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Pockets of disappointing O&G earnings

BY **KAMARUL AZHAR**

It is no secret that the domestic oil and gas (O&G) engineering and services industry has become highly competitive. Probably through no choice of theirs, many of the players have had to sacrifice profit margins to win jobs.

In the recent results season, some of the O&G engineering and services companies revealed razor-thin margins while some even slipped into the red.

Daya Materials Bhd and TH Heavy Engineering Bhd (THHE), for example, recorded net losses in the fourth quarter ended Dec 31, 2013 (4QFY2013) and both cited a revision in profit margins and cost overruns as the reason for bleeding red ink.

Daya Materials incurred a net loss of RM15.6 million in 4QFY2013 compared with a net profit of RM5.15 million in the previous corresponding period. The loss was due to a revision in profit margins due to the finalisation of a cable-laying project in the UK that suffered from cost overruns.

THHE recorded a net loss of RM17.5 million, which was a reversal from a profit after tax of RM6.35 million in the previous corresponding period. The group attributed the loss to lower realised margins on completed jobs arising from higher-than-expected costs to complete projects.

Interestingly, both Daya Materials and THHE recorded good profits in the first three quarters of FY2013. Daya Materials' PAT for the nine-month period ended Sept 30, 2013, was RM19.3 million while THHE's was RM19.1 million.

Their impressive financial results in the first nine months saw their shares soar. Daya Materials gained 133% to reach a 52-week high of 45 sen on Feb 24 while THHE rose 137% to RM1.03 on Feb 19.

The spike in their shares came in handy for Daya Materials and THHE, which placed out shares during the year. Besides a share swap between Berlian McDermott Sdn Bhd and THHE Fabricators Sdn Bhd, THHE raised RM70 million through a sukuk murabahah programme in August last year.

THHE, which is seen as the O&G engineering arm of Lembaga Tabung Haji (LTH), also roped in GuoLine Capital Ltd as a substantial shareholder in May last year through a 10% private placement issued at 45 sen per share.

GuoLine Capital is an investment vehicle of business tycoon Tan Sri Quek Leng Chan. THHE raised RM41.8 million through the private placement.

And just last month, the company proposed to dispose of two million shares or 20% of Floatech (L) Ltd for US$13.13 million.

On April 5 last year, Daya Materials sold 8.1% in its subsidiaries Daya Secadyme Sdn Bhd and Daya OCI Sdn Bhd, 33% in Daya Proffscorp Sdn Bhd and 29% in Daya Petroleum Ventures Sdn Bhd to Wiramas Baiduri Sdn Bhd for a total cash consideration of RM17 million.

Given the rally in their shares, the two companies are deemed "priced to perfection". In other words, the share prices have factored in all possible good news going forward. At this level, any slight negative development will put downward pressure on the stocks.

"It is perplexing how these companies reported good profits in the first three quarters of the year and all of a sudden, they record a loss," says an analyst with a bank-backed research outfit, adding that this will probably leave an aftertaste.

"Does this mean investors should be sceptical about earnings going forward?" he asks.

According to Datuk Shireen Ann Zaharah Muhiudeen, managing director of Corston-Smith Asset Management, there are various reasons why O&G companies have disappointed in 4QFY2013, which cannot be solely attributed to over-aggressive bidding and over-optimistic profit booking.

"The worst case of undershooting, whose reported FY2013 net profit was only about 15% of consensus full-year estimates, was mainly due to cost overruns. We would ascribe this to a lack of experience and poor execution capability," she says in an email reply to questions.

The earnings of other second-tier O&G engineering and services companies also missed consensus expectations for the fourth quarter amid lower contributions from their respective businesses.

Petra Energy Bhd saw its quarterly pre-tax loss widen 47.8% to RM15.55 million in 4QFY2013, mainly due to the recognition of an impairment loss of RM8.9 million and lower contribution from its

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Contract flow expected to be stronger in next 12 to 24 months

FROM PAGE 18

integrated brownfield maintenance and engineering services division.

This division recorded a loss before tax of RM22.2 million, compared with a profit before tax of RM19.4 million in the previous financial year, as a result of the impairment loss and lower topside major maintenance/hook up, construction and commissioning contracts.

In the meantime, Alam Maritim Resources Bhd's net profit shrank substantially to RM3.75 million in 4QFY2013, which was 80% lower than in the previous corresponding period. The lower result was due to the group having to pay a withholding tax of about RM7.7 million, inclusive of a penalty.

Arhnue Tan, an O&G analyst with Alliance Research, says the outlook for the sector is positive as contract flow is expected to be stronger in the next 12 to 24 months, anchored by Petroliam Nasional Bhd's (Petronas) RM50 billion per annum capital expenditure (capex).

Besides that, activities elsewhere in Southeast Asia have been promising with more contracts coming out of Thailand, Vietnam and Myanmar, she states in her Feb 14 initiation report on *THHE*.

Petronas is expected to ramp up its spending in the next 24 months to keep its five-year capex plan of RM300 billion for 2011 to 2015 on track. To date, its capex both at home and abroad stands at RM178.3 billion.

Tan believes THHE is one of the local players that will benefit from large fabrication jobs.

However, according to Alex Goh, an analyst with AmResearch, offshore support vessel (OSV) operators may face a tough year because there seems to be an oversupply in the market.

A local news report quotes Petronas president Tan Sri Shamsul Azhar Abbas as saying that an oversupply of OSVs in the region could lead to a fall in charter rates because a recent tender revealed a 15% drop.

"Our channel checks reveal that these rates are currently stabilising while the listed players have not been aggressively buying anchor handling tug supply vessels in the 5,000 brake horsepower category," says Goh in a March 5 O&G sector report.

According to the Malaysia Offshore Support Vessels' Owners Association, the charter rate for anchor handling tug supply vessels is stable and ranges from US$1.50 to US$1.80 per horsepower, depending on the tenure of the charter.

Major OSV players in the country include Alam Maritim, SILK Holdings Bhd's Jasa Merin (M) Sdn Bhd, Bumi Armada Bhd, Singapore-listed Nam Cheong Ltd, Ekuiti Nasional Bhd's Icon Offshore Bhd and SapuraKencana Petroleum Bhd.

While the outlook may be bright for the sector, investors should still be cautious in investing in O&G stocks, say some fund managers, considering that the sector is trading at an average 20 times earnings, which is higher than the 17 to 18 times historical average.

"Our preference has been for companies that are differentiated in some way from the competition [better technology, expertise, know-how, branding, distribution network] such that they can earn higher returns," comments Shireen of Corston-Smith.

"We are less inclined to go for a large company that has shown fast growth due to aggressive bidding and which has built up a large order book that consists mainly of low margin jobs. We are also unlikely to invest in companies whose management has no expertise or experience in a sector they are planning to enter." E

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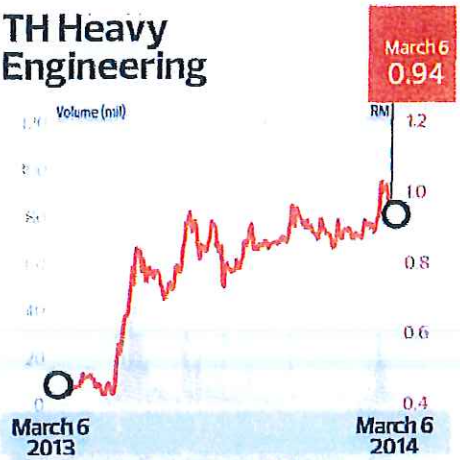
How they performed

NET PROFIT /(LOSS) (RM MIL)	1Q	2Q	3Q	4Q	FY2013
Daya Materials	5	6.7	7.2	(15.6)	3.4
THHE	6	9.2	3.9	(17.5)	1.6

FYE DEC	2013	2012
Ebitda/(loss) (RM mil)	(3.2)	30.3
Net profit /(loss) (RM mil)	1.6	24.2
EPS (sen)	3.4	3.2
ROE (%)	0.36	7.78
		AS AT MARCH 6
Market cap (RM mil)		959.6
Shares outstanding (bil)		1.021
Price/book (times)		2.17
PE forward (times)		19.58
PE historical (times)		25.13
Dividend yield (%)		NA
Estimated free float (%)		59.8

TH Heavy Engineering



The company, through its subsidiaries, fabricates offshore oil and gas-related structures. Its core activities include the fabrication of major steel structures, engineering and offshore marine services.

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Daya Materials

The oil and gas company, along with its subsidiaries, provides oil and gas products and services, speciality chemicals, advanced polymers and technical services.

FYE DEC	2013	2012
Ebitda (RM mil)	12.1	28.4
Net profit/(loss) (RM mil)	3.4	20.2
EPS (sen)	0.27	1.6
ROE (%)	1.47	8.75

	AS AT MARCH 6
Market cap (RM mil)	500
Shares outstanding (bil)	1.389
Price/book (times)	2.13
PE forward (times)	11.25
PE historical (times)	107.58
Dividend yield (%)	0.69
Estimated free float (%)	69.05