

OKP Holdings Limited

Record Profit Smashes Expectations

OKP Holdings Limited's (OKP) 4Q FY11 net profit significantly exceeded our forecasts with full year PATMI coming in at S\$26.6m versus our expectation of S\$23.1m. Net margin doubled year-on-year to 24.2% in 2011. The high quality of OKP's order book and the strong flow of projects up for bidding from now to 2020 suggest that OKP's performance going forward will still be good. In turn, more managerial effort can be shifted to new revenue development. The realization of this scenario will result in a re-rating of OKP's share price over time. **Maintain Increase Exposure based on an intrinsic value of S\$0.980.**

Key Developments:

Tight Cost Control: The fact that OKP has had five consecutive quarters with gross margin >25% is strong evidence of its continuous cost control efforts and project selection/management skills. The combination of these skill sets, the construction methodological flexibility of design and build projects and the execution of variation orders led the company to record a whopping 64.8% gross margin in 4Q 2011.

High Order Book Quality: Although OKP won only seven public sector projects in 2011, three of them had a combined value of S\$137.0m. Their high value (and hence complexity) suggests that there is considerable scope for OKP to apply its project management expertise and maintain profitability.

Strong Project Pipeline: Over the next five years, PUB's S\$750m budget for major canal expansion will provide plenty of opportunities for OKP to monetize its forte in road and drainage infrastructure.

Strong Platform for Growth: Our point is that OKP has a strong core business that provides the foundation for the company to be on the offensive and prospect for new growth opportunities. In OKP's favour is its strong balance sheet, with almost no borrowings, and the previous addition of China Sonangol International (S) Pte Ltd (CSIS) as a strategic investor. Therefore, we believe that the medium term upside potential of OKP remains positive.

Increase Exposure

- Intrinsic Value S\$0.980
- Prev Close S\$0.640

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 formed a JV to enter the private property construction segment in 2010.

Financial Highlights

(Y/E Dec) S\$ m	FY10	FY11	FY12F
Revenue	139.9	109.8	126.3
Gross Profit	29.5	43.2	44.2
Earnings	17.0	26.6	27.6
EPS (S cts)	6.50	9.02	9.04

Source: Company, SIAS Research

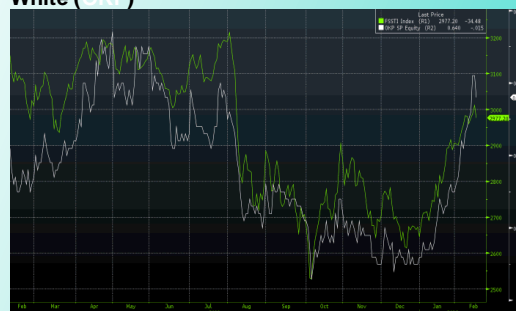
Key ratios (FY12F)

PER	7.1
P/BV	2.0
Return on Common Equity	29.4%
Return on Assets	18.0%
Gross Debt to Common Equity	1.1%
Current ratio	2.2

Source: SIAS Research

Indexed Price Chart

Green (FSSTI)
White (OKP)



Source: Bloomberg

52wks High-Low S\$0.685 /S\$0.515
 Number of Shares 305.3m
 Market Capitalization S\$195.4m

Analyst:

Liu Jinshu, Deputy Lead Analyst
jinsu@siasresearch.com
 Tel: 6227 2107

Focus on Bottom-Line; Not Top-Line: Although full year revenue fell by 21.5% YoY, OKP's gross order book remains at a healthy S\$248.6m as at February 2012. We are not overly concerned about top-line growth as OKP has been strategic in securing projects and is more focused on managing costs and creating efficiencies.

Moreover, newer projects are still in the initial phases of construction and will contribute more towards revenue in the coming quarters. For instance, we estimate that the larger projects (bolded in Figure 1) secured in 2011 may contribute up to 40% of annual revenue at full pace of construction. At the end of 2011, we reckon that they are each less than 25% completed. Furthermore, the ramp up of construction of Angullia Park will also result in higher revenue recognition.

Figure 1: OKP's Order Book and Selected Bids

No	Brief Description	Start Date	Est. End Date	Contract Value (\$m)
1	Ad hoc repairs and upgrading of roads I	03-May-10	02-Aug-13	19.4
2	Ad hoc repairs and upgrading of roads II	03-May-10	02-Aug-13	14.9
3	Cleantech Park Phase 1	19-Oct-10	18-Jun-12	14.5
4	Angullia Park Development	22-Dec-10	22-Apr-13	83.5
5	Widening of Old Choa Chua Kang Road	14-Feb-11	13-Feb-14	28.5
6	Sewer Extension – various locations	29-Mar-11	Nov-12	4.2
7	Interchange at TPE (Design-and-Build)	4-Apr-11	3-Oct-14	61.7
8	PUB – Roadside Drains Improvement I	25-May-11	Nov-12	3.4
9	PUB – Roadside Drains Improvement II	4-Jul-11	Jan-13	2.5
10	Sewer – Tuas Avenue South	19-Aug-11	1-Jul-12	4.9
11	Improvement to Alexandra Canal	5-Sep-11	4-Mar-14	46.8

Source: Company Announcements

Expect Steady Order Book Renewal: We counted at least 11 road infrastructure projects that have yet to be awarded on LTA's website, including the CTE/TPE/SLE interchange expansion. OKP's press release added another three more projects – the expansion of KPE/TPE interchange, the extension and reconstruction of Newton Flyover and the construction of New Lornie Road.

Over the next five years, PUB will also spend S\$750m to expand the capacity of six major canals across the island by 30% to 45%. Not all available projects may fit OKP's criteria and we believe that OKP will continue to be selective. What we like about the PUB projects is that some of them will be rather complex and command high margins. For instance, the expansion of certain canals can be a challenge given land and traffic constraints. Moreover, the rich flow of projects mean that OKP will be able to maintain a high utilization rate.

Financial Review: OKP's balance sheet remains strong. It ended the year with net working capital of S\$65.0m, fully backed by cash of S\$92.5m. In contrast, net working capital at the end of 2010 was S\$48.4m. Trade and other receivables remained at a comfortable S\$29.4m. Full year operating cash flow was S\$5.5m as the company spent S\$25.5m to reduce trade and other payables.

The company proposed a 2 S cents final dividend, which will bring full year 2011 payout to 3 S cents per share – about 1/3 of EPS. Last year, OKP had paid out an additional 2 S cents special dividend. The absence of this additional dividend in spite of a >50% jump in net profit suggests that *OKP is setting aside cash for expansion*. OKP only has S\$1.1m of financial leases and does not require funds to repay bank borrowings.

Property Development: OKP has been signaling its intent to enter the property development market for some time. Based on our discussion with the management, several opportunities are being studied at the moment. For some projects, the company has yet to commit if they would take on a stake in the development or continue to contribute as a builder, depending on the risk/reward profile of the project. OKP is also not limiting itself to the Singapore market. China Sonangol International (S) Pte Ltd (CSIS) as a strategic investor has been a source of leads for OKP. We await for definitive details to materialize.

We believe that OKP will be using its initial property development investments as a platform to eventually move on to larger projects. While there are concerns that the property market in Singapore may be slowing down, the impact on OKP will be relatively small given its limited initial exposure to the property market. Moreover, certain sites may still enjoy upside gains depending on the nature of the development. As such, project selection will still play a role in OKP's venture into property development.

Outlook: In our updated model, we expect 2012 to continue to be a good year for OKP. We are forecasting net profit of S\$27.6m for FY12. We continue to like OKP for its strong core "bread-and-butter" civil engineering business and its efforts to incubate a new source of earnings.

Figure 2: Results Overview

S\$m	FY11	FY10	Growth	Prior FY11F	%
Revenue	109.8	139.9	-21.5%	114.7	95.7%
Gross Profit	43.2	29.5	46.5%	37.5	115.2%
EBIT	32.3	20.6	56.7%	28.0	115.2%
PATMI	26.6	17.0	56.7%	23.1	115.0%
			Chg		Variance
Gross Margin	39.3%	21.1%	18.3%	32.7%	6.7%
EBIT Margin	29.4%	14.7%	14.7%	24.4%	5.0%
Net Margin	24.2%	12.1%	12.1%	20.1%	4.0%

S\$m	2Q FY10	3Q FY10	4Q FY10	1Q FY11	2Q FY11	3Q FY11	4Q FY11
Revenue	39.8	36.6	29.6	32.8	28.3	25.5	23.2
Gross Profit	6.6	7.1	10.0	8.8	11.2	8.3	15.0
EBIT	5.2	5.6	5.5	6.4	8.4	5.9	11.6
PATMI	4.3	4.5	4.6	5.2	6.9	4.9	9.5
Gross Margin	16.5%	19.4%	33.8%	26.7%	39.4%	32.4%	64.8%
EBIT Margin	13.2%	15.2%	18.6%	19.6%	29.6%	23.0%	50.0%
Net Margin	10.8%	12.3%	15.7%	15.9%	24.3%	19.2%	41.1%

Source: Company Announcements, SIAS Research

Figure 3: Economic Profit Valuation Model

S\$m	FY12F	FY13F	FY14F
Revenue	126.3	138.9	152.8
EBIT	33.6	34.2	36.9
Tax on EBIT	-5.9	-6.0	-6.5
NOPLAT	27.7	28.2	30.4
Invested Capital	64.2	79.3	90.8
% of Debt	1.8%	1.4%	1.2%
% of Equity	98.2%	98.6%	98.8%
WACC	11.8%	11.8%	11.8%
Capital Charge	7.6	9.3	10.7
Economic Profit	20.1	18.9	19.7
Terminal Value			217.3
Discount Rate	0.95	0.85	0.76
Present Value	19.0	16.0	14.9
Book Value	88.1	Risk Free	2.5%
Explicit Value	49.9	Beta	1.25
Terminal Value	164.4	Market RP	7.5%
Value of Firm	302.4	Cost of Equity	11.9%
Number of Shares (m)	309.1	Net Cost of Debt	7.7%
Value per share (S\$)	0.980	LT Growth	2.5%

The number of shares assumes the full conversion of all remaining warrants. OKP currently has only 3.8m warrants outstanding.

Source: SIAS Research

Figure 4: Financial Forecasts and Estimates

	FY08	FY09	FY10	FY11	FY12F	FY13F	FY14F
Revenue	101.8	130.0	139.9	109.8	126.3	138.9	152.8
Gross Profit	21.3	23.4	29.5	43.2	44.2	45.1	48.9
Operating Profit	11.6	15.8	19.7	31.2	31.6	32.2	34.9
Net Profit	9.5	14.4	17.0	26.6	27.6	28.1	30.4
Attributable to Shareholders							
Total Current Assets	63.0	105.8	131.2	124.1	127.0	130.7	132.8
Total Non-Current Assets	13.9	16.6	21.9	24.2	31.2	36.8	43.4
Total Current Liabilities	33.3	61.2	82.8	59.1	58.6	56.6	53.2
Total Non-Current Liabilities	2.8	1.7	1.3	1.1	0.5	0.5	0.5
Total Equity	40.7	59.5	68.9	88.1	99.1	110.4	122.5
Cash from Operating Activities	15.8	44.6	39.1	5.5	25.2	31.2	23.5
Cash from Investing Activities	-0.2	-5.0	-8.1	-4.7	-8.3	-9.9	-11.7
Cash from Financing Activities	-5.1	2.6	-8.3	-8.4	-16.6	-16.9	-18.2
Net change in cash	10.5	42.3	22.8	-7.6	0.3	4.4	-6.5
Receivable Days	111.0	73.1	71.3	96.2	96.2	96.2	96.2
Payable Days	146.7	147.3	224.1	360.1	240.0	210.0	180.0
ROE (%)	25.6%	29.2%	26.5%	33.8%	29.4%	26.8%	26.0%
ROA (%)	12.3%	14.5%	12.3%	17.6%	18.0%	17.3%	17.7%
Debt/Equity	10.3%	4.5%	2.7%	1.3%	1.1%	1.0%	0.9%
Current Ratio	1.9	1.7	1.6	2.1	2.2	2.3	2.5
EPS (\$ cents)	4.21	6.06	6.50	9.02	9.04	9.22	9.94
BV/Share (\$ cents)	25.6	23.1	25.3	28.3	32.0	35.6	39.6
PER	15.2	10.6	9.8	7.1	7.1	6.9	6.4
P/BV	2.5	2.8	2.5	2.3	2.0	1.8	1.6

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.

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