Stock Digest

Initiating Coverage - OCK Group Bhd

Tuesday, 31 May, 2016

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On A Higher Plane

Investment Highlights

- We initiate coverage on OCK Group Bhd (OCK) with a **BUY** recommendation and a target price of RM1.00. We like OCK for its strong growth prospects from its ongoing business expansion, both domestically and overseas, that will also provide long-term regenerative earnings. Our call is also premised on the group's position as the largest telecommunication service provider in Malaysia.
- OCK has a good business mix as both its mechanical & electrical engineering services and trading segments complements its core telecommunication network services segment, creating a synergy to its overall business model. Meanwhile, its green business and power solutions segment offers stable recurring income.
- The group is currently on a regional expansion phase through its relatively large scale venture into Indonesia and its long-term investment in Myanmar. Going forward, earnings growth will emanate from its Myanmar venture which will see additional income from the construction and leasing of 920 telecommunication towers by end-2016. Meanwhile, both the Malaysian and Indonesia businesses will focus on increasing the ownerships of telecommunication tower sites.
- We expect OCK to register double digit three-year net profit and revenue CAGRs of 13.3% and 21.8% to reach RM31.7 mln and RM468.5 mln respectively by 2017. We arrive at our target price by ascribing a sum-of-parts (SOP) approach as we value its telecommunication network services and green energy & power solutions business segments with a discounted cash flow approach (WACC: 9.0%, Terminal Growth: 1.5%); whereas we ascribe a fully-diluted 15.0x PER to both its 2017 trading and mechanical & electrical engineering services businesses.

Financial Highlights

FYE Dec (RM mln)	2013A	2014A	2015A	2016F	2017F
Revenue	152.2	185.9	315.9	402.5	468.5
EBITDA	26.0	32.3	50.2	60.7	73.4
Net Profit	13.6	15.6	24.7	29.0	31.7
Revenue Growth (%)	*9.8*	*22.2*	*69.9*	*27.4*	*16.4*
EBITDA Growth (%)	*16.3*	*24.0*	*55.5*	*20.9*	*21.0*
Net Profit Growth (%)	*3.3*	*14.8*	*58.6*	*17.2*	*9.5*
EPS (sen)	1.7	2.0	3.1	3.7	4.0
Diluted EPS (sen) *	N/A	N/A	N/A	3.3	3.5
P/E (x)	47.0	40.9	25.8	22.0	20.1
Diluted P/E (x) *	N/A	N/A	N/A	24.5	22.7
Dividend Yield (%)	0.2	0.0	0.7	0.7	0.7
P/BV (x)	7.62	3.41	1.86	N/A	N/A
ROE (%)	16.2	8.3	7.2	N/A	N/A

** Based on enlarged share capital of 1.06 bln outstanding shares (After adjusting for full warrant conversion)*

Source: Company Data & MSSB Research

Recommendation: BUY

Share Price: RM0.805
Target Price: RM1.00

Key Statistics

Stock Code: 0172

Stock Information: Engaged in the provision of telecommunications network services as well as green energy and power solutions

Sector: Trading/Services

Industry: Professional & Technical Specialty Services

Listing: Main Market

Share Issued (mln): 792.2

Market Capital (RM mln): 641.7

Par Value (RM): 0.10

Major Shareholders:

Aliran Armada Sdn Bhd	39.8%
Lembaga Tabung Angkatan Tentera (LTAT)	13.6%
He Swee Hong	3.1%

Recommendation

We like OCK for its established track record and position as the largest telecommunication service provider in Malaysia, couple with its strong growth prospects in the Myanmar venture. The group has already established itself in a niche position as a one-stop solutions provider for the telecommunication network services industry, managing approximately 4,300 and 20,000 telecommunication sites in Malaysia and Indonesia respectively, while its green business and power solutions segment generates a stable recurring income.

OCK is riding on Myanmar's telecommunication market expansion as the country is gearing towards expanding its network coverage and improving service quality to satisfy consumers demand for better infrastructure and services to support their voice and non-voice transmissions. This is demonstrated by the recent entry of two global telecommunication giants – Telenor and Ooredoo, into the country and OCK's contract with the former will provide the company with its next wave of earnings growth.

On the local front, OCK is aiming to increase the number of its managed telecommunication sites. Accordingly in Budget 2016, an allocation of RM1.20 bln will be provided to the Malaysia Communications and Multimedia Commission (MCMC) to improve the telecommunication infrastructure in the country. The recent rapid deployment of the Long Term Evolution (4G) services has also led to an indirect increase in the demand for additional telecommunication towers in both urban and rural areas, potentially providing another area that OCK could capitalise on, given its market leader position.

At current price of RM0.805, we think OCK is attractive, trading at prospective 2016 and 2017 PERs of 22.0x and 20.1x, which are at discount to its regional peer averages of 25.9x and 24.5x respectively. We are sanguine on OCK growth prospects, backed by its established track record, coupled with its position as the leading telecommunication service provider in Malaysia. At the target price of RM1.00, OCK will trade an implied PER of 27.3x and 25.0x for 2016 and 2017 respectively, which is slightly ahead of its regional peers, but fair, in our opinion, given its strong growth prospects over the next two years.

Investment Risk

Risks to our recommendation include rising raw material costs. OCK's business is heavily dependent on steel prices. Steel costs accounts to slightly below 40.0% of the group's costs of construction in 2015. Any fluctuation in steel prices could dampen its margins growth going forward.

Any project delay could impact its income growth and cash flow, as the group is operating in a capital intensive industry. Delays in project completion will result in cost overrun and penalties. These events could also damage the company's reputation and affect the company's ability in securing future contracts.

The increasing mode of sharing of network telecommunications sites, as encouraged by the Government, could potentially lead to slower demand growth for telecommunication towers. Already, DiGi and Celcom have implemented an integration project for infrastructure collaboration.

Company Background

Established in 2000, OCK is principally involved in the provision of telecommunication network services. The group offers full turnkey solutions to its clients, including: i) network planning, design and optimisation, ii) network deployment, iii) network operations and maintenance, iv) infrastructure management, v) energy management, and vi) professional services.

In addition to providing telecommunication network services, OCK also has three other business segments which encompass;

- Green Energy and Power Solutions
- M&E engineering Services
- Trading of Telecommunication and Network Products

Recognising the potential of the renewable energy industry, OCK ventured into green energy and power solutions as a contractor for third parties as well as ownership of solar farms to derive recurrent earnings. It also provides power generation equipment (e.g. engine generators and transformers) and installation, commissioning as well as testing services.

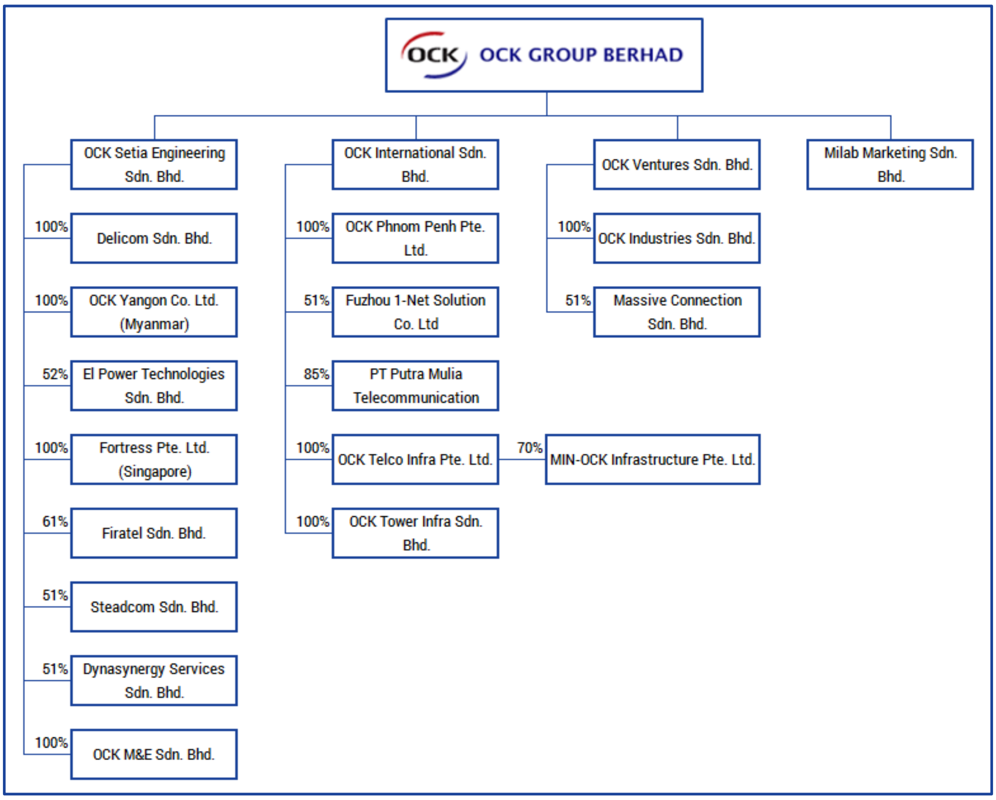
Meanwhile, OCK's M&E Engineering services business provides mechanical and electrical services to housing development projects, commercial high-rise buildings, factories, infrastructures, airports, medical centres and hotels.

The trading segment supplies telco hardware and installation materials such as antennas, feeder cables, connectors to other telco network service providers as well as supplements the group's internal needs.

OCK was listed on the Ace Market of Bursa Malaysia on 17th July 2012 and subsequently in 20th November 2014, the group successfully transferred its listing to the Main Market of Bursa Securities Malaysia. This significant milestone reflects OCK's commitment to its long-term growth via a conscientious global expansion and recurring income strategies, which was further fortified by establishments of its overseas venture such as Fortress (Singapore), OCK Phnom Penh (Cambodia), OCK Yangon (Myanmar), Fuzhou 1 Net (Fuzhou, China) and PT Putra Mulia Telecommunication (PMT), Indonesia.

Among its shareholders, the company counts on several local institutional funds such as Lembaga Tabung Angkatan Tentera (LTAT), Employees Provident Fund (EPF), and Great Eastern Life Assurance (Malaysia) Bhd amongst its thirty largest shareholders. The inclusion of these institutional funds is a testament of the group's strength in the telecommunication network services industry.

Corporate Structure



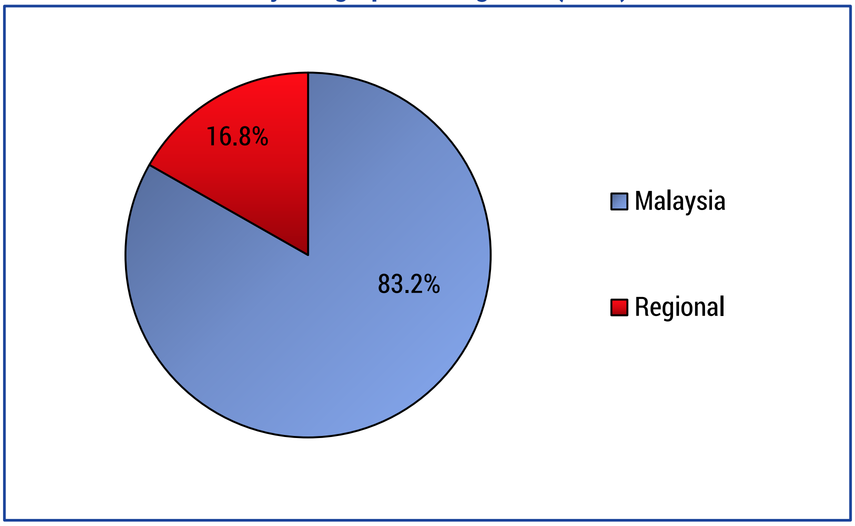
Source: Company Data

Business Segments and Outlook

In 2015, OCK's EBITDA stood at RM50.2 mln on the back of revenue of RM315.9 mln, translating to an EBITDA margin of 15.9%. The group's EBITDA margin has been fluctuating between the low of 15.9% to a high of 17.4% over the past four years as the strong contributions from the telecommunication network services and trading segment, which collectively contributed to approximately 87.2% of the group's EBITDA in 2015, offsets the lower margins from the green energy & power solutions segment.

OCK's turnover is predominantly from Malaysia with RM262.8 mln, or 83.2% of its total revenue of RM315.9 mln in 2015 derived locally. As part of OCK's long-term growth plans and diversification, the group has established its presence in regional markets, particularly in Indonesia and Myanmar market.

Revenue Contribution By Geographical Segment (2015)

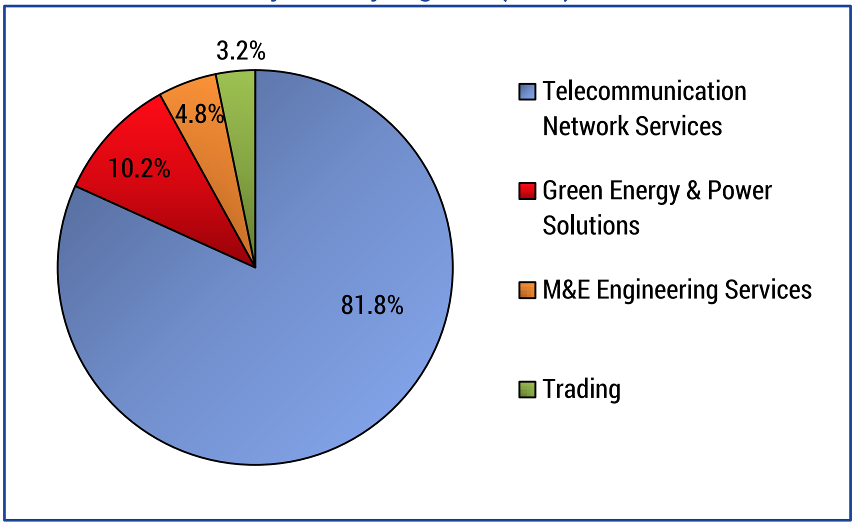


Source: Company Data

The group's clientele comprises a wide range of notable telecommunication services providers both local and international such as;

Source: Company Data

Revenue Contribution By Industry Segment (2015)

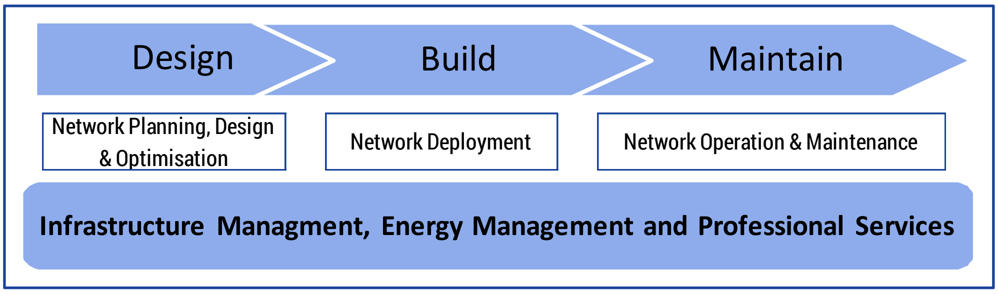


Source: Company Data

Telecommunication Network Services

OCK is a one-stop solutions provider for the telecommunication services industry. The group offers a wide range of services including: (i) network planning, (ii) network deployment, (iii) network operations & maintenance, (iv) energy management, (v) infrastructure management and (vi) other professional services.

Main Segments of Telecommunication Network Services



Source: Company Data

The network planning, design and optimisation is the first stage in the telecommunication network services process. It involves work related to network engineering design in the wired and wireless domain to ensure the services offered meets the need of subscribers or telecommunication operators.

The network deployment stage is when work, including civil, mechanical, electrical infrastructure and telecommunications network equipment for wired and wireless domains are rolled-out. This process involves sourcing or raw materials for the construction of network sites.

Network operations and maintenance process is to ensure the network is operating at an efficient manner, whilst reducing operational costs from down time. Generally, the aforementioned process runs for a period of between one-to-12-months which support the automation of main business processes such as design, planning, fulfillment, assurance and billing. There are two types of maintenance processes: (i) corrective maintenance involves rectifying issues related to network and breakdown, while (ii) preventive maintenance is schedule on a planned basis to ensure the system operates without any disruption.

Infrastructure management process will optimise both the active and passive network infrastructure for higher utilisation of capacities. Some examples of infrastructure management include natural or manmade disaster data/project recovery, documentation management, project management, licensing and site acquisition.

The energy management process revolves around steps to ensure the energy level is optimised and sufficient for consumption. It is also a cost-saving measure to tackle the capital-intensive investment, which is the nature of the telecommunication network services industry.

Lastly, the professional services involve the provision of skilled workers across all disciplines to provide specific or end-to-end expertise to customers. It also involves the provision of other logistic services for project purposes.

Today, OCK manages approximately 4,300 telecommunication sites in Malaysia and approximately 20,000 of the total 80,000 telecommunication sites in Indonesia – the latter via is 85.0%-owned subsidiary, PT Putra Mulia Telecommunications.

In 2015, OCK's core business, the telecommunication network services segment contributed a total of 84.4% to the group's total revenue. The aforementioned segment yields a pretax profit margin of 13.7% in 2015 – the second lowest across its four business segments.

Types of Telecommunication Towers

Monopole Tree | Concrete Lamp Pole | Three-legged tower | Unipole | Minimast

Source: Various

Going forward, OCK plans to focus on building its streams of recurring income. The group's 85.0%-owned subsidiary, PT Putra Mulia Telecommunication which was acquired in mid-2014, has almost doubled its maintenance of telecommunication sites to approximately 20,000 in 2015 (from approximately 11,000 in 2014). As a result, the group's regional revenue contribution has surged 339.7% Y.o.Y to RM53.4 mln in 2015.

The group also has both the Network facility provider (NFP) and Network Service Provider (NSP) license from the Malaysian Communications and Multimedia Communications (MCMC). This allows OCK to build, own and rent telecommunication towers and rooftop structures to the eight telecommunication operators in Malaysia. These telecommunication towers operate on as tower sharing basis, which is cost effective for telecommunication operators. On the domestic front, OCK aims to construct additional 100 telecommunication towers for U Mobile in Malaysia. The management is also eyeing to tie up with Lembaga Tabung Angkatan Tentera (LTAT), by forming a joint-venture for the construction of Automated Enforcement System (AES) pole structures in Malaysia.

In order to capitalise on the potential exponential growth in the telecommunication industry in Myanmar, OCK has inked a master services agreement with Telenor Myanmar Limited (Telenor) in 2015 to lease telecommunication towers to the later. The group has also embarked into a corporate exercise involving a rights issue to raise up to RM132.0 mln to fund the expenditure.

Following the completion of the aforementioned corporate exercise in 4Q2015, OCK will utilise 98.2% or RM129.7 mln from the proceeds as part of its US$75.0 mln (RM300.0 mln) capital expenditure to build and lease 920 telecommunication towers over the next 12 years, plus additional 3 x 5 year lease to Telenor in Myanmar by end-2016. OCK has identified over 600 sites and the first telecommunication tower was constructed in May 2016. The group aims to build additional 1,000 telecommunication towers in both 2017 and 2018 respectively, bringing a total of approximately 3,000 telecommunication towers.

OCK will allocate US$70.0 mln as CAPEX for the construction of 1,000 telecommunication towers in 2017. Given the relatively large scale CAPEX requirement, the group will undertake additional both offshore and onshore term loans the fund the expansion plan.

Going forward, we think that the abovementioned segment will continue to anchor the group's revenue contribution for the foreseeable future, owing to the group's established market in both Malaysia and Indonesia, coupled with the group's on-going long-term expansion plan into Myanmar.

Green Energy & Power Solutions

The green energy business & power solutions segment was the second largest revenue contributor, amounting to 10.2% or RM32.2 mln of OCK's total revenue in 2015.

However, the above said segment only yields a pretax profit margin of 3.1% in 2015 – the lowest amongst its four business segments. OCK ventured into the green energy and power solutions business in October 2013 a part of the group's strategy to diversify its business in a bid to generate a steady stream of recurring income. A total of RM20.0 mln was spent as CAPEX for the venture over the past four years, while the concession period is for a period of 12 years, expiring in 2025.

Today, OCK solar power generation capacity amounts to a total of 2.15 megawatts (MW) harvested from a ground solar farm and three rooftop solar farms; all located in Kelantan. We also note that OCK has recently secured two new rooftop solar farms that has a capacity of 425 & 208 kW respectively, will be completed in 2017, coupled with a new 1.0 MW solar farm which will contribute to its earnings from 2H2016. In addition, the group has established a strong track record, having completed the engineering, procurement and construction (EPC) of the single largest solar farm in Malaysia with a capacity of 10 MW in Sepang.

Solar Farms

Source: Company Data

Meanwhile, the power solutions business segment is engaged in the supply, installation, commission and testing services for power generation equipment such as engine-generators and transformers that are used as back up electricity generators for commercial, retail and factory buildings. We think that the contribution in the abovementioned segment will remain insignificant in the foreseeable future, premised on the group's main focus on expanding its telecommunication network services segment.

Mechanical & Electrical Engineering Services

The mechanical & electrical engineering services segment contributed to 4.8% or RM15.2 mln to the OCK's total revenue in 2015. Although contribution at the top line was minimal, the aforementioned segment yields a decent pretax profit margin of 18.5% in 2015.

Mechanical and electrical engineering works are conducted on a sub-contract basis, including electrical wiring, high tension & low-voltage overhead line services, air-conditioning & mechanical ventilation systems, fire-fighting & protection systems and plumbing & sanitary services. The works are to ensure that the household or business entities such as hospitals, high rise buildings, factory, airport and hotel operate at an efficient manner. Going forward, this segment's outstanding orderbook of approximately RM80.0 mln will be recognised over the next two years.

Trading

Lastly, the trading segment constitutes 3.2% or RM10.2 mln of the group's total revenue in 2015. However, this segment generates the highest pretax profit margin of 23.9% in 2015, translating into a pretax profit of RM2.4 mln. OCK trades various telecommunication and network products such as wide band hybrid combiner, radio frequency (RF) cables and panel antenna.

Earnings Outlook

We estimate OCK could register a blended EBITDA margin of between 15.0%-16.0% over the next two years, close to its historical four-year average of 16.6% on the back of the higher contribution from the telecommunication network services segment, which yielded a decent EBITDA margin of 15.9% in 2015. We also expect the aforementioned segment to continue to dominate the group's sales mix, accounting to approximately 84.0%-85.0% of the group's total revenue over the next two years.

For 2016, we forecast OCK's revenue and EBITDA to record a new high of RM402.5 mln (+27.4% Y.o.Y) and RM60.7 mln (+20.9 Y.o.Y) respectively, owing to the additional contributions from the 920 telecommunication sites in Myanmar, coupled with the on-going business operations in both Malaysia and Indonesia. 2016's net profit is expected to improve by 17.2% Y.o.Y to RM29.0 mln, translating to a marginally lower net profit margin of 7.2% (vs. 7.8% recorded in 2015), due to the higher start-up costs to fund its business expansion plans, specifically for the Myanmar venture.

For 2017, we expect revenue to improve 16.4% Y.o.Y to RM468.5 mln on an additional 1,000 telco sites to be built and leased to Telenor Myanmar, while its EBITDA is expected to grow 21.0% Y.o.Y to RM73.4 mln. OCK's net profit, however, is expected to improve at a slower pace of 9.5% Y.o.Y to RM31.7 mln, which translates to a marginally lower net profit margin of 6.8% due to the increase in both depreciation and finance cost to fund its expansion plans. The management has also guided that OCK's net gearing level is expected to swell up to slightly above 1.0x by 2017 (from a net cash position of RM75.2 mln as of 31st December 2015) due to additional borrowings required to fund its Myanmar expansion plan. An additional US$70.0 mln will be required as CAPEX in 2017 for its telecommunication network services segment.

With total of 3,000 telecommunication towers constructed and maintained by OCK in Myanmar by end-2017, coupled with the increasing number of telecommunication sites that OCK is maintaining in both Malaysia and Indonesia, we project a three-year revenue CAGR of 22.2% and a three-year net profit CAGR of 12.9% to reach RM472.0 mln and RM31.5 mln respectively by 2017.

We also note that OCK does not adopt a formal dividend policy as existing funds are required to finance its high CAPEX requirements. However, the management does not discount the possibility of rewarding its shareholders with dividends in the foreseeable future.

For 1Q2016, OCK's net profit gained 21.2% Y.o.Y to RM3.7 mln on higher contribution from its regional telecommunication network services segment, coupled with higher contract works locally. Revenue for the quarter gained 39.7% Y.o.Y to RM78.4 mln. Although the reported earnings fell short of our forecast, accounting to 12.8% and 19.5% of our full year net profit and revenue forecast of RM29.0 mln and 402.5 mln respectively, we expect the earnings to recover in coming quarters given that the first quarter results are historically softer due to seasonal factors and the contributions from its Myanmar will accelerate from 3Q2016 onwards.

Valuation

We value OCK through a sum-of-parts (SOP) approach as we valued its telecommunication network services and green energy & power solutions business segments on a discounted cash flow approach (key assumptions include a WACC of 9.0%, Terminal Growth rate of 1.5%) to reflect its ability to generate recurring revenues and steady earnings growth over the longer term. Meanwhile, we ascribe a 15.0x PER to both its fully-diluted trading and mechanical & electrical engineering services business, based on their potential earnings contribution in 2017.

At the target price of RM1.00, OCK will trade at implied PERs of 27.3x and 25.0x for 2016 and 2017 respectively, which is close to its peers in the similar industry. We compare OCK to its regional peers as there is no other significant listed player in the country with similar business profile.

Peer Comparison

	BALI TOWERIN	SARANA MENARA	TOWER BERSAM	OCK	AVERAGE
FYE	**Dec**	**Dec**	**Dec**	**Dec**	
Share Price @ 30, May 2016	990*	4000*	6525*	0.81	
Market Capitalisation (mln)	3548.3*	40811.7*	31297.3*	637.8	
P/E 2015 (x)	22.0	16.4	19.3	25.8	20.9
P/E 2016 (x)	N/A	16.5	19.5	22.0	19.4
P/B 2015 (x)	7.07	5.31	14.29	1.86	5.71
ROE (%)	27.8	47.9	63.3	7.2	29.2
DPS (Sen)	N/A	N/A	N/A	0.6	0.6
Dividend Yield (%)	N/A	N/A	N/A	0.7	0.7

** Denotes Indonesian Rupiah*

Source: Company Data & MSSB Research

Income Statement					
FYE Dec (RM mln)	**2013A**	**2014A**	**2015A**	**2016F**	**2017F**
Revenue	152.2	185.9	315.9	402.7	472.0
EBITDA	26.0	32.3	50.2	62.4	77.5
Depreciation & Amortisation	-2.0	-5.0	-8.3	-10.0	-13.7
Net Interest Expense	-2.8	-3.5	-4.6	-9.5	-15.5
Pre-tax Profit	21.2	23.8	37.3	42.9	48.3
Effective Tax Rate	*27.7%*	*28.2%*	*27.3%*	*28.0%*	*28.0%*
Net Profit	13.6	15.6	24.8	28.1	31.5
EBITDA Margin	*17.1%*	*17.4%*	*15.9%*	*15.5%*	*16.4%*
PreTax Margin	*13.9%*	*12.8%*	*11.8%*	*10.6%*	*10.2%*
Net Margin	*8.9%*	*8.4%*	*7.8%*	*7.0%*	*6.7%*

Source: Company Data & MSSB Research

Balance Sheet			
FYE Dec (RM mln)	**2013A**	**2014A**	**2015A**
Total Assets	184.7	302.7	539.0
Fixed Assets	68.2	74.6	102.5
Current Assets	116.5	208.6	385.8
Other LT Assets	0.0	19.5	50.7
Current Liabilities	80.5	80.4	116.3
LT Liabilities	20.4	35.3	79.5
Share Capital	28.5	52.8	79.2
Total Equity	83.7	187.0	343.3

Source: Company Data & MSSB Research

Per Share Data					
FYE Dec (RM mln)	**2013A**	**2014A**	**2015A**	**2016F**	**2017F**
Book Value (Sen)	0.1	0.2	0.4	N/A	N/A
Cash Flow (Sen)	1.9	-0.6	-3.6	N/A	N/A
Net Earnings (sen)	1.7	2.0	3.1	3.5	4.0
Dividend (sen)	0.2	0.0	0.6	0.6	0.6
Payout Ratio (%)	0.1	0.0	19.2	16.9	15.1
Dividend Yield (%)	0.2	0.0	0.7	0.7	0.7
PER (x)	47.2	41.2	25.9	22.8	20.3
P/Cash Flow (x)	42.2	-130.2	-22.4	N/A	N/A
P/Book Value (x)	7.67	3.43	1.87	N/A	N/A
ROE (%)	16.2	8.3	7.2	N/A	N/A
Net Gearing (%)	0.4	Net Cash	Net Cash	N/A	N/A

Source: Company Data & MSSB Research