

Hock Seng Lee (HSL MK)

4Q21 within expectations

Maintain HOLD

4Q21 results were within our expectation, but above consensus on strong contribution from Property. We trim FY22/23E earnings post results house-keeping. HSL's outstanding orderbook of MYR1.7b as of end-FY21 would support earnings growth into FY24. Maintain HOLD with an unchanged TP of MYR1.35, based on the take-over offer price. Valuations are undemanding with the stock trading at its 5-year mean of 15x.

Property provides support to earnings

4Q21 net profit of MYR13m (+25% YoY, +24% QoQ) brought FY21 to MYR41.4m (+26% YoY), 106%/111% of our/consensus forecasts. 4Q21 construction revenue fell 17% YoY (+18% QoQ) on slower works recognition and flat EBIT margin at 4.6%. Property reported an EBIT of MYR9.5m for 4Q21 (+25% YoY, +53% QoQ) supported by higher margins (+3.9ppts YoY, +15.3ppts QoQ) from better product mix from the *Vista Industrial Park* development.

Trimming forecasts

We trim FY22/23E earnings forecasts by 3% each, post house-keeping. Our revised FY22E net profit implies 14% YoY growth. Our forecasts have imputed MYR400m job wins in FY22. We also introduce FY24E earnings.

Near term outlook remains challenging

HSL will focus on replenishing its orderbook, where its major projects i.e. Pan Borneo Highway (Package 7), Sarawak Coastal Road - Batang Paloh bridge and Miri Wastewater treatment plant (Package A) are expected to complete by mid-2023 and 2024 respectively. We estimate its outstanding orderbook was at MYR1.7b end-FY21, providing earnings visibility until FY24. However, HSL's near-term prospects remain challenging due to labour shortages, material supply disruptions (i.e. metal related materials) and high logistic costs.

FYE Dec (MYR m)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue	538	626	648	735	777
EBITDA	53	66	70	78	82
Core net profit	33	41	47	52	55
Core EPS (sen)	6.0	7.5	8.6	9.5	10.0
Core EPS growth (%)	(40.6)	26.3	13.7	10.5	5.5
Net DPS (sen)	0.0	0.0	2.1	2.3	2.4
Core P/E (x)	16.8	17.4	15.8	14.3	13.5
P/BV (x)	0.7	0.8	0.8	0.8	0.7
Net dividend yield (%)	0.0	0.0	1.5	1.7	1.8
ROAE (%)	3.9	4.8	5.2	5.5	5.6
ROAA (%)	2.8	3.3	3.6	3.8	3.8
EV/EBITDA (x)	6.5	8.7	7.7	7.0	6.5
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Consensus net profit	-	-	50	55	na
MKE vs. Consensus (%)	-	-	(5.6)	(4.9)	na

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HOLD

Share Price	MYR 1.35
12m Price Target	MYR 1.35 (+4%)
Previous Price Target	MYR 1.35

Company Description

Hock Seng Lee is involved in marine and civil engineering, building construction and property development.

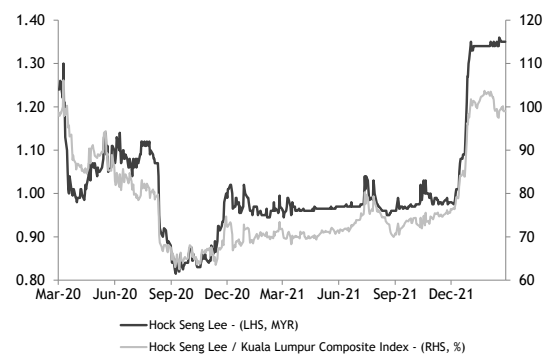
Statistics

52w high/low (MYR)	1.36/0.95
3m avg turnover (USDm)	0.1
Free float (%)	4.8
Issued shares (m)	583
Market capitalisation	MYR786.6M USD187M

Major shareholders:

Hock Seng Lee Enterprise Sdn. Bhd.	73.4%
Permodalan Nasional Bhd.	12.9%
Hock Seng Lee Bhd.	5.7%

Price Performance



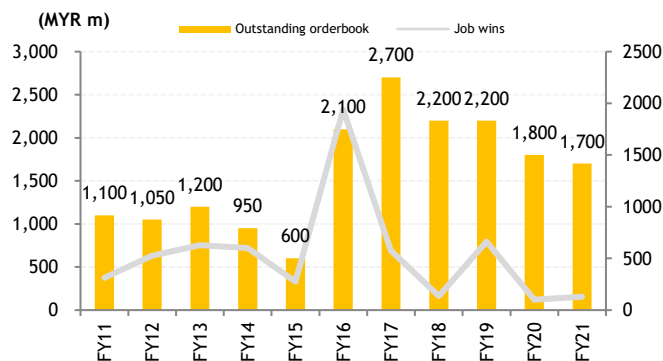
	-1M	-3M	-12M
Absolute (%)	1	38	39
Relative to index (%)	(4)	31	38

Source: FactSet

Value Proposition

- HSL is Sarawak’s market leader in marine engineering mainly due to its comprehensive fleet of equipment for marine-related infrastructure projects.
- HSL has also been involved in building construction, bridges, flyovers, airports, seaports, and road works.
- It is also engaged in property development for residential, commercial and industrial parks. Each of the development is about or >200 acres in size with long development roadmaps.

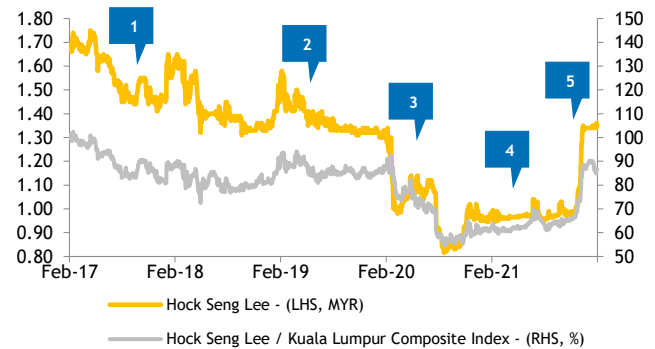
MYR1.7b outstanding order book, FY11-FY21



Source: Company

Price Drivers

Historical share price trend



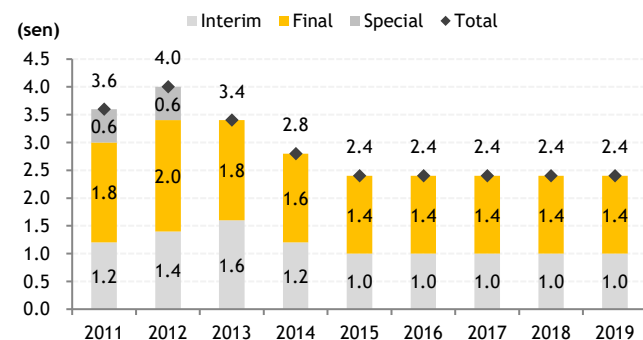
Source: Company, Maybank IBG Research

1. The series of litigation matters involving HSL and the Yu/Yii family concludes (Sept 2017).
2. Secures a construction project to build the Batang Paloh bridge in Mukah (Apr 2019).
3. Implementation of Movement Control Order (18 Mar 2020).
4. First job win in FY21 from Yayasan Sarawak (Mar 2021).
5. Unconditional voluntary take-over offer for the remaining 15.81% in HSL by Hock Seng Lee Enterprise Sdn Bhd (17 Feb 2022).

Financial Metrics

- Expect FY22E earnings to recover, underpinned by its e.MYR1.7b outstanding orderbook end-FY21.
- In a net cash position of MYR150m as of end-FY21, with minimal borrowings.
- No dividend policy, but distributed consistent DPS of 2.4sen p.a. since FY15, except in FY20-21 as its operations were affected by COVID-led movement restrictions.

Dividend history



Source: Company

Swing Factors

Upside

- Larger-than-expected orderbook replenishment could uplift its earnings.
- Increase in Government-led initiatives and infrastructure spending is favourable to the Group.
- Faster-than-expected vaccination programme will play a significant role in its performance outlook.

Downside

- Surges in COVID-19 cases in Sarawak could affect timing of earnings recognition.
- Labour shortages especially foreign workers could delay the progress of its construction projects.
- Unanticipated increase in construction material costs could adversely affect its financial performance.

Risk Rating & Score ¹	Not Rated
Score Momentum ²	na
Last Updated	na
Controversy Score ³	na

Business Model & Industry Issues

- As a market leader in marine engineering, its projects mostly address the “E” issues i.e. centralised sewerage systems in Kuching and Miri, flood mitigation works, embankments, revetments and seawalls. HSL regularly monitors its construction projects to mitigate their environmental impact relating to waste management, energy consumption, etc.
- HSL regularly conducts site inspections to ensure that they are compliant with CIDB Green Card requirements and it has valid work permits for foreign labour under its sub-contractors. HSL also has built its own quarantine centre to cater for the entry of new foreign workers once the border reopens.
- In our view, HSL is setting itself in the best position to manage ESG issues. We believe investors will better appreciate if HSL could provide additional disclosures and long-term targets to improve the ESG factors.

Material E issues

- Compliance on environmental protection is regularly itemised for review at project meetings.
- HSL’s new HQ office that is connected to *La Promenade Mall* is Sarawak’s first privately built building and mall designed for Green Building Index certification
- HSL encourages its staff and public to recycle waste materials by organising frequent ‘*Green Week*’ and providing a recycling centre within its HQ building, which is shared with the public.
- The group provides water saving sanitary and tapware in its property projects to reduce water consumption.
- HSL continuously manages and reduces construction materials on site. It uses water spray and water trucks to manage dust control on site, and monitors the maintenance of vehicles and equipment to avoid air pollution.
- HSL utilises approved sand sources and/or earth fill to avoid land contamination or degradation.

Material S issues

- In FY20, staff gender comprised 85% male and 15% female of the total 1,200 staff members; they are diversified in age (<35yo: 48%, 35-60yo: 44%, >60yo: 8%). Foreign workers made up 17% of its workforce.
- HSL reported 5 property damage incidents in FY20, compared to 10 in FY19, which relate to materials disturbed during excavations or heavy machinery operations. Measures to mitigate such incidents include utilities detection, pilot trenching, awareness training and toolbox briefings.
- Majority of HSL’s contracts are won under the open tender process. All sub-contract and supplier awards also go through rigorous competitive processes.
- HSL regularly conduct site inspection to ensure compliance with CIDB Green Card requirements and any foreign labour used by its sub-contractors have valid work permits.
- HSL has built its own quarantine centre to cater for the entry of new foreign workers once the border reopens.

Key G metrics and issues

- The Board comprises 9 members - 3 Executive Directors and 6 Non-Executive. Independent Directors are fairly well represented at 44% of the Board (4/9).
- Only 1 of the 9 Board members is a woman.
- Its largest shareholder, i.e. Hock Seng Lee Enterprise Sdn Bhd, is represented by 4 board members, while substantial shareholder i.e. Permodalan Nasional Berhad is represented by 1 board member; 4 remaining Independent Directors represent the interests of minority shareholders.
- The positions of Chairman of the Board and Managing Director (MD) are held by different individuals.
- Its Audit, Remuneration & Nomination Committees are chaired by Independent Non-Executive Directors.
- HSL provides detailed disclosure on remuneration of its directors but not of its top senior management (except its MD). In FY20, remuneration to directors was 7.7% of pre-tax profit. Its MD’s total remuneration package for FY20 was 3.5% of pre-tax profit (3y-avg: 2.9%).
- In FY20, KPMG PLT was the independent auditor for HSL. They have been appointed since 1995 (~26 years).
- HSL has adopted the Anti-Corruption and Bribery Policy in FY20.
- HSL has its Code of Ethics and Conduct in place, whereby it is committed to ethical business practices in all its operations. HSL has recurrent related party transactions (RPT) for the day-to-day operations of the Group involving rental of plant, machinery and vessels, purchase of raw materials and other-related construction services. This accounted for 24% of FY20’s revenue. HSL currently adopts a general policy to do all business lawfully, to ensure RPTs are being done on arm-length’s basis.

¹**Risk Rating & Score** - derived by Sustainalytics and assesses the company’s exposure to unmanaged ESG risks. Scores range between 0 - 50 in order of increasing severity with low/high scores & ratings representing negligible/significant risk to the company’s enterprise value, respectively, from ESG-driven financial impacts. ²**Score Momentum** - indicates changes to the company’s score since the last update - a **negative** integer indicates a company’s improving risk score; a **positive** integer indicates a deterioration. ³**Controversy Score** - reported periodically by Sustainalytics in the event of material ESG-related incident(s), with the impact severity scores of these events ranging from Category 0-5 (0 - no reports; 1 - negligible risks; ...; 5 - poses serious risks & indicative of potential structural deficiencies at the company).

Fig 1: Results summary

FY Dec (MYR m)	Quarterly					Cumulative		
	4QFY21	4QFY20	% YoY	3QFY21	% QoQ	FY21	FY20	% YoY
Revenue	172.3	181.7	(5.2)	150.9	14.2	625.5	538.3	16.2
EBIT	15.9	14.2	12.0	12.7	25.5	50.5	39.0	29.3
Net interest inc/(exp)	1.1	0.7	52.8	1.1	1.0	4.4	4.4	(0.7)
Assoc, JV profits	-	-	NM	-	NM	-	-	NM
Pretax profit	17.0	14.9	13.9	13.8	23.6	54.9	43.5	26.2
Tax	(4.0)	(4.5)	(12.4)	(3.2)	22.8	(13.4)	(10.7)	26.1
Minority interest	(0.0)	(0.0)	100.0	(0.0)	(4.0)	(0.0)	(0.1)	(25.8)
Net profit	13.0	10.4	25.1	10.5	23.9	41.4	32.8	26.3
EPS (sen)	2.4	1.9	25.1	1.9	23.9	7.5	6.0	26.3
DPS (sen)	-	-	NM	-	NM	-	-	NM
	4QFY21	4QFY20	+/- ppt	3QFY21	+/- ppt	FY21	FY20	+/- ppt
EBIT margin (%)	9.2	7.8	1.4	8.4	0.8	8.1	7.3	0.8
Tax rate (%)	23.3	30.3	(7.0)	23.4	(0.1)	24.5	24.5	(0.0)
SEGMENTAL	4QFY21	4QFY20	% YoY	3QFY21	% QoQ	FY21	FY20	% YoY
Revenue								
Construction	131.1	158.4	(17.2)	111.3	17.7	491.3	481.0	2.1
Property development	25.8	23.1	11.9	29.1	(11.3)	91.8	56.9	61.4
Others	15.5	0.3	>100	10.4	48.5	42.4	0.4	>100
Total	172.3	181.7	(5.2)	150.9	14.2	625.5	538.3	16.2
EBIT								
Construction	6.0	7.2	(16.0)	6.4	(6.4)	26.9	23.5	14.4
Property development	9.5	7.5	25.2	6.2	52.5	22.5	16.6	35.3
Others	0.4	(0.5)	<-100	0.1	>100	1.1	(1.0)	<-100
Total	15.9	14.2	12.0	12.7	25.5	50.5	39.0	29.3
EBIT margin (%)								
Construction	4.6	4.5	0.1	5.8	(1.2)	5.5	4.9	0.6
Property development	36.6	32.7	3.9	21.3	15.3	24.5	29.2	(4.7)
Total	9.2	7.8	1.4	8.4	0.8	8.1	7.3	0.8

Source: Company, Maybank IBG Research

FYE 31 Dec	FY20A	FY21A	FY22E	FY23E	FY24E
Key Metrics					
P/E (reported) (x)	17.6	13.0	15.8	14.3	13.5
Core P/E (x)	16.8	17.4	15.8	14.3	13.5
P/BV (x)	0.7	0.8	0.8	0.8	0.7
P/NTA (x)	0.7	0.8	0.8	0.8	0.7
Net dividend yield (%)	0.0	0.0	1.5	1.7	1.8
FCF yield (%)	26.8	20.4	10.1	1.4	4.0
EV/EBITDA (x)	6.5	8.7	7.7	7.0	6.5
EV/EBIT (x)	8.9	11.4	9.7	8.7	8.0
INCOME STATEMENT (MYR m)					
Revenue	538.3	625.5	648.2	734.7	776.5
EBITDA	53.5	65.8	70.1	77.8	82.4
Depreciation	(14.4)	(15.4)	(14.9)	(15.0)	(15.6)
EBIT	39.0	50.5	55.2	62.8	66.8
Net interest income / (exp)	4.4	4.4	7.6	6.5	6.3
Associates & JV	0.0	0.0	0.0	0.0	0.0
Exceptionals	0.0	0.0	0.0	0.0	0.0
Pretax profit	43.5	54.9	62.8	69.3	73.1
Income tax	(10.7)	(13.4)	(15.7)	(17.3)	(18.3)
Minorities	(0.1)	(0.0)	0.0	0.0	0.0
Reported net profit	32.8	41.4	47.1	52.0	54.8
Core net profit	32.8	41.4	47.1	52.0	54.8
BALANCE SHEET (MYR m)					
Cash & Short Term Investments	251.7	181.0	239.3	231.3	241.6
Accounts receivable	180.7	280.1	214.3	242.9	256.8
Inventory	146.2	106.4	173.0	196.7	207.9
Property, Plant & Equip (net)	214.3	214.0	220.2	229.0	238.6
Intangible assets	0.0	0.0	0.0	0.0	0.0
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	396.2	504.0	508.9	514.4	520.2
Total assets	1,189.2	1,285.5	1,355.7	1,414.4	1,465.1
ST interest bearing debt	14.7	13.2	13.2	13.2	13.2
Accounts payable	117.1	105.9	140.3	159.5	168.5
LT interest bearing debt	32.3	18.2	18.2	18.2	18.2
Other liabilities	179.0	261.0	261.0	261.0	261.0
Total Liabilities	343.5	398.0	432.4	451.6	460.6
Shareholders Equity	842.3	884.1	919.9	959.4	1,001.1
Minority Interest	3.3	3.4	3.4	3.4	3.4
Total shareholder equity	845.6	887.5	923.3	962.8	1,004.5
Total liabilities and equity	1,189.2	1,285.5	1,355.7	1,414.4	1,465.1
CASH FLOW (MYR m)					
Pretax profit	43.5	54.9	62.8	69.3	73.1
Depreciation & amortisation	14.4	15.4	14.9	15.0	15.6
Adj net interest (income)/exp	3.0	3.7	7.6	6.5	6.3
Change in working capital	112.6	112.6	33.5	(33.1)	(15.9)
Cash taxes paid	(11.6)	(12.6)	(15.7)	(17.3)	(18.3)
Other operating cash flow	(3.1)	(15.5)	(7.6)	(6.5)	(6.3)
Cash flow from operations	158.8	158.5	95.5	33.9	54.5
Capex	(11.4)	(11.4)	(20.7)	(23.5)	(24.8)
Free cash flow	147.4	147.1	74.8	10.4	29.7
Dividends paid	(7.7)	0.0	(11.3)	(12.5)	(13.2)
Change in Debt	(12.7)	(15.6)	0.0	0.0	0.0
Other invest/financing cash flow	(16.0)	(16.0)	(5.2)	(5.9)	(6.2)
Net cash flow	110.8	115.4	58.3	(8.0)	10.3

FYE 31 Dec	FY20A	FY21A	FY22E	FY23E	FY24E
Key Ratios					
Growth ratios (%)					
Revenue growth	(21.3)	16.2	3.6	13.4	5.7
EBITDA growth	(38.1)	23.2	6.4	11.0	6.0
EBIT growth	(44.9)	29.3	9.3	13.8	6.4
Pretax growth	(41.3)	26.2	14.4	10.5	5.5
Reported net profit growth	(40.6)	26.3	13.7	10.5	5.5
Core net profit growth	(40.6)	26.3	13.7	10.5	5.5
Profitability ratios (%)					
EBITDA margin	9.9	10.5	10.8	10.6	10.6
EBIT margin	7.3	8.1	8.5	8.5	8.6
Pretax profit margin	8.1	8.8	9.7	9.4	9.4
Payout ratio	0.0	0.0	24.0	24.0	24.0
DuPont analysis					
Net profit margin (%)	6.1	6.6	7.3	7.1	7.1
Revenue/Assets (x)	0.5	0.5	0.5	0.5	0.5
Assets/Equity (x)	1.4	1.5	1.5	1.5	1.5
ROAE (%)	3.9	4.8	5.2	5.5	5.6
ROAA (%)	2.8	3.3	3.6	3.8	3.8
Liquidity & Efficiency					
Cash conversion cycle	165.5	142.2	147.7	131.3	135.8
Days receivable outstanding	130.0	132.6	137.3	112.0	115.8
Days inventory outstanding	114.2	81.8	87.6	102.0	105.6
Days payables outstanding	78.7	72.2	77.2	82.7	85.6
Dividend cover (x)	nm	nm	4.2	4.2	4.2
Current ratio (x)	2.5	2.3	2.2	2.2	2.3
Leverage & Expense Analysis					
Asset/Liability (x)	3.5	3.2	3.1	3.1	3.2
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Net gearing (%) (excl. perps)	net cash	net cash	net cash	net cash	net cash
Net interest cover (x)	na	na	na	na	na
Debt/EBITDA (x)	0.9	0.5	0.4	0.4	0.4
Capex/revenue (%)	2.1	1.8	3.2	3.2	3.2
Net debt/ (net cash)	(204.8)	(149.6)	(207.9)	(199.9)	(210.2)

Source: Company; Maybank

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