

OKP Holdings Limited

High Growth and Unrealized Value

OKP Holdings Limited (OKP) reported a strong set of 2Q FY11 results that exceeded our high expectations, with PATMI growing by 60.6% YoY and 31.6% QoQ. With an estimated net order book of close to S\$200m and proven cost management initiatives, we now expect OKP to turn in a record PATMI of S\$23.1m for FY11F versus S\$17.0m in FY10. **Maintain Increase Exposure based on an upgraded intrinsic value of S\$0.980.**

Key Developments:

Margin Expansion Sustained: OKP's net margin grew by 13.6% points YoY and 8.4% points QoQ to 24.3% in 2Q FY11. Accordingly, OKP's sustained margin expansion came on the back of a) its experience and resultant knowledge in "design-and-build" projects and b) greater efficiencies arising from its new yard at Sungei Kadut.

More "Design-and-Build" Projects: We look forward to OKP sustaining its margins as it embarks on more "design-and-build" projects. OKP current gross order book of S\$381.6m will last the company until Oct 2014 with more than S\$100m of revenue to be recognized in 2012. Our checks on GeBIZ showed that OKP is among the top three bidders for at least two PUB projects totalling S\$56.1m. If successful, these contracts will raise OKP's order book by about 15%. Looking beyond 2011, the North South Expressway will also provide ample opportunities for OKP.

Multi-Prong Strategy: Moreover, OKP is not banking on the infrastructure sector for all of its growth. According to the management, OKP is seeing more tender opportunities from the Oil & Gas industry. Following its EGM last year, OKP now also has the mandate to pursue property development projects and capitalize on opportunities from China Sonangol Land.

Unrealized Value: We reiterate that OKP currently sits on cash of S\$98.6m or net current assets of S\$54.5m and leases of just S\$1.3m. This cash reserve can be used to fund inorganic growth and maintain profitability. Excluding its cash of 32.4 S cents per share, OKP trades at an attractive multiple of 4.5x trailing 12M earnings.

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 had recently formed a JV to enter the private property construction segment.

Financial Highlights

(Y/E Dec) S\$ m	FY09	FY10	FY11F
Revenue	130.0	139.9	130.1
Gross Profit	23.4	29.5	39.0
Earnings	14.4	17.0	23.1
EPS (S cts)	6.1	6.5	8.1

Source: Company, SIAS Research

Key ratios (FY11F)

PER	7.9
P/BV	2.3
Return on Common Equity	29.6%
Return on Assets	15.7%
Gross Debt to Common Equity	2.1%
Current ratio	2.1

Source: SIAS Research

Indexed Price Chart

Green (FSSTI)

White (OKP)



Source: Bloomberg

52wks High-Low[^] S\$0.685 /S\$0.4316

Number of Shares 304.4m

Market Capitalization S\$194.8m

[^]adjusted for warrants conversion

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Strong Delivery and Execution Deserves Attention

Prudence and Cost Control Worked: OKP's net attributable profit reached S\$12.1m in 1H FY11, in spite of a 17% decline in revenue. We are not too concerned about the reduction in revenue. OKP's strategy of bidding for projects prudently and controlling costs tightly has raised its margins and reduced reliance on order book expansion for profit growth.

In fact, OKP reduces its execution risk, such as unforeseen delays and rework, by pacing its order book growth. In the construction industry, delays and rework can lead to cost overruns and liquidated damages.

Moreover, OKP's gross order book of S\$381.6m means that it has ample revenue to be recognized over the next few quarters. About S\$232.6m or 61% of OKP's order book are for projects that will stretch beyond 2011.

Figure 1: OKP's Order Book and Selected Bids

No	Brief Description	Start Date	Est. End Date	Contract Value (\$m)
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
10	Sewer Extension – various locations	29-Mar-11	Nov-12	4.2
11	Interchange at TPE (Design-and-Build)	4-Apr-11	3-Oct-14	61.7
12	PUB – Roadside Drains Improvement I	25-May-11	Nov-12	3.4
13	PUB – Roadside Drains Improvement II	4-Jul-11	Jan-13	2.5

* Construction of the Angullia Park Development is being undertaken by a 50/50 JV with OKP and Soilbuild.

No	Selected Tenders	OKP's Bid	OKP's Bid Position
1	PUB – Improvement to Alexandra Canal	S\$46.8m	Top 3
2	PUB – Roadside Drains Improvement III	S\$9.3m	Top 3

Source: Company Announcements, LTA website, GeBiz, SIAS Research

Recap on the TPE Interchange Project: We recall that work on the TPE interchange project would have already started before the CTE project is completed by the end of this year. This further reassures us that OKP will be able to sustain its profitability in 2011.

The scope of works for the TPE project is similar to the CTE widening project and includes the construction of roads, slip roads, new vehicular structure (flyover), ramps and electrical substations.

Conserving Cash: OKP declared an interim dividend of S\$0.01 for 1H FY11, which is comparable to that of last year, in spite of the strong performance and high cash balance. We view this as a signal that OKP is setting aside cash for inorganic growth, i.e. investments in potential opportunities – a potential catalyst in the future.

Figure 2: Results Overview

S\$m	1H FY11	1H FY10	Growth	Prior FY11F	1H % of FY11F
Revenue	61.1	73.7	-17.0%	153.8	39.8%
Gross Profit	19.9	12.4	60.9%	38.5	51.8%
EBIT	14.8	9.5	55.6%	27.6	53.6%
PATMI	12.1	7.8	55.6%	22.8	53.2%
			Chg		Variance
Gross Margin	32.6%	16.8%	15.8%	25.0%	7.6%
EBIT Margin	24.2%	12.9%	11.3%	17.9%	6.3%
Net Margin	19.8%	10.6%	9.3%	14.8%	5.0%

Revenue was lower than expected, but margin growth led profit to outperform.

S\$m	2Q FY10	3Q FY10	4Q FY10	1Q FY11	2Q FY11
Revenue	39.8	36.6	29.6	32.8	28.3
Gross Profit	6.6	7.1	10.0	8.8	11.2
EBIT	5.2	5.6	5.5	6.4	8.4
PATMI	4.3	4.5	4.6	5.2	6.9
Gross Margin	16.5%	19.4%	33.8%	26.7%	39.4%
EBIT Margin	13.2%	15.2%	18.6%	19.6%	29.6%
Net Margin	10.8%	12.3%	15.7%	15.9%	24.3%

Source: Company Announcements, SIAS Research

Forecasts and Valuation: We raised our FY11F PATMI forecast from S\$22.8m to S\$23.1m following OKP's strong performance in 2Q FY11. However, we lowered our revenue forecast for FY11F to S\$130.1m in line with the decline in revenue. Incorporating the higher margins into our model, we arrived at a higher intrinsic value of S\$0.980. **Maintain Increase Exposure.**

Figure 3: Economic Profit Valuation Model

S\$m	FY11F	FY12F	FY13F	FY14F
Revenue	130.1	146.3	168.3	193.5
EBIT	28.0	32.8	37.7	43.4
Tax on EBIT	-4.9	-5.7	-6.6	-7.6
NOPLAT	23.1	27.1	31.2	35.9
Invested Capital	71.2	78.3	88.7	102.8
% of Debt	2.6%	2.4%	2.1%	1.8%
% of Equity	97.4%	97.6%	97.9%	98.2%
WACC	11.8%	11.9%	11.9%	11.9%
Capital Charge	8.4	9.3	10.6	12.3
Economic Profit	14.7	17.8	20.6	23.6
Terminal Value				256.7
Discount Rate	0.95	0.85	0.75	0.67
Present Value	13.9	15.1	15.6	15.9
Book Value	68.9	Risk Free		2.1%
Explicit Value	60.4	Beta		1.1
Terminal Value	173.0	Market RP		9.1%
Value of Firm	302.4	Cost of Equity		12.1%
Number of Shares (m)	309.1	Net Cost of Debt		1.8%
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 4.67m warrants outstanding.

Source: SIAS Research

Figure 4: Financial Forecasts and Estimates

	FY08	FY09	FY10	FY11F	FY12F	FY13F	FY14F
Revenue	101.8	130.0	139.9	130.1	146.3	168.3	193.5
Gross Profit	21.3	23.4	29.5	39.0	43.9	50.5	58.1
Operating Profit	11.6	15.8	19.7	28.0	32.8	37.7	43.4
Net Profit	9.5	14.4	17.0	23.1	27.1	31.2	35.9
Attributable to Shareholders							
Total Current Assets	63.0	105.8	131.2	115.4	123.5	137.3	153.8
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	53.8	55.7	62.6	71.4
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	87.0	97.8	110.3	124.7
Cash from Operating Activities	15.8	44.6	39.1	4.4	20.0	45.9	35.7
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	-13.9	-16.3	-18.7	-21.5
Net change in cash	10.5	42.3	22.8	-16.4	-4.6	17.3	2.4
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%	29.6%	29.3%	29.9%	30.5%
ROA (%)	12.3%	14.5%	12.3%	15.7%	18.3%	19.0%	19.3%
Debt/Equity	10.3%	4.5%	2.7%	2.1%	1.9%	1.7%	1.5%
Current Ratio	1.9	1.7	1.6	2.1	2.2	2.2	2.2
EPS (S cents)	4.21	6.06	6.50	8.11	8.77	10.08	11.61
BV/Share (S cents)	25.6	23.1	25.3	27.6	31.1	35.2	39.8
PER	15.2	10.6	9.8	7.9	7.3	6.3	5.5
P/BV	2.5	2.8	2.5	2.3	2.1	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.

IMPORTANT DISCLOSURE

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