12 August 2021

Basic Materials | Metals

Pantech Group (PGHB MK)

Not Rated

Returning To The Peak

Fair Value (Upside):	MYR0.72 (+31%)
Price:	MYR0.55
Market Cap:	USD98.1m
Avg Daily Turnover (MYR/USD)	0.67m/0.16m

- **Fair value of MYR0.72 based on 11x FY23F P/E, or +1.5SD from its 5-year mean.** Benefiting from rising ASP, and strong pipes, valves and fittings (PVF) demand underpinned by global economic recovery, Pantech Group is likely to double its earnings in FY22F (Feb) and record its highest profit in FY23F since the oil & gas industry downturn in 2015. That aside, the group is one of the rare small-cap oil & gas counters offering attractive dividend yields of 4.8-5.3%.

- **Robust work orders with longer orderbook visibility.** PGHB manufactures and sells steel pipes, fittings, flanges, valves, structural products to 69 countries worldwide. The oil & gas industry has accounted for 55-61% of the total revenue in the past five years, followed by palm oil and refineries at 10-20%. PVF orders have been on the rise largely due to the global economic recovery. Current orderbook stands at MYR380m, providing longer revenue visibility of 6-7 months, or up to February next year – higher than the usual 3-5 months.

- **Riding on commodities prices tailwinds with cost pass-through mechanism.** PGHB, being a manufacturer and distributor, is able to pass through the rising raw materials cost to its customers. In fact, margins have increased due to the recent supply shortages. The group will order the raw materials immediately after the orders have been secured to lock in the margins. As there is still no change in China's output cut policy, we believe the steel production cut should accelerate in 2H21 and continue to support prices assuming global demand remains solid.

- **Uptick in oil & gas global spending.** With our in-house oil price forecasts of USD65.00-60.00/bbl in 2022-2023, PGHB should benefit from the uptick in global oil & gas spending. Domestically, the company is one of the seven and only locally owned, exclusive pipe suppliers under the Petronas Framework Agreement. We understand that work orders remain robust and the tender size for work scheduled for 2022 is bigger. This is also in line with Petronas' capex guidance of MYR40-45bn in the next five years.

- **Earnings to double in FY22F and attractive yields.** We project earnings to double in FY22F to MYR53.3m largely due to stronger contribution from higher sales revenue from both segments as a result of better PVF demand and ASPs**.** We expect another 11% earnings growth in FY23F without capacity limit to manufacturing plants due to the MCO ruling. At a 40% payout, PGHB is forecasted to offer attractive dividend yields of 4.8-5.3% in FY22-24.

- **Risks:** Sharp decline in commodity prices resulting in inventory losses, as well as significantly lower oil prices to limit client spending and PVF orders.

Analyst

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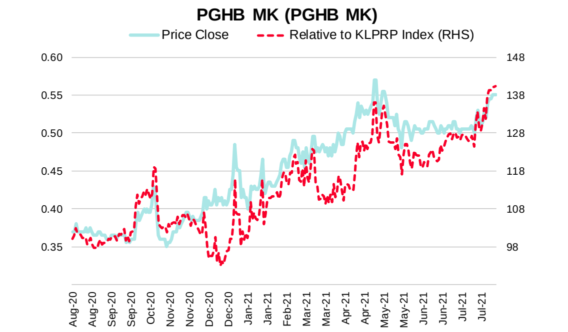
Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	22.2	8.9	5.8	20.9	48.6
Relative	28.2	9.9	11.4	21.1	40.2
52-wk Price low/high (MYR)					0.35 – 0.57



Source: Bloomberg

Forecasts and Valuation	Feb-20	Feb-21	Feb-22F	Feb-23F	Feb-24F
Total turnover (MYRm)	603	486	619	639	667
Recurring net profit (MYRm)	36	26	53	59	58
Recurring net profit growth (%)	-	(26.5)	101.5	10.9	(1.3)
Recurring P/E (x)	12.41	16.88	8.38	7.55	7.65
P/B (x)	0.7	0.7	0.6	0.6	0.6
P/CF (x)	3.28	4.60	12.73	7.09	7.96
Dividend Yield (%)	na	5.9	4.8	5.3	5.2
EV/EBITDA (x)	7.13	7.26	4.73	4.20	3.99
Return on average equity (%)	-	4.0	7.7	8.2	7.7
Net debt to equity (%)	13.6	3.8	3.0	net cash	net cash

Source: Company data, RHB

Note:
Small cap stocks are defined as companies with a market capitalisation of less than USD1bn.

Financial Exhibits

Asia
Malaysia
Basic Materials
Pantech Group
PGHB MK
Not Rated

Valuation basis

P/E

Key drivers

i. Higher work orders from clients;
ii. Higher ASPs

Key risks

i. Weaker-than-expected work orders from clients;
ii. Significantly lower-than-expected oil prices that could limit client spending,
iii. Higher-than-expected operating costs.

Company Profile

Established in 1987, Pantech Group manufactures and sells steel pipes, fittings, flanges, valves, structural products, and exotic materials. The products are supplied to 69 countries worldwide. The company operates through two major segments: Trading and Manufacturing.

Financial summary (MYR)	Feb-20	Feb-21	Feb-22F	Feb-23F	Feb-24F
Recurring EPS	0.04	0.03	0.07	0.07	0.07
DPS	-	0.03	0.03	0.03	0.03
BVPS	0.81	0.83	0.87	0.91	0.96
Return on average equity (%)	-	4.0	7.7	8.2	7.7

Valuation metrics	Feb-20	Feb-21	Feb-22F	Feb-23F	Feb-24F
Recurring P/E (x)	12.41	16.88	8.38	7.55	7.65
P/B (x)	0.7	0.7	0.6	0.6	0.6
FCF Yield (%)	27.8	20.8	5.6	12.5	12.6
Dividend Yield (%)	-	5.9	4.8	5.3	5.2
EV/EBITDA (x)	7.13	7.26	4.73	4.20	3.99
EV/EBIT (x)	9.52	10.39	5.95	5.02	4.74

Income statement (MYRm)	Feb-20	Feb-21	Feb-22F	Feb-23F	Feb-24F
Total turnover	603	486	619	639	667
Gross profit	127	110	144	151	154
EBITDA	74	64	97	102	99
Depreciation and amortisation	(19)	(19)	(20)	(17)	(16)
Operating profit	55	45	77	85	83
Net interest	(10)	(6)	(7)	(7)	(6)
Pre-tax profit	46	36	70	78	77
Taxation	(10)	(10)	(17)	(19)	(18)
Reported net profit	36	26	53	59	58
Recurring net profit	36	26	53	59	58

Cash flow (MYRm)	Feb-20	Feb-21	Feb-22F	Feb-23F	Feb-24F
Change in working capital	(411)	44	(38)	(13)	(18)
Cash flow from operations	136	97	35	63	56
Capex	(12)	(4)	(10)	(7)	0
Cash flow from investing activities	(13)	(13)	(10)	(7)	0
Dividends paid	(15)	(10)	(21)	(24)	(23)
Cash flow from financing activities	(84)	(36)	(16)	(21)	(43)
Cash at beginning of period	49	89	138	146	182
Net change in cash	40	48	9	35	13
Ending balance cash	89	138	146	182	195

Balance sheet (MYRm)	Feb-20	Feb-21	Feb-22F	Feb-23F	Feb-24F
Total cash and equivalents	89	138	146	182	195
Tangible fixed assets	344	331	321	311	296
Total investments	9	9	9	9	9
Total assets	909	907	967	1,007	1,025
Short-term debt	130	121	134	137	121
Total long-term debt	49	42	34	34	30
Total liabilities	250	233	260	265	248
Total equity	659	674	706	742	777
Total liabilities & equity	909	907	967	1,007	1,025

Key metrics	Feb-20	Feb-21	Feb-22F	Feb-23F	Feb-24F
Revenue growth (%)	0.0	(19.3)	27.4	3.2	4.3
Recurrent EPS growth (%)	0.0	(26.5)	101.5	10.9	(1.3)
Gross margin (%)	21.0	22.6	23.2	23.7	23.0
Operating EBITDA margin (%)	12.3	13.1	15.7	15.9	14.8
Net profit margin (%)	6.0	5.4	8.6	9.3	8.8
Dividend payout ratio (%)	0.0	100.0	40.0	40.0	40.0
Capex/sales (%)	2.0	0.9	1.6	1.1	0.0
Interest cover (x)	4.95	6.52	10.96	11.85	13.13

Source: Company data, RHB

Investment Thesis

Experienced PVF manufacturer and distributor

Established in 1987, PGHB manufactures and sells steel pipes, fittings, flanges, valves, structural products, and exotic materials. The products are supplied to 69 countries worldwide. The company operates through two major segments: trading and manufacturing.

Trading: PGHB distributes PVF for different international vendors and its own manufacturing arm. Its clients are predominantly in Malaysia, across various sectors such as oil & gas, gas reticulation, marine, onshore and offshore heavy engineering, power generation, petrochemicals, palm oil refining, and etc.

Manufacturing: PGHB has three factories in Malaysia (Pasir Gudang, Tanjung Langsat, and Klang) and one in Tamworth, UK, which manufactures standard and customised ranges of pipes and fittings of various materials to international standards. The specialised facility at Tanjung Langsat has the largest hot-dip galvanising bath in Southern West Malaysia.

Figure 1: PGHB's manufacturing segment

Manufacturing Company	Specialised Items Produced	Annual Capacity (metric tonne)	Output achieved in FY2021
Pantech Steel Industries Sdn. Bhd. (PSI)	Carbon steel butt welded fittings and Induction long bends	21,000	90% (up from 80% in FY2020)
Pantech Stainless & Alloy Industries Sdn. Bhd. (PSA)	Stainless steel pipes & fittings	18,000	80% (maintained)
Nautic Steels Limited (Nautic)	Copper nickel & nickel alloy pipes & fittings, flanges and ancillary products	800	65% (maintained)
Pantech Galvanising Sdn. Bhd. (PGSB)	Hot-dip galvanising treatment and coating services	48,000	65% (maintained)

Source: Company

Domestic PVF market leader with wide and established client base

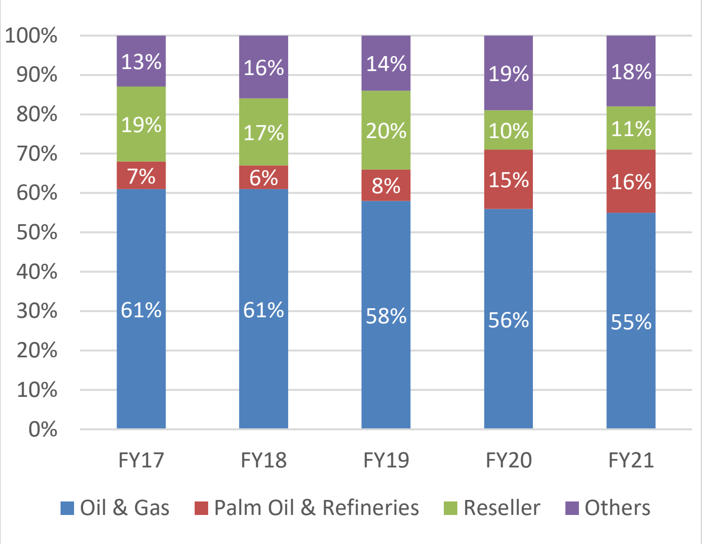
PGHB is estimated to have a 40% market share in the supply of PVFs. Operating as a one-stop centre for PVFs, the extensive inventory base with more than 30,000 products, valued at MYR287m (as of 1QFY22), allows the group to respond to clients' requirements in a timely manner. This will provide a great competitive edge against other domestic players, which are in a relatively fragmented PVF supply market.

With that, PGHB is also capable of taking large PVFs orders from clients, ie oil majors and renown turnkey contractors given its distribution of a wide product range from different vendors. Over the years, the group has established a strong customer base of >500 across different industries worldwide. The oil & gas industry has accounted for 55-61% of the total revenue in the past five years, followed by palm oil and refineries at 10-20%. Within the oil & gas space, the clients include offshore fabricators, shipyard owners, petrochemical players and also upstream services players. These products are used for scheduled maintenance and plant turnaround as well as greenfield projects. Hence, the oil majors' capex and opex spending budget will have a significant impact on PGHB's sales.

Figure 2: Established clientele

Source: Company

Figure 3: Revenue breakdown by industry



Source: RHB, Company data

Robust work orders with longer orderbook visibility

PVF orders have been on a rise largely on the back of global economic recovery following the increased vaccination pace. Current orderbook stands at MYR380m, providing longer revenue visibility of 6-7 months, or up to February next year – higher than the usual 3-5 months. Management guided that overseas PVF orders have increased largely from Europe and the US, and there are many new enquiries from different countries ie Spain and India. This could also be attributable to the global PVF supply shortages as a consequence of a spike in commodities prices and freight costs.

The anticipated global demand is likely to benefit PGHB's trading arm more in FY22F, given the wide range of PVF requirements while operations of the manufacturing plants are capped by the country's current movement restrictions. The group's two manufacturing plants were closed for two weeks in July and are currently operating under a 60% workforce. However, the actual plant utilisation could be higher even with a lower workforce in place. We believe the two major carbon steel and stainless steel plants will achieve about 80% utilisation in FY22F assuming the workforce limit gradually increases. In FY23F, we believe these two plants can resume to 90% utilisation on the back of higher vaccination rate.

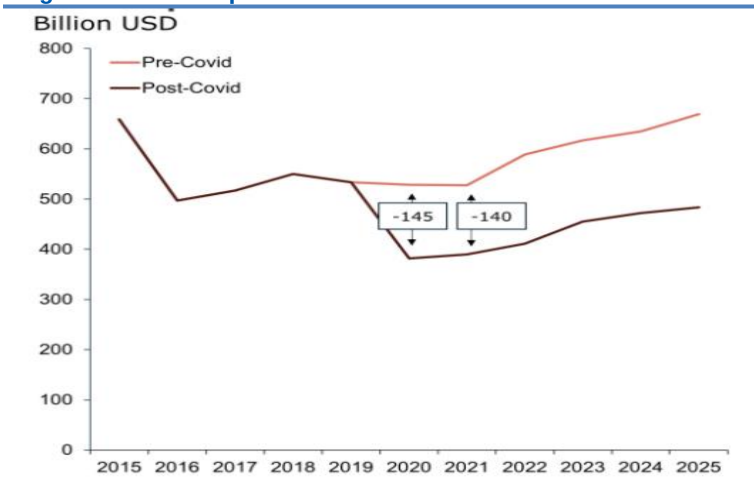
Higher oil & gas spending to boost PVF demand

In 2020, global upstream spending was slashed by 27% to USD382bn compared to the original budget. Despite oil prices trading above USD70.00 per bbl, in May 2021, Rystad Energy forecasted that the investment level of all public upstream companies will only grow c.2% to USD390bn in 2021. This is much lower than budgeted prior to the pandemic. In the medium term, global upstream spending is still estimated to register a CAGR of 5% to USD480bn in 2025.

Domestically, Petronas had a slow start of capex spending in 1Q21, accounting only 15-17% of 2021's guided total capex of MYR40-45bn. The lower capex spending YoY was mainly due to project delays and rephrasing of activities amidst the continuous increase in COVID-19 cases. Overall, we believe 2Q21 capex spending may not increase significantly, as compared to 1Q21, but capex spending should ramp up in 2H21. Therefore, with our in-house oil price forecasts of USD65.00-60.00 per bbl in 2022-2023, we expect some of these work orders to pick up accordingly. This is also in line with Petronas' capex guidance of MYR40-45bn in the next five years.

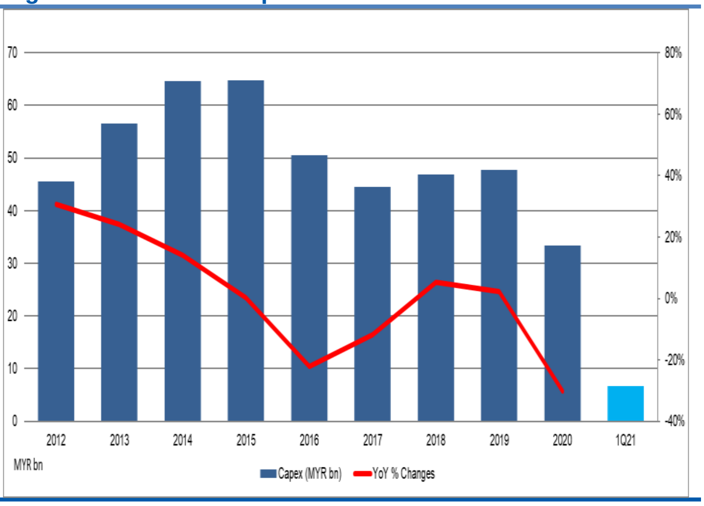
PGHB is in the right position to capitalise from the capex cycle, with 55-61% of revenue contributed from the oil & gas sector. Additionally, on the local front, we think the group will benefit from the ramp-up in Petronas' local upstream capex, with the company being one of the seven and only locally owned, exclusive suppliers under the Petronas Framework Agreement. We understand that work orders from offshore EPCC contractors remain robust and the tender size for work scheduled for 2022 is bigger.

Figure 4: Global upstream investment forecast to 2025



Source: Rystad Energy

Figure 5: Petronas' capex trend



Source: Petronas

Riding on commodities prices tailwinds with cost pass-through mechanism

The manufacturing arm imports feedstock like stainless steel coil and carbon seamless pipes to manufacture end products. We understand that despite the cost of raw materials on the rise, PGHB, being a manufacturer and distributor, is able to pass through the cost pressure to customers. In fact, margins have increased due to the recent supply shortages. On the other hand, the group will order the raw materials immediately after the orders have been secured in order to lock in the margins. At this juncture, the raw materials ordered will take approximately four months to deliver.

As such, PGHB is a beneficiary of rising steel prices with the ability to pass through the cost pressure to customers. Putting things into perspective, steel prices had a strong run in first four months of 2021, led by China's policy of cutting crude steel output to reduce carbon dioxide (CO_2) emissions and low new investment by global steelmakers, amidst recovering global steel demand in tandem with rising industrial activities. However, prices have softened subsequently following the Chinese Government's measures to stabilise commodity prices including raising margin requirements for iron ore's future contracts.

While there is still no change in China's output cut policy, it is quite unlikely for China to achieve a YoY lower steel production in 2021 given steel production has grown 12% YoY in1H21. Having said that, we believe the steel production cut should accelerate in 2H21 and continue to support prices assuming global demand remains solid.

Just like any other manufacturer and/or distributor, Pantech is also weary of being left with high priced inventory, and hence, has adopted timely inventory management to turn inventory frequently without bearing huge inventory losses if the prices were to decline drastically. Additionally, the strong partnership with freight companies is important in ensuring orders are delivered in a timely manner, especially during a time when export players are facing international container shortages and elevated freight costs. We understand that PGHB has renewed its shipment contract with COSCO until Apr 2022. This in turn allows the company to have better price fixing in terms of freight costs to its customers.

Posing highest profit since industry downturn in 2015

Revenue has plunged by 19% MYR486.3m in FY21, dragged by disruptions in business operations during the movement restrictions. The 2-month plant closure resulted in the group's first ever loss making quarter, recording MYR5.9m losses in 1QFY21. Fast forward to a year later, it has managed to be back in the black, booking core profit of MYR15.2m in 1QFY22. This is on the back of strong contribution from the trading and manufacturing divisions.

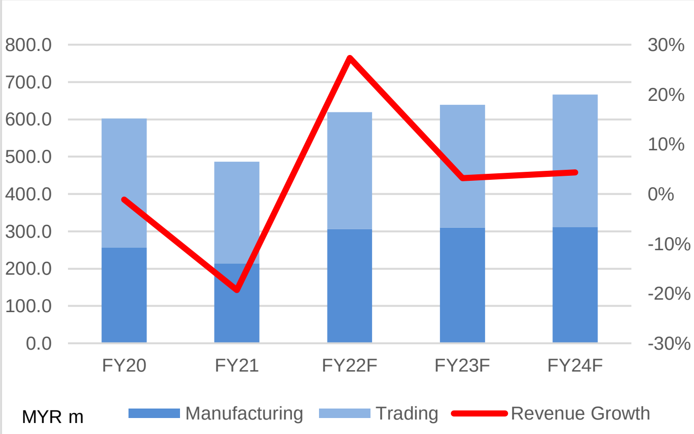
All in, we project earnings to double in FY22F to MYR53.3m largely due to stronger contribution from higher sales revenue from both segments as a result of better PVF demand and ASP. Note that our FY22F net profit implies average quarterly profit of MYR12.7m in 2Q-4QFY22F. This is because we have assumed total sales have been affected by the movement restrictions, especially when manufacturing plants were closed for two weeks in July and only allowed to operate at a reduced workforce till now. In FY23F, earnings are estimated to grow a further 10% on higher plant utilisation, masking slightly weaker ASP assumptions. Earnings should then decline marginally by 1% as we impute a more conservative lower ASP in FY24F.

We have assumed a total share base of 812.5m, which includes the 60.8m outstanding unexercised warrants. These warrants will expire on 21 Dec 2021 and have an exercise price of MYR0.50. We understand that proceeds of the warrants will be used for working capital purposes.

Attractive dividend yields and healthy balance sheet

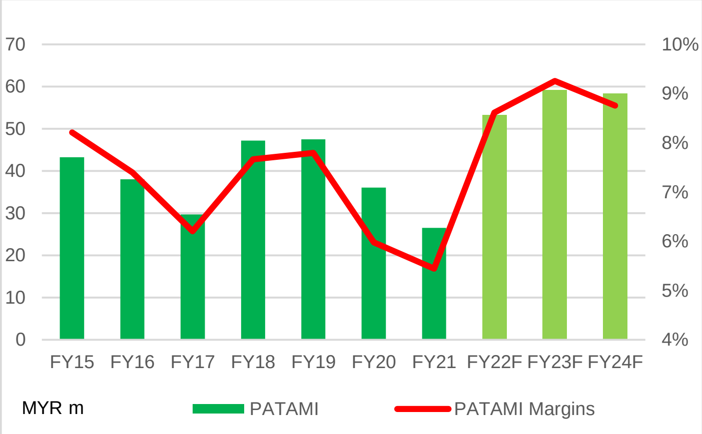
As at FY21, net gearing and interest coverage ratios were 0.04x and 6.5x. Based on our projections, PGHB's net gearing will be rather similar in FY22F and could turn into a minimal net cash position in FY23F-F24F, backed by healthy cash flow generation. Presently, the company does not have a fixed dividend policy but it has been paying dividend at a payout ratio of c.40% in the past, except for a higher payout ratio in FY21F due to the COVID-19 pandemic. At a 40% payout ratio, this would translate into attractive dividend yields of 4.8-5.3% in FY22F-24F.

Figure 6: Revenue boosted by both segments



Source: RHB, Company data

Figure 7: Highest profit projection since FY15



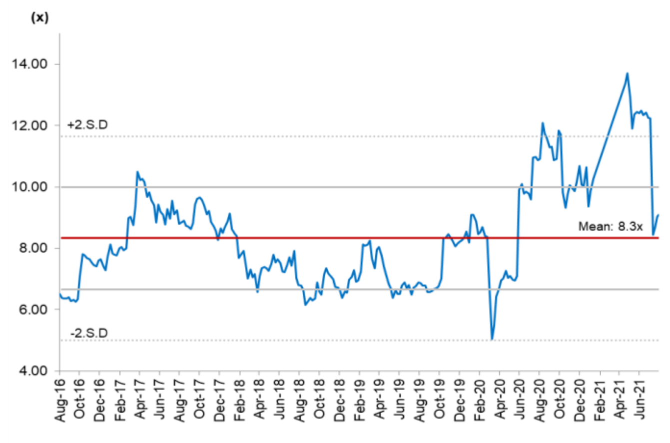
Source: RHB, Company data

Valuation & Recommendation

Strong earnings outlook as rerating catalyst

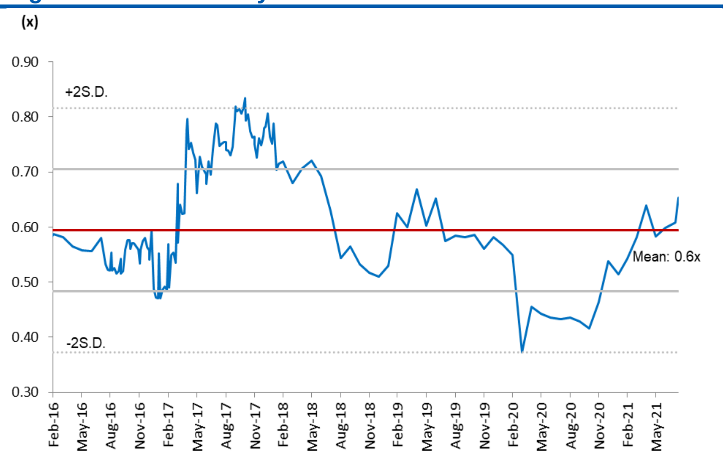
Our fair value of MYR0.72 based on 11x FY23F P/E, which is slightly below the Bursa Malaysia Energy Index. This is also pegged to +1.5SD from its 5-year mean. We believe PGHB deserves the premium as it is likely to achieve its highest profit since the oil & gas industry downturn in 2015. The group's position as a PVF supplier, mainly for the oil & gas position, is rather unique given most steel players are supplying to construction players. PGHB sees competition from Dancomech Holdings (DMEC MK, NR) for valve supply, while Choo Bee Metal Industries (CBEE MK, NR) and Hiap Teck Ventures (HTVB MK, NR) supply American Petroleum Institute (API) pipes to oil & gas players. Most of the listed steel players are not really comparable in terms of forward valuation due to the lack of consensus numbers, except for Ann Joo Resources (AJR MK, NR) at 8x 2-year forward P/E. PGHB deserves a better valuation than steel peers, with its more stable profit track record and without sinking into losses since its incorporation.

Figure 8: Pantech's 5-year P/E band



Source: RHB, Bloomberg

Figure 9: Pantech's 5-year P/BV band



Source: RHB, Bloomberg

Key Risks

Key risks for the company include:

i. Sharp decline in commodities prices resulting in inventory losses;

ii. Weaker-than-expected work orders from clients;

iii. Significantly lower-than-expected oil prices that could limit client spending;

iv. Higher-than-expected operating costs.

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