

OKP Holdings Limited

Stunning Results Confirm Growth

OKP Holdings Limited (OKP) handed in another impressive set of results with 1Q FY11 net attributable profit growing by **49.4% YoY** to S\$5.2m. This set of results confirmed that 4Q FY10's record net margin of 15% - 16% is being repeated as OKP takes on more complex projects, while managing its costs tightly. OKP continues to trade at a very attractive FY11F P/E of only 3.3x on an ex-cash basis. **Maintain Increase Exposure call based on a revised intrinsic value of S\$0.950 (previously S\$0.930).**

Key Developments:

How Margins Were Enhanced: The crux of the issue is that OKP has been bidding prudently, with a focus on more complex projects, e.g. design and build contracts, where the design component will give OKP the flexibility to tailor its designs and processes to maximize margins. Examples of such contracts include the CTE widening and the TPE interchange projects. These two projects alone have a combined value of S\$181.0m.

Property Development Opportunities? OKP has been looking at property development and construction opportunities for some time now, following its EGM last year to expand its scope of activities. Last month, China Sonangol Land bought Amber Towers for S\$161.6m, presenting another opportunity for further cooperation to OKP. Previously, OKP's JV with Soilbuild won a S\$83.5m contract to build China Sonangol's Angullia Park Development.

Fine Execution of Strategy + Huge Warchest: The point is that OKP's brilliant strategy of targeting multiple segments within the construction industry including MRT construction, while selecting only highly profitable projects, provides the company with ample growth opportunities. With a warchest of S\$111.0m of cash, OKP has the financial resources to either pursue growth or to return capital to shareholders. This represents substantial value to be discovered.

Increase Exposure

- Intrinsic Value S\$0.950
- Prev Close S\$0.650

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	153.8
Gross Profit	23.4	29.5	38.5
Earnings	14.4	17.0	22.8
EPS (S cts)	6.1	6.5	8.0

Source: Company, SIAS Research

Key ratios (FY11F)

PER	8.1
P/BV	2.4
Return on Common Equity	29.2%
Return on Assets	15.3%
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\$0.6644 /S\$0.4074
 Number of Shares 304.3m
 Market Capitalization S\$197.8m
[^]adjusted for warrants conversion

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A Record Set of Results That Will Be Revisited

Record Set of Results: OKP's 1Q FY11 net attributable profit of S\$5.2m came on the back of record margins. Net margin grew by 5.6% points YoY and 0.2% points QoQ. These margins came about due to cost savings obtained from design and build contracts. Previously, build only contracts came with strict specifications that may not margin centric. The additional design flexibility gave OKP room to eke out cost savings without compromising its high standards of construction.

Strong Order Book to Sustain Margins: Ultimately, OKP has been successful in selecting and bidding for high value contracts. Currently, the high value design and build contracts, i.e. the CTE widening and TPE interchange projects, make up for almost 50% of OKP's current order book of S\$375.8m. Largely as a result of the TPE project, OKP's order book was increased by 21.2%.

TPE Interchange Project: Before the CTE project is completed by the end of this year, work would have started on the newly awarded TPE Interchange contract. The excellent timing of these two projects, as a result of the company's careful bidding process, meant that the high margins will be sustained for the whole of 2011. The TPE Interchange project is expected to be completed by Oct 2014.

The scope of works for the TPE project is vast and includes the construction of roads, slip roads, new vehicular structure (flyover), ramps and electrical substations. We felt that these works are similar to OKP's CTE widening project and as such, OKP should be able to manage project risks relatively well.

These developments confirm that OKP is able to grow its traditional civil engineering / road construction business without compromising margins. The strong margins also showed us that OKP has been successful in mitigating higher construction costs, e.g. labour costs, worker levies and raw material prices.

Property Development and Construction will be another Growth Engine: For 1Q FY11, OKP made just S\$13k of net profit from the Angullia Park Development project on proportionate revenue of S\$0.3m. We understand that construction will pick up pace in 2Q FY11 once ground clearing and piling works have been completed. Consequentially, we will see more revenue and profit being recognized with a greater percentage of the project completed.

With the Amber Towers development, we see that OKP may just enter into another private property construction project in the medium term (we also do not rule out any role in property development). Of note, OKP is now a substantially stronger player in this field as a result of its experience with Soilbuild.

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
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

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

Source: Company Announcements, LTA website, SIAS Research

Forecasts and Valuation: As a result of OKP's strong performance and robust margins, we raised our FY11F PATMI forecast from S\$19.3m to S\$22.8m. We had previously not expected OKP's margins to be so strong. Taking into account the conversion of all outstanding warrants, we estimate OKP's FY11F EPS to come in at 8.1 S cents (up 24.1% versus FY10 EPS of 6.5 S cents). Inputting these updates into our valuation model, we arrived at an intrinsic value of S\$0.950. **Maintain Increase Exposure.**

Additional catalysts that may provide further share price upside include the successful tender of a MRT construction contract, and in 2012, the bidding of the North South Expressway contracts – OKP's traditional strength.

Figure 2: Results Analysis

S\$m	1Q FY11	1Q FY10	Growth	Prior FY11F	%
Revenue	32.8	33.9	-3.1%	160.8	20.4%
Gross Profit	8.8	5.8	50.9%	32.2	27.2%
EBIT	6.4	4.3	50.8%	23.4	27.5%
PATMI	5.2	3.5	49.4%	19.3	27.1%
Gross Margin	26.7%	17.1%	9.6%	20.0%	6.7%
EBIT Margin	19.6%	12.6%	7.0%	14.6%	5.0%
Net Margin	15.9%	10.3%	5.6%	12.0%	3.9%

Source: SIAS Research

OKP's 1Q FY11 margins have significantly exceeded our forecasts. In all, we are not concerned about the YoY decline in revenue, as it is most likely due to timing differences. Construction revenue is recognized based on percentage of completion of existing projects.

More importantly, OKP's order book, which translates to demand for its services, is still growing.

Figure 3: Economic Profit Valuation Model

	FY11F	FY12F	FY13F	FY14F
Revenue (S\$m)	153.8	176.9	203.5	234.0
EBIT (S\$m)	27.6	33.4	40.3	48.7
Tax on EBIT (S\$m)	-4.8	-5.8	-7.0	-8.5
NOPLAT (S\$m)	22.8	27.6	33.3	40.2
Invested Capital (S\$m)	71.2	88.7	99.7	113.1
% of Debt	2.6%	2.1%	1.8%	1.6%
% of Equity	97.4%	97.9%	98.2%	98.4%
WACC	12.6%	12.6%	12.7%	12.7%
Capital Charge (S\$m)	9.0	11.2	12.6	14.3
Economic Profit (S\$m)	13.8	16.4	20.7	25.8
Terminal Value (S\$m)				259.9
Discount Rate	0.91	0.81	0.72	0.64
Present Value (S\$m)	12.7	13.3	14.9	16.5
Book Value (S\$m)	68.9	Risk Free		2.4%
Explicit Value (S\$m)	57.3	Beta		1.1
Terminal Value (S\$m)	166.1	Market RP		9.7%
Value of Firm (S\$m)	292.3	Cost of Equity		12.88%
Number of Shares (m)	309.1	Net Cost of Debt		1.76%
Value per share (S\$)	0.950	LT Growth		2.50%

The number of shares assumes the full conversion of all remaining warrants. OKP currently has only 4.8m warrants outstanding.

Source: SIAS Research

Figure 4: Financial Forecasts and Estimates

	FY08	FY09	FY10	FY11F	FY12F	FY13	FY14
Revenue	101.8	130.0	139.9	153.8	176.9	203.5	234.0
Gross Profit	21.3	23.4	29.5	38.5	46.0	54.9	65.5
Operating Profit	11.6	15.8	19.7	27.6	33.4	40.3	48.7
Net Profit	9.5	14.4	17.0	22.8	27.6	33.3	40.2
Attributable to Shareholders							
Total Current Assets	63.0	105.8	131.2	119.1	132.8	149.8	169.9
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	57.7	65.0	74.3	84.9
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	86.9	97.9	111.2	127.3
Cash from Operating Activities	15.8	44.6	39.1	-1.7	32.4	41.9	48.1
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	-13.7	-16.5	-20.0	-24.1
Net change in cash	10.5	42.3	22.8	-22.3	7.6	12.0	12.2
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%	29.2%	29.8%	31.8%	33.7%
ROA (%)	12.3%	14.5%	12.3%	15.3%	17.8%	19.0%	20.1%
Debt/Equity	10.3%	4.5%	2.7%	2.1%	1.9%	1.7%	1.4%
Current Ratio	1.9	1.7	1.6	2.1	2.0	2.0	2.0
EPS (S cents)	4.21	6.06	6.50	8.00	8.92	10.77	13.00
BV/Share (S cents)	25.6	23.1	25.3	27.6	31.1	35.5	40.7
PER	15.4	10.7	10.0	8.1	7.3	6.0	5.0
P/BV	2.5	2.8	2.6	2.4	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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