



Wah Seong Corp (WSC MK) : BUY

Mkt. Cap: US\$229m | 3m Avg. Daily Val: US\$0.16m

Last Traded Price (30 Aug 2018): RM1.22

Price Target 12-mth: RM1.80 (48% upside) (Prev RM1.90)

Shariah Compliant: Yes

Analyst

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Dragged by Petra Energy

- 2Q18 missed expectations; due to loss from JV and associates
- Contract replenishment prospects remain positive; potential additional work from NS2 reroute
- Further upside from potential margins expansion from NS2 project
- Reiterate BUY with lower TP of RM1.80

Forecasts and Valuation

FY Dec (RMm)	2017A	2018F	2019F	2020F
Revenue	2,492	2,957	2,789	3,000
EBITDA	281	302	323	345
Pre-tax Profit	123	125	148	169
Net Profit	113	97.9	115	132
Net Pft (Pre Ex.)	91.1	97.9	115	132
Net Pft Gth (Pre-ex) (%)	117.4	7.5	17.7	14.2
EPS (sen)	14.6	12.7	14.9	17.0
EPS Pre Ex. (sen)	11.8	12.7	14.9	17.0
EPS Gth Pre Ex (%)	117	8	18	14
Diluted EPS (sen)	11.8	12.7	14.9	17.0
Net DPS (sen)	4.39	3.80	4.48	5.11
BV Per Share (sen)	116	125	135	147
PE (X)	8.3	9.6	8.2	7.2
PE Pre Ex. (X)	10.4	9.6	8.2	7.2
P/Cash Flow (X)	2.9	3.1	3.2	3.8
EV/EBITDA (X)	6.2	4.6	3.6	3.0
Net Div Yield (%)	3.6	3.1	3.7	4.2
P/Book Value (X)	1.1	1.0	0.9	0.8
Net Debt/Equity (X)	0.7	0.3	0.1	0.0
ROAE (%)	13.5	10.5	11.5	12.1

Source of all data on this page: Company, AllianceDBS, Bloomberg Finance L.P.

What's New

- WSC reported 2Q18 revenue and headline profit of RM760m (+70% y-o-y, -4% q-o-q) and RM21m (+203% y-o-y, -28% q-o-q) respectively. Excluding the RM1.1m gain on disposal of non-core assets in the industrial and trading segment, RM0.4 reversal of impairment loss and RM6m forex loss, core profit came in at RM26m (+183% y-o-y, +15% q-o-q). At RM48m, 1H18 core earnings made up only 39%/42% of our/consensus full-year estimate, WSC's 1H18 performance missed expectations.
- 1H18 revenue and EBIT makes up 50%/53% of our FY18 estimates. The letdown is caused by loss of RM6m from its JV and associate in 2Q18. We understand the loss from Petra Energy is RM5m.
- We cut our FY18/19/20 earnings by 21%/10%/6% to account for lower contribution from its JV and associates, namely from Petra Energy.

2Q18 performance

- The strong growth in revenue and core profit is due to contributions from the Nord Stream 2 (NS2) project.
- We believe that there is potential for WSC to register higher-than-expected margins in FY18 compared to FY17 due to improved efficiency and increase in economies of scale from the production ramp-up to double shifts at its pipe-coating plants in Finland and Germany. Furthermore, we are sanguine of its margins outlook in FY19 as the massive NS2 project is based on a fixed cost-recovery margin plus bonus incentive upon

Flash Note

completion. We have not included any performance bonus in our forecast for the NS2 project. There is also potential for additional work from the NS2 project as it seeks new routes to avoid Denmark territorial waters on security grounds.

Performance review by business segments

- The O&G segment contributed 71%/90% of total revenue/operating profit in 2Q18 at RM536m (+131% y-o-y, +0% q-o-q)/ RM38m (+275% y-o-y, +23% q-o-q). Operating margins improved to 7.1% in 2Q18 (2Q17: 4.4%, 1Q18:5.8%). The improvements are due to increased efficiency from full production ramp-up for the NS2 project. We believe its 3Q18 performance will be similar to 2Q18.
- The renewable energy segment contributed 10%/18% of total revenue/operating profit in 2Q18 at RM74m (+5% y-o-y, +103% q-o-q)/ RM8m (+275% y-o-y, +23% q-o-q). Operating margins stabilised at 10.3% in 2Q18 (2Q17: 12.3%, 1Q18:5.4%). Improvements in performance are due to higher sales generated from the boiler and steam turbine businesses.
- The industrial and trading segment contributed 14%/7% of total revenue/operating profit in 2Q18 at RM109m (+3% y-o-y, -27% q-o-q)/ RM3m (+794% y-o-y, -51% q-o-q). Operating margins stabilised at 2.7% in 2Q18 (2Q17: -0.4%, 1Q18:4.1%). Improvements

in y-o-y operating margins were due to higher profit contribution from the sale of construction equipment and gain on disposal of plant and machinery from the closure of the steel pipe manufacturing business.

O&G division underpins earnings turnaround. We forecast this segment to remain WSC's main earnings contributor with a 3-year revenue CAGR of 9% from FY17-20. This is supported by its current outstanding O&G orderbook of c.RM1.6bn (82% of total orderbook).

Its O&G tenderbook remains strong at RM5.9bn, or RM5.0bn if the Multi-Product Pipeline and Trans Sabah pipeline projects are excluded. This represents an increase from an overall tenderbook of RM5.0bn in FY17. The areas of focus are Australia, Europe and East Africa. We understand that the next sizeable bid will be from Australia with the contract expected to be awarded in 2H19.

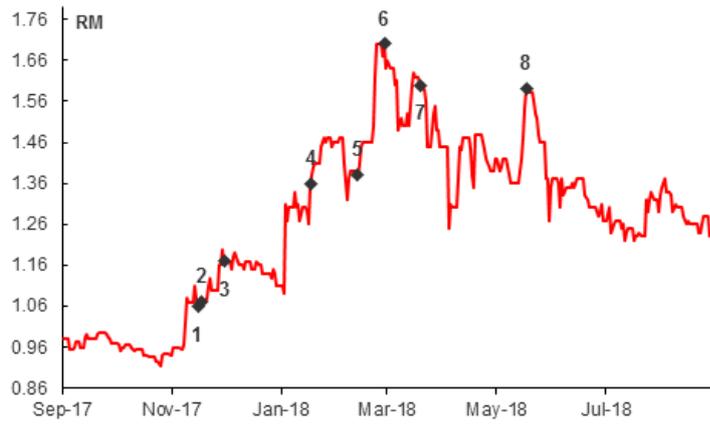
Valuation. Our TP is revised to RM1.80 as we roll forward our valuation base year to FY19 and revised our earnings assumptions. Our TP is based on 12x fully-diluted FY19F EPS, which is the sector's weighted average PE for small-cap players. However, this is still at a significant discount to its key competitor ShawCor's current PE of 35x.

Quarterly / Interim Income Statement (RMm)

FY Dec	2Q2017	1Q2018	2Q2018	% chg yoy	% chg qoq
Revenue	446	793	760	70.4	(4.1)
Cost of Goods Sold	(361)	(709)	(675)	86.7	(4.8)
Gross Profit	84.8	84.1	85.4	0.7	1.5
Other Oper. (Exp)/Inc	(60.3)	(47.8)	(36.3)	(39.8)	(23.9)
Operating Profit	24.5	36.4	49.1	100.7	35.0
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	nm	nm
Associates & JV Inc	1.72	2.23	(6.3)	nm	(384.2)
Net Interest (Exp)/Inc	(10.7)	(9.8)	(9.5)	10.9	2.6
Exceptional Gain/(Loss)	(2.1)	7.09	(4.5)	(116.3)	(163.1)
Pre-tax Profit	13.5	35.9	28.8	114.0	(19.9)
Tax	(3.9)	(12.0)	(6.3)	61.5	(47.4)
Minority Interest	(2.6)	5.28	(1.5)	44.5	(127.6)
Net Profit	6.94	29.2	21.0	203.3	(28.0)
Net profit bef Except.	9.01	22.2	25.5	183.3	15.1
EBITDA	48.1	88.6	88.1	83.2	(0.6)
Margins (%)					
Gross Margins	19.0	10.6	11.2		
Opg Profit Margins	5.5	4.6	6.5		
Net Profit Margins	1.6	3.7	2.8		

Source of all data: Company, AllianceDBS

Target Price & Ratings History



Note: Share price and Target price are adjusted for corporate actions.

S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	15 Nov 17	1.06	1.35	BUY
2:	17 Nov 17	1.07	1.35	BUY
3:	30 Nov 17	1.17	1.90	BUY
4:	17 Jan 18	1.36	1.90	BUY
5:	12 Feb 18	1.38	1.90	BUY
6:	27 Feb 18	1.70	1.90	BUY
7:	19 Mar 18	1.60	1.90	BUY
8:	17 May 18	1.59	1.90	BUY

Source: AllianceDBS

Analyst: Inani ROZIDIN

DISCLOSURE

Stock rating definitions

STRONG BUY	-	> 20% total return over the next 3 months, with identifiable share price catalysts within this time frame
BUY	-	> 15% total return over the next 12 months for small caps, >10% for large caps
HOLD	-	-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps
FULLY VALUED	-	negative total return > -10% over the next 12 months
SELL	-	negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame

Commonly used abbreviations

Adex = advertising expenditure	EPS = earnings per share	PBT = profit before tax
bn = billion	EV = enterprise value	P/B = price / book ratio
BV = book value	FCF = free cash flow	P/E = price / earnings ratio
CF = cash flow	FV = fair value	PEG = P/E ratio to growth ratio
CAGR = compounded annual growth rate	FY = financial year	q-o-q = quarter-on-quarter
Capex = capital expenditure	m = million	RM = Ringgit
CY = calendar year	M-o-m = month-on-month	ROA = return on assets
Div yld = dividend yield	NAV = net assets value	ROE = return on equity
DCF = discounted cash flow	NM = not meaningful	TP = target price
DDM = dividend discount model	NTA = net tangible assets	trn = trillion
DPS = dividend per share	NR = not rated	WACC = weighted average cost of capital
EBIT = earnings before interest & tax	p.a. = per annum	y-o-y = year-on-year
EBITDA = EBIT before depreciation and amortisation	PAT = profit after tax	YTD = year-to-date

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