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COMPANY UPDATE
Wednesday, January 29, 2014
FBM KLCI: 1,781.25
Sector: Oil and Gas

Pantech Group Holdings Berhad

Beneficiary of Upcoming Offshore Fabrication Projects

TP: RM1.22 *(+36%)*
Last Traded: RM0.90
Buy

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We hosted a group luncheon with management of Pantech Group comprising: 1) Mr. Adrian Tan (Executive Director), 2) Mr. Wang Woon Chin (Group Financial Controller), and 3) Ms. Mavis Chew (Investor Relations and Accounts). Below are the key takeaways from the event:

New UK Capacity to Boost Earnings. Nautic's total capacity has increased to 800 mt p.a. (previous: 500 mt p.a.) following expansion on the plot of land (1.3 acres) nearby Nautic's existing factory (Figure 1). The new factory, with built-up area of approximately 22,500 sq ft, will also have a warehouse facility, similar to Nautic's first factory. The group targets to further increase Nautic's total capacity to 1,000 mt p.a. by CY15, which will provide a meaningful boost to bottomline. This is given higher margin (gross: circa 40%) for copper-nickel products which are approximately double of stainless steel and carbon steel products (circa 20%). In addition, we anticipate strong demand for Nautic's products, underpinned by its recent NORSOK certification and Petrobras' escalated capex spending at Brazil.

Figure 1: Nautic's New Facility in UK

Source: Company

Temporal Weakness in Local Demand. Due to the slow rollout of local O&G fabrication projects in 9MFY14, Pantech's domestic sales have reduced to 49% of total sales (FY13: 60%). This was also evident from weaker trading revenue in 9MFY14 (-22% YoY). We note that this is consistent with the slow trickle of fabrication awards in FY13-14 that have caused Malaysian yards, including those owned by Pantech's major clients (eg. SapuraKencana (SAKP) and MMHE) to be largely underutilised. To offset the slowdown in orders, Pantech had recently ventured into production of structural items to cushion the decline in sales.

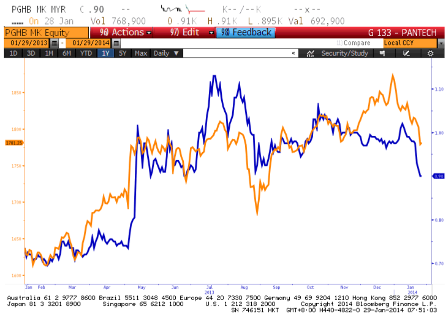
Share Information	
Bloomberg Code	PGHB MK
Stock Code	5125
Listing	Main Market
Share Cap (m)	564.9
Market Cap (RMm)	508.0
Par Value (RM)	0.20
52-wk Hi/Lo (RM)	0.69/1.16
12-mth Avg Daily Vol ('000)	3,164
Estimated Free Float (%)	37
Beta	1.8
Major Shareholders (%)	
Jimmy Chew	18.3%
Goh Teoh Kean	15.1%
Koperasi Permodalan Felda	10.4%

Forecast Revision (%)	FY14	FY15
Forecast Revision (%)	0	0
Net profit (RM mn)	57.2	65.0
Consensus	56.7	62.4
TA/Consensus	101	104
Previous Rating	Buy (Maintained)	

Financial Indicators	FY14	FY15
Net debt/equity (x)	0.3	0.3
NTA/Share (RM)	0.85	0.93
P/NTA (x)	1.1	1.0
ROE (%)	13.5	14.0
ROA (%)	7.9	8.3

Share Performance		
Price Change (%)	**Pantech**	**FBMKLCI**
1 mth	-7.7	-4.3
3 mth	-13.5	-1.9
6 mth	-14.3	-1.0
12 mth	22.4	8.8

12-Mth) **Share Price** relative to the **FBM KLCI**



Source: Bloomberg

Expect Rebound from New Fabrication Projects and RAPID. Nevertheless, we anticipate a rebound in Pantech's orders in FY16, underpinned by award of major projects for Pantech's clients in CY14, including SAKP, MMHE and Dialog Group. The time lag is because we anticipate clients to only place orders between 1 to 1 ½ years after award of contracts, in accordance with each project's progress.

We anticipate that SAKP and MMHE are leading contenders for major offshore fabrication projects due for award in CY14, including: i) USD1.0bn (RM3.1bn) Central Processing Platforms (CPP) and Wellhead Platforms (WHP) at Bergading field located at the North Malay Basin, ii) USD1.5bn CPPs and WHPs at West Sepat gas field offshore Terengganu, and 3) CPPs and WHPs at Bokor Dulang, and Semarang fields worth USD1.0bn for each field. In addition, the impending take-off of RAPID (Final Investment Decision in March 2014) will also result in long term earnings visibility for Pantech. We understand that the group had submitted preliminary costs quotations for RAPID back in 4QCY13.

Capex Halved in FY15. FY15 group capex of RM27.6mn is approximately half of FY14 capex spend (RM53.4mn), and comprises of: 1) RM2.0mn for land, 2) RM11bn for building, and 3) RM14.6mn for machinery and equipment. The new machineries will enable the group to increase production of higher value products, such as induction long bends, and fittings (nickel alloy and stainless steel) that carry better margin. In addition, we understand that part of the land and building capex will enable the group to explore options for relocating and expansion of its current smallish warehouse located at Kuantan, Pahang.

Syariah Compliant by Year-End. Pantech expects to be re-instated as a Syariah compliant stock by the Securities Commission (SC) by 4QCY14. To recap, earlier during the SC's review in Nov 2013, Pantech was a whisker short of fulfilling the financial ratio benchmark whereby: i) cash-in-conventional-accounts/assets, and ii) conventional debt/assets must not exceed 33%. The group is currently in the process of restructuring its debts and thus expects to be readmitted to the SC's list of syariah-compliant securities by Nov-Dec 2014.

Figure 2: Capacity Utilisation

Manufacturing Facility	Location	Capacity (mt p.a)	Capacity Utilisation*
Carbon Steel Fittings & Induction Long Bends	Klang, Selangor	18,500	100%
Stainless Steel Pipes & Fittings	Pasir Gudang, Johor	14,400	67%
Copper Nickel & Nickel Alloy Pipes & Fittings	Tamworth ,UK	800	75%

** as at end-Nov 2013*

Source: Company, TA Research

Impact

In-line with management's guidance, we revise our capex assumptions in FY14/15 to RM57.4mn/RM30.8mn (previous: RM44.6mn/RM47.9mn).

Valuation

We believe that orders momentum will recover for the group in the medium term despite weak local demand in 2HFY14. This is on the back of: 1) ramp-up in production of higher-value stainless steel fittings to replace stainless steel pipe exports to the US (ceased since Oct 2013), 2) upcoming demand from new local O&G projects, including offshore fabrication projects and RAPID, and 3) 25% capacity expansion at UK in FY15 coupled with recent NORSOK certification. Maintain Buy on Pantech with unchanged target price of RM1.22 based on 12x fully diluted CY14 P/E.

Figure 3: Earnings Summary

FYE Feb (RM mn)		FY12	FY13	FY14E	FY15F	FY16F
Revenue		434.6	637.2	555.2	637.7	684.4
EBITDA		60.0	98.9	97.2	110.4	122.0
EBITDA margin	(%)	13.8	15.5	17.5	17.3	17.8
Pretax Profit		47.2	80.2	76.2	86.7	96.2
Net Profit		34.2	55.0	57.2	65.0	72.2
EPS	(sen)	7.6	11.5	11.5	13.1	14.5
EPS (diluted)	(sen)	5.4	9.1	9.2	10.4	11.6
EPS growth	(%)	(1.7)	51.5	(0.2)	13.8	10.9
FD EPS growth	(%)	(5.6)	68.9	0.6	13.8	10.9
PER	(x)	11.8	7.8	7.8	6.9	6.2
FD PER	(x)	16.7	9.9	9.8	8.6	7.8
GDPS	(sen)	3.5	4.6	4.6	5.2	5.8
Dividend yield	(%)	3.9	5.1	5.1	5.8	6.4