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COMPANY UPDATE
Friday, April 08, 2016
FBM KLCI: 1,724.29
Sector: Oil & Gas

EA Technique (M) Bhd

Luxury to Cherry Pick Contracts

TP: RM1.58 *(+32%)*

Last Traded: RM1.19

BUY

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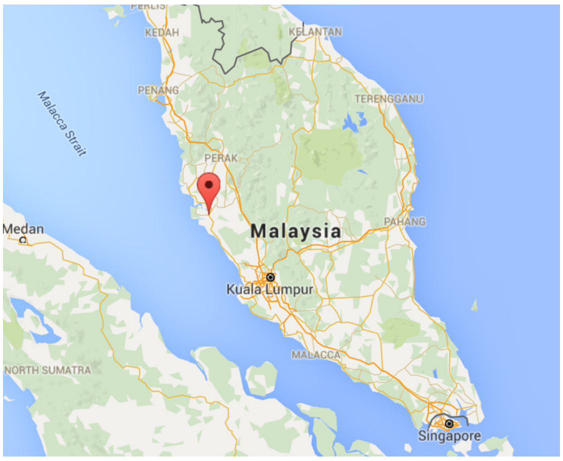
We recently met management of EA Technique (M) Bhd (EA Tech), represented by Dato' IR Abdul Hak (MD) and En. Abd Rahman (Deputy GM). We emerged feeling sanguine about the group's prospects, underpinned by:- 1) venture into ship repair services by FY17, 2) opportunity to capitalize on Petronas Chemical's growing demand for CPP tankers, 3) ability to cherry pick projects with attractive margins, and 4) fleet expansion may be faster than expected. We tweak our earnings to incorporate a lower USD/MYR assumption, and also assumed earlier contribution from a new CPP tanker. As a result, our FY16/17/18 earnings are lowered by 8%/2%/4%. Accordingly, our TP is revised to RM1.58 (previous: RM1.62) based on unchanged 10x FY16 P/E. Reiterate Buy.

Docking Into Vessel Repair Business

Building Dry Dock for New Revenue Stream. EA Tech unveiled plans to venture into provision of ship repair and drydocking services. We are optimistic on this new endeavor, given attractive operating margins which we believe ranges between 10%-15%. The group targets to complete the construction of its dry dock facilities in 6-8 months - alluding to a launch as soon as 2017. On top of that, capex spend will be minimal, estimated at RM25mn. This is because EA Tech will use its existing 10-acre shipyard at Hutan Melintang, Perak (Figure 1).

Figure 1: Location of Shipyard in Hutan Melintang, Perak



Source: Google Maps

In-house Servicing Saves Costs Too. To recap, EA Tech's existing yard serves as a supporting arm for its fleet of marine vessels. It is used for in-house shipbuilding, minor fabrication, and floating repair of vessels. The yard is capable of constructing one vessel of up to 10,000dwt, or six tugboats at any one time. It was recently upgraded and expanded, with partial funding from IPO proceeds (RM10mn). Notwithstanding new income from repair of external vessels, EA Tech is able to achieve cost savings from in-house fleet servicing. For FY16, the group intends to dry dock four of its tankers - that will cost an estimated RM15mn in total.

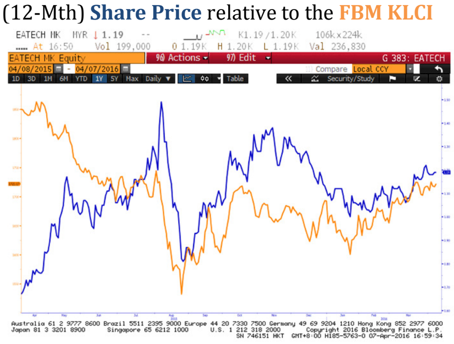
Share Information	
Bloomberg Code	EATECH MK
Stock Code	5259
Listing	Main Market
Share Cap (mn)	504
Market Cap (RMmn)	605
Par Value (RM)	0.50
52-wk Hi/Lo (RM)	1.50/0.63
12-mth Avg Daily Vol ('000 shrs	2,018
Estimated Free Float (%)	35
Beta	n.a.
Major Shareholders (%)	Johor Corp - 50.6
	Dato' Hak - 5.8
	CIMB Principal - 4.6

Forecast Revision (%)	FY16	FY17
Forecast Revision (%)	(8.3)	(1.5)
Core Net Profit (RM mn	79.6	93.1
Consensus	n.a.	n.a.
TA/Consensus (%)	n.a.	n.a.
Previous Rating	Buy (Maintained)	

Financial Indicators	FY16	FY17
Net (Debt)/Equity (x)	0.7	0.4
ROA (%)	8.4	9.7
ROE (%)	22.6	22.3
FCFF/Share (sen)	2.0	4.9
P/CFPS (x)	60.0	24.7

Share Performance		
Price Change (%)	EATECH	FBMKLCI
1 mth	6.3	1.6
3 mth	10.2	4.2
6 mth	(7.0)	2.1
12 mth	78.9	(7.1)

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



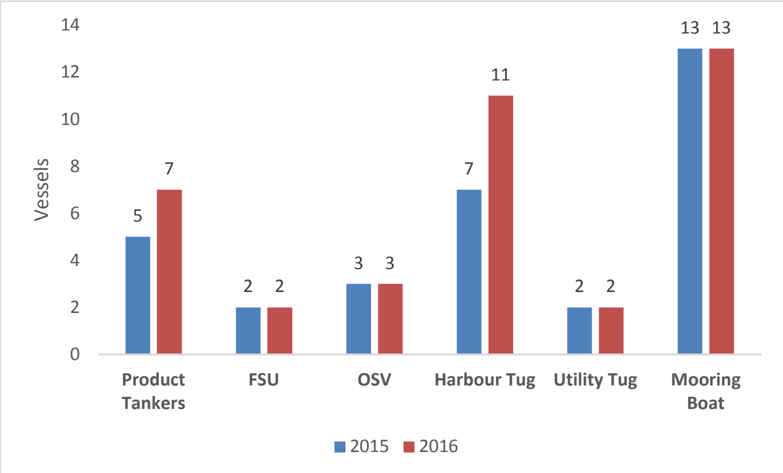
Source: Bloomberg

Calm Waters with Limited Competition. There is minimal competition for repair yards with similar capacity (10,000dwt) in the West Coast of Peninsular Malaysia. This includes yards owned by Muhibbah Engineering and Boustead Naval. However, the former's capacity is much smaller (5,000 dwt), whilst the latter is mainly focused on the military segment. EA Tech is targeting ships transiting through the Straits of Malacca and also military vessels. For the latter, EA Tech has submitted an application to the Ministry of Finance.

Fleet Growth More Robust Than Expected

Meanwhile, we believe there may be accelerated expansion of EA Tech's fleet (Figure 2). We understand that the group had recently acquired a 7-year old CPP tanker (capacity: 7,000 dwt) for an attractive price of USD2.9mn – far below market value. This vessel is currently being refurbished, at a marginal cost of approximately RM2.0mn. We believe this alludes to a potential contract win as the group does not normally acquire speculative newbuilds. Nevertheless, given the vessel's low purchase price, we believe EA Tech is able to bid competitively.

Figure 2: Fleet Count



Source: Company, TA Research

Leveraging on PetChem's Explosive Growth

PetChem's Growing Tanker Requirements. We are sanguine about future contracts from EA Tech's new client, Petronas Chemicals (PChem). Recall that the group secured its maiden contract with PChem recently (Feb 2016) for the provision of a CPP (Clean Petroleum Product) tanker. According to management, PChem is currently serviced by a fleet of 15-16 CPP tankers. However, given PChem's aggressive expansion, fleet requirements would likely be in excess of 23 ships in the medium-to-long term. To recap, PChem is increasing its capacity by 64% to 19.7mn tonnes p.a. over 2016-19, underpinned by RAPID.

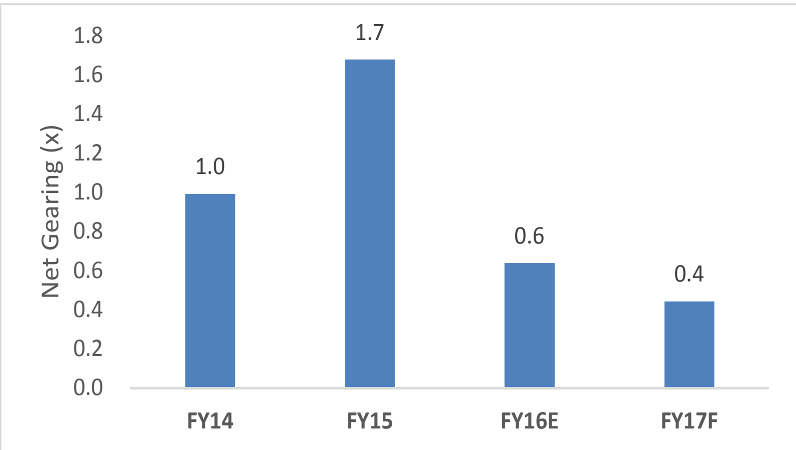
But Management is Prudently Aggressive. There is currently a shortage of local small-mid sized capacity transport players, which have been dropping out rapidly. This includes Gagasan Carriers, which was a key supplier of tankers to PChem, but is currently under financial distress. Therefore, we believe EA Tech is in an enviable position, with promising prospects to grow alongside PChem. Nevertheless management intends to be prudent for now - with conservative plans to provide 3 tankers to PChem over 3 years. Management is currently monitoring the progress of its maiden contract with PChem - in terms of payment frequency, ease of negotiations, fulfilment of terms, etc. Understandably, EA Tech hopes to achieve a certain level of comfort with its new client before committing to aggressive fleet expansion. Furthermore, EA Tech is selective in transporting only bulk chemical cargoes such as MTBE and Methanol.

Robust Pipeline of Tenders Progressing Well

Picky in Selecting High Margin Projects. On the back of EA Tech's substantial tenderbook (RM1.7bn), management is confident of its ability to cherry pick projects. Therefore, the group is targeting projects with higher margins, which may render EPCIC projects less attractive. Nevertheless, for the USD110mn EPCIC bid, given that EA Tech is one of the final two shortlisted bidders, management has been meeting closely with the client. We understand the latter is a local marginal field operator, and the other competing bidder is also a local yard. To recap, this project comprises smaller platform modules that will likely be fabricated at EA Tech's yard, if the group secures the contract.

Targeting International FSOs. According to management, margins do matter in spite of chunky contract values. Therefore, EA Tech is keeping its options open and eyeing more lucrative FSO projects, including two international tenders in Qatar and Vietnam. For the latter, we understand it is for the supply and lease-out of a large capacity FSO with long term tenure of 7+3 years. Nevertheless, we acknowledge that competition will be stiff given that big international peers will be bidding as well. Due to the larger scale of this project, EA Tech does not discount the possibility of raising debt or equity (estimate: USD40mn). Management is inclined towards the former given that financing cost for the group remains low. Furthermore, EA Tech's net gearing (Figure 3) will drop significantly upon delivery of the North Malay Basin FSO to Hess (4Q16).

Figure 3: Net Gearing



Tenders Moving Along Nicely. Meanwhile, other tenders are progressing well - with EA Tech having emerged as one of the final three bidders for the supply of 6 harbour tugboats to Johor Port (tenure: 7 years). As highlighted earlier, we believe the group has bright chances of securing this contract given the scarcity of Malaysian-owned vessels operating in ports in Johor. Whereas for the tender to supply 1+4 commodity bulk carriers (3+2 years), the group is awaiting its 30%-JV partner to finalise negotiations with the client. Although EA Tech is keen to diversify to this new vessel class, management appears less optimistic that this project is able to surpass the group's IRR hurdle rate.

Impact

We tweak our earnings forecast to incorporate the following:- 1) lowered USD/MYR assumption for FY16/17/18 to 4.05/4.0/4.0 (previous: 4.30 in FY16-18), and 2) brought forward contribution from a new CPP tanker to 4Q16 (previous: 4Q17). As a result, our FY16/17/18 earnings are lowered by 8%/2%/4%.

Valuation

Following the earnings revision, our TP on EAT is revised to RM1.58 (previous: RM1.62) based on unchanged 10x FY16 EPS. Reiterate Buy given attractive valuations (current: 8x FY16 P/E), which is currently trading at a steep 48% discount to peers' average (15x). On top of that, earnings are buffered by locked-in long term transport contracts and an expanding fleet. To top it off, EA Tech's burgeoning tenderbook is an earnings rerating catalyst.

Earnings Summary

Income Statemernt

FYE 31 Dec (RMmn)		2014	2015	2016E	2017F	2018F
Revenue		155.7	549.1	545.4	613.8	641.2
EBITDA		**56.8**	**146.6**	**169.4**	**184.9**	**194.5**
Depreciation		(25.0)	(43.6)	(46.8)	(49.4)	(52.0)
Net finance cost		(12.2)	(13.4)	(14.7)	(9.2)	(10.0)
Share of Associates		0.0	0.0	0.0	0.0	0.0
Exceptionals		0.1	(38.9)	0.0	0.0	0.0
Pretax Profit		19.7	50.8	107.9	126.3	132.5
Taxation		(5.5)	(13.4)	(28.0)	(32.8)	(34.5)
Net Profit		14.2	37.3	79.6	93.1	97.7
Core Net Profit		**14.1**	**76.2**	**79.6**	**93.1**	**97.7**
Per Share Data						
Core EPS	(sen)	3.6	15.1	15.8	18.5	19.4
DPS	(sen)	2.0	2.3	4.7	5.5	5.8
Book Value	(RM)	0.7	0.6	0.7	0.8	1.0

Ratios

FYE 31 Dec (RMmn)		2014	2015	2016E	2017F	2018F
Valuations						
Core PER	(x)	33.1	7.9	7.6	6.5	6.2
Dividend yield	(%)	1.7	1.9	4.0	4.6	4.8
EV/EBITDA	(x)	13.0	7.5	5.0	4.3	3.9
P/BV	(x)	1.7	2.0	1.7	1.4	1.2
FCF Yield	(%)	(209.8)	(449.7)	1.7	4.0	11.7
Profitability ratios						
EBITDA margin	(%)	36.5	26.7	31.1	30.1	30.3
EBIT margin	(%)	20.4	18.8	22.5	22.1	22.2
PBT margin	(%)	12.6	9.2	19.8	20.6	20.7
Core Net margin	(%)	9.1	13.9	14.6	15.2	15.2
Core ROE	(%)	5.3	12.6	22.6	22.3	20.1
Core ROA	(%)	2.1	7.7	8.4	9.7	8.6
Liquidity ratios						
Current Ratio	(x)	1.4	0.9	0.8	0.7	1.0
Interest Cover	(x)	2.2	6.6	7.1	9.2	9.4
Leverage ratios						
Total Debt/ Assets	(x)	0.5	0.6	0.5	0.4	0.4
Total Debt/Equity	(x)	1.2	2.0	1.2	0.8	0.9
Net Debt(Cash)/ Equity	(x)	1.0	1.7	0.7	0.4	0.3
Interest Coverage	(x)	2.2	6.6	7.1	9.2	9.4
Growth ratios						
Revenue	(%)	28.5	252.7	(0.7)	12.5	4.5
EBITDA	(%)	5.7	158.3	15.5	9.2	5.2
PBT	(%)	(66.8)	157.8	112.5	17.1	4.9
Core Net Profit	(%)	(31.8)	439.5	4.5	16.9	4.9
Core EPS	(%)	(82.4)	317.4	4.5	16.9	4.9
Key Assumptions						
Fleet Count	(units)		32	38	41	41
Average Fleet Utilisation	(%)		96	91	91	91
New Engineering Orders	(USD mn)		0	0	82	0

Balance Sheet

FYE 31 Dec (RMmn)	2014	2015	2016E	2017F	2018F
Property, Plant & Equip	536.7	644.0	673.5	710.1	747.9
Others	3.2	2.4	2.4	2.4	2.4
Non-Current Assets	**539.9**	**646.3**	**675.9**	**712.4**	**750.2**
Trade and other rcvb	58.2	87.9	89.7	84.1	94.9
Cash and Deposits	64.4	85.4	178.9	167.1	294.8
Others	0.0	168.8	0.0	0.0	0.0
Current Assets	**122.6**	**342.1**	**268.6**	**251.2**	**389.7**
Total Assets	**662.5**	**988.4**	**944.4**	**963.7**	**1,139.9**
LT Borrowings	287.0	295.7	218.0	177.3	228.2
Deferred Tax	16.7	29.4	29.4	29.4	29.4
Others	0.0	0.0	0.0	0.0	0.0
Non-Current Liabilities	**303.7**	**325.1**	**247.4**	**206.7**	**257.6**
ST Borrowings	44.8	285.8	210.7	171.4	220.6
Trade & other Payables	43.0	81.6	134.5	168.2	175.7
Others	1.1	0.0	0.0	0.0	0.0
Current Liabilities	**89.0**	**367.4**	**345.2**	**339.6**	**396.2**
Total Liabilities	**392.6**	**692.6**	**592.6**	**546.3**	**653.8**
Share capital	126.0	126.0	126.0	126.0	126.0
Reserves	143.9	169.9	225.6	290.8	359.2
Equity	**269.9**	**295.9**	**351.8**	**417.3**	**486.1**
Total Equity + Liabilities	**662.5**	**988.4**	**944.4**	**963.6**	**1,139.9**

Cash Flow Statement

FYE 31 Dec (RMmn)	2014	2015	2016E	2017F	2018F
Pretax Profit	19.7	50.8	107.9	126.3	132.5
Depreciation	25.0	43.6	46.8	49.4	52.0
Net Interest	12.2	13.4	14.7	9.2	10.0
Associates & JCEs	0.0	0.0	0.0	0.0	0.0
Working Cap Changes	30.4	8.9	51.1	39.3	(3.3)
Income Tax Paid	(5.5)	(13.4)	(28.0)	(32.8)	(34.5)
Others	(51.5)	(159.3)	168.8	0.0	0.0
CF from Operations	**30.3**	**(56.1)**	**361.2**	**191.3**	**156.8**
Capex	(129.0)	(135.5)	(76.4)	(85.9)	(89.8)
Acquisitions/Disposal	1.7	0.0	0.0	0.0	0.0
Interest Received	2.2	2.3	2.6	5.5	5.2
Others	(27.6)	(23.0)	2.6	5.5	5.2
CF from Investing	**(154.9)**	**(158.5)**	**(73.7)**	**(80.4)**	**(84.6)**
Share Issuance	71.6	0.0	0.0	0.0	0.0
Net Change in Debt	72.2	249.7	(152.8)	(80.0)	100.0
Dividends	0.0	(11.3)	(23.9)	(27.9)	(29.3)
Others	38.9	(2.7)	(17.4)	(14.8)	(15.2)
CF from Financing	**182.7**	**235.6**	**(194.1)**	**(122.7)**	**55.5**
Net Cash Flow	58.1	21.1	93.5	(11.8)	127.7
Beginning Cash	6.3	64.4	85.4	178.9	167.1
Ending Cash	**64.4**	**85.4**	**178.9**	**167.1**	**294.8**

Disclaimer

for TA SECURITIES HOLDINGS BERHAD (14948-M)
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