

1 September 2016

Malaysia | Small & Mid Caps

## Pestech International

**Buy** (Maintained)

Target Price: MYR2.12  
 Price: MYR1.53  
 Market Cap: USD282m  
 Bloomberg Ticker: PEST MK

### Another Earnings Record

We like Pestech's unique business proposition, as it rides on the fast growing regional demand for electricity and rail related infrastructure. Robust FY16 earnings have prompted us to raise our next three years' earnings estimates. Therefore, reiterate BUY with a higher MYR2.12 TP (from MYR1.96, 39% upside) after rolling over target 20x P/E to 2017 (from FY17) and adding the DCF of DPL's concession.

**Two-pronged strategy.** Pestech International (Pestech) is in the right business at the right place and time. The robust regional electricity demand certainly bodes well for the company, which continues to solidify its foothold in the region, with the Philippines being its latest new market. Pestech is also expanding into rail electrification projects after it bought over certain rail equipment assets from Balfour Beatty. An earlier intention to list wholly-owned Pestech (Cambodia) on the Cambodian Stock Exchange (CSX) also may help to strengthen its foothold in the Indochina market. Meanwhile, its outstanding orderbook as at 30 Jun is MYR820m. Pestech's FY16 (Jun) results came in ahead of our and street estimates, thanks to higher job recognitions that were further boosted by a 9-year tax holiday granted to Diamond Power (DPL). This significantly cut its effective tax rate to only 5.9% vs 24% assumed in our financial model.

**Forecast and risks.** After trimming our effective tax rate assumption and a few other minor housekeeping activities, our FY17-18 earnings are revised up by 78.3% and 9% respectively. We also introduce our FY19 numbers in this report. Major risks include new contract wins falling short of our assumptions and an escalation in input costs, which will trim margins.

#### 4QFY16 (Jun) earnings – results above expectations

(MYRm)	4QFY16	3QFY16	QoQ	4QFY15	YoY	Comments
Revenue	190.7	123.4	54.5%	na	na	Higher job recognition
EBIT	39.9	25.2	58.2%	na	na	
EBIT margin (%)	20.9%	20.4%		na	na	EBIT margin remains stable
Pretax profit	28.9	22.0	31.2%	na	na	
Pretax margin (%)	15.1%	17.8%		na	na	
Net profit	22.5	12.5	79.4%	na	na	
Core profit	25.5	12.2	109.4%	na	na	Above our and consensus estimates
Core net margin (%)	13.3%	9.8%		na	na	

Source: Company data, RHB

**Reiterate BUY.** We reiterate our BUY call with a revised MYR2.12 TP (from MYR1.96). This is as we raise our earnings estimates for the next two years and rollover our 20x target P/E to 2017F (from FY17F) and adding the DCF of DPL's concession. We deem the premium P/E justifiable, vis-à-vis typical utilities firms, given Pestech's robust growth prospects.

Forecasts and Valuations	Jun-15	Jun-16	Jun-17F	Jun-18F	Jun-19F
Total turnover (MYRm)	268	509	622	652	728
Reported net profit (MYRm)	37.7	72.8	74.6	75.4	84.1
Recurring net profit (MYRm)	30.3	66.8	74.6	75.4	84.1
Recurring net profit growth (%)	18.4	120.1	11.8	1.0	11.6
Recurring EPS (MYR)	0.05	0.09	0.10	0.10	0.11
DPS (MYR)	0.01	na	0.01	0.01	0.01
Recurring P/E (x)	28.1	17.1	15.3	15.2	13.6
P/B (x)	4.84	3.69	3.03	2.57	2.20
P/CF (x)	na	na	na	na	11.0
Dividend Yield (%)	0.3	na	0.7	0.7	0.7
EV/EBITDA (x)	19.6	12.6	14.0	14.4	12.4
Return on average equity (%)	23.1	26.7	21.8	18.4	17.4
Net debt to equity (%)	43.1	85.8	137.0	128.7	100.7
Our vs consensus EPS (adjusted) (%)			11.1	(1.0)	0.0

Source: Company data, RHB

#### Share Data

Avg Daily Turnover (MYR/USD)	1.50m/0.37m
52-wk Price low/high (MYR)	1.32 - 1.76
Free Float (%)	40
Shares outstanding (m)	746
Estimated Return	39%

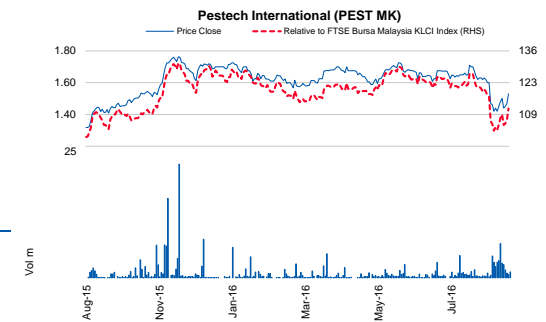
#### Shareholders (%)

Lim Ah Hock	34.2
Lim Pay Chuan	20.5

#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(10.8)	(10.0)	(10.8)	(3.2)	16.1
Relative	(9.9)	(11.5)	(13.8)	(4.6)	12.0

Source: Bloomberg



Source: Bloomberg

#### Analyst

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Figure 1: Pestech's results table

FYE Jun (MYRm)	4QFY15	3QFY16	4QFY16	QoQ (%)	YoY (%)	FY15	FY16	YoY (%)	Comments
<b>Revenue</b>	na	123.4	190.7	54.5	na	na	508.7	na	Higher job recognition in 4Q.
<b>EBITDA</b>	na	25.2	39.9	58.2	na	na	116.4	na	Increased revenue coupled with stable EBITDA margins lifted EBITDA for 4Q.
<i>EBITDA margin (%)</i>	na	20.4	20.9			na	22.9		
Depreciation	na	(1.1)	(1.1)	(3.1)	na	na	(4.4)	na	
<b>EBIT</b>	na	24.1	38.8	61.1	na	na	112.0	na	
<i>EBIT margin (%)</i>	na	19.5	20.3			na	22.0		
Interest expense	na	(2.4)	(6.9)	184.3	na	na	(12.6)	na	
Interest income	na	0.0	0.0	na	na	na	0.0	na	
Associates	na	0.0	0.0	na	na	na	0.0	na	
El/others	na	0.4	(3.0)	(913.5)	na	na	6.5	na	Forex gain/(loss).
<b>Pretax profit</b>	na	22.0	28.9	31.2	na	na	105.8	na	
<i>Pretax margin (%)</i>	na	17.8	15.1			na	20.8		
Tax	na	(3.1)	5.7	(287.5)	na	na	(6.3)	na	Corporate tax writeback following the over provision in past quarters.
<i>Effective tax rate (%)</i>	na	(13.9)	19.9			na	(5.9)		
Minority interest	na	(6.4)	(12.2)	89.4	na	na	0.0	na	
<b>Net profit</b>	na	12.5	22.5	79.4	na	na	72.8	na	
<b>Core profit</b>	na	12.2	25.5	109.4	na	na	66.4	na	Result was above our and consensus expectations.
<i>Core net margin (%)</i>	na	9.8	13.3			na	13.0		

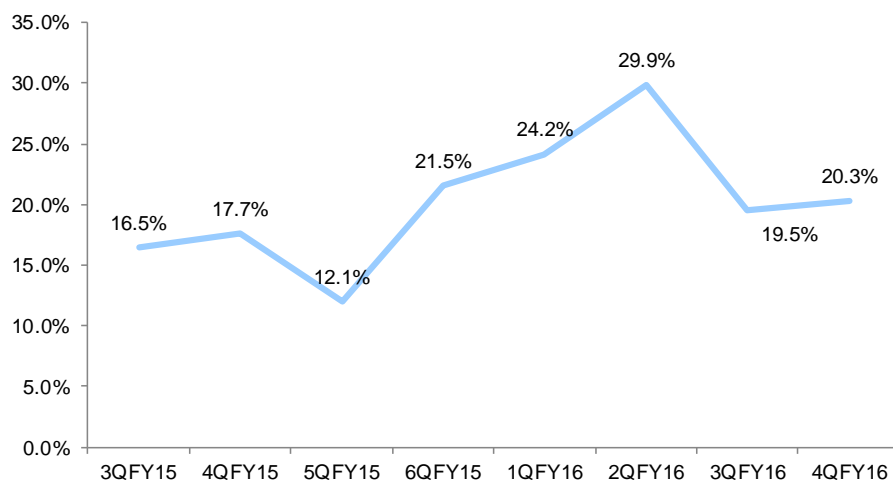
Source: Company data, RHB

Figure 2: Pestech' past eight quarters of results

FYE Jun (MYRm)	3QFY15	4QFY15	5QFY15	6QFY15	1QFY16	2QFY16	3QFY16	4QFY16
<b>Revenue</b>	<b>68.5</b>	<b>66.8</b>	<b>73.3</b>	<b>88.9</b>	<b>48.3</b>	<b>146.3</b>	<b>123.4</b>	<b>190.7</b>
<b>EBITDA</b>	<b>12.1</b>	<b>12.6</b>	<b>9.7</b>	<b>20.2</b>	<b>12.7</b>	<b>45.0</b>	<b>25.2</b>	<b>39.9</b>
<i>EBITDA Margin (%)</i>	<i>17.6</i>	<i>18.8</i>	<i>13.3</i>	<i>22.7</i>	<i>26.3</i>	<i>30.7</i>	<i>20.4</i>	<i>20.9</i>
Depreciation	(0.8)	(0.8)	(0.9)	(1.1)	(1.0)	(1.2)	(1.1)	(1.1)
<b>EBIT</b>	<b>11.3</b>	<b>11.8</b>	<b>8.8</b>	<b>19.2</b>	<b>11.7</b>	<b>43.8</b>	<b>24.1</b>	<b>38.8</b>
<i>EBIT Margin (%)</i>	<i>16.5</i>	<i>17.7</i>	<i>12.1</i>	<i>21.5</i>	<i>24.2</i>	<i>29.9</i>	<i>19.5</i>	<i>20.3</i>
Interest expense	(0.8)	(1.3)	(1.4)	(1.2)	(1.5)	(1.7)	(2.4)	(6.9)
Interest income	(0.4)	0.1	(0.0)	0.0	0.0	0.0	0.0	0.0
Associates	(0.2)	0.0	(0.2)	(0.1)	0.0	0.0	0.0	0.0
EI/Others	0.0	0.0	0.0	14.3	16.4	(7.3)	0.4	(3.0)
<b>Pretax profit</b>	<b>9.9</b>	<b>10.6</b>	<b>7.2</b>	<b>32.2</b>	<b>26.5</b>	<b>28.4</b>	<b>22.0</b>	<b>28.9</b>
<i>Pretax Margin (%)</i>	<i>14.4</i>	<i>15.8</i>	<i>9.8</i>	<i>36.2</i>	<i>54.9</i>	<i>19.4</i>	<i>17.8</i>	<i>15.1</i>
Tax	(2.6)	(3.0)	0.4	(7.9)	(6.2)	(2.7)	(3.1)	5.7
<i>Effective tax rate (%)</i>	<i>(25.9)</i>	<i>(28.6)</i>	<i>5.3</i>	<i>(24.4)</i>	<i>(23.4)</i>	<i>(9.6)</i>	<i>(13.9)</i>	<i>19.9</i>
Minority Interest	(0.0)	0.0	(0.0)	0.1	0.2	(8.4)	(6.4)	(12.2)
<b>Net Profit</b>	<b>7.3</b>	<b>7.6</b>	<b>7.6</b>	<b>24.5</b>	<b>20.5</b>	<b>17.3</b>	<b>12.5</b>	<b>22.5</b>
<b>Core Profit</b>	<b>7.3</b>	<b>7.6</b>	<b>7.6</b>	<b>10.1</b>	<b>4.2</b>	<b>24.6</b>	<b>12.2</b>	<b>25.5</b>
<i>Core Net Margin (%)</i>	<i>10.6</i>	<i>11.3</i>	<i>10.4</i>	<i>11.4</i>	<i>8.6</i>	<i>16.8</i>	<i>9.8</i>	<i>13.3</i>

Source: Company data, RHB

Figure 3: Pestech's EBIT margins evolution



Source: Company data, RHB

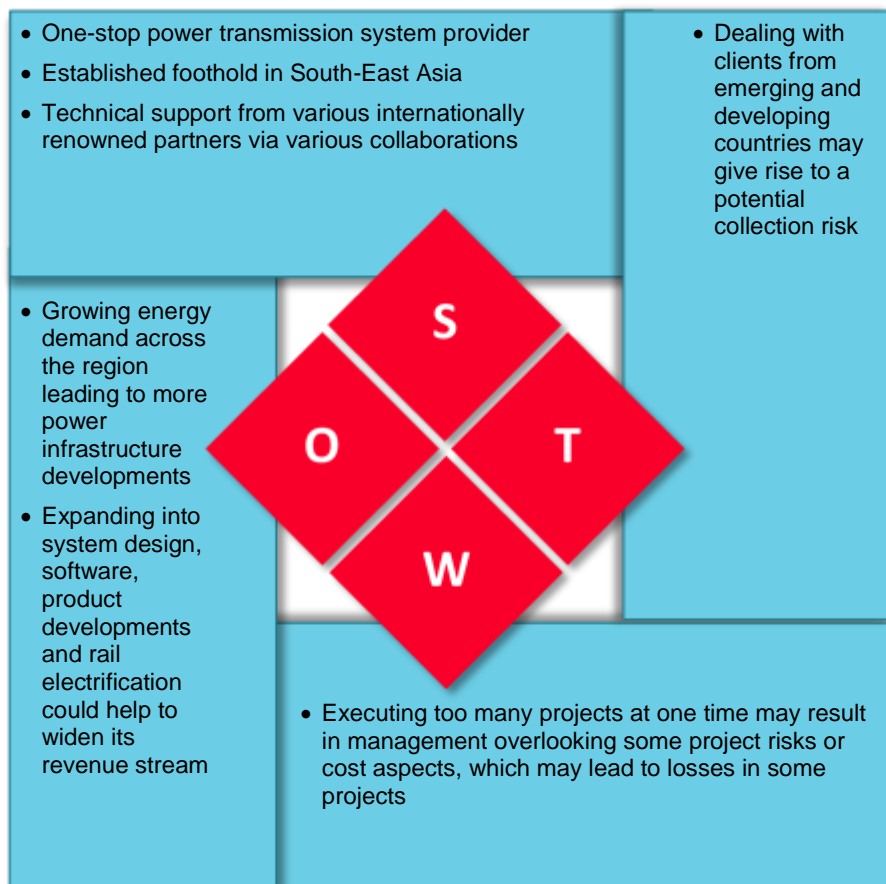
## Financial Exhibits

Financial model updated on: 2016-08-30.

Asia	<b>Financial summary</b>	<b>Jun-15</b>	<b>Jun-16</b>	<b>Jun-17F</b>	<b>Jun-18F</b>	<b>Jun-19F</b>
Malaysia	Recurring EPS (MYR)	0.05	0.09	0.10	0.10	0.11
Malaysia	EPS (MYR)	0.07	0.10	0.10	0.10	0.11
<b>Pestech International</b>	DPS (MYR)	0.01	0.00	0.01	0.01	0.01
Bloomberg PEST MK	BVPS (MYR)	0.32	0.41	0.50	0.60	0.70
<b>Buy</b>	Weighted avg adjusted shares (m)	556	745	746	746	746
<b>Valuation basis</b>	<b>Valuation metrics</b>	<b>Jun-15</b>	<b>Jun-16</b>	<b>Jun-17F</b>	<b>Jun-18F</b>	<b>Jun-19F</b>
We value Pestech based on 20x 2017F P/E (a premium to typical utilities companies considering its robust growth outlook) plus the DCF of DPL's transmission concession.	Recurring P/E (x)	28.1	17.1	15.3	15.2	13.6
	P/E (x)	22.6	15.6	15.3	15.2	13.6
	P/B (x)	4.84	3.69	3.03	2.57	2.20
	FCF Yield (%)	(6.8)	(14.7)	(22.7)	(2.2)	8.2
	Dividend Yield (%)	0.3	0.0	0.7	0.7	0.7
	EV/EBITDA (x)	19.6	12.6	14.0	14.4	12.4
	EV/EBIT (x)	21.1	13.1	14.4	14.9	12.8
<b>Key drivers</b>	<b>Income statement (MYRm)</b>	<b>Jun-15</b>	<b>Jun-16</b>	<b>Jun-17F</b>	<b>Jun-18F</b>	<b>Jun-19F</b>
The robust regional electricity and rail demand.	Total turnover	268	509	622	652	728
	Gross profit	61	134	162	166	187
	EBITDA	47	115	125	126	143
	Depreciation and amortisation	(3)	(4)	(3)	(4)	(4)
	Operating profit	44	111	122	123	139
	Net interest	(4)	(11)	(20)	(28)	(28)
	Income from associates & JVs	(1)	0	0	0	0
	Pre-tax profit	49	106	102	95	110
	Taxation	(11)	(6)	(10)	(13)	(22)
	Minority interests	0	(27)	(17)	(6)	(4)
	Recurring net profit	30	67	75	75	84
<b>Key risks</b>	<b>Cash flow (MYRm)</b>	<b>Jun-15</b>	<b>Jun-16</b>	<b>Jun-17F</b>	<b>Jun-18F</b>	<b>Jun-19F</b>
i. New contract wins falling short of our assumptions;	Change in working capital	(83.4)	(266.2)	(383.4)	(156.1)	(45.5)
ii. Escalation in input costs will trim margins.	Cash flow from operations	(44.9)	(153.1)	(248.8)	(15.1)	104.1
	Capex	(13.2)	(14.0)	(10.0)	(10.0)	(10.0)
	Cash flow from investing activities	(12.1)	(13.9)	(9.5)	(9.5)	(9.5)
	Proceeds from issue of shares	27.1	4.8	0.0	0.0	0.0
	Dividends paid	(3.7)	0.0	(7.5)	(7.5)	(8.4)
	Cash flow from financing activities	61.8	165.4	262.3	34.1	(77.4)
<b>Company Profile</b>	<b>Balance sheet (MYRm)</b>	<b>Jun-15</b>	<b>Jun-16</b>	<b>Jun-17F</b>	<b>Jun-18F</b>	<b>Jun-19F</b>
Pestech International (Pestech) specialises in the provision of comprehensive power system engineering and technical solutions for the construction of electric power assets.	Total cash and equivalents	30	18	22	32	49
	Tangible fixed assets	39	49	55	61	67
	Intangible assets	75	82	82	82	82
	Total other assets	0	0	0	0	0
	Total assets	499	804	1,157	1,287	1,321
	Short-term debt	119	191	181	151	121
	Other liabilities	26	0	20	0	(20)
	Total liabilities	266	470	739	796	750
	Shareholders' equity	235	309	377	444	520
	Minority interests	(2)	24	41	47	51
	Total equity	234	333	418	492	571
	Net debt	101	286	572	633	575
	Total liabilities & equity	499	804	1,157	1,287	1,321
	<b>Key metrics</b>	<b>Jun-15</b>	<b>Jun-16</b>	<b>Jun-17F</b>	<b>Jun-18F</b>	<b>Jun-19F</b>
	Revenue growth (%)	19.3	89.9	22.3	4.8	11.6
	Recurrent EPS growth (%)	(3.8)	64.4	11.5	1.0	11.6
	Gross margin (%)	22.7	26.3	26.1	25.4	25.7
	Operating EBITDA margin (%)	17.6	22.6	20.1	19.4	19.7
	Net profit margin (%)	14.1	14.3	12.0	11.6	11.6
	Dividend payout ratio (%)	9.9	0.0	10.0	10.0	10.0
	Capex/sales (%)	4.9	2.8	1.6	1.5	1.4
	Interest cover (x)	10.0	8.8	6.0	4.3	4.8

Source: Company data, RHB

## SWOT Analysis



## Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2016-05-27	Buy	1.96	1.73
2016-04-01	Buy	1.87	1.69
2016-02-26	Buy	1.73	1.62
2015-11-27	Take Profit	1.47	1.68
2015-08-31	Buy	1.71	1.32
2015-07-31	Buy	1.71	1.49
2015-05-20	Buy	1.55	1.28
2015-04-09	Neutral	1.26	1.39
2015-03-02	Neutral	1.13	1.23
2015-02-17	Neutral	1.09	1.08

Source: RHB, Bloomberg

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**Neutral:** Share price may fall within the range of +/- 10% over the next 12 months

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