet: We also like OKP's balance sheet which carries lease liabilities of only S\$1.8m with no other debt and cash of S\$100.1m. We do not really see this cash pool as a drag on ROE, but more of a war chest to finance projects and investments. In a nutshell, OKP has ready resources to capture growth opportunities – representing value to be unlocked.

Figure 4: Economic Profit Valuation Model

S\$m	FY11F	FY12F	FY13F	FY14F
Revenue	160.8	185.0	212.7	244.6
EBIT	23.4	27.0	31.1	35.7
Tax on EBIT	-4.1	-4.7	-5.4	-6.2
NOPLAT	19.3	22.3	25.6	29.5
Invested Capital	71.2	77.0	86.2	96.5
% of Debt	2.6%	2.4%	2.1%	1.9%
% of Equity	97.4%	97.6%	97.9%	98.1%
WACC	11.5%	11.5%	11.5%	11.5%
Capital Charge	8.2	8.8	9.9	11.1
Economic Profit	11.1	13.5	15.7	18.4
Terminal Value				208.4
Discount Rate	0.90	0.80	0.72	0.65
Present Value	10.0	10.8	11.3	11.9
Book Value	68.9	Risk Free		2.5%
Explicit Value	44.0	Beta		1.1
Terminal Value	134.6	Market RP		8.4%
Value of Firm	247.6	Cost of Equity		11.74%
Number of Shares (m)	266.4	Net Cost of Debt		1.76%
Value per share (S\$)	0.930	LT Growth		2.50%

Number of shares is based on the enlarged share capital after the exercise of warrants not owned by majority shareholders Or Kim Peow Investments Pte Ltd and China Sonangol International (S) Pte Ltd. These warrants will expire in January 2013. To date, outstanding warrants, with a strike of S\$0.200 per share, represent only 16.8% of OKP's current share capital.

Source: SIAS Research

Figure 5: Financial Forecasts and Estimates

	FY08	FY09	FY10	FY11F	FY12F	FY13	FY14
Revenue	101.8	130.0	139.9	160.8	185.0	212.7	244.6
Gross Profit	21.3	23.4	29.5	32.2	37.0	42.5	48.9
Operating Profit	11.6	15.8	19.7	23.4	27.0	31.1	35.7
Net Profit	9.5	14.4	17.0	19.3	22.3	25.6	29.5
Attributable to Shareholders							
Total Current Assets	63.0	105.8	131.2	108.0	120.6	134.6	150.6
Total Non-Current Assets	13.9	16.6	21.9	26.4	31.0	36.6	43.2
Total Current Liabilities	33.3	61.2	82.8	58.3	66.3	75.7	86.5
Total Non-Current Liabilities	2.8	1.7	1.3	0.9	0.9	0.9	0.9
Total Equity	40.7	59.5	68.9	75.4	84.4	94.6	106.4
Cash from Operating Activities	15.8	44.6	39.1	-7.4	30.1	31.5	39.8
Cash from Investing Activities	-0.2	-5.0	-8.1	-7.0	-8.3	-9.9	-11.7
Cash from Financing Activities	-5.1	2.6	-8.3	-11.6	-13.4	-15.4	-17.7
Net change in cash	10.5	42.3	22.8	-25.9	8.4	6.3	10.4
Receivable Days	111.0	73.1	71.3	71.3	71.3	71.3	71.3
Payable Days	118.7	248.7	290.5	180.0	180.0	180.0	180.0
ROE (%)	25.6%	29.2%	26.5%	26.7%	27.9%	28.6%	29.4%
ROA (%)	12.3%	14.5%	12.3%	13.4%	15.6%	15.9%	16.2%
Debt/Equity	10.3%	4.5%	2.7%	2.4%	2.2%	1.9%	1.7%
Current Ratio	1.9	1.7	1.6	1.9	1.8	1.8	1.7
EPS (S cents)	4.21	6.06	6.50	7.15	8.27	9.51	10.94
BV/Share (S cents)	25.6	23.1	25.3	27.4	30.7	34.5	38.8
PER	13.7	9.5	8.8	8.0	7.0	6.0	5.3
P/BV	2.2	2.5	2.3	2.1	1.9	1.7	1.5

Source: Company, SIAS Research

Rating Definition:

Increase Exposure – The current price of the stock is significantly lower than the underlying fundamental value. Readers can consider increasing their exposure in their portfolio to a higher level.

Invest – The current price of the stock is sufficiently lower than the underlying fundamental value of the firm. Readers can consider adding this stock to their portfolio.

Fairly Valued – The current price of the stock is reflective of the underlying fundamental value of the firm. Readers may not need to take actions at current price.

Take Profit – The current price of the stock is sufficiently higher than the underlying fundamental value of the firm. Readers can consider rebalancing their portfolio to take advantage of the profits.

Reduce Exposure - The current price of the stock is significantly higher than the underlying fundamental value of the firm. Readers can consider reducing their holdings in their portfolio.

IMPORTANT DISCLOSURE

As of the date of this report, the analyst and his immediate family may own or have positions in any securities mentioned herein or any securities related thereto and may from time to time add or dispose of or may be materially interested in any such securities. Portfolio structure should be the responsibility of the investor and they should take into consideration their financial position and risk profile when structuring their portfolio. Investors should seek the assistance of a qualified and licensed financial advisor to help them structure their portfolio. This research report is based on information, which we believe to be reliable. Any opinions expressed reflect our judgment at report date and are subject to change without notice. This research material is for information only. It does not have regards to the specific investment objectives, financial situation and the particular needs of any specific person who may receive or access this research material. It is not to be construed as an offer, or solicitation of an offer to sell or buy securities referred herein. The use of this material does not absolve you of your responsibility for your own investment decisions. We accept no liability for any direct or indirect loss arising from the use of this research material. We, our associates, directors and/or employees may have an interest in the securities and/or companies mentioned herein. This research material may not be reproduced, distributed or published for any purpose by anyone without our specific prior consent.
