INITIATION

CIMB

TH Heavy Engineering

COMPANY NOTE

RH MK / THHE.KL

Market Cap	Avg Daily Turnover	Free Float
US$261.4m	US$1.29m	61.6%
RM832.0m	RM4.16m	1,021 m shares

Current	RM0.82
Target	RM1.20
Prev. Target	N/A
Up/Downside	47.5%

STOCK RATING

ADD

HOLD

REDUCE

Notes from the Field

Norziana MOHD INON
T (60) 3 2261 9075
E norziana.inon@cimb.com

Company Visit	☑	Expert Opinion	☑
Channel Check	☑	Customer Views	☐

“THHE has been actively tendering for works with strategic partner McDermott... fabrication contract awards could pick up in 2H14, which would improve FY15 earnings visibility.

– Nor Badli Alias, CEO

T(oo) H(ot!)

Undervalued and under-researched, THHE is set to chart a blazing, sector-beating 3-year EPS CAGR of 106%, thanks to a bigger yard and fresh forays into FPSO and T&I. Look no further for a stock that offers a tantalising combination of highest growth and cheapest valuations.

We begin coverage with an Add call. A growing order book and successful FPSO and T&I ventures are the potential re-rating catalysts. We value the stock at a CY15 P/E of 16.4x, a 30% discount to the average P/E of the oil & gas big caps. THHE replaces Perisai as our top pick among the oil & gas small caps.

From fabrication...

Formerly known as Ramunia, TH Heavy Engineering (THHE) has its roots in fabrication, where operations are carried out at its 57-acre yard in Pulau Indah. To compete better with its bigger rivals, the company is upgrading and doubling the yard's capacity to 20,000 tonnes p.a. by end-3Q14. Furthermore, THHE's JV with US-based McDermott allows it to tap on the American company's 300-acre Batam yard and engineering capabilities.

...to FPSO and T&I

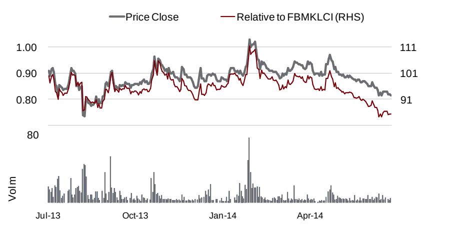
To reduce its dependence on fabrication contracts which tend to be lumpy, THHE has made inroads into the floating production, storage and offloading (FPSO) and transport and installation (T&I) businesses whose income is longer term in nature. In May 2014, THHE secured a 9-year US$372m FPSO contract, with extension options of up to 10 years. Its key FPSO asset is 80%-owned Deep Producer 1 (DP1). The company has exposure to T&I through its 30% stake in McDermott's pipelay barge DB30.

RM1.6bn record order book

The US$372m FPSO contract catapults THHE's order book to a new record of RM1.6bn. The only way for the order book to go is up following the ongoing yard expansion. The company also plans to add three more FPSO vessels over the next five years.

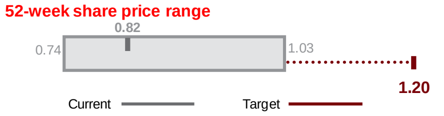
106% 3-year EPS CAGR

We are the second research house to cover THHE, which has been largely overlooked by the market. The stock presents the most attractive growth story in our oil & gas portfolio, offering a 3-year EPS CAGR of 106%, significantly above the sector average of 34%. Yet, its valuations are the cheapest, at 8-12x FY15-16 earnings. Earnings visibility is solid given the FPSO contract.



Source: Bloomberg

52-week share price range



Financial Summary

	Dec-12A	Dec-13A	Dec-14F	Dec-15F	Dec-16F
Revenue (RMm)	190.4	259.9	244.2	758.4	856.9
Operating EBITDA (RMm)	34.9	0.2	30.4	115.6	155.7
Net Profit (RMm)	24.17	8.19	25.87	74.96	98.60
Core EPS (RM)	0.052	0.011	0.025	0.073	0.097
Core EPS Growth	0%	(79%)	130%	190%	32%
FD Core P/E (x)	15.64	73.89	32.17	11.10	8.44
DPS (RM)	-	-	-	-	-
Dividend Yield	0%	0%	0%	0%	0%
EV/EBITDA (x)	15	4,944	31	9	6
P/FCFE (x)	NA	NA	NA	NA	11.86
Net Gearing	49.0%	49.7%	44.4%	29.1%	18.7%
P/BV (x)	1.22	2.18	2.03	1.72	1.43
ROE		2.4%	6.5%	16.8%	18.5%
% Change In Core EPS Estimates					
CIMB/consensus EPS (x)			0.50	0.81	1.00

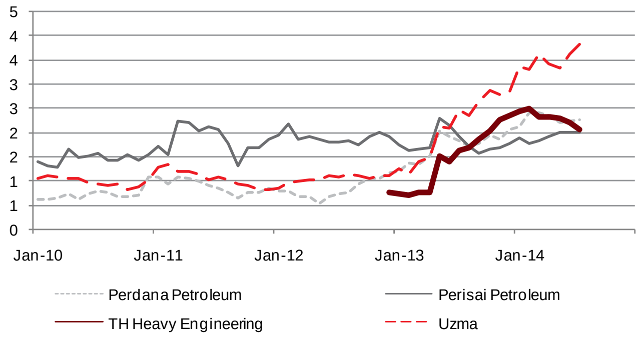
SOURCE: CIMB, COMPANY REPORTS

PEER COMPARISON

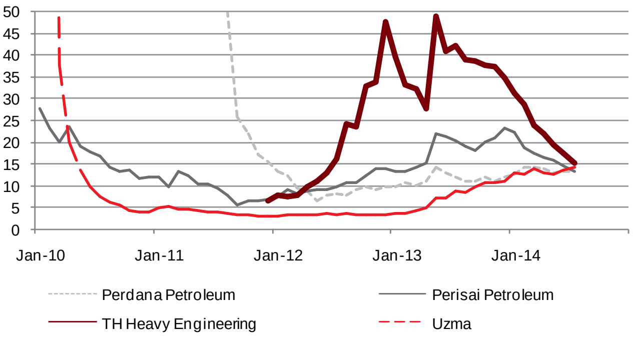
Research Coverage

	Bloomberg Code	Market	Recommendation	Mkt Cap US$m	Price	Target Price	Upside
Perdana Petroleum	PETR MK	MY	ADD	431	1.86	2.40	29.0%
Perisai Petroleum	PPT MK	MY	ADD	570	1.52	2.37	55.8%
TH Heavy Engineering	**RH MK**	**MY**	**ADD**	**261**	**0.82**	**1.20**	**47.5%**
Uzma	UZMA MK	MY	ADD	323	3.90	4.68	20.0%

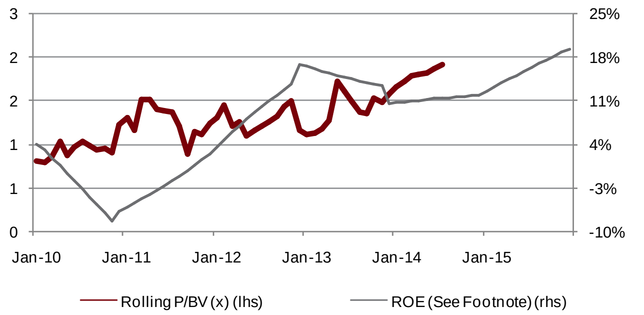
Rolling P/BV (x)



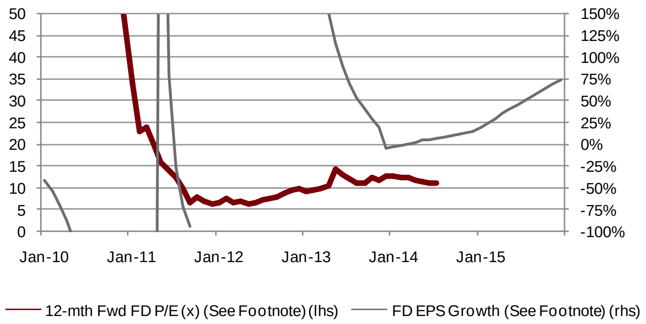
12-month Forward Rolling FD P/E (x)



Peer Aggregate: P/BV vs ROE



Peer Aggregate: 12-mth Fwd FD P/E vs FD EPS Growth



Valuation

	FD P/E (x) (See Footnote)			P/BV (x)			EV/EBITDA (x)		
	Dec-13	Dec-14	Dec-15	Dec-13	Dec-14	Dec-15	Dec-13	Dec-14	Dec-15
Perdana Petroleum	23.80	14.22	12.77	2.41	2.17	2.18	21.23	10.54	9.59
Perisai Petroleum	19.64	22.13	10.41	1.69	2.29	2.07	15.17	10.93	8.64
TH Heavy Engineering	**73.89**	**32.17**	**11.10**	**2.18**	**2.03**	**1.72**	**4,943.59**	**30.76**	**8.65**
Uzma	15.57	15.57	13.67	4.01	3.73	2.93	10.49	9.33	8.82

Growth and Returns

	FD EPS Growth (See Footnote)			ROE (See Footnote)			Dividend Yield		
	Dec-13	Dec-14	Dec-15	Dec-13	Dec-14	Dec-15	Dec-13	Dec-14	Dec-15
Perdana Petroleum	116.7%	67.4%	11.4%	10.9%	16.0%	17.0%	0.00%	0.00%	0.00%
Perisai Petroleum	-28.6%	-11.3%	112.6%	10.4%	8.9%	20.9%	0.00%	0.00%	0.00%
TH Heavy Engineering	**-78.8%**	**129.7%**	**189.8%**	**2.4%**	**6.5%**	**16.8%**	**0.00%**	**0.00%**	**0.00%**
Uzma	19.7%	0.0%	13.9%	29.2%	24.5%	24.0%	0.51%	0.00%	0.00%

SOURCE: CIMB, COMPANY REPORTS

Calculations are performed using EFA™ Monthly Interpolated Annualisation and Aggregation algorithms to December year ends.
NPAT/EPS values for calculations and valuations are based on recurring and normalised values for GAAP and IFRS accounting standard companies respectively.

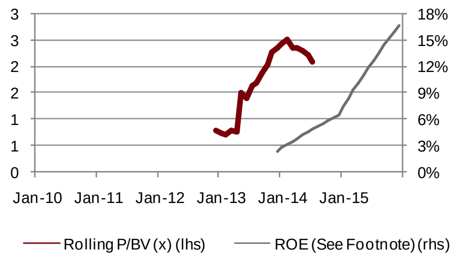
BY THE NUMBERS

Share price info

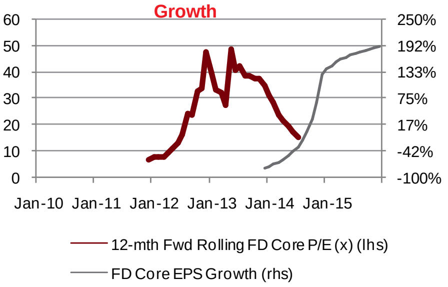
Share px perf. (%)	1M	3M	12M
Relative	-5.6	-12	-16.9
Absolute	-5.8	-10.9	-12.4

Major shareholders	% held
Lembaga Tabung Haji	29.3
Tan Sri Quek Leng Chan	9.1

P/BV vs ROE



12-mth Fwd FD Core P/E vs FD Core EPS Growth



Expect a 3-year EPS CAGR of 106%, thanks to three engines of growth: the mainstay business of fabrication, and fresh ventures into FPSO and T&I.

Profit & Loss

(RMm)	Dec-12A	Dec-13A	Dec-14F	Dec-15F	Dec-16F
Total Net Revenues	**190.4**	**259.9**	**244.2**	**758.4**	**856.9**
Gross Profit	**66.8**	**44.4**	**85.5**	**265.5**	**299.9**
Operating EBITDA	**34.9**	**0.2**	**30.4**	**115.6**	**155.7**
Depreciation And Amortisation	(4.5)	(8.9)	(18.8)	(30.3)	(34.3)
Operating EBIT	**30.5**	**(8.7)**	**11.7**	**85.3**	**121.4**
Financial Income/(Expense)	(0.1)	2.7	(2.4)	(4.0)	(6.7)
Pretax Income/(Loss) from Assoc.	0.0	5.0	20.0	20.0	20.0
Non-Operating Income/(Expense)	0.0	0.0	0.0	0.0	0.0
Profit Before Tax (pre-EI)	**30.3**	**(1.0)**	**29.3**	**101.3**	**134.7**
Exceptional Items					
Pre-tax Profit	**30.3**	**(1.0)**	**29.3**	**101.3**	**134.7**
Taxation	(6.1)	2.5	(1.5)	(5.1)	(6.7)
Exceptional Income - post-tax					
Profit After Tax	**24.2**	**1.6**	**27.8**	**96.2**	**128.0**
Minority Interests	0.0	6.6	(1.9)	(21.2)	(29.4)
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax					
Net Profit	**24.2**	**8.2**	**25.9**	**75.0**	**98.6**
Recurring Net Profit	24.2	8.2	25.9	75.0	98.6
Fully Diluted Recurring Net Profit	**24.2**	**8.2**	**25.9**	**75.0**	**98.6**

We forecast RM950m capex in FY14-15 for the yard upgrade and foray into FPSO

Cash Flow

(RMm)	Dec-12A	Dec-13A	Dec-14F	Dec-15F	Dec-16F
EBITDA	34.9	0.2	30.4	115.6	155.7
Cash Flow from Invt. & Assoc.					
Change In Working Capital	(24.6)	(36.8)	(39.8)	(43.3)	(47.1)
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense					
Other Operating Cashflow					
Net Interest (Paid)/Received	(2.4)	(5.4)	(2.4)	(4.0)	(6.7)
Tax Paid	(0.1)	(0.3)	(1.5)	(5.1)	(6.7)
Cashflow From Operations	**7.8**	**(42.4)**	**(13.3)**	**63.2**	**95.1**
Capex	(123.4)	(64.8)	(475.0)	(475.0)	(10.0)
Disposals Of FAs/subsidiaries	0.0	0.0	0.0	0.0	0.0
Acq. Of Subsidiaries/investments	0.0	(77.9)	(20.0)	(20.0)	(20.0)
Other Investing Cashflow	9.0	103.1	25.0	25.0	25.0
Cash Flow From Investing	**(114.4)**	**(39.7)**	**(470.0)**	**(470.0)**	**(5.0)**
Debt Raised/(repaid)	(20.0)	(201.3)	(20.0)	(20.0)	(20.0)
Proceeds From Issue Of Shares	106.1	41.8	0.0	0.0	0.0
Shares Repurchased					
Dividends Paid					
Preferred Dividends					
Other Financing Cashflow	18.9	302.0	50.0	50.0	50.0
Cash Flow From Financing	**105.0**	**142.5**	**30.0**	**30.0**	**30.0**
Total Cash Generated	(1.7)	60.4	(453.3)	(376.8)	120.1
Free Cashflow To Equity	**(126.6)**	**(283.4)**	**(503.3)**	**(426.8)**	**70.1**
Free Cashflow To Firm	**(103.6)**	**(75.5)**	**(474.9)**	**(396.8)**	**102.8**

SOURCE: CIMB, COMPANY REPORTS

BY THE NUMBERS

Net gearing is manageable at around 0.5x. There is no dividend target for now.

Balance Sheet

(RMm)	Dec-12A	Dec-13A	Dec-14F	Dec-15F	Dec-16F
Total Cash And Equivalents	47.0	86.8	95.5	105.1	115.6
Total Debtors	111.1	211.4	232.6	255.8	281.4
Inventories	0.8	5.7	5.0	5.0	5.0
Total Other Current Assets	290.3	2.2	2.0	2.0	2.0
Total Current Assets	**449.2**	**306.1**	**335.1**	**367.9**	**404.0**
Fixed Assets	147.0	492.6	810.4	851.5	897.1
Total Investments	17.3	91.9	85.9	5.0	5.0
Intangible Assets	0.0	0.0	0.0	0.0	0.0
Total Other Non-Current Assets	0.0	0.0	0.0	0.0	0.0
Total Non-current Assets	**164.3**	**584.5**	**896.3**	**856.5**	**902.1**
Short-term Debt	199.3	28.6	28.3	27.1	27.4
Current Portion of Long-Term Debt					
Total Creditors	102.8	154.9	539.3	464.2	461.4
Other Current Liabilities	0.2	2.0	2.0	2.0	2.0
Total Current Liabilities	**302.2**	**185.5**	**569.6**	**493.3**	**490.8**
Total Long-term Debt	0.2	272.9	250.0	225.0	202.5
Hybrid Debt - Debt Component					
Total Other Non-Current Liabilities	0.1	0.1	0.1	0.1	0.1
Total Non-current Liabilities	**0.3**	**273.0**	**250.1**	**225.1**	**202.6**
Total Provisions	0.0	0.0	0.0	0.0	0.0
Total Liabilities	**302.5**	**458.5**	**819.7**	**718.4**	**693.4**
Shareholders' Equity	311.0	381.0	409.7	484.7	583.3
Minority Interests	0.0	51.1	1.9	21.2	29.4
Total Equity	**311.0**	**432.2**	**411.7**	**505.9**	**612.7**

We forecast a low effective tax rate of 5% as the FPSO vessel is registered in Labuan and there are around RM150m of unabsorbed losses

Key Ratios

	Dec-12A	Dec-13A	Dec-14F	Dec-15F	Dec-16F
Revenue Growth	0%	37%	(6%)	211%	13%
Operating EBITDA Growth	0%	(100%)	18987%	280%	35%
Operating EBITDA Margin	18.4%	0.1%	12.5%	15.2%	18.2%
Net Cash Per Share (RM)	(0.33)	(0.21)	(0.18)	(0.14)	(0.11)
BVPS (RM)	0.67	0.37	0.40	0.47	0.57
Gross Interest Cover	9.94	(1.31)	1.39	8.53	9.56
Effective Tax Rate	20.2%	0.0%	5.0%	5.0%	5.0%
Net Dividend Payout Ratio	NA	NA	NA	NA	NA
Accounts Receivables Days	213.6	226.5	331.8	117.5	114.7
Inventory Days	2.46	5.54	12.32	3.70	3.29
Accounts Payables Days	304.4	218.2	798.1	371.5	304.1
ROIC (%)	5.1%	(1.5%)	1.6%	12.6%	14.1%
ROCE (%)	N/A	(1.4%)	1.6%	11.8%	15.2%

The FPSO vessel will start to contribute significantly in 2H16 after a 2-year conversion period

Key Drivers

	Dec-12A	Dec-13A	Dec-14F	Dec-15F	Dec-16F
Outstanding Orderbook (RMm)	220	400	2,000	2,500	3,000
Order Book Wins (RMm)	N/A	N/A	N/A	N/A	N/A
Order Book Depletion (RMm)	N/A	N/A	N/A	N/A	N/A
Average Day Rate Per Ship (US$)	-	-	-	-	150,000.0
No. Of Ships (unit)	-	-	1	1	1
Average Utilisation Rate (%)	0.0%	0.0%	0.0%	0.0%	50.0%

SOURCE: CIMB, COMPANY REPORTS

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"THHE's mainstay is still fabrication, but the FPSO business gives us our safety net, our visibility of fixed earnings.

– Nor Badli Alias, CEO

1. BACKGROUND

1.1 From Ramunia to TH Heavy

Formerly known as Ramunia Holdings, THHE was incorporated in Nov 2003 and listed in Jan 2005 via the restructuring and delisting of Saship (Sabah Shipyard) Holdings. The company changed to its present name in 2012 after state-owned pilgrimage fund Tabung Haji, from which the company's TH initials are drawn, emerged as the largest shareholder in Aug that year. Tabung Haji currently owns a 29.29% stake in THHE.

Another major shareholder is Hong Leong's Tan Sri Quek Leng Chan, who owns a 9.09% stake through multiple vehicles. Tan Sri Quek became THHE's second largest shareholder after taking up the company's 10% placement of new shares at RM0.45/share in May 2013. He does not have board representation. Other than Tabung Haji and Tan Sri Quek, there are no other substantial shareholders. Less than 5% of the stock is owned by foreign investors, with the biggest being Norway-based Norges with a 2.88% stake.

1.2 Early exit from PN17 status

Under the previous Ramunia management, the company started out as a fabricator. It was classified as a Practice Note 17 (PN17) company in Mar 2010 after it sold its yard in Teluk Ramunia, Johor to Sime Darby (Sime MK, Hold) for RM530m and subsequently became a shell company. Under the current management headed by CEO Nor Badli Alias, 48, who took the helm in Jun 2010, the company acquired a 57-acre fabrication yard at Pulau Indah, Selangor for RM83.8m from now-delisted Oilcorp in Feb 2011. In Oct 2012, THHE exited PN17 status. It was an early upliftment as the company had turned profitable in 1Q12, well before the Oct 2012 completion of the regularisation plan that raised RM106m of fresh capital through a rights issue.

Under the listing requirement, a company has to be profitable in the immediate two consecutive quarters after it has completed its regularisation plan for the PN17 status to be removed. In THHE's case, it had turned profitable for two consecutive quarters (1Q12 and 2Q12) before the completion of the regularisation plan in Oct 2012.

1.3 CEO Badli heads management team

Badli was appointed CEO in Jun 2010. He has a 0.14% direct stake in THHE. Prior to taking up the CEO position at THHE, he was the CEO of Lityan Holdings, currently known as Theta Edge (THETA MK, Not Rated), a technology and telecommunications subsidiary of Tabung Haji, effective Oct 2007. Earlier, he had been appointed CFO of FPSO Ventures, a subsidiary of MISC (MISC MK, Add), in 2003. Before Badli joined FPSO Ventures, he had been in the merchant banking and financial advisory industry for over 10 years. Currently, he is also the president of Malaysian Offshore Contractors Association, a position he has held since Jun 2012.

2. OUTLOOK

2.1 Two new sources of income: FPSO and T&I

FPSO

Without abandoning its fabrication roots, THHE recently ventured into the FPSO business following a contract award by Nippon Oil in May 2014. The contract is worth US$372m for the primary period of nine years until Nov 2023, with an additional potential contract value of up to US$457m should Nippon Oil exercise the full extension options of up to 10 years. The contract calls for the deployment of FPSO vessel DP1 at the Layang development project located in Block SK10 in offshore Sarawak.

Although THHE is new to the FPSO business, Badli is no stranger to it, having been the CFO of MISC's subsidiary FPSO Ventures from 2003 to 2007.

T&I

In Oct 2013, THHE finalised two JVs with McDermott, a move that both signals the former's entry into the T&I business and strengthens its presence in the fabrication business:

- THHE acquired a 30% stake in Berlian McDermott for US$24.5m cash. Berlian McDermott is involved in the T&I business, with the key asset being pipelay barge DB30, a highly reliable derrick lay barge with heavy-lift and pipelay capabilities.
- McDermott acquired a 30% stake in THHE Fabricators, also for US$24.5m cash. McDermott owns a 300-acre yard in Batam, Indonesia, giving an acreage boost to THHE, which has a 57-acre yard in Pulau Indah through THHE Fabricators.

Subsequently, THHE and McDermott formed a 50:50 engineering outfit, THHE McDermott Engineering, to seek Petronas work. The JV is currently working towards getting a Petronas licence by year-end.

2.2 Going up the value chain with a bigger asset base

Yard

Spanning 57 acres, THHE's yard is located at Pulau Indah Industrial Park, Selangor (Figure 1). It fronts the Straits of Malacca and is well-connected to three major ports, namely Westport, Northport and Southport. The yard has approximately 120,000 sq m of open area and 16,000 sq m of covered area. Its total capacity is around 10,000 tonnes p.a.

Figure 1: Pulau Indah fabrication yard

SOURCE: COMPANY

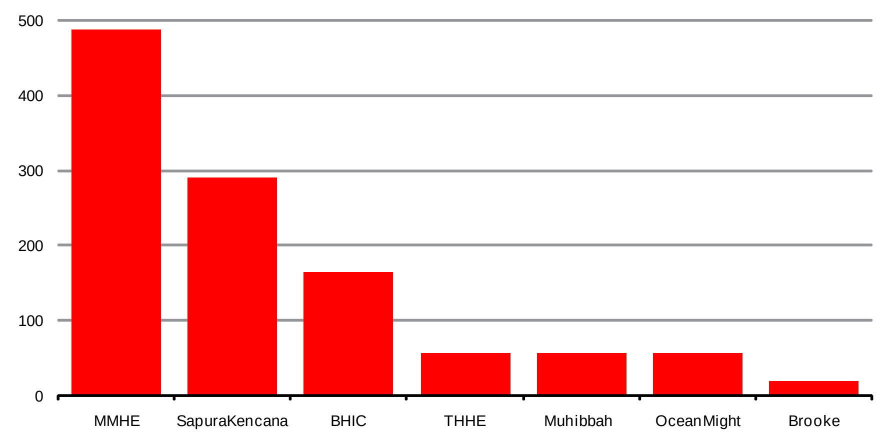
THHE's ownership of the yard reduces the uncertainties inherent in third-party reliance and internalises costs. Furthermore, given the covered space, the company is able to perform fabrication activities 24 hours a day in all-weather conditions. Also, it is a seafront yard, which means that the company is able to load structures onto transport vessels straight from the yard, thus reducing land transport costs.

THHE is one of seven Petronas licensees, all domestic, that are eligible to bid for engineering and construction contracts for offshore structures tendered by Petronas and its production sharing contractors (PSC) in Malaysia. Other licensees are SapuraKencana (SAKP MK, Add), Malaysia Marine and Heavy

Engineering (MMHE MK, Hold), Muhibbah Engineering (MUHI MK, Add), Boustead Heavy Industries Corp (BHIC MK, Not Rated), KKB Engineering's (KKB MK, Not Rated) unit OceanMight and Sarawak state-owned Brooke Dockyard. The licence is undoubtedly a major advantage as it automatically creates a significant barrier to entry for new operators.

In addition, THHE's 70:30 partnership with McDermott in THHE Fabricators could open a new chapter for the company. The partnership offers THHE access to McDermott's engineering capabilities and a 300-acre yard in Batam, allowing the company to bid for more lucrative and technically challenging jobs. Compared with other Petronas domestic fabrication licensees, namely MMHE which has a 488-acre yard in Pasir Gudang, Johor and SapuraKencana which has a 240-acre yard in Lumut, Perak and a 50-acre yard in Labuan, THHE's 57-acre yard is substantially small (Figure 2), hindering it from participating in large-scale jobs prior to the partnership with McDermott. Having said that, the size of a yard is by no means an indication of the operator's efficiency.

Figure 2: Petronas-licensed offshore fabricators and their yard size (acre)



SOURCES: COMPANY REPORTS

The location of THHE's yard in Pulau Indah is strategic, not only because it is well-connected to the three major ports, but also because it is away from the crowded Johor-Singapore-Batam area which has a high level of fabrication activities, resulting in a higher salary structure and rampant staff poaching among yards.

FPSO

THHE acquired DP1 (Figure 3), formerly the 68,000dwt tanker MV Laurita, in Jul 2011 for US$82.5m, which was just 41% of the US$200m the previous owner, Norway-based FPSO Ocean, spent building the vessel speculatively. The acquisition was made by THHE's then wholly-owned unit, Labuan-based Floatech. In Feb 2014, THHE sold 20% of Floatech to Kuala Lumpur-based Global Mariner Offshore Services (GMOS) for US$13.126m. The directors and shareholders of GMOS are Zahar Mohd Hashim Zainuddin (95.1%), Shafinaz Shaukat (4.3%) and Dato' Dr. Freezailah Che Yeom (0.6%). Zahar had spent more than 30 years with Petronas and its unit MISC before he retired as a vice-president of MISC in Mar 2010. In early Jul 2014, Goh Ban Huat (GBH MK, Not Rated) proposed to buy 35% of GMOS for RM38m cash.

Figure 3: Deep Producer 1

SOURCE: COMPANY

DP1 had been without a contract until May 2014 when THHE secured the contract from Nippon Oil for work at Layang. Under the contract, THHE will deliver and install DP1 at the project location and lease the vessel until Nov 2023 for the 9-year US$372m primary charter. Commercial production is expected to start in 2Q16.

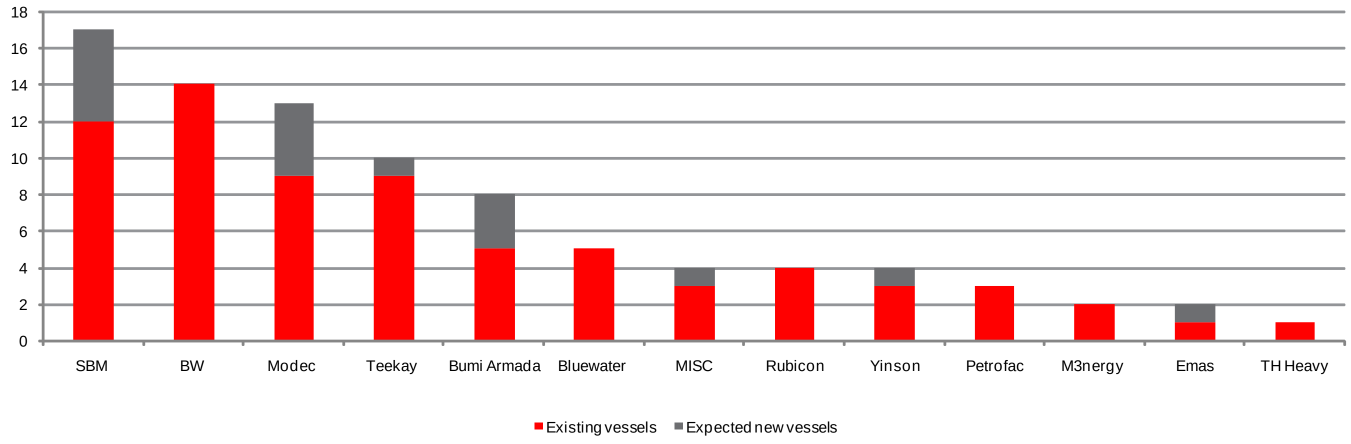
We understand that the plans call for natural gas produced from Layang and Helang to be supplied through subsea pipelines of approximately 200km long to the MLNG Tiga liquefaction plant, which is partly owned by JX Nippon Oil & Energy Corp, in Bintulu, Sarawak. The natural gas will be sold as liquefied natural gas after liquefaction while the condensate and Layang oil will be shipped from the FPSO vessel. After the expiry of the primary charter in Nov 2023, Nippon Oil has the option to extend the lease for up to 10 years with the maximum options valued at US$457m.

DP1 has a storage capacity of 400,000-500,000 barrels of oil with a lifespan of about 20 years. It was built in 1981 at a Japanese shipyard but was given a steel renewal programme at a Dubai dockyard last year.

THHE plans to acquire three more FPSO vessels over the next five years. The company is also keen to purchase a mobile offshore production unit (MOPU) to support Petronas's marginal field development projects. Last year, the company submitted a bid for a risk service contract (RSC) with a Singaporean party but the JV was not successful. However, the JV is still open to exploring RSC opportunities.

THHE is a newcomer in the FPSO business and counts these players as its competitors: Bumi Armada, MISC, Yinson (YNS MK, Not Rated), Perisai (PPT MK, Add) and privately-owned M3nergy. Bumi Armada leads the pack with eight FPSO vessels (Figure 4), followed by Yinson with four after it acquired Norway's Fred Olsen. M3nergy has two while Perisai has one in partnership with Ezra's (EZRA SP, Add) unit Emas Offshore. In the MOPU space, Perisai and MISC are the only Malaysian owners and operators.

Figure 4: FPSO ranking by fleet size



SOURCES: COMPANY REPORTS

DB30

THHE now has a foothold in the T&I business through a 30% interest in Berlian McDermott, which owns DB30 (Figure 5), a derrick lay barge with heavy-lift and pipelay capabilities. With this partnership, the market can expect THHE and McDermott to become a major contender for engineering, procurement, construction, installation and commissioning (EPCIC) projects, after SapuraKencana and MMHE.

Figure 5: DB30

SOURCE: COMPANY

Built in Japan in 1975, DB30 is among the oldest derrick lay barges that are working in the region but it is highly reliable and comes with a proven track record. In Malaysia, the biggest T&I player is SapuraKencana, which owns six derrick lay barges, followed by Perisai, Alam Maritim (AMRB MK, Add), Puncak Niaga's (PNH MK, Add) unit Global Offshore and Barakah (BARAKAH MK, Not Rated), which have one barge each. Perisai's barge, Enterprise 3, is owned on a 51:49 basis with Emas Offshore while Alam jointly owns barge 1MAS300 with Singapore-based Swiber (SWIB SP, Reduce).

Berlian McDermott is bidding for several T&I contracts, including sub-contractor packages for Petronas's Pan Malaysia project. To recap, in Dec 2013, Petronas awarded four T&I packages, worth about RM10bn, to three parties, namely Barakah (package A), Global Offshore (package B) and SapuraKencana (packages C and D). THHE, along with Perisai and Alam which did not manage to clinch the main packages, is in talks with these three winners for subcontract works. Work for subcontractors is expected to start in 3Q14.

DB30 is currently working on a 2-month spot contract in Brunei for Brunei Shell. It is scheduled to be mobilised to another project site in Southeast Asia upon the completion of the project in Brunei.

2.3 Record orders of RM1.6bn with further upside

Currently, THHE has an order book of RM1.6bn, which is an all-time high. 25% of the orders come from the fabrication business and 75% comes from the FPSO business. The fabrication contracts will keep the company busy until mid-FY15 while the FPSO order will last nine years, excluding the extension options. Notable fabrication projects are Murphy's Permas topsides, Lundin's Bertam wellhead platform and Petronas Carigali's Kinabalu topside (Figure 6).

Figure 6: Fabrication order book

Announcement date	Contract	Contract value (RMm)	Outstanding value (RMm)	Duration (months)	Client	Contract expiry
2-Apr-13	Permas topsides	196	61	16	Murphy	Aug-14
12-Nov-13	Bertam wellhead platform	120	80	12	Lundin	Nov-14
5-Feb-14	Kinabalu topside	250	222	18	Petronas Carigali	Aug-15
	Others	50	37	Various	Various	
	Total	**616**	**400**			

SOURCES: COMPANY, BMSB

THHE is bidding for RM1bn worth of fabrication projects, with the bulk of it coming from three fabrication jobs that are expected to be awarded by Petronas and its PSCs by year-end. The company's historical success rate is 15-20%. Its main competitors are SapuraKencana and MMHE among the locals while the foreign counterparts include Hyundai and Aker.

THHE's current orders are 100% domestic. Management believes that Malaysia is currently big enough a market for a company its size. Having said that, management is eyeing new markets, in particular Thailand, Australia and the Middle East, for potential future participation in the fabrication business.

Figure 7: SWOT analysis

Strengths	Opportunities
Ready in-house assets, i.e. yard, DP1, DB30	Petronas's capex for various segments
Record orders of RM1.6bn with further upside	Access to McDermott's assets and capabilities
Tabung Haji as the largest shareholder	Additional capacity at upgraded yard
Strong relationship with Petronas and McDermott	Opportunities in other Southeast Asian markets
Weaknesses	**Threats**
FPSO is capital intensive	Delay in conversion of FPSO vessel
Shortage of skilled personnel at the yard	Missing out on T&I work, which tends to be lumpy
Rising wage inflation	Substantial drop in oil price could curb E&P work
Dependence on domestic work	Entrance of new FPSO and T&I players

SOURCE: CIMB

3. SWOT ANALYSIS

In our view, THHE's main strength is the ownership of key assets, namely a yard, an FPSO vessel and a pipelay barge. The FPSO contract helps THHE crack into a niche business and ensures earnings visibility. We believe the complexity of the FPSO business highlights the company's edge and provides excellent long-term opportunities for competing internationally. Tabung Haji's backing as the largest shareholder provides a big comfort given its status as a state-owned company and its solid financial standing, raking in RM1.9bn net profit in 2012. Having said that, delayed completion of the FPSO conversion and a major reversal of the oil price could be dampeners on THHE's earnings growth (see the next section on Risks).

4. RISKS

4.1 Substantial drop in crude oil price

THHE's investments in the key assets are shored up by the expectations of higher exploration and production (E&P) activities. Should the crude oil price drop substantially in the near term, E&P activities may slow down, reducing the demand for the assets. However, we understand that as long as the oil price is north of US$60/barrel, most projects in Malaysia are viable. THHE operates 100% in Malaysia. Brent crude price is currently hovering at US$108/barrel, and last traded at US$60/barrel in 2009.

4.2 Delay in FPSO conversion

A hold-up in the conversion of the FPSO vessel may delay the start of the vessel's operations at Layang and subsequently, cause a setback in the income stream. Front-end and engineering design (FEED) work is ongoing at the Dubai dockyard and is slated for completion in less than two months. An invitation to bid for the conversion work will be put out in Aug 2014 for award in Oct 2014. The conversion work will take two years until Jun 2016. The converted vessel will then be mobilised to the project site in Sarawak waters.

5. FINANCIALS

5.1 Turnaround and PN17 exit in FY12

THHE had been an ailing company until its turnaround in FY12 when it reported a net profit of RM24m, a major reversal from FY11's net loss of RM11m, and emerged from PN17 status. However, its net profit plunged 66% to RM8m in FY13, mostly due to these factors:

- RM6m provision due to a delay in the delivery of the RM24m West Desaru fabrication of wellhead support structures for Aquaterra Energy in Johor. Management has assured us that it has fully provided for the project.
- Lower margins for the West Desaru project as well as D12 and Laila projects for Shell.

- Higher costs relating to projects under bidding and additional manpower. Salaries and wages jumped 122% from RM18m in FY12 to RM40m in FY13 as the number of employees rose from 229 in FY12 to 438 in FY13.

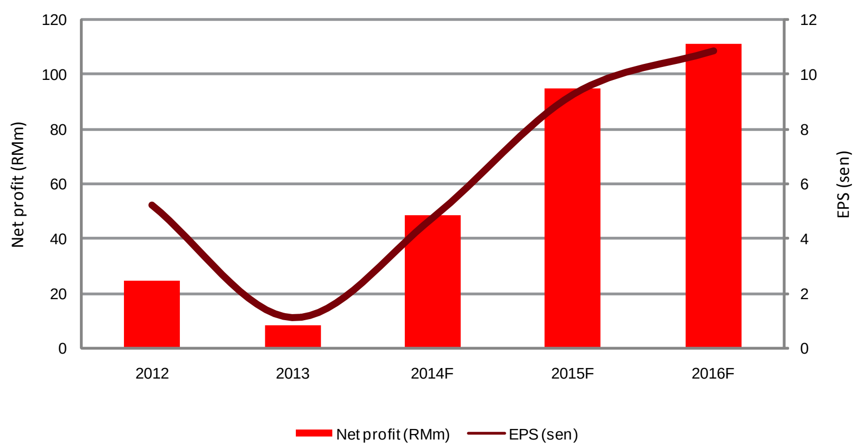
5.2 Doubling yard capacity to 20,000 tonnes p.a.

The Pulau Indah yard is currently 25% utilised but in anticipation of future projects, THHE is modernising and doubling the yard capacity from 10,000 tonnes p.a. to 20,000 tonnes p.a. The upgrade works are slated for completion by end-3Q14. With the upgraded yard, the company can, starting from 4Q14, take on a fabrication order book of up to RM1.2bn p.a. compared with RM400m p.a. currently. There is upside to the fabrication order book if the company acquires or leases neighbouring yard space, taking its yard capacity to around 80,000 tonnes p.a. and subsequently closing the capacity gap between THHE and the bigger yard operators, namely SapuraKencana and MMHE.

5.3 Record net profits; FPSO is a game-changer

From a net profit of RM8m in FY13, we forecast that THHE will scale new net profit highs of RM26m (+216% yoy) in FY14, RM75m (+190% yoy) in FY15 and RM99m (+32% yoy) in FY16 (Figure 8), fuelled by the company's three engines of growth 1) the bigger and upgraded yard in Pulau Indah, with the added boost from McDermott's yard in Batam, 2) the FPSO business through DP1, and 3) the T&I business through DB30.

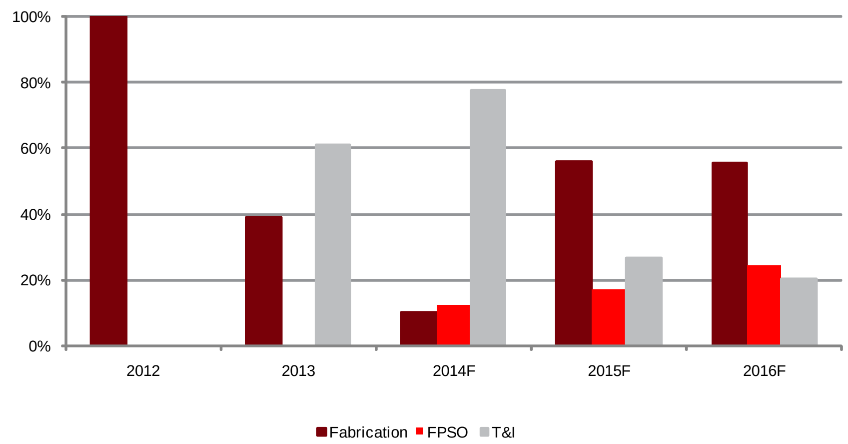
Figure 8: Net profit and EPS, FY12-16F



SOURCES: CIMB, COMPANY REPORTS

The FPSO business is a game-changer and will drastically change THHE's earnings profile but the FPSO income stream will not flow in substantially until 2H16 after the 2-year conversion period. Until then, the fabrication business will still be the major earnings driver, contributing around 55% to net profits in FY15-16 although we expect the contributions from the FPSO business to rise from 17% in FY15 to 24% to FY16 (Figure 9).

Figure 9: Net profit breakdown by business, FY12-16F



SOURCES: CIMB, COMPANY REPORTS

5.4 Sector -beating 3-year EPS CAGR of 106%

We project a very robust 3-year EPS CAGR of 106%, the highest in the sector, and substantially above the sector average of 34% (Figure 12):

- Contributions from the Permas and Bertam fabrication projects, which will be completed in 2H, and the start of the Kinabalu fabrication project, as well as the first full-year contribution from 30%-owned DB30 underpin our 130% EPS growth forecast in FY14 (Figure 8).
- Contributions from the Kinabalu project, which will be completed in 2H, and more work at the expanded yard boost our FY15 EPS by 190% (Figure 8).
- The start of DP1 operations at Layang in Jun after the 2-year conversion supports our 32% EPS growth forecast in FY16 (Figure 8).

5.5 Strengthening margins and asset turnover

THHE's ROEs are expected to rise from 2.2% in FY12 to 17.6% in FY15 (Figure 10), in line with the bottomline improvement that leads to new net profit highs in FY14-16. We expect EBIT margins to expand from 0.3% in FY12 to 14.9% in FY16 (Figure 10) as the company realises increasing contribution from the high-margin FPSO operations. We also expect asset turnover to climb from 0.23x in FY14 to 0.68x in FY16 (Figure 10), reflecting the company's growing efficiency in using its assets to generate sales.

Figure 10: Dupont analysis

FYE Dec	2012	2013	2014F	2015F	2016F
ROE (%)	10.4	2.2	6.1	16.3	17.6
Tax & MI retention (%)	79.8	(840.9)	88.4	74.0	73.2
Interest burden (%)	90.8	(143.3)	165.7	111.0	105.7
EBIT margin (%)	17.5	0.3	7.2	12.0	14.9
Asset turnover (x)	0.38	0.35	0.23	0.62	0.68
Equity multiplier (x)	2.13	2.02	2.51	2.68	2.26

SOURCES: CIMB, COMPANY REPORTS

5.6 RM950m capex to support yard and FPSO vessel

THHE has allocated RM950m in capex for FY14 and FY15, of which up RM750m will be used for the FPSO operations and RM200m for the yard operations. The company is looking to undertake a fundraising exercise in 4Q14 to raise an estimated RM500m to part-finance the capex. This exercise could see the entrance of a third major shareholder, after Tabung Haji and Tan Seri Quek who collectively own 38% of the company.

Assuming a combination of a 20% placement of new shares at RM0.82/share and bank borrowings, FY14-16 EPS would be diluted by around 17% and net gearing would rise from 0.5x as at 30 Mar 2014 to 1.2x.

A unit of Tabung Haji, THHE naturally puts emphasis on Islamic instruments for its fundraising exercise. The stock is currently syariah-compliant and management intends to keep it that way. A dividend target has not been set.

5.7 Lower-than-statutory effective tax rate

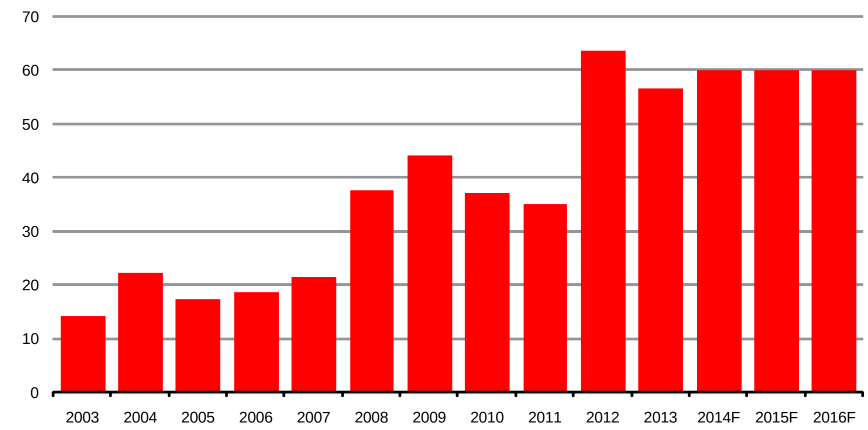
We forecast an effective tax rate of 5% in FY14-16, thanks to offshore leasing activities and unabsorbed losses amounting to around RM150m. Registered in Labuan, DP1 is subject to a fixed maximum tax rate of RM20,000/year under the Labuan Offshore Business Activity Act 1990.

6. VALUATION AND RECOMMENDATION

6.1 Beneficiary of Petronas's spending

High capital spending levels are contingent on continued high oil prices but national oil companies are especially bullish about boosting their spending, with more of it to be ploughed into E&P. Petronas plans to spend a total of RM300bn over a 5-year period starting 2012 (Figure 11). With 100% of its revenue generated in Malaysia, THHE is no doubt capitalising on Petronas's capex and the growth offered by the sector in Malaysia.

Figure 11: Petronas's capex, 2003-16F (RMbn)



SOURCES: CIMB, COMPANY REPORTS

6.2 Growing record order book further

THHE has an order book of RM1.6bn, which is an all-time high. The fabrication contracts, which account for 25% of the orders, will keep the company busy until mid-FY15 while the FPSO contract, which makes up the remaining 75% of the jobs in hand, will last nine years, excluding the extension options. Nonetheless, management is active in scouting for new fabrication contracts to fill up its expanded yard.

6.3 Highest growth, cheapest valuations

THHE is the most attractive growth story in our oil & gas portfolio, offering a sector-beating 3-year EPS CAGR of 106% vs. the sector average of 34%. Yet, its valuations are the cheapest at 8-12x FY15-16 earnings (Figures 12-13). Earnings visibility is solid given the FPSO contract.

6.4 Initiate with Add and RM1.20 target price

We begin coverage with an Add call and a target price of RM1.20. We value the stock at a CY15 P/E of 16.4x, a 30% discount to the average P/E of the oil & gas big caps. We also attach a 30% discount to other small-cap names, i.e. Perisai, Perdana (PETR MK, Add), Wah Seong (WSC MK, Add), Uzma (UZMA MK, Add) and Alam. There is 48% upside to our target price, well above the market's expected returns. A bigger yard and a successful FPSO and T&I ventures are the potential re-rating catalysts that support our Add rating. THHE replaces Perisai as our top pick among the oil & gas small caps.

Figure 12: Sector comparisons

Company	Bloomberg Ticker	Recom.	Price (local curr)	Target Price (local curr)	Market Cap (US$ m)	Core P/E (x)		3-year EPS CAGR (%)	Recurring ROE (%)		Dividend Yield (%)	
						CY2014	CY2015		CY2014	CY2015	CY2014	CY2015
Dialog Group	DLG MK	ADD	1.84	4.16	2,964	14.6	11.6	20.0%	24.7%	27.1%	2.0%	2.1%
Malaysia Marine & Heavy Eng	MMHE MK	HOLD	3.56	3.98	1,789	21.8	20.2	21.6%	10.7%	11.9%	1.7%	2.0%
Perdana Petroleum	PETR MK	ADD	1.86	2.40	431	14.2	12.8	30.4%	15.9%	17.0%	0.0%	0.0%
Perisai Petroleum	PPT MK	ADD	1.52	2.37	570	23.8	10.5	26.7%	8.8%	20.9%	0.0%	0.0%
Petronas Dagangan	PETD MK	HOLD	20.72	26.00	6,467	25.3	18.6	10.5%	9.0%	10.6%	2.3%	2.3%
SapuraKencana Petroleum	SAKP MK	ADD	4.38	7.00	8,245	16.3	14.6	26.6%	19.2%	21.8%	0.6%	0.7%
TH Heavy Engineering	RH MK	ADD	0.82	1.20	261	32.2	11.1	106.1%	6.4%	16.8%	0.0%	0.0%
UMW Oil & Gas	UMWOG MK	ADD	4.11	5.18	2,791	27.7	18.5	39.9%	15.7%	40.1%	0.5%	0.7%
Uzma	UZMA MK	ADD	3.90	4.68	323	15.6	13.7	17.9%	24.3%	24.0%	0.0%	0.0%
Wah Seong Corp	WSC MK	ADD	1.89	2.72	459	10.8	10.5	38.6%	16.4%	24.0%	3.7%	4.0%
Average						**20.2**	**14.2**	**33.8%**	**15.1%**	**21.4%**	**1.1%**	**1.2%**

SOURCES: CIMB, COMPANY REPORTS

Figure 13: Core P/E, CY2014-16 (x)

Company	2014	2015	2016
Dialog Group	14.6	11.6	10.1
Malaysia Marine & Heavy Eng	21.8	20.2	16.4
Perdana Petroleum	14.2	12.8	10.5
Perisai Petroleum	23.8	10.5	10.2
Petronas Dagangan	25.3	18.6	18.5
SapuraKencana Petroleum	16.3	14.6	13.6
TH Heavy Engineering	32.2	11.1	8.4
UMW Oil & Gas	27.7	18.5	17.0
Uzma	15.6	13.7	9.3
Wah Seong Corp	10.8	10.5	12.4
Average	**20.2**	**14.2**	**12.7**

SOURCES: CIMB, COMPANY REPORTS

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The survey result is as of the date appearing in the Corporate Governance Report of Thai Listed Companies. As a result, the survey result may be changed after that date. CIMBS does not confirm nor certify the accuracy of such survey result.

Score Range:	90 - 100	80 - 89	70 - 79	Below 70 or	No Survey Result
Description:	Excellent	Very Good	Good	N/A	

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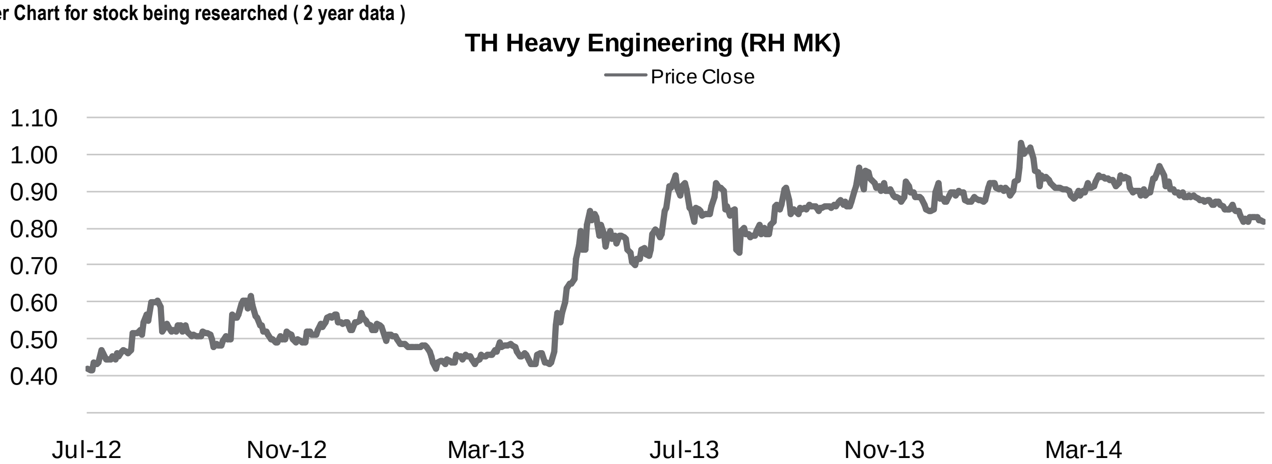
Distribution of stock ratings and investment banking clients for quarter ended on 30 June 2014 1467 companies under coverage for quarter ended on 30 June 2014		
	Rating Distribution (%)	Investment Banking clients (%)
Outperform/Buy/Trading Buy/Add	58.9%	7.2%
Neutral/Hold	27.9%	3.9%
Underperform/Sell/Trading Sell/Reduce	13.2%	1.0%

Spitzer Chart for stock being researched (2 year data)



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CIMB Recommendation Framework #1

Stock Ratings	**Definition**
Add	The stock's total return is expected to exceed 10% over the next 12 months.
Hold	The stock's total return is expected to be between 0% and positive 10% over the next 12 months.
Reduce	The stock's total return is expected to fall below 0% or more over the next 12 months.

The total expected return of a stock is defined as the sum of the: (i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock.
Stock price targets have an investment horizon of 12 months.

Sector Ratings	**Definition**
Overweight	An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation.
Neutral	A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
Underweight	An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

Country Ratings	**Definition**
Overweight	An Overweight rating means investors should be positioned with an above-market weight in this country relative to benchmark.
Neutral	A Neutral rating means investors should be positioned with a neutral weight in this country relative to benchmark.
Underweight	An Underweight rating means investors should be positioned with a below-market weight in this country relative to benchmark.

CIMB Stock Recommendation Framework #2 *

Outperform	The stock's total return is expected to exceed a relevant benchmark's total return by 5% or more over the next 12 months.
Neutral	The stock's total return is expected to be within +/-5% of a relevant benchmark's total return.
Underperform	The stock's total return is expected to be below a relevant benchmark's total return by 5% or more over the next 12 months.

Trading Buy	The stock's total return is expected to exceed a relevant benchmark's total return by 3% or more over the next 3 months.
Trading Sell	The stock's total return is expected to be below a relevant benchmark's total return by 3% or more over the next 3 months.

** This framework only applies to stocks listed on the Singapore Stock Exchange, Bursa Malaysia, Stock Exchange of Thailand, Jakarta Stock Exchange, Australian Securities Exchange, Taiwan Stock Exchange and National Stock Exchange of India/Bombay Stock Exchange. Occasionally, it is permitted for the total expected returns to be temporarily outside the prescribed ranges due to extreme market volatility or other justifiable company or industry-specific reasons.*
CIMB Research Pte Ltd (Co. Reg. No. 198701620M)

CIMB Stock Recommendation Framework #3 **

Outperform	Expected positive total returns of 10% or more over the next 12 months.
Neutral	Expected total returns of between -10% and +10% over the next 12 months.
Underperform	Expected negative total returns of 10% or more over the next 12 months.
Trading Buy	Expected positive total returns of 10% or more over the next 3 months.
Trading Sell	Expected negative total returns of 10% or more over the next 3 months.

*** This framework only applies to stocks listed on the Korea Exchange, Hong Kong Stock Exchange and China listings on the Singapore Stock Exchange. Occasionally, it is permitted for the total expected returns to be temporarily outside the prescribed ranges due to extreme market volatility or other justifiable company or industry-specific reasons.*

Corporate Governance Report of Thai Listed Companies (CGR). CG Rating by the Thai Institute of Directors Association (IOD) in 2013.
AAV – Good, **ADVANC** - Excellent, **AMATA** - Very Good, **ANAN** – Good, **AOT** - Excellent, **AP** - Very Good, **BANPU** - Excellent , **BAY** - Excellent , **BBL** - Excellent, **BCH** – Good, **BCP** - Excellent, **BEC** - Very Good, **BGH** - not available, **BJC** – Very Good, **BH** - Very Good, **BIGC** - Very Good, **BTS** - Excellent, **CCET** – Very Good, **CENTEL** – Very Good, **CK** - Excellent, **CPALL** - Very Good, **CPF** – Excellent, **CPN** - Excellent, **DELTA** - Very Good, **DTAC** - Excellent, **EGCO** – Excellent, **GLOBAL** - Good, **GLOW** - Very Good, **GRAMMY** – Excellent, **HANA** - Excellent, **HEMRAJ** - Excellent, **HMPRO** - Very Good, **INTUCH** – Excellent, **ITD** – Very Good, **IVL** - Excellent, **JAS** – Very Good, **KAMART** – not available, **KBANK** - Excellent, **KKP** – Excellent, **KTB** - Excellent, **LH** - Very Good, **LPN** - Excellent, **MAJOR** – Very Good, **MAKRO** – Very Good, **MCOT** - Excellent, **MEGA** – not available, **MINT** - Excellent, **PS** - Excellent, **PSL** - Excellent, **PTT** - Excellent, **PTTGC** - Excellent, **PTTEP** - Excellent, **QH** - Excellent, **RATCH** - Excellent, **ROBINS** - Excellent, **RS** – Excellent, **SAMART** – Excellent, **SC** – Excellent, **SCB** - Excellent, **SCC** - Excellent, **SCCC** - Very Good, **SIRI** – Very Good, **SPALI** - Excellent, **STA** - Good, **STEC** - Very Good, **TCAP** - Excellent, **THAI** - Excellent, **THCOM** – Excellent, **TICON** – Very Good, **TISCO** - Excellent, **TMB** - Excellent, **TOP** - Excellent, **TRUE** - Excellent, **TTW** – Excellent, **TUF** - Very Good, **VGI** – Excellent, **WORK** – Good.