

SILK Holdings (SIB MK)

Share Price: MYR0.725

MCap (USD): 0.1B

Malaysia

Target Price: MYR0.87 (+20%)

ADTV (USD): 0.9M

O&G/Infra

Not Rated

Embedded in value

- SILK offers a small-cap exposure to the growing O&G OSV sub-sector.
- Its highway concession will soon break-even in profits, riding on robust traffic growth.
- Embedded in value, we believe the stock is worth **MYR0.87**.

What's New

SILK offers a small-cap exposure to the growing oil & gas (O&G) offshore supply vessel (OSV) sub-sector, with a fleet size of 17 presently (and 19 by end-FY7/14), quite similar to Perdana Petroleum (PETR MK; BUY; TP: MYR1.90) in terms of fleet size.

Its Kajang Ring Road (KRR) concession is still loss-making but we expect it to be profitable next year, riding on robust double-digit traffic growth and a toll rate hike in 2015. What is positive is that the KRR is already cash flow positive after servicing interest cost.

What's Our View

Although group profits are small at just MYR2m net in 1QFY7/14, this should improve steadily. Net gearing of 10.9x at end-Oct 2013 is not a concern as 96% of the debts are project financing, backed by cash flows/assets of its businesses.

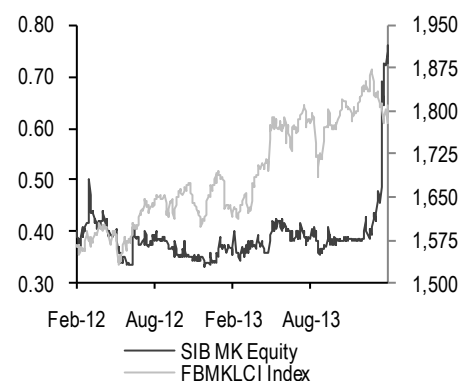
Despite a 76.8% rise in its share price YTD, the stock remains undervalued with the current share price reflecting just a FY7/15 PER of 16x for its OSV operations, and zero value assigned to the KRR. We value the stock at MYR0.87 based on SOP and after assigning a 20% discount for its small-cap status.

FYE Jul (MYR m)	FY11A	FY12A	FY13A	FY14F	FY15F
Sales	247.7	341.1	383.3	411.6	441.7
EBITDA	128.2	192.3	230.0	267.4	282.0
Core net profit	(11.2)	(0.7)	4.4	11.0	29.3
Core EPS (sen)	(2.9)	(0.2)	1.1	2.3	4.7
Core EPS growth (%)	NM	(94.0)	NM	110.3	100.5
Net DPS (sen)	-	-	-	-	-
BVPS (MYR)	(2.0)	(2.0)	(1.9)	(1.5)	(1.0)
Core P/E (x)	-	-	65.5	31.1	15.5
EV/EBITDA (x)	14.9	9.9	8.3	7.1	6.8
Net dividend yield (%)	-	-	-	-	-
P/BV (x)	-	-	-	-	-
Net debt/equity (%)	1065.8	1095.2	1132.4	1114.2	830.5
ROAE (%)	-	-	3.3	7.3	16.1
ROAA (%)	-	-	0.2	0.5	1.2

Key Data

Shariah status	YES
52w high/low (MYR)	0.78/0.335
Free float (%)	18.8
Issued shares (m)	486
Market capitalization	MYR0.4B
Major shareholders:	
BIN DZULKIF JOHAN ZA	29.9%
BIN ALI ABDUL RAHMAN	19.3%
BIN HASHIM MOHAMMED	17.5%

Share Price Performance



	1 Mth	3 Mth	12 Mth
Absolute (%)	72.6	93.3	104.2
Relative to country (%)	73.9	91.6	92.6

Maybank vs Market

	Positive	Neutral	Negative
Market Recs	na	na	na
	Maybank	Consensus	% +/-
Target Price (MYR)	0.87	na	na
FY14 Net Profit (MYR m)	11.0	na	na
FY15 Net Profit (MYR m)	29.3	na	na

Source: Bloomberg; Maybank

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Overview

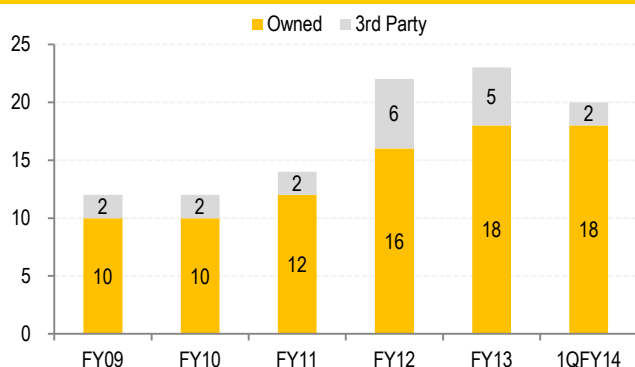
O&G & Infrastructure

SILK Holdings is an investment holding company with a 70% interest in Jasa Merin (Malaysia) S/B, an offshore supply vessel (OSV) owner and operator, and a 100% stake in Sistem Lingkaran-Lebuh raya Kajang S/B, the concessionaire for the 37km Kajang Traffic Dispersal Ring Road (KRR) with a 23-year concession period remaining (expiring on 31 Jul 2037).

Originally holding just a 100% of Sistem Lingkaran-Lebuh raya Kajang, the group assumed its present structure after a regularised scheme out of the Practice Note (PN) 17 status which was completed on 14 Oct 2009, which involved the injection of Jasa Merin (Malaysia).

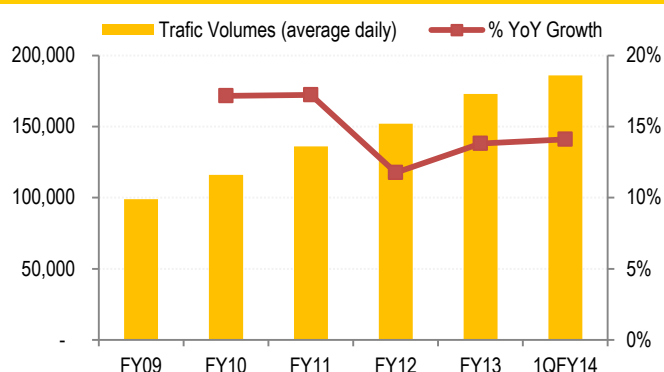
The group's OSV fleet size has since expanded from 10 owned vessels in FY7/09 to 18 in FY7/13 (19 by end-FY7/14), while its KRR's traffic growth has been strong at a 15% CAGR from FY7/09 to FY7/13 (+14% YoY in 1QFY7/14). The OSV business has been the sole earnings contributor to the group as the KRR has been loss-making, but with the losses narrowing.

OSV fleet



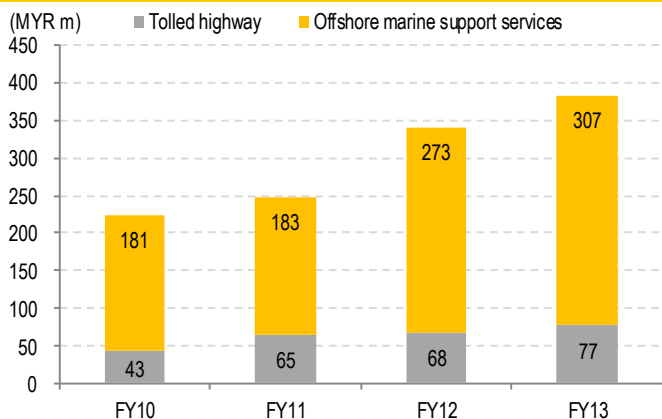
Source: Company

KRR's traffic volume and growth



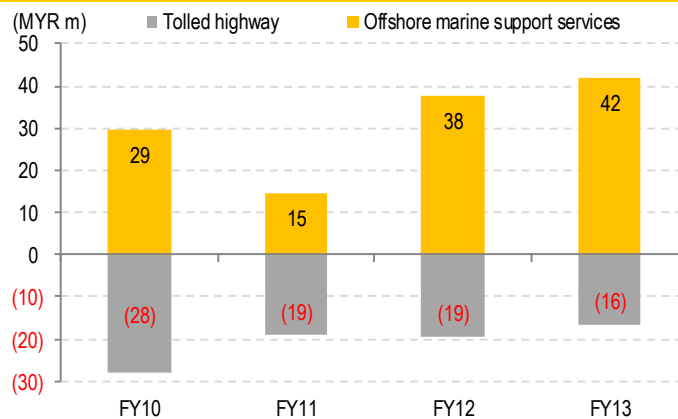
Source: Company

Segmental revenue



Source: Company

Segmental pretax profit



Source: Company

OSV Operations

5th largest OSV operator in Malaysia

Jasa Merin (Malaysia) S/B (JM), which commenced operations in 1982, is an offshore support vessel (OSV) owner and operator, providing services to oil majors operating in Malaysian waters. It has over 30 years of experience with an excellent track record and is recognised by the oil majors. JM is 70% owned by AQL Aman S/B, a 100%-subsidiary of SILK Holdings, with the remaining 30% owned by State-owned Terengganu Incorporated S/B (TIA).

Vessels are Malaysia-built and flagged

JM presently owns and operates 17 units of OSVs (after disposing two older units and added on one new unit in FY7/14-YTD, vs 18 units at end-FY7/13) comprising 15 anchor-handling tug and supply vessels (AHTS) and 2 straight supply vessels (SSVs). All its fleet are locally built with Muhibbah Engineering as its preferred vessel builder. All of its OSVs are Malaysia-flagged and are relatively young, averaging 4 years in age.

Fully employed, moving into deepwater

Currently, all JM's OSVs are on long term charters. In FY13, JM secured 7 new contracts and extended 2 earlier charters. In terms of fleet expansion, JM has been consistently growing its fleet size during the down-cycle (2008-11) and despite that, it has been successful in securing charters for these OSVs. Based on its new building programs, 2 AHTS (JM Cemerlang, JM Abadi) are currently under construction with deliveries by mid-2014.

Fleet size of OSV players (units)

Bumi Armada	45
Alam Maritim	38
Icon Offshore	34
Borcus	33
Jasa Merin	17
Perdana Petroleum	17

Sources: Company, Maybank KE

Jasa Merin's fleet profile

Vessel name	Type	Delivery date	Size (bhp/crane capacity-MT)	Accommodation pax	Age
JM Aman*	SSV	2004	4,600	28	Disposed
JM Indah	SSV	2007	4,640	39	7
JM Murni	SSV	2007	4,640	39	7
JM Bayu	AHTS 70m	2010	10,888	42	4
JM Sepoi	AHTS 70m	2011	10,888	42	3
JM Samudra	AHTS 70m	2011	10,888	42	3
JM Setia	AHTS 70m	2011	10,888	42	3
JM Ehsan	AHTS 70m	2011	10,888	42	3
IDS Darussalam	AHTS 70m	2011	10,888	42	3
JM Damai**	AHTS 60m	2005	5,444	28	Disposed
JM Hadhari	AHTS 60m	2008	5,500	27	6
JM Seri Besut	AHTS 60m	2008	5,500	27	6
JM Tenang	AHTS 60m	2009	5,220	28	5
JM Intan	AHTS 60m	2009	5,220	28	5
JM Gagah 2	AHTS 60m	2010	5,220	42	4
JM Perkasa 2	AHTS 60m	2010	5,220	42	4
JM Purnama	AHTS 60m	2011	5,220	42	3
JM Permai	AHTS 60m	2012	5,220	46	2
JM Gemilang	AHTS 60m	2014	5,200	na	0
JM Cemerlang***	AHTS 62M	2014	5,218	na	na
JM Abadi***	AHTS 70M	2014	5,218	na	na
Average age					4.0

Sources: Company, Maybank KE

*disposal announced 28 Jan 2014 **disposal announced on 6 Feb 2014 ***under construction

Outlook

Prospects are bright for JM to capitalise on the wave of opportunities in the Malaysia OSV market. Higher drilling activities, increasing demand for platforms and floating solutions, rising development for enhanced oil recovery (EOR) activities and deepwater explorations augur well for the OSV market.

In addition, charter rates and utilisation levels are recovering to pre-crisis levels. Contract tenures have extended, from 2-3 years to 5 years, reflecting the buoyancy in the OSV market. Coupled with the decent financing options, newbuilding programs have kick-started after a lull over the past few years.

There is an increasing demand for higher specifications vessels (i.e. PSV, workbarge/boat, 8-12k bhp AHTS). With PETRONAS giving preference to locally owned-operated flagged vessels and relatively younger fleet, the market is flushed with opportunities for local players like JM.

Financials

JM has recently completed the acquisition of the other 49% stake of four OSVs (JM Bayu, JM Sepoi, JM Samudra, JM Setia) from GMV-Jasa S/B for MYR49.5m in Dec 2013. This means that from 2014, the entire JM fleet is 100%-owned. This would contribute positively to the group, adding -MYR2.1m/4.2m in net profit in FY14/15 after taking into consideration the interest (financing) costs. Notwithstanding that, the delivery of 2 new OSVs (JM Gemilang and JM Abadi) will likely be contracted out, at decent domestic market rates.

We expect JM to generate higher net profit of MYR30m/MYR32m in FY14/15 (FY13E: MYR26m), driven by the added fleet and higher stakes in four OSVs. Our main assumptions are: (i) average total capacity owned to increase 6.6% YoY to 129.8k bhp in FY14 and 2.2% YoY to 132.5k bhp in FY15 and (ii) gross profit margin to remain stable at an estimated 37%.

Silk Highway

Intra-urban toll expressway concession

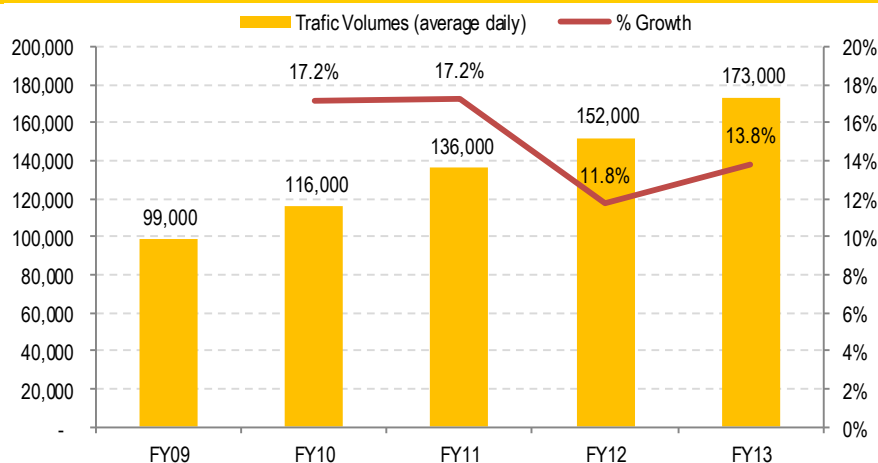
Sistem Lingkar-Lebuhraya Kajang S/B (Silk Highway) operates the Kajang Traffic Dispersal Ring Road (KRR) under a 36-year concession that commenced in 2001 and expires in 2037. The construction cost of the highway was MYR1.1b. KRR is located in Kajang (south-east of the Klang Valley) and encircles the Kajang Town, facilitating a bypass route to alleviate the traffic congestion in the Kajang Town.

Robust traffic growth

The KRR commenced operations in 2004. Since FY09, traffic has grown at a strong 15% 4-year CAGR from 99,000 vehicles per day to 173,000 vehicles per day in FY13. The robust growth is attributable to: i) strong population growth in Kajang and its surrounding areas and ii) strategic connectivity to the other highways.

- Due to the close proximity of Kajang to the Kuala Lumpur city centre of ~21km, improved connectivity via new highways and affordable housing prices, Kajang has attracted migrants from the other areas. Population in Kajang grew at 4.1% 10-year CAGR between 2000 and 2010, higher than the population growth in Selangor of 3.1% 10-year CAGR.
- The KRR is connected to several major highways including Federal Route 1, Cheras-Kajang Highway (Grand Saga), Sungai Besi Highway (Besraya), Kajang-Seremban Highway (LEKAS), North-South Expressway (PLUS) and South Klang Valley Expressway (SKVE). With this strategic connections, the KRR not only reduces traveling time between the North and South of Kajang but it also eases travelling to and from Kuala Lumpur, Cheras, Sg. Long, Balakong, Putrajaya, Semenyih, Bangi, KL International Airport and Seremban.

Traffic volumes and growth



Source: Company

Details of KRR

Length	37km / 216 lane km
Interchanges	11
Lanes	3 & 4
Toll plazas	4 at Sg. Long, Bukit Kajang, Sg. Ramal, Sg. Balak
Toll system	Open toll system
Current installed capacity	600,000 vehicles/day

Source: Company

Scheduled toll rates for Class 1 vehicles

Current	MYR1.00
2010	MYR1.30*
2015	MYR1.80
2020	MYR2.40

Source: Company *delayed

KRR Road Map and connectivity to other major highways



Source: Company

Outlook

Traffic volume at the KRR is expected to grow steadily, bolstered by robust population growth potential within the highway catchment areas including Kajang, Cheras, Bangi, Semenyih and Seremban. Kajang has been identified as one of the high growth areas within the Klang Valley going forward with vast areas of undeveloped land bank. It is still not as densely populated as the other areas with similar proximity to KL city and property prices are also relatively more affordable. Leveraging on these advantages, increasing property developers have set foot in Kajang and launched new townships near the KRR. However, upon completion of the KVMRT line 1 Sg. Buloh-Kajang in 2017, traffic growth at the KRR could be slower.

Property developers with projects in Kajang

Property developer	Property Development Projects
Dijaya Corp	Tropicana Heights Kajang
Gamuda Bhd	Jade Hills
Ireka Corporation	Commerical and industrial park development
MKH Bhd	Kajang 2, Pelangi Heights, Recco Avenue, Kajang East, Hill Park Homes
Naza TTDI	TTDI Grove, Kajang
Sime Darby	Saujana Impian
I&P Group	Alam Sari

Source: Company, Maybank KE

Financials

Silk Highway's revenue has grown at a 17% 4-year CAGR (FY7/09-FY7/13) in tandem with the traffic growth. Although the scheduled 30% toll rate hike in 2010 was delayed, Silk Highway has been compensated by the government and this has also contributed to its revenue growth.

Despite the strong growth, traffic volumes are still lower than what had been expected when the concession was inked, leading to underutilization of the highway that has the capacity to cater for 600,000 vehicles per day. For instance, 1QFY7/14 (Aug-Oct 2013) traffic volume of 186,000 vehicles per day was still very much below what traffic consultant Halcrow's low/base case forecasts of c.388,000/444,000 vehicles per day, for 2013.

Hence, Silk Highway has been at an accounting net loss position, although it is generating positive operating cash flows. The shortfall in traffic volume has invariably resulted in a widened mismatch of its toll revenue with its high i) financing, and ii) depreciation & amortization costs.

- The finance cost of the initial MYR1b Al-Bai Bithaman Ajil Islamic Debt Securities issued in 2001 was 10.6%. A debt restructuring in 2008 replaced the original securities with a MYR752.2m Sukuk Mudharabah with an effective rate of 8%. Under the Sukuk Mudharabah, Silk Highway will only need to pay a minimum financing cost of 3.5% and capital repayment is limited to the available cash for the first seven years until 25 Jan 2015.
- Silk Highway adopted IC Interpretation 12: *Service Concession Arrangements* (new accounting standard) in FY11 that led to higher annual amortization cost of MYR10.6m in FY11 from MYR7.3m in FY10.

Going forward, with the steady traffic volume growth and next scheduled toll rate hike in 2015 to MYR1.80 (+38%) from MYR1.30, we expect Silk Highway to turn profitable in FY7/15. Its Sukuk Mudharabah is due for a restructuring in 25 Jan 2015, and this could potentially reduce its finance cost, providing upside to earnings. Based on our scenario analysis, a 0.5% reduction in finance cost starting Feb 2015 would increase the Silk Holdings' FY7/15 net profit by +4.4%.

Financials & Valuations

Stronger group profits ahead

We project SILK Holdings to deliver group net profits of MYR11.0m in FY7/14 (FY7/13: MYR4.4m) and MYR29.3m in FY7/15 with the growth coming from (i) three new OSVs in FY7/14 and a full stake in four existing OSVs effective Dec 2013 which were previously 51% owned, and (ii) continuous robust traffic growth at the KRR and a toll hike (+38% for Class 1 vehicles) due in 2015. In 1QFY7/14, SILK Holdings reported a net profit of MYR2.2m, and our forecasts assume another MYR8.8m in 2Q-4QFY7/14.

Dilutive impact from RCULS conversion

Two financial instruments mature in FY7/14-15: (i) a 10-Year Cumulative Convertible Redeemable Preference Shares (CC-RPS; MYR16m outstanding at end-FY7/13), which matured on 5 Nov 2013, and (ii) a 10-Year Redeemable Convertible Unsecured Loan Stock (RCULS; MYR39.9m outstanding), maturing on 13 Oct 2014. The CC-RPS were converted in 52.7m new SILK Holdings shares in Nov 2013, while the RCULS, if fully converted by Oct 2014, will result in an estimated 178.9m new SILK Holdings shares. This would raise SILK Holdings' paid-up from 486.1m shares presently (post-CC-RPS conversion) to c.665m (+37%).

Net gearing

Group total borrowings stood at MYR1.65b at end-FY7/13. This represents 12.0x its shareholders fund of MYR138m. Excluding MYR92m cash balance, net debt was 11.3x that of shareholders fund. The debts are mostly project financing type for its OSV and KRR operations. Group debt has risen further by another MYR133m, we estimate, after Jasa Merin borrowed MYR92.2m to finance its 2 new OSVs in Oct 2013 and MYR40m to pay for a 49% stake in 4 OSVs in Feb 2013.

SOP valuations

We fairly value SILK Holdings at MYR0.87 using sum-of-parts (SOP), after (i) assigning a 15x PER valuation on its FY7/15 OSV earnings, similar to our assigned value for its listed peer, Perdana Petroleum, (ii) estimating the KRR's intrinsic equity value using the discounted cash flow (DCF) method, using a cost of equity of 9.4%, (iii) assigning a 20% discount for SILK Holdings' small-cap status, and (iv) having considered the full dilutive impact from the RCULS conversion (in Oct 2014). SILK Holdings' current share price reflects just a FY7/15 PER of 16x for its OSV operations, without any zero value assigned to the KRR.

Silk Holdings: Sum-of-the-parts valuation

	Value	Stake	Attr. Value	Per shr (MYR)	% of total	Comments
Silk Highway	389.1	100%	389.1	0.80	54.1%	DCF
Jasa Merin	31.5	70%	330.5	0.68	45.9%	15x FY7/15 PER
Less: RCULS			(39.9)	(0.08)		
Total equity value			679.68	1.40		
Diluted equity value				1.08		
(-) 20% small cap discount				(0.22)		
Discounted equity value				0.87		

Source: Maybank KE

Shareholders & Management

SILK Holdings is substantially held by En Johan Zainuddin bin Dzulkifli (33.5% at 10 Oct 2013), En Abdul Rahman bin Ali (21.7%) and Dato' Mohd Azlan Hashim (19.6%). En Johan is presently a non-independent non-executive director of SILK Holdings, while Dato' Mohd Azlan is the executive chairman, and a non-independent executive director. Dato' Mohd Azlan is also the former executive chairman of Bursa Malaysia Berhad and he presently holds directorships in Khazanah Nasional, Scomi Group and IHH Healthcare, among others.

INCOME STATEMENT (MYR m)

FYE Jul	FY12	FY13	FY14F	FY15F
Revenue	341.1	383.3	411.6	441.7
EBITDA	192.3	230.0	267.4	282.0
Depreciation & Amortisation	(73.5)	(93.5)	(118.8)	(113.0)
Operating Profit (EBIT)	118.8	136.6	148.6	169.0
Interest (Exp)/Inc	(101.5)	(110.1)	(118.4)	(121.8)
Associates	-	-	-	-
One-offs	-	-	-	-
Pre-Tax Profit	17.3	26.4	30.2	47.2
Tax	(8.0)	(7.7)	(7.1)	(8.5)
Minority Interest	(10.1)	(14.3)	(12.1)	(9.4)
Net Profit	(0.7)	4.4	11.0	29.3
Recurring Net Profit	(0.7)	4.4	11.0	29.3
Revenue Growth %	37.7	12.4	7.4	7.3
EBITDA Growth (%)	50.0	19.6	16.2	5.5
EBIT Growth (%)	46.0	15.0	8.8	13.7
Net Profit Growth (%)	(94.0)	NM	149.5	166.1
Recurring Net Profit Growth	(94.0)	NM	149.5	166.1
Tax Rate %	45.9	29.1	23.5	17.9

CASH FLOW (MYR m)

FYE Jul	FY12	FY13	FY14F	FY15F
Profit before taxation	17.3	26.4	41.4	74.2
Depreciation	(73.5)	(93.5)	(118.8)	(113.0)
Net interest	(101.5)	(110.1)	(118.4)	(121.8)
Working capital change	321.0	433.1	463.1	440.2
Cash tax paid	0.4	(1.5)	(7.1)	(8.5)
Others (incl'd exceptional)	-	-	-	-
Cash flow from operations	163.7	254.4	260.2	271.2
Capex	(111.0)	(327.3)	(250.0)	0.0
Disposal/(purchase)	1.3	0.3	0.0	0.0
Others	3.6	0.0	0.0	0.0
Cash flow from investing	(106.1)	(327.0)	(250.0)	0.0
Debt raised/(repaid)	36.9	182.3	139.6	(15.0)
Equity raised/(repaid)	-	-	-	-
Dividends (paid)	(1.5)	(0.3)	0.0	0.0
Interest payments	(86.3)	(89.0)	(118.4)	(121.8)
Others	-	-	-	-
Cash flow from financing	(50.9)	93.0	21.2	(136.8)
Change in cash	6.7	20.4	31.5	134.4

BALANCE SHEET (MYR m)

FYE Jul	FY12	FY13	FY14F	FY15F
Fixed Assets	898.6	1146.1	1299.5	1209.4
Other LT Assets	891.1	877.0	854.9	832.0
Cash/ST Investments	71.4	91.8	127.2	263.5
Other Current Assets	87.4	64.5	69.2	74.2
Total Assets	1948.5	2179.5	2350.8	2379.0
ST Debt	92.5	146.1	174.1	171.1
Other Current Liabilities	80.1	99.8	93.6	96.2
LT Debt	1375.1	1503.7	1615.4	1603.4
Other LT Liabilities	197.5	202.4	202.9	196.6
Minority Interest	75.8	89.8	101.9	111.4
Shareholders' Equity	127.5	137.6	163.0	200.4
Total Liabilities-Capital	1948.5	2179.5	2350.8	2379.0
Share Capital (m)	397.0	433.3	486.1	665.0
Gross Debt/(Cash)	1467.6	1649.9	1789.5	1774.5
Net Debt/(Cash)	1396.2	1558.1	1662.3	1511.0
Working Capital	(13.8)	(89.6)	(71.2)	70.4

RATES & RATIOS

FYE Jul	FY12	FY13	FY14F	FY15F
EBITDA Margin %	56.4	60.0	65.0	63.8
Op. Profit Margin %	34.8	35.6	36.1	38.3
Net Profit Margin %	(0.2)	1.2	2.7	6.6
ROE %	-	3.3	7.3	16.1
ROA %	-	0.2	0.5	1.2
Net Margin Ex. El %	(0.2)	1.2	2.7	6.6
Dividend Cover (x)	-	-	-	-
Interest Cover (x)	1.2	1.2	1.3	1.4
Asset Turnover (x)	0.2	0.2	0.2	0.2
Asset/Debt (x)	1.3	1.3	1.3	1.3
Debtors Turn (days)	91.0	60.0	60.0	60.0
Creditors Turn (days)	118.6	113.0	113.0	113.0
Inventory Turn (days)	1.7	1.2	1.2	1.2
Net Gearing %	1095.2	1132.4	1114.2	830.5
Debt/ EBITDA (x)	7.6	7.2	6.7	6.3
Debt/ Market Cap (x)	4.2	4.7	5.1	5.0

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