BCT Asia advisory

BURSA MidS

INITIATION REPORT **_31 July 2017_**

Name of PLC: *Pintaras Jaya Bhd*		***PLC Website:*** *www.pintaras.com.my*	
Business Summary : *Involved in the provision of geotechnical engineering & construction services and manufacturing of industrial metal containers*			
Top Three Shareholders: *Dr Chiu Hong Keong and deemed interest*		*58.12%*	
Khoo Keow Pin		*6.45%*	
Lembaga Tabung Haji		*4.99%*	
Market / Sector:	*MAIN / Construction*	***Stock Code:*** ***Bloomberg Ticker:***	*9598* *PINT MK*
Market Capitalisation:	*RM 664.8m*	***Recommendation:***	*HOLD*
Target Price:	*RM 4.11*	***Expected Capital Gain:***	*2%*
Current Price:	*RM 4.03*	***Expected Div Yield:*** ***Expected Total Return:***	*5%* *7%*

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Key Stock Statistics	**2016**	**2017F**	**2018F**	**2019F**
EPS (sen)	10.9	22.9	24.7	29.4
P/E (x)	37.1	17.6	16.3	13.7
Net Dividend/Share (sen)	20.0	20.0	20.0	20.0
NTA/Share (RM)	2.03	2.10	2.35	2.65
Book Value/Share (RM)	2.03	2.10	2.35	2.65
Issued Capital (mil shares)	163.5	165.0	165.0	165.0
52-weeks Share Price Range (RM)				3.30 - 4.27
Estimated Free Float				30%
Average Volume (shares)				410,000

Per Share Data	**2016**	**2017F**	**2018F**	**2019F**
Year-end 30 June				
Book Value (RM)	2.03	2.10	2.35	2.65
Operating Cash Flow (sen)	15.2	20.5	28.7	37.7
EPS (sen)	10.9	22.9	24.7	29.4
Net Dividend/Share (sen)	20.0	20.0	20.0	20.0
Payout Ratio (%)	183.9	87.5	81.0	68.1
P/E (x)	37.1	17.6	16.3	13.7
P/Cash Flow (x)	26.5	19.6	14.0	10.7
P/Book Value (x)	2.0	1.9	1.7	1.5
Dividend Yield (%)	5.0	5.0	5.0	5.0
ROE (%)	5.4	11.1	11.1	11.8
Net Gearing (%)	n.c.	n.c.	n.c.	n.c.

n.c. - net cash

P&L Analysis (RM mil)	**2016**	**2017F**	**2018F**	**2019F**
Revenue	136.87	195.77	230.00	280.00
EBITDA	34.20	58.97	63.90	73.90
Depreciation	(16.20)	(15.00)	(15.00)	(15.00)
Net interest income	5.04	5.00	4.00	4.00
Pre-tax Profit	23.04	48.97	52.90	62.90
Net Profit	17.79	37.71	40.73	48.43
EBITDA Margin (%)	25.0	30.1	27.8	26.4
Pre-tax Margin (%)	16.8	25.0	23.0	22.5
Net-Margin (%)	13.0	19.3	17.7	17.3

1. Investment Highlights/Summary

- Pintaras Jaya Bhd (Pintaras) is a leading foundations and piling specialist with a strong operating track record of almost 30 years. It has been listed since 1994.

- Its net profit performance has been consistent, ranging between RM44.9m to RM51.9m in FY12 to FY15. However, earnings delivery in FY16 was undermined by project challenges and competition. FY17 earnings so far have rebounded strongly.

- The Company has consistently delivered healthy margins above its peers. For the last five years, its net margin averaged 23%.

- Its balance sheet is solid, with net cash and liquid investments amounting to RM1.17/share. Due to strong operating cash flow, its historical dividend payout ratio exceeds 40%.

- We like Pintaras for its strong management, long track record as a PLC and solid balance sheet. Earnings visibility at this juncture is however low with its order book almost fully depleted.

- We believe that industry outlook is promising – announced public sector infra projects are likely to commence soon, and excess piling capacity in the industry has been declining. Hence, we expect replenishment jobs to start materialising for Pintaras. We initiate with a **HOLD** recommendation. Significant replenishment contracts above and beyond our current assumptions will likely warrant earnings and recommendation upgrade.

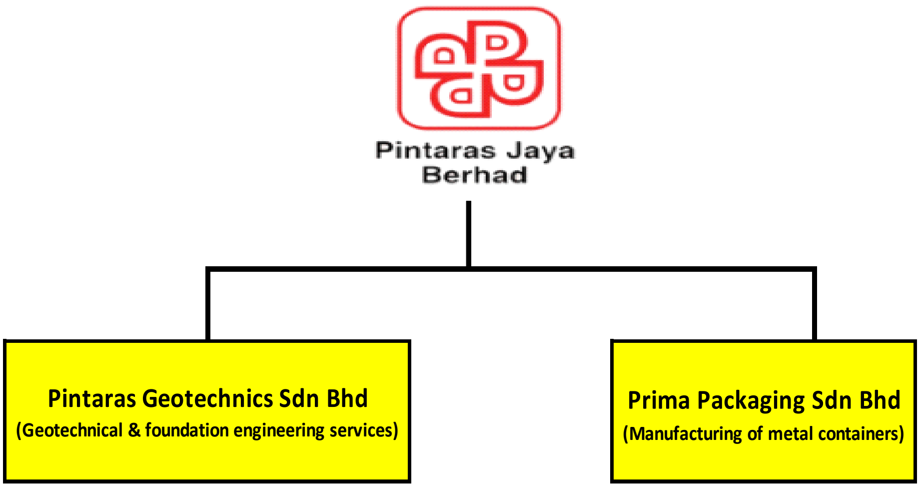
2. Company Background

a) History

Pintaras has been operating in the Malaysia's construction scene for 28 years, specialising in the provision of piling and foundation services. Founded by its present Chairman-cum-managing director Dr Chui Hong Keong in 1989, through his leadership, Pintaras is today one of the country's largest players in this segment with a strong reputation and track record. Pintaras also has a long history as a public-listed corporation, having been listed since 1994.

b) Corporate Structure

The Company operates its business through two primary subsidiaries operating in two distinctive business segments.



c) Management

The executive management of Pintaras comprises highly qualified and experienced personnel:

- Dr Chiu Hong Keong (Chairman and Managing Director) holds a Bachelor of Civil Engineering degree (First Class Honours) from the University of Auckland and Doctorate of Philosophy degree in Engineering from Monash University

- Ir Khoo Keow Pin (Executive Director) graduated with a Bachelor of Civil Engineering degree from Cheng-Kung University, Taiwan and obtained his Master in Geotechnical Engineering degree from the University of Toronto

- Khoo Yok Kee (Executive Director) graduated with a Bachelor of Economics (Accounting) degree from Monash University and obtained her Master of Business Administration from Southern Cross University. She is a Fellow of CPA Australia and a member of the Malaysian Institute of Accountants

Pintaras has been nominated twice, once in 1998 and another time in 2013, as one of the top 200 companies for the Forbes Asia "Best under a Billion Company" award.

3. Business Segment

a) Piling and Foundation

This is Pintaras' core business and involves the provision of geotechnical solutions to the construction industry. The services offered as shown below, are considered specialist works within the industry:

- Piling systems
- Earth retaining systems
- Sub-structures & basements
- Ground improvement

Complementing the piling and foundation works, the Company is also involved to a lesser extent in earthworks, civil engineering and building works.

Pintaras is widely regarded as a leading piling contractor and also owns one of the largest fleet of piling equipment in the industry. Its 28-year operating history has enabled the Group to build up a wide range of specialist machineries, plus technical and management expertise across a wide spectrum of jobs throughout Malaysia. These represent some of the critical success factors of piling companies.

Pintaras is able to offer one stop geotechnical solutions, ranging from design, construction to installation of piling and foundation systems with minimal sub-contracting to third parties. With a full range of machineries and tools at their disposal, the Company is able to carry out all types of piling works and their expertise is often sought for complex and large scale projects.

Recent notable piling jobs and their respective contract values that Pintaras has completed include:

- Warisan Merdeka RM74.0m
- Shopping Mall (i-City) RM72.8m
- Lakeville Residence RM71.0m
- Hilton Project (i-City) RM67.6m
- Southville City RM59.0m

Although Pintaras' construction revenue of late is derived mainly from the private sector, the Company also has extensive experience in public infrastructure works such as MRT, and design & build expressway bridges.

b) Manufacturing

For the purposes of diversification, Pintaras undertook the acquisition of Prima Packaging Sdn Bhd (Prima) in 1999. Prima specialises in the manufacturing of industrial metal pails and cans, and was formed in 1974 to cater primarily to the paint and chemical industry. Over the years its product range has expanded to include cookie cans, biscuit cans and printed plates.

Prima is the largest industrial metal container manufacturer in Malaysia, producing in excess of 8 million pails and cans annually. The products are distributed nationwide and also to many regional countries. It has a wide customer base of almost 200 locally, and these include leading paint and chemical companies:

- BASF
- Boustead Sissions
- Colourland
- Jotun Malaysia
- Kansai Paint
- KCC Paint
- Nippon Paint Malaysia

4. Piling and Foundations Industry

Piling and foundation services is a sub-segment within the larger construction industry and is a pre-requisite to the erection of all building or infrastructures above ground. This segment commands better margins as compared to general construction works as it requires specialised capital equipment and technical expertise, and thus has higher barriers to entry. Sub-structure services are normally sought at the onset of any construction project and hence, the risk of bad debts is also generally regarded to be lower.

On the other hand, piling and geotechnical engineering is often subject to risk of unforeseen ground conditions which may lead to delayed completion and cost over-run. Piling business is cyclical in nature as in the overall construction industry, and future cash flow and earnings are directly correlated to projects flow and order book. On top of it, the short duration of piling contracts (ranging from 6 -18 months) implies lower earnings visibility as compared with large turnkey civil and building contractors where the duration of contracts can stretch for up to 3 to 5 years.

Traditionally, the piling and foundation segment accounts for about 10-15% of the construction industry market size. As such the growth of pilling and foundation services markets is highly correlated to the expansion of the broader construction industry. In turn, growth in the construction industry is highly dependent on factors such as government-led infrastructural spending, sustained economic growth boosting construction of new residential, commercial and industrial properties, a supportive interest rate environment and steady population growth.

Listed below are the prominent piling operators which dominate the local piling industry:

- Pintaras
- Econpile
- Ikhmas Jaya
- Sunway Geotechnics
- Geohan
- Geopancar
- Aneka Jaringan
- BAUER Malaysia
- Keller Asean

5. Construction Industry Outlook

Malaysia’s construction industry against the backdrop of 11th Malaysia Plan (11MP), Economic Transformation Programme and Government Transformation Programme is projected to grow strongly over the next few years.

According to independent market researcher (Protégé Associates), revenue of the construction industry in Malaysia is projected to grow at CAGR of 8.9% from 2017 to 2021 to reach RM76.58bn from RM50.09bn estimated in 2016. It is also worthwhile to note that under the 11MP (2016-2020), gross development expenditure is budgeted at RM260bn, an increase of 16.3% versus under the 10MP (2011-2015).

With the government intending to implement numerous transport infrastructure and major development projects, the local construction sector is expected to derive huge benefits from robust construction activities in the coming years. The major infrastructure and development projects in Malaysia include, among others:

Proposed/Planned Construction Projects	Estimated Total Development Cost (RM Billion)
Bandar Malaysia	150
East Coast Rail Link	55
KL-Singapore High Speed Rail Link	50
Klang Valley Mass Rapid Transit (MRT) Line 3	50
Penang Transport Master Plan	27
Klang Valley Light Rail Transit (LRT) Line 3	9
Gemas-Johor Baru double tracking line	8

Ongoing Construction Projects	Estimated Total Development Cost (RM Billion)
Pengerang Integrated Petroleum Complex	115
Kwasa Damansara	50
Tun Razak Exchange	40
Klang Valley Mass Rapid Transit (MRT) Line 2	32
Pan Borneo Highway	30

The market is anticipating contracts for the above mentioned projects to roll out steadily beginning second half of 2017 and beyond.

As for the property market, current market sentiment remains lacklustre due to strict lending guidelines and an oversupply situation in the high-rise residential/commercial segment. However, the long term prospects of property sector in the Greater Kuala Lumpur are bright, underpinned by population growth and continued urbanisation. Furthermore, the property market in the Klang Valley is expected to experience positive spill over effects from the above mega development projects, especially from transportation projects. The upcoming new MRT and LRT lines will likely encourage the development of new projects located around the stations. In addition, there are also various expressway projects currently being built and planned to improve urban vehicular connectivity:

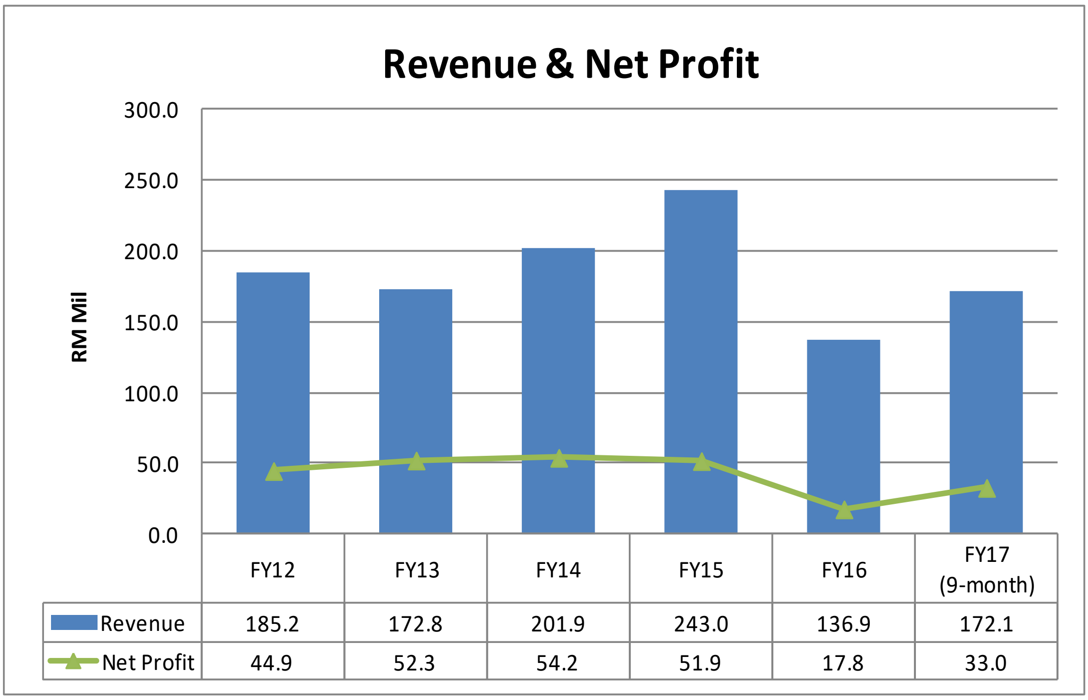
- RM1.18b Duta-Ulu Kelang Expressway (DUKE phase 2)
- RM5.04b West Coast Expressway (WCE)
- RM2.50b Kinrara-Damansara Expressway (Kidex)
- RM1.50b Kuala Lumpur Outer Ring Road (KLORR)
- RM4.18b Damansara-Shah Alam Expressway (DASH)
- RM4.30b Sungai Besi-Ulu Kelang Elevated Expressway (SUKE)
- RM2.42b Serdang-Kinrara-Putrajaya Highway (SKIP)

These expressways will provide catalysts for future new property development launches around access points along the expressways.

In the central business district of Kuala Lumpur, there are many planned high rise development that will transform the capital city’s skyline in the near future. Besides Tun Razak Exchange and Bandar Malaysia, some of the projects in the planning are Kampung Baru Redevelopment, Plaza Rakyat Development and KL River City Development. High-profile corporate headquarters for TNB, YTL Group etc. are also believed to be on the cards.

6. Financial Review

a) Revenue and Profit Track Record



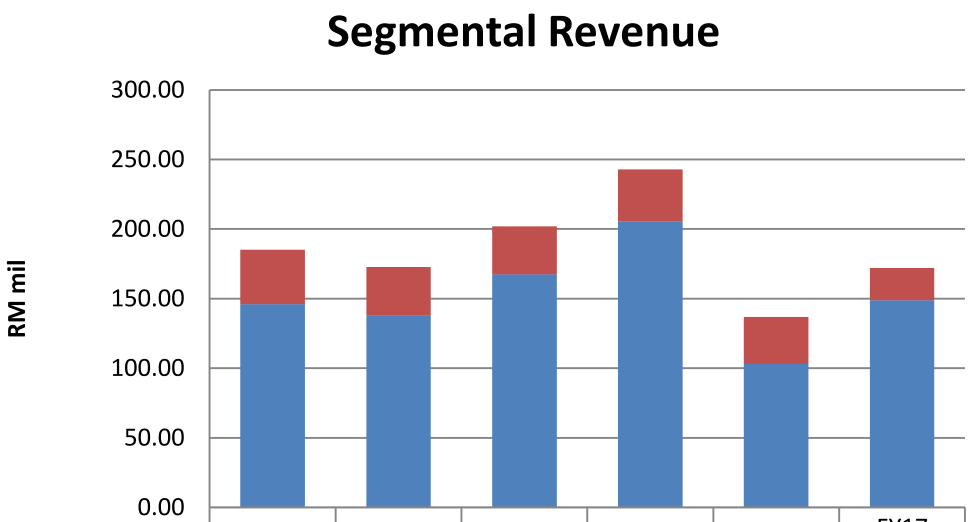
Pintaras has been growing modestly over the past few years. Between FY12 to FY15, the revenue and net profit grew at a 4-year CAGR of 9.48% and 4.96% respectively.

In FY16 the Company's performance suffered a setback, where revenue and net profit fell sharply by 43.7% and 65.7% respectively from FY15. We believe the piling division undertook a demanding and challenging project, which lead to cost over-runs. Furthermore, with manpower and equipment resources already committed, the Company did not take on new jobs, resulting in a lower rate of order book replenishment. We understand that competition in the marketplace also intensified during this period due to surplus industry capacity.

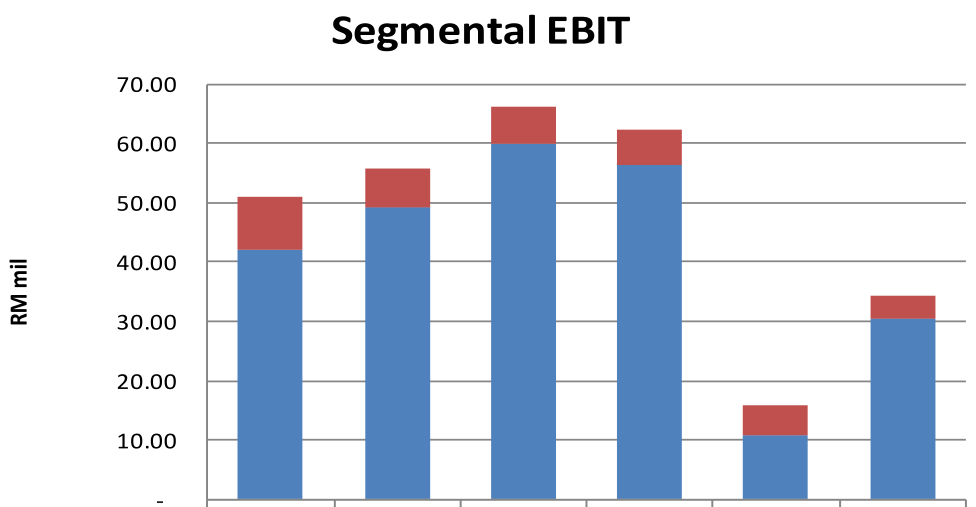
For first 9 months of FY17, the Company's revenue and net profit has rebounded strongly, exceeding full year FY16 numbers due mainly to increased volume of construction works after having secured two contracts worth RM140.4m for i-City project in January 2016.

b) Segmental Analysis

Construction segment accounts for about 80-85% of Pintaras' total revenue and about 90% of total earnings before interest & taxes (EBIT). This segment is the earnings driver for Pintaras. Contribution of the manufacturing segment to the Company is relatively stable. Over the past 5 years, the revenue and EBIT of this segment has dropped to current ~RM30m and ~RM5m respectively. Management has attributed the slowdown to heightened competition and subdued product demand, impacted mainly by competition from industrial plastic containers.



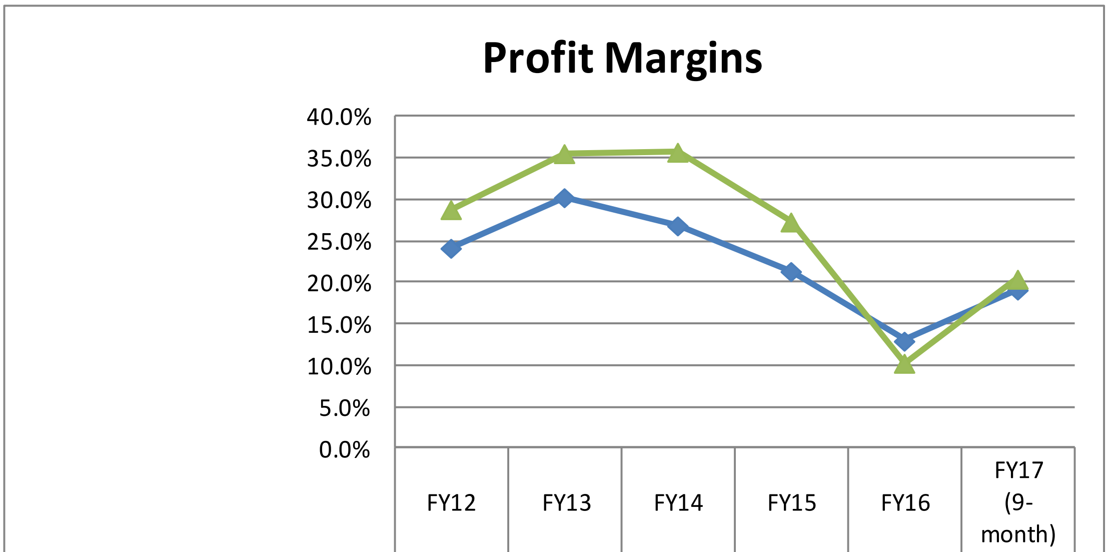
	FY12	FY13	FY14	FY15	FY16	FY17 (9-month)
Manufacturing	39.02	34.84	34.49	37.40	33.79	23.31
Construction	146.15	138.01	167.42	205.60	103.08	148.77



	FY12	FY13	FY14	FY15	FY16	FY17 (9-month)
Manufacturing	8.88	6.61	6.39	5.95	5.24	3.87
Construction	42.18	49.15	59.91	56.28	10.66	30.46

c) Historical Profit Margin Trend

Historically, Pintaras has delivered above-average profit margins. This is due to the fact that management has been selective in bidding for new jobs that command better margins, rather than focusing on increasing its order book size. Backed by strong engineering knowledge and full range of specialised machineries, Pintaras is able to win high margin projects. Furthermore, the Company undertakes jobs with minimal sub-contracting, thus helping to preserve profitability. Also, a number of its machineries, though fully depreciated, are still in good operating condition, thus enhancing cost competitiveness.



	FY12	FY13	FY14	FY15	FY16	FY17 (9-month)
Overall Net Profit Margin (%)	24.2%	30.3%	26.9%	21.4%	13.0%	19.2%
Construction EBIT Margin (%)	28.9%	35.6%	35.8%	27.4%	10.3%	20.5%

Note: the abnormal low margins in FY16 are mainly due to cost over-run

The Company's profit margins have been declining since FY13, impacted by the escalating labour and material costs in the recent years. We believe that rising competition has also contributed to the decline.

7. <u>Earnings Outlook</u>

It has been 10 months since Pintaras last secured a new contract, and by our estimation, its only ongoing project in Sri Petaling is completing soon. As such, we expect financial performance in the first six months of FY18 to be weak.

We expect demand for piling services to accelerate over the next 12 months with jobs coming from LRT3, Tun Razak Exchange, Bandar Malaysia, Kwasa Damansara etc. Its key listed competitors – Econpile and Ikhmas Jaya – are currently enjoying record high order book (~RM2bn collectively) and this suggests to us that excess capacity in the industry is declining. Overall, we believe Pintaras is well-positioned to replenish its order book over the next 6 to 12 months.

Management guided that its tender book is currently in the region of RM1.2b. Based on historical trend, we believe that a success rate of 20-25% is achievable. To enhance its chances of success, we believe that management may adopt a more aggressive strategy and tender for jobs with more competitive pricing.

Our earnings estimate for FY18 and FY19 is driven by the following key assumptions:

- Order book replenishment estimate for FY18 is projected at RM200mil, rising to RM250m for FY19

- EBIT margin (construction) at a conservative 20%. We believe that the high margins that Pintaras has been enjoying historically may not be achievable as it bids for new jobs more aggressively

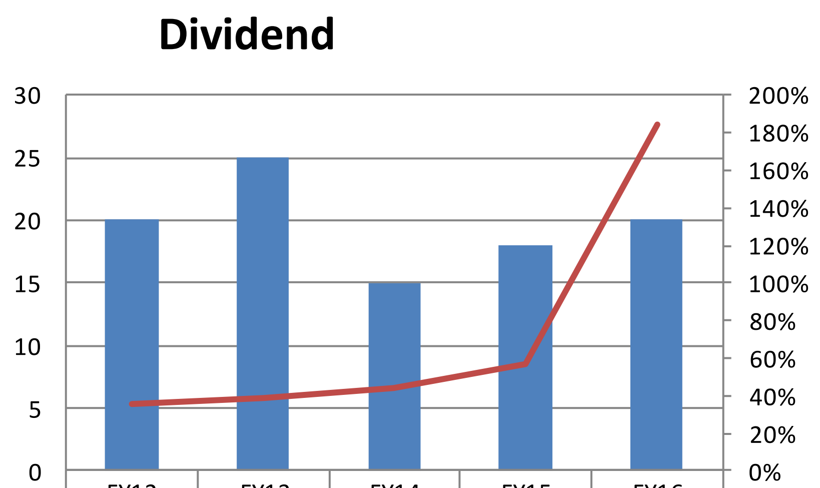
- No topline growth for manufacturing segment and its EBIT margin will sustain at around 18%

8. Balance Sheet

Pintaras has a solid balance sheet. It's a debt free company with cash in hand amounting to RM163.4m or 99sen/share. This cash excludes its portfolio investment farmed out to external fund managers with a market value of RM29.5m or 18sen/share. Taken together, the cash and liquid portfolio investment translates to RM1.17/share or 29% of its stock price.

9. Dividend

Pintaras has consistently paid out dividends every year since listing. Though the Company does not have a dividend policy, its average yearly dividend payout ratio from FY05 to FY15 is 44.6%. Even during the poor performance registered in FY16, management continued to sustain dividend at 20sen/share, representing a payout ratio of 184%. The impressive dividend payout track record is due to its strong operating cash flow and relatively low capex requirements in recent years.



	FY12	FY13	FY14	FY15	FY16
Dividend per Share (sen)	20	25	15	18	20
Dividend Payout Ratio (%)	36%	38%	45%	56%	184%

Looking at the past 5-year average dividend per share (DPS) of 19.6sen, we believe the Company is likely to maintain its annual DPS at around 20sen in the coming financial years. At a DPS of 20sen, Pintaras' dividend yield stands at about 5% based on current market price.

10. Peer Comparison

Key Performances	Pintaras	Econpile	Ikhmas
Net Margin (3-year average)	20.4%	11.0%	6.9%
EBIT Margin (3-year average)	24.5%	19.5%	15.7%
Return on Equity (3-year average)	12.7%	23.1%	13.5%
Dividend Yield (FY16 dividend)	4.96%	1.28%	0.72%

Note: Pintaras' EBIT margin excludes manufacturing segment

- Pintaras commands much higher net margin and EBIT margin compared to its listed peers
- Due to conservative management style and cash-flushed balance sheet, Pintaras has a lower return on equity (ROE)
- Based on the current market prices, Pintaras has more attractive yield vis-à-vis peers

11. Key Investment Risks

- Lower-than-expected order book replenishment
  This is the key downside risk to our earnings forecasts. We are assuming an annual order book replenishment of RM200m for FY18 and RM250m for FY19. Our earnings forecast will be affected if the targeted order book comes short.

- Intensifying competition
  As listed entities, Econpile and Ikhmas Jaya now enjoy a higher profile and have access to capital markets which we believe enhances the capacity to take on larger jobs. These companies have secured their fair share of high-profile jobs in recent years, and are worthy competitors to Pintaras. Meanwhile, local piling companies continue to face competition from foreign players who are also well established in the local market.

- Lower-than-expected margins
  Pintaras may slash its margins to quickly replenish its depleting order book. Also, any delays in handover of projects and sharp increase in material and labour costs will lead to lower profit margins.

- Potential public sector spending cuts
  Delays in the implementation of government-led infrastructure projects.

- Continued consolidation of property market
  Postponement of property launches due to weak market sentiment may adversely affect Pintaras' order book replenishment timeline.

12. Valuation and Recommendation

Construction industry is projected to grow strongly in the next few years benefitting from government largess. The piling and foundation services market is also expected to experience strong prospects in tandem with growth in overall construction activities.

In the short term, share price catalyst for construction players (including piling operators) are in sight as many high-profile and high-value projects are scheduled to commence construction soon. We believe Pintaras, with ample capacity, is in an advantageous position to capitalise on the coming jobs flow.

We have a **HOLD** recommendation for Pintaras at this juncture due to its depleted order book and limited earnings visibility. As discussed, we believe replenishment contracts will start materialising and any significant improvement above and beyond our replenishment assumptions will likely warrant earnings and recommendation upgrade.

Our current fair value of the stock is RM4.11. This is based on an ex-cash P/E of 14x on FY18 core EPS of 21sen (piling and manufacturing earnings only, excluding interest and investment income), plus the RM1.17 per share value of its cash and investment portfolio.

We believe that a 14x multiple is fair at this juncture given that the stock has: i) a long operating track record in the industry and as well as a PLC, ii) a significant amount of unutilised capacity so there is potential for a strong earnings rebound in the event of significant job wins in the near future, iii) promising industry prospects. From a yield perspective, share price should remain well-supported given its projected dividend yield of 5%.

Share Price Chart of Pintaras

Disclosures/Disclaimer

Investment ratings:
Buy (generally >10% upside over the next 12 months)
Hold (generally negative 10% downside to positive 10% upside over the next 12 months)
Sell (generally >10% downside over the next 12 months)

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