

9 June 2021

Clean Energy | Solar Power

Pekat Group (PEKAT MK)

Bright Sunshine

Fair Value (Return):	MYR0.56 (+76%)
IPO Price:	MYR0.32
Closing Application Date:	10 Jun 2021
Indicative Listing Date	23 Jun 2021

- **MYR0.56 FV based on 20x FY22F P/E.** At the MYR0.32/share IPO price, MYR44.4m will be raised from the public issue of 138.7m shares, mainly for the construction of a new head office and working capital. This is in view of Pekat Group's expected business growth. Future earnings will be supported by its 1.2x orderbook cover ratio, mainly comprising solar EPCC contracts, where demand is driven by favourable government policies and the inexorable global trend towards renewable energy (RE). The IPO price implies 11x FY22F P/E, ie a significant discount to its peer.
- **Solar photovoltaic (PV) installation high demand beneficiary.** Pekat is mainly involved in the engineering, procurement, construction & commissioning (EPCC) of solar PV systems for the commercial, industrial, and residential segments. The solar EPCC business has benefitted greatly from the various government programmes in place, eg Net Energy Metering (NEM), to accelerate solar energy adoption. Accordingly, solar EPCC revenue has grown at a respectable 3-year (FY17-20) CAGR of 69%. Moving forward, solar PV demand remains high, as the world continues to adopt RE. Pekat will continue to see contract flows, in our view, given its 11-year track record in the industry.
- **Expanding earthing & lightning protection systems (ELP) and solar businesses.** With the IPO proceeds, the group plans to expand its businesses by securing more contracts, concurrently carrying out projects, and providing more maintenance services. Pekat aims to recruit an additional 33 staff by end 2024 to support this. The group is also constructing a new head office that integrates a showcase area, central monitoring station, training centre, workshop, and warehouse under one roof. We believe this will cater for the future growth of its businesses.
- **Earnings estimates.** While we do expect some margins compression from raw material price increases and stiff competition, we still project FY21F earnings to increase 19.5% YoY on its outstanding solar EPCC and ELP orderbook of MYR154.9m as of 3 May – MYR117.2m of this is expected to be delivered by end 2021. Moving into FY22-23, we expect earnings growth of 10.2-10.1%, anchored by job wins from both commercial & industrial (C&I) and Large Scale Solar 4 (LSS4) EPCC projects. Associate MFP Solar will also see full-year contribution from both the VAT Manufacturing Malaysia (VAT) and Proton power purchase agreements (PPAs).
- **Valuation at significant discount to peer.** We ascribe a MYR0.56 FV based on a target 20x FY22F P/E. Our target is fair, as it is a discount to our ascribed 25x target for Solarvest (SOLAR MK, NEUTRAL, TP: MYR1.50), given that Pekat is the smaller of the two solar EPCC players. It could trade at a higher valuation, given the robust solar contract flows and sustained market interest in solar EPCC-related counters. There is also further upside to our forecast that can come from higher-than-expected EPCC wins from LSS4 and further solar PPA investment via MFP Solar. Key risks include a change in government RE policies, downturn of the construction industry, competition risks, and raw material price fluctuations.

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Company Description

Pekat is principally involved in the EPCC of solar PV systems and power plants, as well as the supply and installation of ELP systems. Its other segments include the distribution of electrical products and accessories.

IPO Details

Public Issue (%)	21.5
Shares outstanding (m)	664.97m
Implied market cap	MYR206.4m

Major Shareholders (%)

Chin Soo Mau	34.9
Hextar	19.6
Tai Yee Chee	10.4
Wee Chek Aik	8.6

Utilisation of IPO Proceeds

Construction of new head office	MYRm 18.0
Working capital	12.7
Repayment of bank borrowings	10.0
Estimated listing expenses	3.7
TOTAL	MYR44.4

Additional Data

Listing Market	ACE
Bursa Code	0233

Forecasts and Key Data	Dec-19	Dec-20	Dec-21F	Dec-22F	Dec-23F
Total turnover (MYRm)	119.5	125.6	180.7	217.7	240.6
Recurring net profit (MYRm)	18.0	13.8	16.5	18.2	20.0
Recurring net profit growth	48.8	-23.1	19.5	10.2	10.1
Recurring EPS (MYR)	0.03	0.02	0.03	0.03	0.03
Recurring P/E (x)	11.5	14.9	12.5	11.3	10.3
P/BV (x)	4.1	3.2	1.7	1.4	1.3
P/CF (x)	15.1	51.0	37.1	71.7	57.8
Dividend yield (%)	-	-	-	-	-
EV/EBITDA (x)	8.7	10.4	7.5	7.4	6.8
ROE (%)	33.6	23.7	17.5	13.6	13.1
Net debt to equity (%)	7.5	4.4	Net Cash	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 Overview And Valuation

FY20 results review. Revenue increased 5.1% YoY, mainly due to the solar division, which saw the segment's topline grow 22.7% YoY – this was due to an increase in C&I EPCC contracts. While revenue increased, gross profit was 17.8% YoY lower. GPM compressed by 8.4ppts due to increasing competition in the solar PV and ELP industries, where Pekat has to price its services lower to stay competitive. As a result, FY20 core profit was down 23% YoY.

Balance sheet. The group has a healthy balance sheet with low net gearing of only 0.04x as of FY20. We like its low net gearing position, especially with the current uncertain macroeconomic environment. With the IPO proceeds of MYR44.4m, this will provide Pekat ample of liquidity to expand its business. Historically, operating cash flow over the past two financial years have also been positive, ranging between MYR4m and MYR13m pa. The group does not have a formal dividend policy in place at this point in time.

Earnings forecast. We project FY21F earnings to increase 19.5% on its outstanding solar EPCC and ELP orderbook of MYR154.9m as of 3 May, of which MYR117.2m is expected to be delivered by end 2021. As of 3 May, MYR43.9m worth of solar EPCC and ELP contracts have already been billed in FY21. While we do expect margins to compress on increases in raw material prices, we still expect earnings growth to come from the solar segment. Its MFP Solar associate will also see full-year contributions from the VAT PPA, as well as half-year contributions from the Proton PPA in FY21.

Moving into FY22-23, we expect earnings growth of 10.2-10.1%, driven by job wins from both C&I and LSS4 EPCC projects. Note that our LSS4 EPCC contract win assumption is only c.MYR75m (c.30MW, ie just less than 5% of the total LSS4 MW awarded).

Valuation. We ascribe a FV of MYR0.56 based on a target 20x FY22F P/E. Our target P/E is fair, as it is a discount to our ascribed target P/E of 25x for Solarvest's EPCC business – this mainly due to Pekat being the smaller solar EPCC player of the two. Our valuation is also at a discount when compared to the regional peer average of 25x.

At an IPO price of MYR0.32, the stock is just trading at only 11x FY22F P/E vs Solarvest's fully diluted or FD P/E of 28x. We believe Pekat should trade at a higher valuation, given the robust solar contract flows and premium valuation give to solar EPCC-related counters. There is also further upside to our forecast, which could come from higher-than-expected EPCC wins from LSS4 and further solar PPA investments via the MFP Solar associate.

Figure 1: Peer comparison

	FYE	Mkt cap (m)	1-year Fwd	P/E (x) 2-year Fwd	3-year Fwd	1-year Fwd	P/BV (x) 2-year Fwd	3-year Fwd	1-year Fwd	ROE (%) 2-year Fwd	3-year Fwd
Pekat	Dec	208	12.5	11.3	10.3	1.7	1.4	1.3	17.5	13.6	13.1
Local peers											
Solarvest Holdings*	Mar	849	45.6	27.9	30.6	6.8	5.4	4.6	16.3	21.9	16.5
Samaiden Group**	Jun	336	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Cypark Resources**	Oct	556	6.2	5.2	4.9	0.6	0.5	0.4	8.8	9.1	8.4

Note: *Valuations are based on a fully diluted share base

Note 2: **From Bloomberg consensus

Source: Bloomberg, RHB

Outlook

Beneficiary of high solar PV installation. The solar EPCC segment is set to grow, given the increasing adoption of solar energy in Malaysia. This is in line with the country's 31% RE target in its generation mix by 2025.

Malaysia has in place various government initiatives and programmes such as NEM, Large Scale Solar (LSS), Sarawak Alternative Rural Electrification Scheme (SARES), and Green Investment Tax Allowance (GITA)/Green Investment Tax Exemption (GITE) to encourage the installation of solar panels. Evidently, Pekat has benefitted from these programmes, as its solar EPCC segment revenue has grown at a respectable 3-year CAGR of 69% during FY17-20.

Riding on the group's proven track record – led by an experienced management team – Pekat will continue to benefit from the increase in solar EPCC jobs, in our view. For FY21, we expect the solar EPCC segment revenue to grow 73% YoY, based on a contract win assumption of c.MYR120m, mainly from the C&I segment.

For FY22-23, we expect the segment's revenue to grow 28-11%, driven by a c.MYR75m LSS4 EPCC contract win, which will be recognised across the two years, and increasing C&I contract wins of c.MYR130-140m, as the group hires more personnel.

Figure 2: Description of various government initiatives

Government initiative	Description
NEM	A solar PV programme to complement the feed-in tariff (FIT) mechanism. The NEM programme was first introduced in Nov 2016 with quota allocation of 500MW up to 2020. The concept of NEM is that the energy produced from installed solar PV systems will be consumed first, and any excess will be exported to Tenaga Nasional (TNB MK, BUY, TP: MYR12.49) on a "one-on-one" offset basis. The Government recently introduced the new NEM 3.0 programme that will be in effect during 2021-2023 and the total quota allocated is up to 500MW.
Supply Agreement of Renewable Energy (SARE)	Provides users with the option of solar leasing, PPA, or hybrid of solar leasing and PPA of solar PV systems. With this policy, users can enjoy zero upfront costs to install PV panels, and payment for the monthly leasing fee or solar energy usage can be made to the solar company involved via their TNB bill.
LSS	A solar PV programme announced in 2016 to encourage the construction of large-scale grid-connected solar plants.
SARES	A MYR500m electrification programme to provide power to locations not feasible to be connected to the power grid. The programme was first started in 2016 and has electrified an estimated 6,346 households in 238 villages as of 2019.
GITA/GITE	Aims to encourage investment in green technology. In Budget 2020, GITA and GITE received extensions to 2023. Also, tax incentives will be introduced to companies implementing solar-leasing activities, with income tax exemption of 70% for up to 10 years.

Source: Various sources, RHB

Steady ELP segment. Pekat has over 20 years of experience in this business. The ELP segment is tied to the health of the domestic construction sector. While the latter has seen a slowdown in recent years, the ELP segment's revenue still stood well, ranging between MYR30m and MYR34m during FY17-19. As the construction sector is expected to see a rebound on acceleration and revival of major infrastructure projects, as well as resumption of activities across all sectors, we can expect the ELP segment to post steady growth going forward. As of 3 May, the group has an unbilled orderbook of c.MYR62m, which should provide two years of earnings visibility.

Synergies between the three divisions. The trading division provides synergistic benefits to both the solar EPCC and ELP divisions, as the latter two units use some of the electrical products and accessories from the trading wing. These include solar inverters, surge protection devices, solar PV monitoring systems, lightning rods, conductors, etc. As such, this provides Pekat with a cost advantage, as the materials and products are purchased at wholesale prices.

Figure 3: Products sold by the trading division



Source: Company

Expanding both the ELP and solar businesses. The group intends to expand its businesses with the IPO proceeds, where 28.6% will be used for working capital purposes. This increase in working capital provides Pekat with additional liquidity, which in turn allows the group to secure more contracts, carry out projects concurrently, and provide more maintenance services going forward. The group also plans to recruit an additional 33 staff (total staff now: 135) by end 2024 to support the expansion of its businesses.

Apart from hiring new personnel, Pekat will utilise 40.6% of the IPO proceeds to construct a new head office. This will be an integrated facility that will house a showcase area, central monitoring station, training centre, workshop, and warehouse. This allows the group to have all its facilities under one roof. Notably, the warehouse will have storage space capacity of 49,755sq ft of floor and 16,085sq ft of racking spaces, representing an increase of 321.7% and 244.1% when compared to the existing warehouse (current utilisation rate: 99.1%). The increase in working and storage spaces will cater for the future growth of the business, in our view.

Pekati also intends to develop an integrated monitoring, management, and assessment platform for solar PV facilities and ELP systems that the group installs. This platform will be used in the central monitoring system at the new head office. It will also be sold to customers. These platforms can include systems such as solar PV monitoring and energy management, lightning risk assessment, and ELP monitoring systems. We believe these systems will provide Pekati with a competitive edge, given the value add to its customers.

Figure 4: Artist's rendition of the new head office



Source: Company

Solar asset ownerships via MFP Solar. Pekat, together with Mega First Corp (MFCB), formed MFP Solar in 2019 – the former has a 45% stake. The business model of MFP Solar is to invest in solar PV power plants with generating capacities starting from 1MWp, based on a build, own, operate & transfer model, where MFP Solar will enter into a PPA with customers.

MFCB is responsible for the financial, operations & management of MFP Solar while Pekat is in charge of the technical aspects – ie EPCC and operations & maintenance (O&M) – of the solar investment. The business model is also synergistic to Pekat's existing EPCC businesses, as the group will have the first right of refusal to the EPCC and O&M contracts for all of MFP Solar's solar assets.

Currently, MFP Solar has two PPAs: VAT and Proton. The VAT PPA is a 1.5MWp solar PV power plant at VAT's facility in Batu Kawan, Penang. This PPA will last for 20 years and was commissioned in Aug 2020. As such, we can expect full-year earnings contributions in FY21.

The Proton PPA is an even bigger solar plant at 12.1MWp. The plant is expected to be commissioned in 2Q21, and we can expect full-year contributions in FY22. Moving forward, we believe MFP Solar will continue to invest in solar assets. This will benefit Pekat via higher EPCC jobs due to the first right of refusal given, as well as recurring income from electricity sales. Note: Our earnings forecast has yet to impute any upsides from further solar assets.

Key Risks

Solar division dependent on the Government's RE policies. Pekat's solar segment is subjected to various policies related to RE, which are set by the Government. While there are policies and support mechanisms for RE, they may be modified unexpectedly. Demand for solar PV may also be adversely affected by any unfavourable actions or changes made by the Government in relation to RE programmes such as LSS and NEM.

ELP division dependent on the construction industry. The ELP wing is reliant on the health of the construction industry in Malaysia. Any significant downturn to the industry may see lower contract wins for this unit.

Trading division dependent on authorised distributorships and third-party manufacturers. The group is dependent on the authorised distributorship for five third-party brands. Any failure to renew the distributorship licenses may impact Pekat's business operations and affect earnings. The group is also dependent on third-party manufacturers for its own-brand products, ie the Pekat, PWeld, and LEDsystem brands. Any issues arising from third-party manufacturers may impact the sales of its own-brand products.

Competition risks. The group may face competition from other similar service providers, ie local and international competitors that are able to offer the same services and may compete in terms of pricing and service quality. This could adversely affect earnings and profitability.

Unexpected increases in material costs. This may lead to an overall increase in the total cost of implementing solar EPCC and ELP projects, of which the group may have to either increase the tender price or absorb some costs. This may affect its competitiveness and profitability. There is also a risk of unanticipated cost increases half-way through a project, as such contracts are based on a fixed lump sum model.

Company Overview

Pekat is mainly involved in the EPCC of solar PV systems and power plants, as well as the supply and installation of ELP systems. Other segments include the distribution of electrical products and accessories. Historically, the solar EPCC segment contributes the highest revenue, at 57% of FY20 total revenue. Pekat has over 11 years of experience in the solar EPCC field and has installed a cumulative 66.4MWp of solar panels. The group's main focus is on commercial, industrial, and residential EPCC contracts. The group is able to carry out the entire scope of EPCC works – from designing to constructing and commissioning. This segment also includes O&M services.

For the ELP division (21% of FY20 revenue), Pekat has over 20 years of experience as a subcontractor, specialising in the supply and installation of ELP systems for buildings and structures. ELP systems can protect occupants, property, and equipment from any unintended electric current (eg short circuits and lightning strikes) by channelling the electric current safely to earth.

For the trading division, it involves the sales of both own (29% of FY20 trading segment revenue) and third-party brands (71% of FY20 trading segment revenue) of electrical products and accessories. These are ELP products and accessories, solar PV-related products, surge protection devices, and aviation warning light systems. Some of the third-party brands include Noark, Solar Log, Sungrow, Struder, Furse, and FurseWeld. The group's own brands include Pekat, PWeld, and LEDsystem.

Pekat is led by an experienced management team. Chin Soo Mau is the MD with 26 years of experience in the supply and installation of ELP systems and 11 years of experience in the solar PV industry. He is supported by EDs Tai Chee Yee and Wee Chek Aik, both of whom have a similar number of years of experience in the industry.

Figure 5: Key milestones

Key Milestones				
1999 Incorporation and commencement of Pekat Teknologi Sdn Bhd as distributor of surge protective devices	2000 Expanded to provide complete ELP solutions & was awarded 2 contracts for supply & installation of ELP systems on mobile communications base stations	2001 Awarded first pile cap earthing systems installation (ELP system) for Customs and Entrepreneur Building 2G1 in Putrajaya	2006 Established a branch office in Penang to expand coverage to the Northern region of Peninsular Malaysia	2008 <ul style="list-style-type: none"> Secured the authorised distributorship for "Furse" brand Started distributing "Pekat" brand of surge protection devices as part of product expansion
	2010 Expanded into solar PV industry when awarded the first contract to design, supply and install an on-grid solar PV system at Platinum Sentral with an installed capacity of 168kWp	2011 Registered in the Malaysian Book of Records for being the first solar PV installer to receive ISO 50001:2011 certification for energy management system	2013 Established a branch office in Johor Bahru to expand coverage to the Southern region of Peninsular Malaysia	2020 Completed the acquisition of an industrial land ("Elmina Land") (approximately 137,928 sq ft) and intends to build its new head office and operational facility on the Elmina Land

Source: Company

Figure 6: Utilisation of IPO proceeds

Details	Amount (MYRm)	Percentage (%)	Estimated timeframe for utilisation upon listing
Construction of new head office and operational facility	18.00	40.6	Mar 2023
Working capital	12.67	28.6	Within 12 months
Repayment of bank borrowings	10.00	22.5	Within 3 months
Estimated listing expenses	3.70	8.3	Within 1 month
Total public issue proceeds	44.37	100.0	

Source: Company prospectus

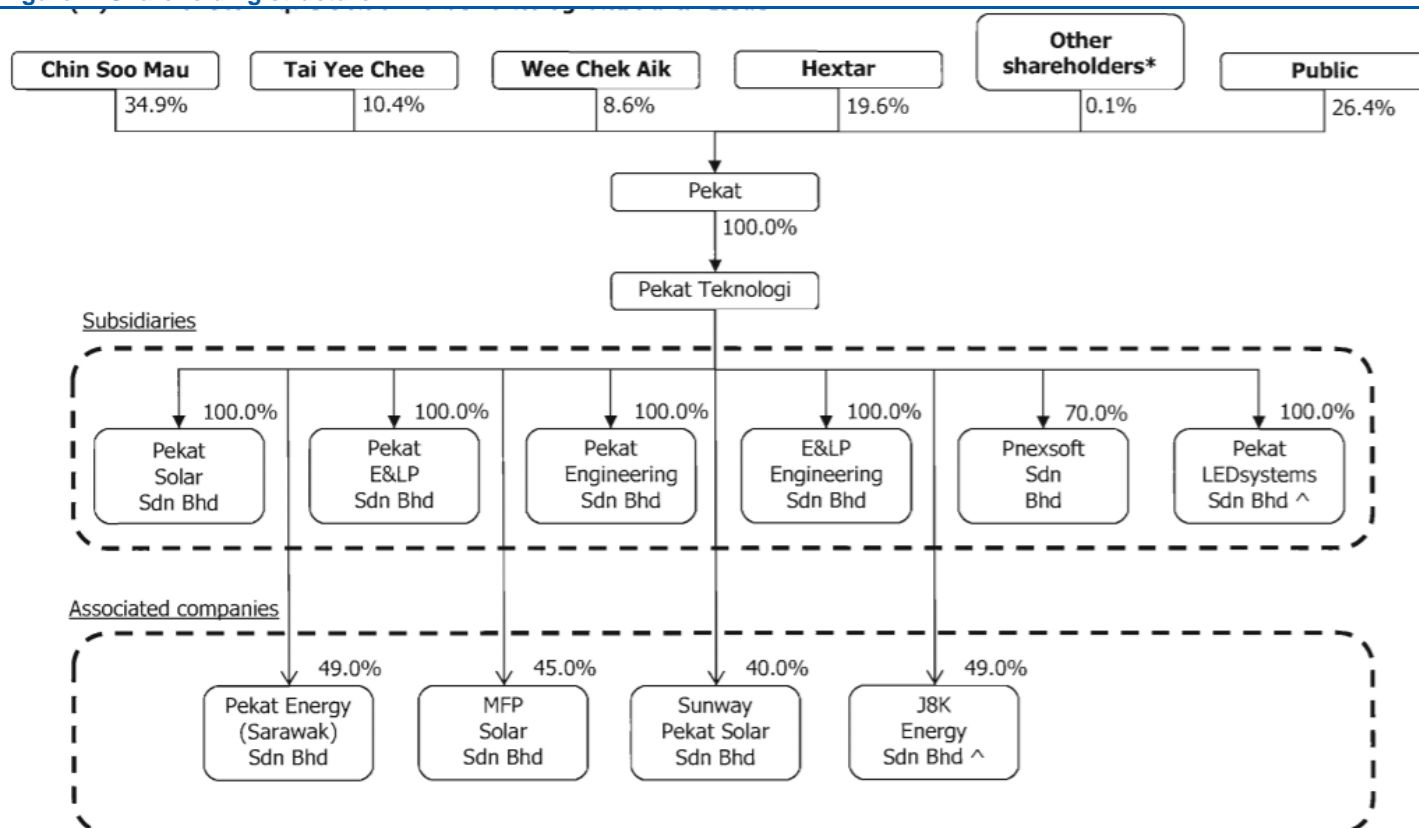
IPO proceeds utilisation. At an IPO price of MYR0.32 per share, total proceeds will be MYR44.4m. The bulk of the IPO proceeds (40.6%) will be used for the construction of a new head office and operational facility. The current head office – Cubic Office Space – is small, given the growing workforce, as management foresees a higher number of employees being hired as the business grows.

Pekat completed the acquisition of Elmina land in Jul 2020, and intends to build a new head office that can integrate a showcase area, central monitoring station, training centre, workshop, and warehouse under one roof. The new head office is slated for completion by Mar 2023.

Apart from the new head office, 28.6% of the IPO proceeds will be for working capital purposes, where the group expects to grow in tandem with the expected growth of the business. Some solar EPCC and ELP projects require tender and performance bonds, and this can result in the locking up of working capital, which – in turn – affects liquidity.

22.5% of the IPO proceeds will be used to pare down borrowings, and this may result in annual interest savings of MYR0.3m.

Figure 7: Shareholding structure



Source: Company prospectus

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