

15 March 2013 | Visit Note

## Cahaya Mata Sarawak Bhd

*Price hardly reflects fundamentals*

Not Rated

Fair Value: RM6.86

### INVESTMENT HIGHLIGHTS

- Direct proxy to robust Sarawak.
- Earnings outlook remains bright leveraging from Sarawak's robust construction and Samalaju Development.
- Healthy margins and balance sheet, minimum 30% dividend payout.
- Trading at discounted valuation, probably due to political risks. Expect stock to gravitate towards its fundamentals after GE13. Fair value of RM6.86 based on Sum-of-parts (SOP) valuation.

We went on a familiarisation trip to Sarawak last week organised by Cahya Mata Sarawak Bhd (CMS). The trip covered: 1) a briefing with Regional Corridor Development Authority (Recoda) management on the progress of SCORE, 2) CMS's corporate presentation chaired by CMS's CEO, Datuk Richard Curtis, 3) visit to CMS's property projects in Kuching, 4) visits to clinker and cement plant in Mambung and Bintulu, and 5) visit to Samalaju Industrial area.

**SCORE's Samalaju progressing well...** SCORE project is progressing very well with total committed foreign investment of RM29.1b since the establishment of the project in 2008. The development of Samalaju (one of the 5 SCORE areas) is in advanced stage now with the overall construction of Samalaju's projects 30% completed.

**... benefitting CMS and Sarawak contractors.** The Recoda's official also mentioned that there will be more infrastructures such as roads, water treatment plants, and power plants to be built in Sarawak, particularly in Samalaju due to higher population and industrial activities. We believe this will benefit not only CMS as the most prominent company in Sarawak, but also other Sarawak companies such as Hock Seng Lee and Naim Holdings Bhd.

**Earnings outlook to stay bright over short – long term due to direct proxy status to Sarawak growth story.** We believe CMS's earnings outlook will stay bright in the foreseeable future leveraging on Sarawak's growth story. This is premised on the fact that i) CMS is currently a sole supplier of cement in Sarawak, ii) CMS has exposure to one of the most lucrative SCORE projects (a ferrosilicone plant) though its 20% stake in OM Materials Sarawak, iii) CMS has other businesses that is "linked" to the Sarawak's development plan (property, construction materials, quarry, road maintenance, and Samalaju Development)

**Nonetheless, CMS's fundamentals have yet to be priced in.** We believe CMS's valuation does not reflect its fundamentals despite its status as a direct proxy to Sarawak's robust development. The current price is trading at huge 55% discount to fair value of RM6.86 (based on SOP). The stock is also trading at undemanding 6.8x of PER against its 5-year average PER of 9.5x.

RETURN STATS	
Price (14 <sup>th</sup> March 2013)	RM3.09
Fair Value	RM6.86
Expected Share Price Return	+122%
Expected Dividend Yield	+5.5%
<b>Expected Total Return</b>	<b>+127.5%</b>

STOCK INFO	
KLCI	1640.74
Bursa / Bloomberg	1651 / BIN MK
Board / Sector	Main/ Construction
Syariah Compliant	YES
Issued shares (mil)	322.8
Par Value (RM)	1.00
Market cap. (RM'm)	984.63
Price over NA	0.6x
52-wk price Range	RM2.34–RM3.50
Beta (against KLCI)	0.89
3-mth Avg Daily Vol	0.15m
3-mth Avg Daily Value	RM0.13m
Major Shareholders	
Majaharta Sdn Bhd	13.8%
Lejla Taib	11.4%
Dato Sri Sulaiman	9.1%

## INVESTMENT STATISTICS

FYE Dec	FY08	FY09	FY10	FY11	FY12	FY13F*
Revenue	893.0	874.6	943.5	1012.6	1203.3	1249.0
Pre-tax Profit	150.6	98.5	118.8	178.7	230.8	241.7
Net Profit	95.8	41.0	65.8	120.0	138.8	149.0
EPS	29.1	12.4	20.4	37.2	42.3	45.0
DPS sen	5.0	5.0	5.0	15.0	17.0	17.0
Dividend Yield	1.6	1.6	1.6	4.9	5.5	5.5
Net Profit Margin %	10.7	4.7	7.0	11.9	11.5	11.9
Return on Equity %	7.7	3.2	5.1	8.8	9.6	8.9
PER	10.6	24.7	15.1	8.3	7.3	6.8

Source: Company, Bloomberg, MIDF Research  
\*Consensus Figures

## BACKGROUND AND UPDATE

**The biggest in the biggest pie.** With most of CMS's operations based in Sarawak, CMS is the biggest private sector player in the largest state in Malaysia, Sarawak. From humble beginnings dating back to 1974 as a manufacturer of a single product, cement, CMS's portfolio today spans construction materials, trading, construction, road maintenance, property development, financial services and education.

### **Cement Division**

**The only cement player in Sarawak.** CMS is the sole supplier of cement and clinker in Sarawak. It has 2 plants in Kuching and Bintulu with combined capacity of 1.75mmt per annum. It also has a clinker plant in Mambung with 0.8 mmt p.a capacity. Being the only cement player in Sarawak, we believe CMS's cement division earnings is sustainable in the foreseeable future driven by stable cement price coupled with healthy demand of 10%-12.5% amidst a robust construction activities for both infrastructure and property in Sarawak. The division contributed a large pie of its topline, and made up 43% of its RM231m total pre-tax income in FY12.

**Going forward,** due to increasing cement demand in Sarawak, CMS intends to expand its existing clinker plant most probably in 2014 in Mambung into an integrated cement plant. This will add another 0.6mmt capacity per year.

### **Construction Materials and Trading**

**Complement cement, construction and property development divisions.** The management highlighted that CMS's construction materials division, which is the second biggest earner of CMS's bottomline, will continue to grow and more importantly complement its existing construction-related businesses – cement, construction and property divisions. Currently it has 5 quarries in Kuching with licenses of up to 20 years. It is one of the largest quarry operators in Sarawak with 23% market share or 3.15mmt pa of rated capacity per year. Meanwhile, CMS has 6 premix plants in Kuching, Sarikei, Sibu, Miri, Bintulu and Limbang to manufacture and supply premix concrete for use in roads and airport runways. CMS also owns 5500mt p.a plant of steel wires and mesh in Bintulu with 80+% utilisation rate per year.

### **Construction & Road Maintenance**

**Road builder and operator.** As the management is not keen to seek for more construction jobs due to the low margin nature of the business, it is more focused on its recurring income business of road maintenance concessions in Sarawak. Currently it holds concessions of up until 2017 – 2018 to maintain 680km of Federal roads and 4,800 km of the State roads. In fact, the road concessions division is generating +70-80% more than its construction's pre-tax profit.

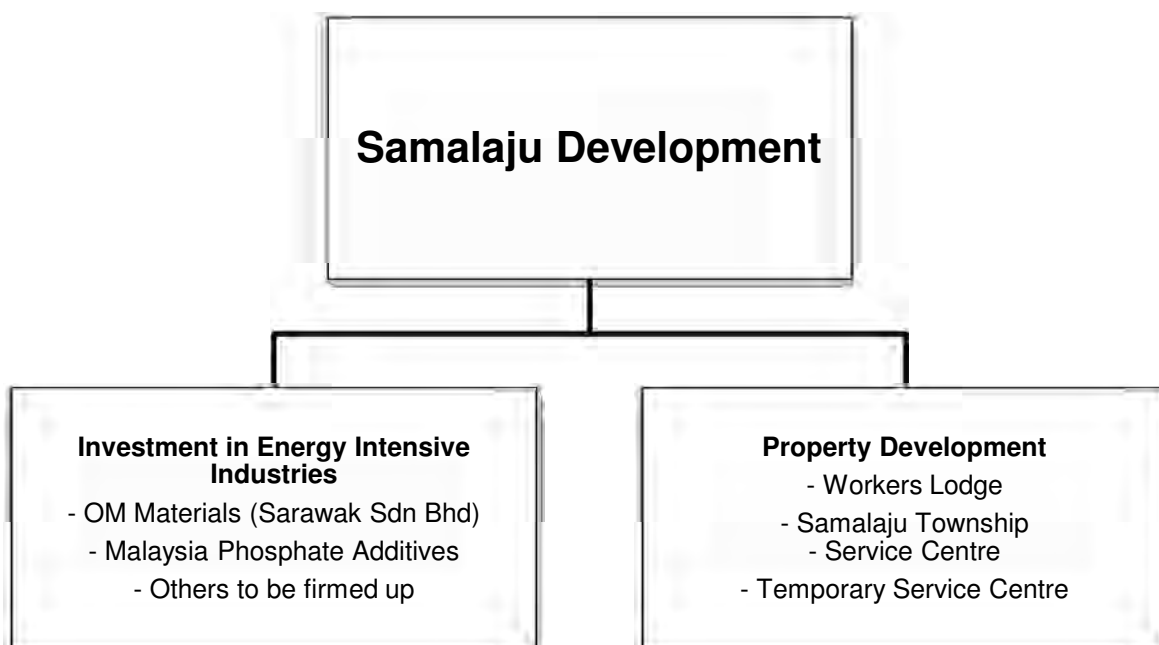
## Property Development

Although the division has yet to contribute significantly to CMS's bottomline, management updated that CMS is going to launch more property projects this year. CMS has few property projects in Kuching's strategic landbanks namely Bandar Samariang and The Isthmus. Management is also looking to sell the land if the opportunity arises. It had sold a 275.5-acre of land in Samariang, Kuching to Hock Seng Lee last year, totalling RM25.5m. The management explained that the key catalyst for property development in Kuching is the urbanisation of the Kuching town to cater the growing population.

Location	Stake	Acres	Estimated GDV (5 years)	Type of Development
Bandar Samariang Phase 1 (balance) and Part 1 of Phase 2	100%	4,211	474	Mixed use - mid income
The Isthmus	51%	199	511	Mixed use - new CBD
Lot 9244	51%	19	130	Semi Detached, Terrace
Lane Park Residences	51%	4	24	Boutique high end Semi-Detached
Bintawa Lot 622	51%	8	80	Commercial
Bintawa Lot 744	51%	35	350	Commercial with river frontage
Toll Bridge land Lot 9882	51%	8	150	Mixed use - prime river frontage
		<b>4,484</b>	<b>1,719</b>	

## Samalaju Development (One of 5 SCORE's nod growth area)

CMS has a direct involvement in Samalaju development with i) 20% direct stakes in OM Materials Sarawak Sdn Bhd (OM Materials) and ii) 51% direct stake in Samalaju Property Development Sdn Bhd. Samalaju is one of the 5 SCORE's area with ideal location to locate heavy and energy intensive industries. It involve heavy industrial areas with few major projects including Press Metal's Aluminium Ingots & Billets (completed), Tokuyama's Polycrystalline Silicon (on-going), Pertama Asia's and OM Materials' Silicone Manganese and Asia Advance Material's Ferrosilicon (on-going) plants.



**Strategic investment in OM Material Sarawak.** CMS's management is optimistic in its 20% stake in OM Materials Sarawak Sdn Bhd. OM Materials is listed on ASX and is one of the world's largest manganese ore producers with over 15 years incorporation. It is currently building a Ferrosilicon Alloys (FSA) plant with 308k mt p.a. (Phase 1) in Sarawak. The construction of the plant is scheduled to complete in 2015. The project cost stood at USD424m (RM1.29b) and it is funded with 70% debt and 30% equity. With the 20% stake in the company, CMS's equity portion works out to be USD25.4m (RM76.3m). As at 4QFY12, CMS has RM434m net cash balance, hence no issue on the funding.

**Additional associates income of RM77m starting from 2015.** Interestingly, management guided us that the investment is expected to gain USD613m revenue per year from 2015 onwards. With 20% stake in OM Material Sarawak, we estimate that CMS could generate a net profit of RM76.8m per year from 2015 onwards. This is on the basis of 30% project IRR guided by the management.

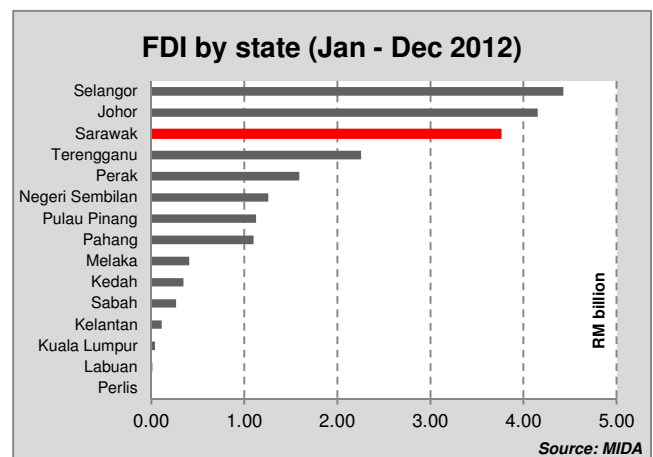
**Owns 51% in Samalaju property development.** With a 51% stake in Samalaju Property Development, the management expects the division to continue contributing to the Group's bottomline over the next 10 years. It built the workers lodge which contributed RM13m to its pre-tax income.

## OUTLOOK - Visible earnings

**To continue to "SCORE" in Sarawak.** Sarawak is entering a phase of "rapid development" which is driven by its SCORE projects. SCORE, particularly in Samalaju has attracted foreign investors since its inception in 2008. In fact, according to MIDA, Sarawak is now the 3<sup>rd</sup> biggest contributor to Malaysia's FDI contributed mainly by SCORE's Samalaju.

We understand that the key attractions of SCORE are: 1) the cheap power price as compared to any countries in the rest of the world, 2) rich natural resources, 3) adjacent to logistics with integrated ports, 4) cheap land value, and 5) cheap water tariff. This bodes well for CMS as one of the prominent companies in Sarawak involved in construction-related industries i.e. cement and clinker, construction materials, construction and road maintenance and property development. We believe SCORE will continue to attract foreign investors and the related projects will keep the corridor vibrant for some time. Hence, we see expect good earnings visibility for CMS moving forward.

**20% stake in OM Materials Sarawak – great investment.** The strategic investment in one of the biggest ore manganese manufacturer, OM Materials is expected to contribute significantly in the next 2 years. Ore manganese is essential to iron and steel production by virtue of its sulfur-fixing, deoxidizing, and alloying properties. Steelmaking, including ironmaking component, has accounted for most manganese demand, presently in the range of 85% to 90% of the total demand. Not only steel making, aluminium-making also demands ore manganese to act as alloying agent. Admittedly, the world's steel outlook is still bleak at the moment due to unresolved overcapacity problem in China. However, OM Materials Sarawak has secured offtake agreement with some of the steel millers. The offtakers are mostly global steel player leaders. The offtake is already signed, absorbing 60% of the rated plant capacity.



## FINANCIALS & FORECASTS

**CMS's topline is growing at double-digit growth for the past 4 years.** CMS's topline looks promising with 4-year CAGR of 11.2% for the period of 2009-2012. Strong growth was mainly attributable to the strong performance of its core businesses of cement and clinker, and construction materials & trading. Both divisions accounted for 60% of its total revenue as at FY13. Going forward, we expect the trend to continue in the foreseeable future, driven by strong construction growth in the state amidst urbanisation in Kuching and SCORE-related projects.

**Bottomline to be boosted by higher margins of its core businesses, with contribution from OM Materials to kick in most likely in 2016.** For the past 4 years, CMS's net profit has been growing at a double digit rate of growth (CAGR: 50%). This was boosted by healthy margins of its cement, construction material and construction and road maintenance divisions. CMS has continued its effort to improve its margins by cutting costs through upgrading its cement and clinker plant and eyeing for several concessions of road and maintenance in Sarawak.

**Healthy dividend.** CMS has a dividend policy of minimum payout of 30%. Interestingly, CMS has paid 17 sen dividends to shareholders, which represents 40.4% of FY12 net profit. This translates into a decent 5.5% dividend yield (based on current price). Going forward, management intends to maintain the policy of minimum 30% payout.

## VALUATION

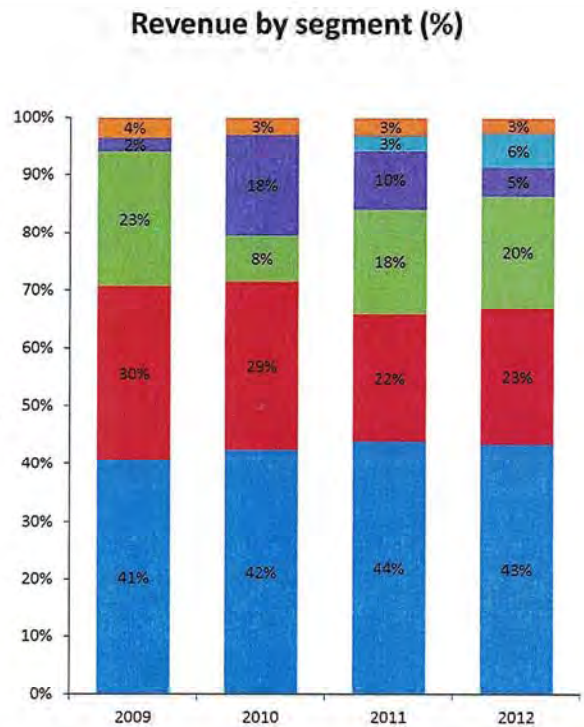
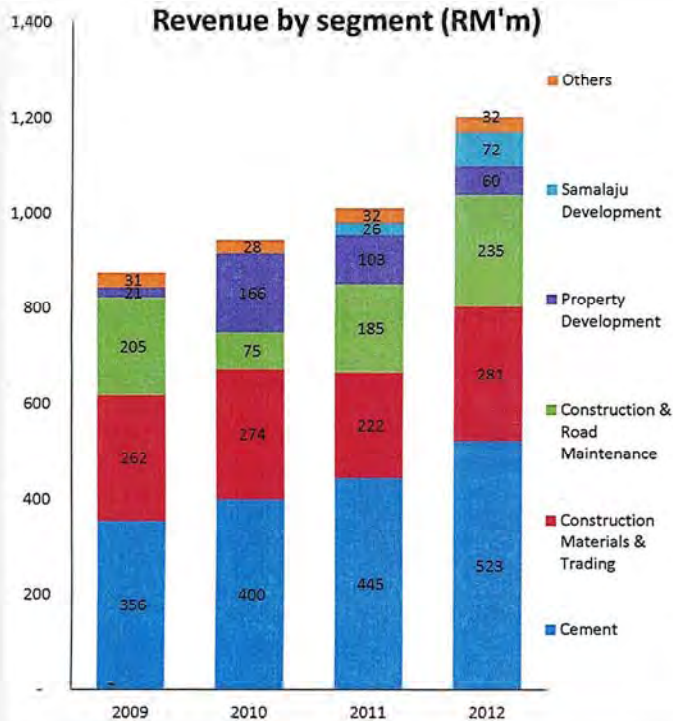
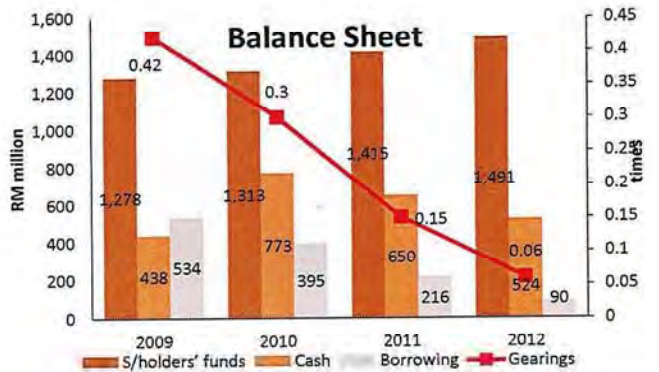
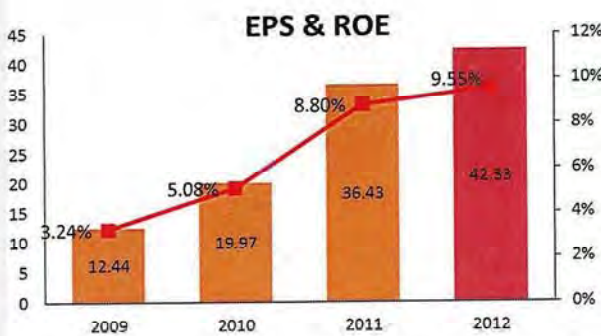
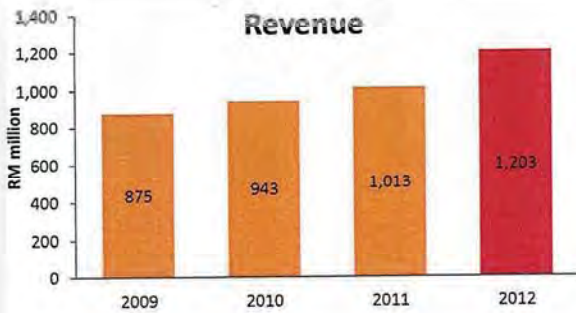
**Fundamental value may be reverted after GE13.** We value CMS at RM6.86 by adopting sum-of-the-parts (SOP) valuation. CMS closed at RM3.09 yesterday, which is a 55% discount to our RNAV valuation. Meanwhile, the stock is also trading at 28% discount (PER of 6.8x EPS13) to its 5-year historical average PER of 9.5x. We believe the discounted valuation is mainly due to the risk premium imputed by investors in view of the high political risk perceived to be associated with company.

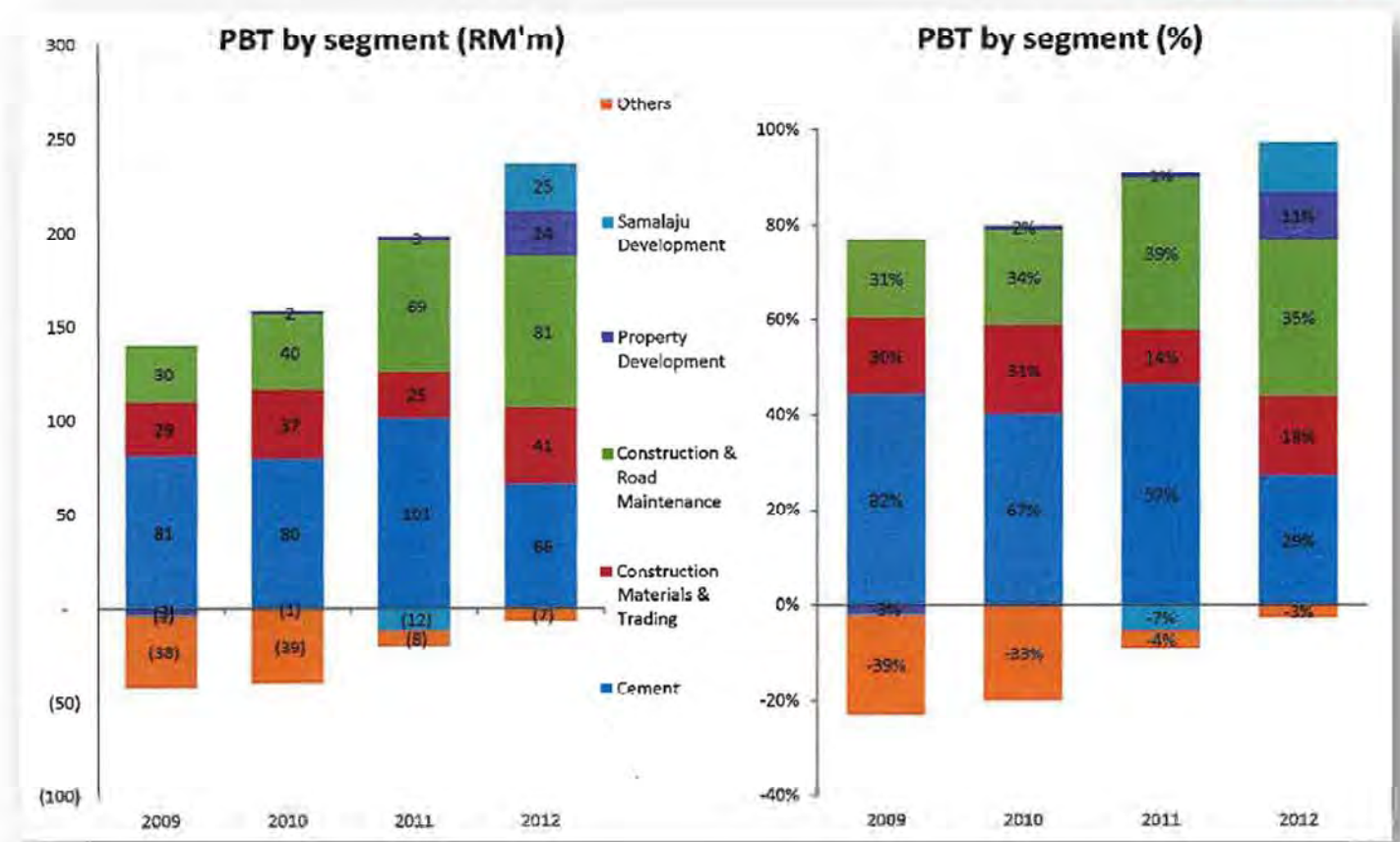
We believe the steep discount will narrow after the General Election. CMS has proven its mettle by registering another profit record last year. As a prominent company in Sarawak, it is a direct proxy to the state's urbanisation and SCORE which will sustain its business for over short- long term period. CMS is one of the election stocks that we expect to outperform moving forward.



Business segment	Stake	Method	Value
Cement	100%	FY13 PER of 10x	544.5
Construction materials & trading	100%	FY13 PER of 10x	286.0
Construction and road maintenance	100%	FY13 PER of 10x	613.6
Property Development	Various	NPV (10% WACC)	102.2
Listed associates			
KKB Engineering	20.05%	Market Capitalization	77.5
K&N Kenanga	25.07%	Market Capitalization	106.4
(-/+ ) Net Debt/Net Cash as at 4QFY12			434.4
RNAV			2266.9
No of shares			330.3
<b>RNAV / shares after 20% holding di</b>			<b>6.86</b>
<b>5 year average PER of 9.5x EPS13</b>			<b>4.28</b>







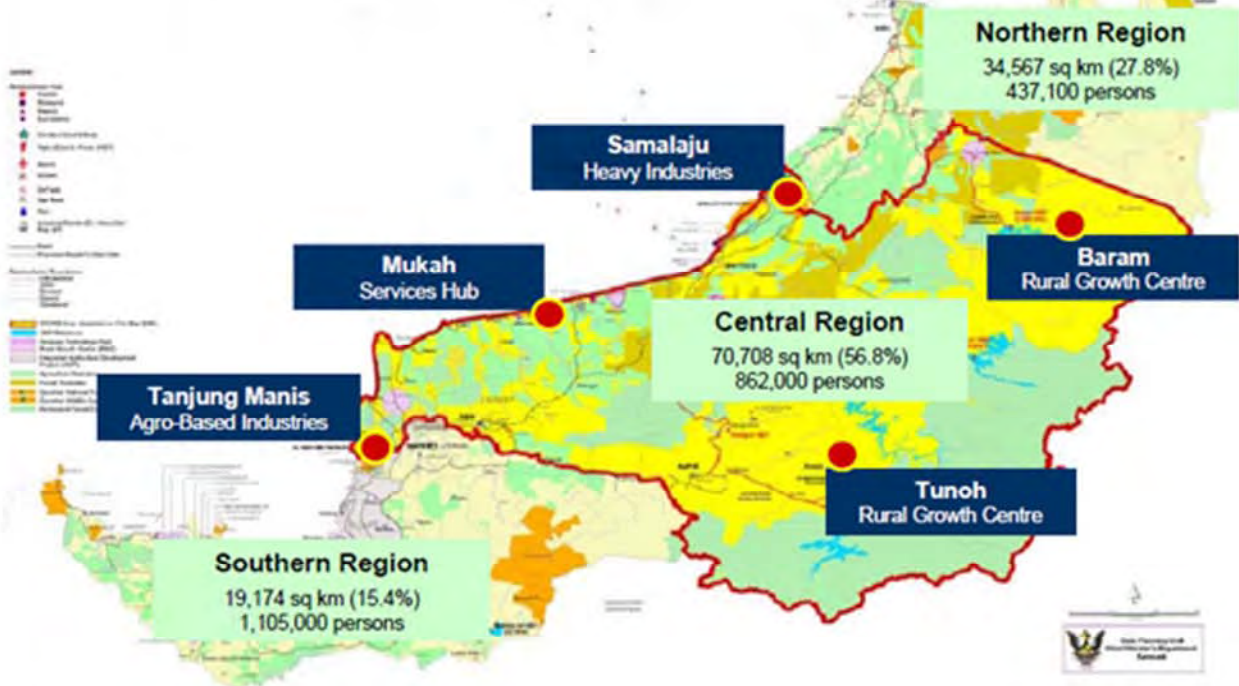
## DAILY PRICE CHART



Iqbal Zainal  
 mohd.iqbal@midf.com.my  
 03-2772 1668



## SCORE Development Area 5 New Growth Nodes





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### MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

#### STOCK RECOMMENDATIONS

BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	Total return is expected to be <15% over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >15% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.

#### SECTOR RECOMMENDATIONS

POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.