

Nam Cheong (NCL SP)

Energy & Petrochemicals - Oil & Gas Services

Market Cap: USD239m

Neutral (from Buy)

 Target Price: **SGD0.175**

 Price: **SGD0.162**

Winter Soldier, Soldiering On

 Macro
 Risks
 Growth
 Value


Source: Bloomberg

Avg Turnover (SGD/USD)	1.04m/0.74m
Cons. Upside (%)	12.5
Upside (%)	8.0
52-wk Price low/high (SGD)	0.14 - 0.42
Free float (%)	42
Share outstanding (m)	2,096
Shareholders (%)	
SK Tong Enterprise Sdn Bhd	27.3
Hung Yung Enterprise Sdn Bhd	15.2
Su Kouk Tiong	7.8
Share Performance (%)	
	YTD 1m 3m 6m 12m
Absolute	(48.6) (1.2) (15.6) (48.6) (61.4)
Relative	(36.5) 1.2 (12.2) (34.5) (51.5)

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Nam Cheong's 3Q15 PATMI was at breakeven as revenue recognition slowed with fewer vessels on the steep part of the S-curve. Downgrade to Neutral with SGD0.175 TP based on 0.8x P/B. We continue to believe the business model is viable, given long-term demand remains intact (see Fig 2). However, the variance of estimates has now grown too large – any vessel sales would generate a revenue spike since vessels are farther along their completion stages.

- ◆ **A slow quarter.** This quarter was slower as fewer vessels were completed and delivered (See Figure 1 for details), and there were also fewer vessels on the steep part of the S-curve. A higher mix of build-to-order vessels in the order book took the shipbuilding margin down to 14.3% from 15.3% in 2Q15. Management guides that 25% of the MYR880m net orderbook will be recognised in 4Q15 (implying higher shipbuilding revenue than 3Q15's MYR182m) with the rest in FY16. When queried, management revealed that the market prices of its assets are still above costs, and no impairment to the book value is necessary.
- ◆ **Business model built for winter, enquiries up in 4Q15.** Describing Nam Cheong as a "winter soldier", management remains confident that its business model will be the first to benefit in the eventual upturn, given that build to order yards will not have a ready stock to meet demand when it returns. This is in line with our views of the business, in general. Internal stress tests indicate that the business can be "sustained for a prolonged period on low or no orders". They also reported a higher level of enquiries in 4Q15, "perhaps because oil majors have leftover budgets unspent after too much knee-jerk [in freezing capex]".
- ◆ **Any sales could cause a significant revenue spike now.** Based on Nam Cheong's accounting practices, the sale of a USD30m vessel near completion would result in revenue recognition of MYR100m-130m, with a significant impact on the bottomline. Because of this, the variance of estimates has grown too large for consistent estimation. We model for the sale of eight USD20m vessels in FY16F, with half the forecast revenue already in next year's order book. Given the weak sales outlook, we slash estimates 50%/45%/28% for FY15-17F and downgrade the stock to NEUTRAL as investors have other choices with higher earnings visibility. Our 0.8x P/B basis is conservative given Nam Cheong's capacity-light model, and because long-term demand remains intact.

Forecasts and Valuations	Dec-13	Dec-14	Dec-15F	Dec-16F	Dec-17F
Total turnover (MYRm)	1,257	1,929	935	1,340	1,600
Reported net profit (MYRm)	206	302	50	70	117
Recurring net profit (MYRm)	193	302	50	70	117
Recurring net profit growth (%)	41.6	56.1	(83.3)	38.2	68.0
Recurring EPS (MYR)	0.09	0.14	0.02	0.03	0.06
DPS (MYR)	0.03	0.05	0.02	0.02	0.02
Recurring P/E (x)	5.4	3.5	20.7	15.0	8.9
P/B (x)	1.12	0.86	0.77	0.75	0.71
P/CF (x)	na	17.2	na	na	5.2
Dividend Yield (%)	6.0	9.0	3.0	3.6	3.9
EV/EBITDA (x)	7.2	5.1	28.0	20.7	13.6
Return on average equity (%)	26.9	28.0	3.9	5.0	8.1
Net debt to equity (%)	52.1	41.8	88.4	92.7	78.8
Our vs consensus EPS (adjusted) (%)			(57.6)	(40.8)	(24.2)

Additional Notes

Figure 1: Results in review

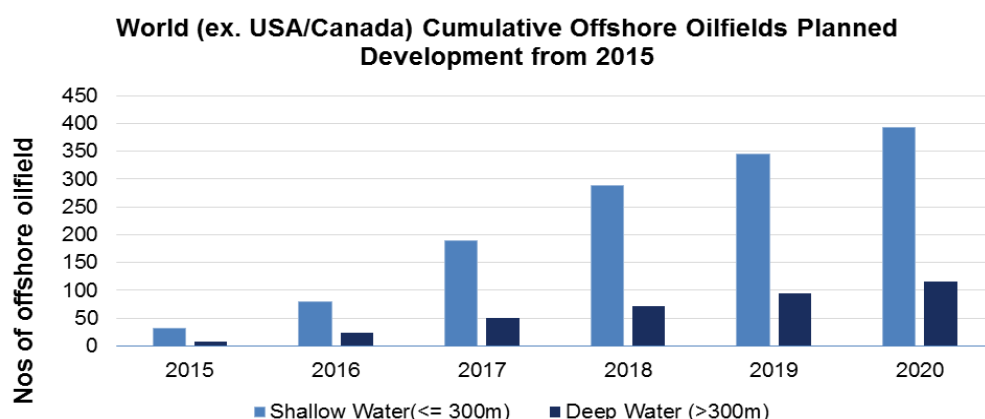
MYR ('000)	3Q14	2Q15	3Q15	YoY	QoQ	Reasons
Shipbuilding	595,099	179,179	182,136	-69%	2%	Completed and delivered two vessels in 3Q15 vs six in 3Q14. 3Q14 was also an abnormally high revenue-recognition quarter (67% higher than in 2Q14) due to many vessels hitting the steep part of the S-curve for revenue recognition.
Charter income	23,522	13,484	7,136	-70%	-47%	Lower vessel utilisation rate in 3Q15.
Revenue	618,621	192,663	189,272	-69%	-2%	
Cost of sales	(469,896)	(162,080)	(168,131)	-64%	4%	
Gross profit	148,725	30,583	21,141	-86%	-31%	
Other income	1,116	13,807	3,147	182%	-77%	Fair value gain on derivatives of MYR10.9m in 2Q15.
Administrative expenses	(14,881)	(25,829)	(16,038)	8%	-38%	Net foreign exchange loss of MYR7.4m in 2Q15. There was a marketing expense charge of c.MYR7m which only came due this quarter for vessels sold in prior periods.
Finance costs	(7,540)	(6,257)	(4,722)	-37%	-25%	Lower finance costs due to higher proportion capitalised into vessels under construction.
Share of profit/(loss) from JV/associates	2,217	(223)	(2,517)	nm	nm	Lower vessel utilisation rate in 3Q15 at associates.
Profit before tax	129,637	12,081	1,011	-99%	-92%	
Income tax expense	(3,998)	(1,598)	(601)	-85%	-62%	
Minority interest		196	(404)	-162%	nm	Subsidiary recorded losses in prior quarters, which were reversed in
PATMI	126,293	10,679	6	-100%	-100%	

Group gross margin	24.0%	15.9%	11.2%
Net margin	20.4%	5.5%	0.0%

Segment Revenues	3Q14	2Q15	3Q15	YoY	QoQ
Shipbuilding	595,099	179,179	182,136	-69%	2%
Chartering	23,522	13,484	7,136	-70%	-47%
Gross Profits					
Shipbuilding	143,038	27,452	26,128	-82%	-5%
Chartering	5,687	3,131	(4,987)	-188%	nm
Gross Margins					
Shipbuilding	24.0%	15.3%	14.3%		Higher contribution from build-to-order vessels in 2Q15 and 3Q15.
Chartering	24.2%	23.2%	-69.9%		Lower vessel utilisation rate in 3Q15.

Source: Company, RHB

Figure 2: Long term offshore vessel demand remains intact



Source: IHS, Oct 2015

Financial Exhibits

Profit & Loss (MYRm)	Dec-13	Dec-14	Dec-15F	Dec-16F	Dec-17F
Total turnover	1,257	1,929	935	1,340	1,600
Cost of sales	(993)	(1,550)	(791)	(1,165)	(1,374)
Gross profit	264	378	144	175	226
Gen & admin expenses	(66)	(90)	(83)	(83)	(85)
Operating profit	199	289	61	93	141
Operating EBITDA	212	307	80	113	163
Depreciation of fixed assets	(13)	(18)	(19)	(21)	(22)
Operating EBIT	199	289	61	93	141
Net income from investments	3	10	(3)	0	0
Other recurring income	9	20	22	18	18
Interest expense	(11)	(16)	(28)	(40)	(40)
Exceptional income - net	13	-	-	-	-
Pre-tax profit	212	303	52	71	120
Taxation	(6)	(1)	(1)	(1)	(2)
Minority interests	(1)	(0)	(0)	(0)	(0)
Profit after tax & minorities	206	302	50	70	117
Reported net profit	206	302	50	70	117
Recurring net profit	193	302	50	70	117

Source: Company data, RHB

Cash flow (MYRm)	Dec-13	Dec-14	Dec-15F	Dec-16F	Dec-17F
Operating profit	199	289	61	93	141
Depreciation & amortisation	13	18	19	21	22
Change in working capital	(419)	(233)	(381)	(123)	62
Other operating cash flow	10	45	19	19	19
Operating cash flow	(197)	119	(282)	9	244
Interest paid	(34)	(54)	(28)	(40)	(40)
Tax paid	(0)	(4)	(1)	(1)	(2)
Cash flow from operations	(231)	61	(311)	(32)	202
Capex	(36)	142	(30)	(31)	(32)
Other investing cash flow	(81)	(225)	(1)	-	-
Cash flow from investing activities	(117)	(83)	(31)	(31)	(32)
Dividends paid	(26)	(55)	(94)	(32)	(38)
Shares repurchased	-	(12)	(2)	-	-
Proceeds from issue of shares	119	-	-	-	-
Increase in debt	401	517	324	-	-
Other financing cash flow	(1)	(0)	-	-	-
Cash flow from financing activities	493	450	227	(32)	(38)
Cash at beginning of period	216	362	800	769	675
Total cash generated	145	428	(115)	(94)	132
Forex effects	5	13	-	-	-
Implied cash at end of period	366	803	685	675	807

Source: Company data, RHB

Financial Exhibits

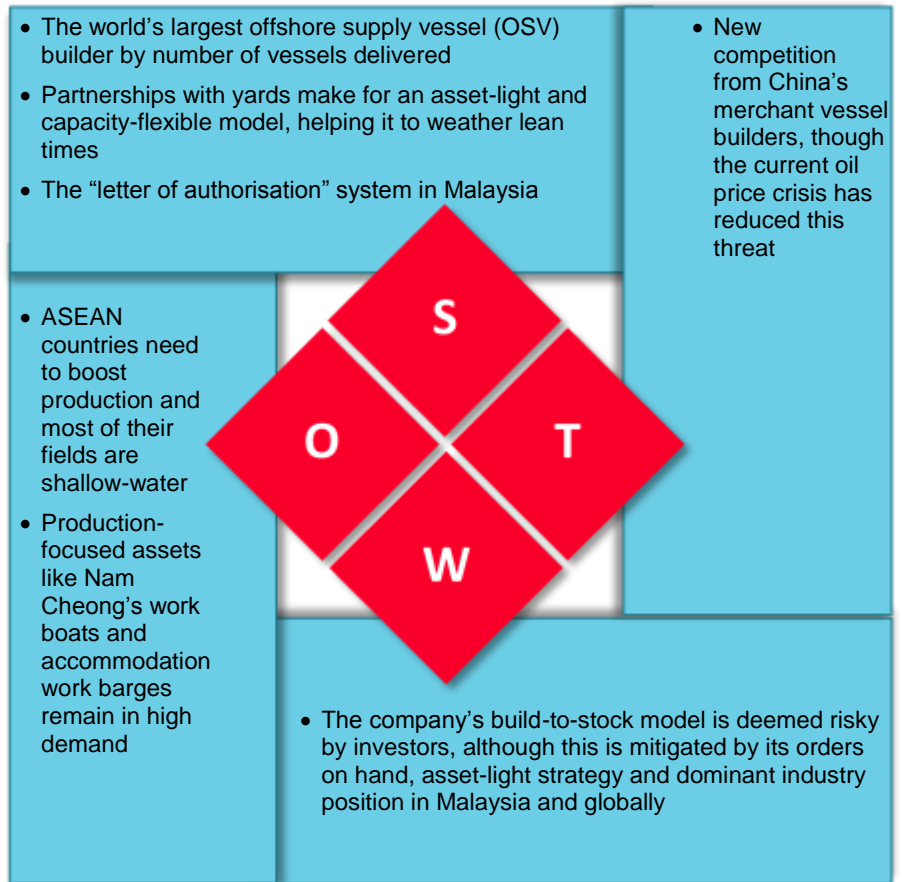
Balance Sheet (MYRm)	Dec-13	Dec-14	Dec-15F	Dec-16F	Dec-17F
Total cash and equivalents	362	800	769	675	807
Inventories	751	1,041	1,734	2,234	2,259
Accounts receivable	635	643	640	441	526
Other current assets	51	165	254	254	254
Total current assets	1,799	2,649	3,397	3,603	3,845
Tangible fixed assets	290	282	440	450	460
Total other assets	90	321	338	337	337
Total non-current assets	380	603	778	787	796
Total assets	2,179	3,252	4,175	4,390	4,642
Short-term debt	242	556	880	880	880
Accounts payable	381	672	780	957	1,129
Other current liabilities	5	48	48	48	48
Total current liabilities	628	1,276	1,708	1,885	2,057
Total long-term debt	609	753	1,097	1,097	1,097
Other liabilities	4	4	4	4	4
Total non-current liabilities	613	757	1,101	1,101	1,101
Total liabilities	1,241	2,033	2,809	2,986	3,158
Share capital	488	488	486	486	486
Retained earnings reserve	411	657	613	651	731
Other reserves	39	73	266	266	266
Shareholders' equity	938	1,219	1,365	1,403	1,483
Minority interests	1	1	1	1	1
Other equity	0	(0)	0	(0)	0
Total equity	939	1,219	1,366	1,404	1,484
Total liabilities & equity	2,179	3,252	4,175	4,390	4,642

Source: Company data, RHB

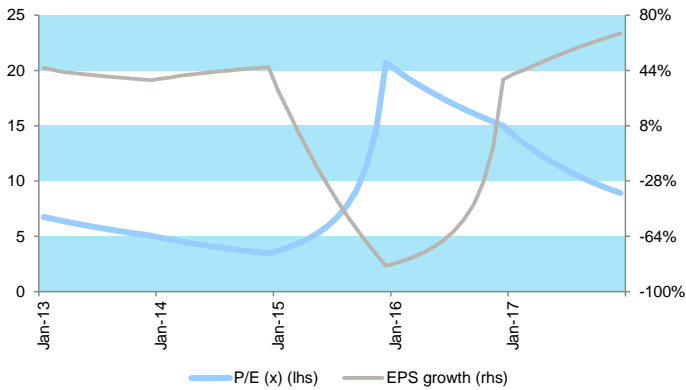
Key Ratios (MYR)	Dec-13	Dec-14	Dec-15F	Dec-16F	Dec-17F
Revenue growth (%)	43.5	53.4	(51.5)	43.3	19.4
Operating profit growth (%)	43.5	45.3	(78.8)	51.2	52.3
Net profit growth (%)	50.5	46.8	(83.3)	38.2	68.0
EPS growth (%)	37.7	46.2	(83.3)	38.1	68.0
BVPS growth (%)	44.1	30.4	11.7	2.8	5.7
Operating margin (%)	15.8	15.0	6.5	6.9	8.8
Net profit margin (%)	16.4	15.6	5.4	5.2	7.3
Return on average assets (%)	11.8	11.1	1.4	1.6	2.6
Return on average equity (%)	26.9	28.0	3.9	5.0	8.1
Net debt to equity (%)	52.1	41.8	88.4	92.7	78.8
DPS	0.03	0.05	0.02	0.02	0.02
Recurrent cash flow per share	(0.11)	0.03	(0.15)	(0.02)	0.10

Source: Company data, RHB

SWOT Analysis

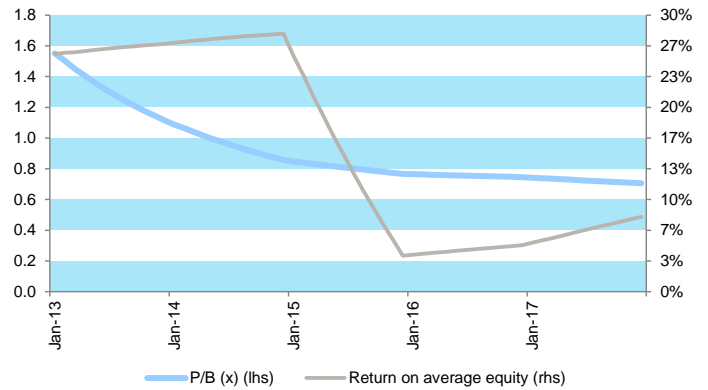


P/E (x) vs EPS growth



Source: Company data, RHB

P/BV (x) vs ROAE

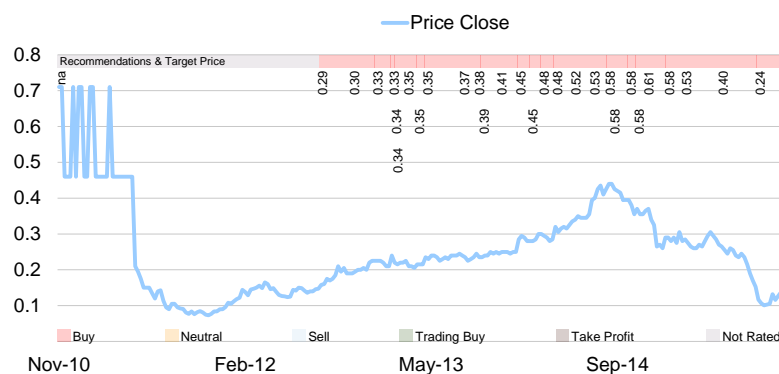


Source: Company data, RHB

Company Profile

Nam Cheong (NCL) is the largest OSV builder in the world with a 12-15% share of the global shallow-water OSV market. It specialises in building small-mid AHTS, PSVs, workboats and accommodation barges. It also operates a fleet of standby vessels and a number of OSVs in conjunction with its partners.

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2015-08-14	Buy	0.24	0.19
2015-05-15	Buy	0.40	0.31
2015-02-13	Buy	0.53	0.32
2015-01-02	Buy	0.58	0.33
2014-12-03	Buy	0.61	0.36
2014-12-02	Buy	0.61	0.36
2014-11-12	Buy	0.61	0.42
2014-10-19	Buy	0.58	0.40
2014-09-29	Buy	0.58	0.44
2014-08-20	Buy	0.58	0.48

Source : RHB, Bloomberg

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Trading Buy: Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain

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