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PANTECH GROUP HOLDINGS BHD ("PANTECH") – Riding High On the O&G Spending Boom

Recommendation: Buy

Share Price: RM0.675

FINANCIAL SUMMARY				
FYE 28 Feb (RM mil)	**2011**	**2012**	**2013F**	**2014F**
Revenue	336	435	558	616
Trading	*244*	*308*	*279*	*308*
Manufacturing	*92*	*127*	*279*	*308*
EBITDA	46	64	86	94
Trading	*43*	*46*	*54*	*58*
Manufacturing	*7*	*11*	*32*	*36*
EBITDA Margin (%)	14	15	15	15
Trading	*18*	*15*	*19*	*19*
Manufacturing	*8*	*9*	*11*	*12*
Pre-tax Profit	40	56	70	83
Net Profit	29	34	52	62
EPS (sen)	6.5	7.6	11	13
DPS (sen)	4	4	5	5
PER (x)	10.4	8.9	6.1	5.2
Dividend Yield (%)	5.9	5.9	7.4	7.4

OTHER KEY DATA	
Listing	Main Board
Issued Cap. (mil, RM0.2 par)	483
Market Cap. (RM mil)	326
52 Week Low/High (RM)	0.41 / 0.69
Net Gearing (%)	32
ROE (%)	10.5
P/BV (x)	0.9
BV/share (RM)	0.8

Major Shareholders	**(%)**
CTL Capital Holdings	22.4
GL Management Agency	16.6
Koperasi Permodalan Felda	8.7

Source: Company, Bloomberg & PCM estimates

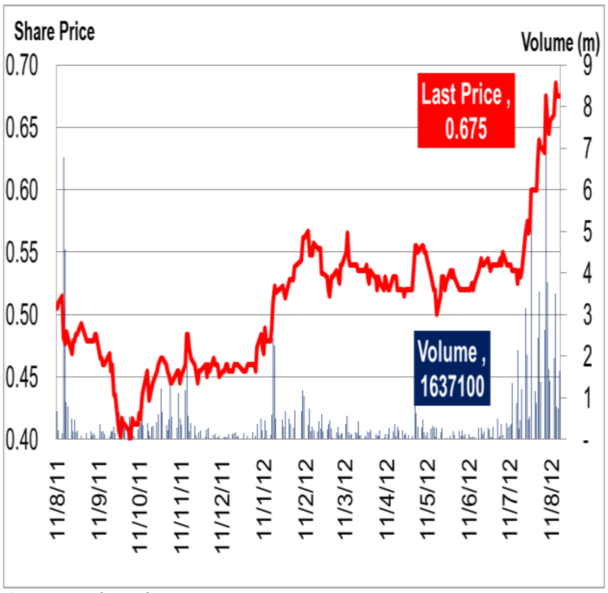
Although market jitters over the uncertainties of the macro economy, O&G industry remains resilient underpinned by the huge spending forecast. However, PANTECH has seldom appeared on most of the analysts' radar despite that it plays a very important role as a supplier of pipes, fittings and flow controls (PFF) at the tail end of the O&G value chain.

We like PANTECH for the following:-

- Better clarity of the turnaround of stainless steel segment which was in the red since its launch in May 2011
- PANTECH is riding high on the O&G spending boom and the growth will mainly come from the trading segment, stainless steel and Nautic Steel (UK) which was acquired in March 2012.
- 2.3 sen dividend announced yielding 3.4% by Oct 2012. Impressive dividend yield of 7-8% p.a., from quarterly payout.

We recommend buying PANTECH even though its share price has run up by about 25% since June 2012 because we think that the current valuation of 6x FY2013 EPS is grossly undervalued.

Price Chart of PANTECH (1 Year)



Source: Bloomberg

Highlights:

Background – PANTECH was established in 1987 under the name Pantech Hardware and Machinery Trading (PHMT), supplying industrial hardware and machinery in the southern region of Peninsular Malaysia. Listed in 1997, Pantech evolved as one of the largest stockiest and project management company of piping and steel products for the Oil and gas industries in this region through its associate company, Tuah Nusa Sdn Bhd (TNSB), a PETRONAS's Licensed Vendor. PANTECH stocks, supplies, and also manufactures high pressure seamless and specialized pipes, fittings, flanges, valves of carbon, stainless and high performance alloy steel materials for use in the Oil and Gas, Gas Reticulation, Marine, Onshore and Offshore Heavy Engineering, Power Generation, Petrochemicals, Chemical, Ole-chemical, Palm Oil Refining and other related industries. PANTECH owns 2 manufacturing plants located at Meru, Klang and Pasir Gudang - the former manufactures carbon steel pipes fittings and the latter which was built in 2011 manufactures stainless steel pipes and fittings (***see Table 1***). In March 2012, PANTECH acquired 100% equity of UK based niche manufacturer and supplier of copper nickel pipes, fittings and flanges (PFF) Nautic Group, for a consideration of GBP9.5m or at about 6.7x PE.

Table 1: Manufacturing Plants Details

	Location	Capacity (MT)	Utilisation (%)	Land size (m^2)	built-up area (m^2)
Plant 1:	Meru, Klang	18,500	90*	82,962	15,405
Carbon Steel Pipe Fittings					
Plant 2:	Pasir Gudang	14,500	75	110,000	20,500
Stainless Steel Pipe					
Stainless Steel Pipe Fittings		900	65		

* optimal utilisation

Source: PCM & Co

Trading Division Is Still The Major Earnings Contributor – Currently, trading of PFF contributes almost 70% of the group's revenue. According to the management, earnings contribution from the manufacturing division is expected to rise due to the higher margin from Nautic Steel which specializes in niche market, increasing utilization of capacity and improving efficiency level particularly the stainless steel manufacturing plant. Overall, manufacturing division is expected to contribute 50% to the revenue in FY2013 due to the vibrant demand from O&G sector. However, trading division is expected to contribute about 60% of earnings, remains as the major earnings contributor.

Turnaround of Stainless Steel – PANTECH invested RM130m in year 2010/11 to venture into the business of stainless steel. The group revenue and earnings in FY2011/2012 was commendable but overall performance was dragged down somewhat by the newly operating stainless steel plant which was going through the learning curve. However, we see dawn of the turnaround now as stainless steel segment will break even in FY2013 and we expect it will give rise to a spike in earnings in FY2014.

Riding High On the O&G Spending Boom – Apart from the local RM300 billion five-year capital expenditure plans committed by our national oil company, global upstream capital and operating expenditures (CAPEX and OPEX) are set to reach a combined record of $1.23 trillion in 2012, of which 60% is for new projects and this is expected to rise to $1.64 trillion in 2016, according the latest IHS Upstream Spending Report. Therefore, we believe PANTECH will be riding high on the O&G spending boom at least for another 3-5 years and its growth will mainly come from trading, stainless steel and Nautic steel.

Expansion Potential & Growth from Stainless Steel – As mentioned above, the turnaround of the stainless steel division will cause a spike in earnings by FY2014. Notwithstanding the current low utilization rate of 65%, the factory with built-up size of 20.5k m^2 in Pasir Gudang only occupy about 20% of total land size which means it has plenty of room for future expansion.

Leverage On Nautic Steel's Technical Knowhow & established Networks – On the other hand, Pantech will be able to leverage on the newly acquired Nautic Steel's established network to market its existing products directly to the large oil players such as Qatar Petroleum, Kuwait Oil Company, Petronas, BP, Esso, Shell and the Brazilian Navy. Moreover, PANTECH is expected to strengthen its expertise in exotic products such as pipe fittings and flanges for sea water systems and acidic environments which are designed to operate under highly corrosive conditions and extreme temperature using Nautic Steel's technical knowhow to manufacture niche products comprising duplex and super duplex stainless steel, copper nickel and alloys to complement its existing capability in producing carbon steel fittings, and stainless steel pipes and fittings.

Quarterly Dividend and Great Yield – We are also attracted by the ~40% dividend pay-out on a quarterly basis which will translate into about 7-8% dividend yield p.a. PANTECH has announced a final dividend of 1.3 sen for FY2012 going ex on 3 Sept 2012 and an special interim dividend of 1 sen for FY2013 going ex on 5 Oct 2012 totalled 2.3 sen translating into 3.4% yield within next 2 months.

Recommendation:-

In spite of the fact that 80% of PANTECH's revenue actually comes from O&G sector and it is perceived as a quasi O&G company, its valuation is far below the average of the O&G peers. The current valuation at 6x FY2013 EPS is grossly undervalued. Therefore, we recommend "Buy".

For Phillip Capital Management Sdn Bhd

Nona Salleh
Executive Chairperson

APPENDIX
LIST OF STOCKS RECOMMENDED SINCE 2010

Our Picks – 2010/11/12						
No	**Stock**	**Date**	**Price***	**Price @ 17/8/12**	**% Change**	**Comments**
1	MBSB	30 Nov 09	RM0.655	RM2.41	267.9	Hold. News of takeover by RHB re-surfaced.
2	Dayang	29 April 10	RM1.30	RM2.08	60.0	Medium Term Buy. Multi-billion umbrella contract coming out.
3	KSL	30 June 10	RM 1.30	RM1.40	7.7	Buy/Hold. Price stayed despite good take up rate of Bk Tinggi project.
4	Kian Joo	28 Aug 10	RM1.287	RM2.61	102.8	Hold. Surged in CanOne price has spilled over to Kian Joo
5	TSH	17 Sep 10	RM1.055	RM2.60	146.4	Hold. Proposed acquisition of Pontian United Plant is positive.
6	Public Bank	18 Oct 10	RM12.12	RM14.38	18.6	LT Buy/Hold. Earnings have been depressed by lower margin.
7	Padini	25 Oct 10	RM0.896	RM2.26	152.2	Buy/Hold. Still see much growth prospect domestically.
8	AirAsia	17 Dec 10	RM 2.64	RM3.59	36.0	Buy/Hold. Will put more effort to develop Indonesia business.
9	Benalec	18 Jan 11	RM 1.32	RM1.17	-11.4	Buy/Hold. Owner doing more aggressive buying of its share at this level.
10	CIMB	9 Mar 11	RM 7.71	RM7.86	1.9	Hold. Intend to expand to South Korea and India.
11	Sarawak Oil Palm	30 Mar 11	RM 3.46	RM6.82	97.1	Hold. Rebounded more than other plantation stocks.
12	TRC	20 Apr 11	RM0.586	RM0.65	10.9	Medium Term Buy. 2nd quarter results will still be weak but strong going forward.
13	AMedia	6 June 11	RM0.285	RM0.83	191.2	Hold. Price surge substantially but no news of TV contract on LRT.
14	Bstead	4 Aug 11	RM4.37	RM5.37	22.9	Buy/Hold. Relisted Pharmaniaga has performed very well.
15	Dialog	19 Aug 11	RM2.374	RM2.41	1.5	Buy/Hold. Main beneficiary of RAPID project in Johore.
16	Yinson	13 Sep 11	RM1.129	RM2.02	78.9	Buy. Shareholders approved acquisition of FPSO.
17	Tenaga	27 Sep 11	RM 4.94	RM6.80	37.7	Buy. Price has retraced to support of RM6.80
18	Eng Kah	18 Nov 11	RM 3.14	RM3.70	17.8	Hold. Bonus and warrant issues will improve liquidity.
19	Prestariang	14 Dec 11	RM0.645	RM1.27	96.9	Still a Buy. Market is very bullish on its setting of an IT university.
20	Padini	21 Mar 12	RM1.43	RM2.26	58.0	Buy. As above.
21	MPHB	27 April 12	RM2.64	RM3.75	42.0	Buy. Proposed demerger will offer 1:2 free share @RM1.00 each
22	Top Glove	17 May 12	RM4.20	RM5.41	28.8	Hold. Coming to RM5.50 resistance.
23	Genting	30 May 12	RM10.00	RM9.06	-9.4	Medium Term Buy. Px fall in line with that of global gaming counters.
24	Airport	8 June 12	RM5.62	RM5.30	-5.7	Buy. Market is concerned with initial losses from KLIA2 next year.
25	RHB Cap	31 July 12	RM7.37	RM7.26	-1.5	Buy. 2nd cheapest banking stock listed on Bursa.
26	OCK	6 Aug 12	RM0.435	RM0.43	-1.1	Buy. To build its own BTS transmission tower.

**Price adjusted for dividend, bonus and rights*