AmInvestment Bank

Company report

AmInvestment Bank Bhd
www.amesecurities.com

MANUFACTURING

EONMETALL GROUP

(EONM MK EQUITY, EONM.KL) **05 Aug 2016**

If Da Vinci Were IT-Savvy

BUY

(Initiation)

Rationale for report: Initiation

Price	RM0.80
Fair Value	RM1.05
52-week High/Low	RM0.92/RM0.19

Key Changes

Fair value	Initiation
EPS	Initiation

YE to Dec	FY15	FY16F	FY17F	FY18F
Revenue (RM mil)	79.7	117.6	125.9	134.3
Core net profit (RM mil)	6.2	20.6	22.5	24.6
FD Core EPS (sen)	3.6	12.0	13.2	14.4
FD Core EPS growth (%)	-	234.1	9.2	9.2
Consensus Net Profit (RM mil)	-	19.3	20.5	22.8
DPS (sen)	-	2.5	2.5	2.5
PE (x)	22.0	6.6	6.0	5.5
EV/EBITDA (x)	14.8	6.3	5.6	4.6
Div yield (%)	-	3.1	3.1	3.1
ROE (%)	4.2	13.1	12.9	12.7
Net Gearing (%)	36.9	24.0	12.2	1.5

Stock and Financial Data

Shares Outstanding (million)	171.2
Market Cap (RMmil)	136.1
Book Value (RM/share)	0.87
P/BV (x)	0.9
ROE (%)	4.2
Net Gearing (%)	36.9
Major Shareholders	Dato' Goh Cheng Huat (67.9%)
Free Float	33.1
Avg Daily Value (RMmil)	2.2

Price performance	3mth	6mth	12mth
Absolute (%)	114.9	224.5	218.0
Relative (%)	115.2	221.5	236.5

Investment Highlights

- **Eonmetall Group (Eonmetall) produces metalwork machinery and steel products such as cold-rolled coils (CRC), galvanised coils, slotted angles and racking systems. It is also engaged in the engineering, procurement, construction and commissioning (EPCC) of solvent oil extraction plants.**

- **We liken the brains behind the company to "Da Vinci who were IT-savvy" as they are made up of: an inventor/innovator who is extremely good with machines, and a "techie" who rose through the ranks to helm the company.**

- **The bases of our investment case for Eonmetall are:**

  1. **We believe Eonmetall has put itself back onto a growth path, having found itself a "blue ocean" in the EPCC of palm-pressed fibre oil extraction (PFOE) and palm kernel oil extraction (PKOE) plants, an innovation which is an extension to its core competencies in metalwork machinery and IT;**

  2. **For its bread and butter businesses, Eonmetall's game plans have also been "innovation" for metalwork machinery (making the machines smarter and more automated by leveraging on its competence in IT), and "re-invention" for steel products (moving up the value chain by venturing into value-added product, i.e. racking systems); and**

  3. **Eonmetall has cost advantages in the form of: i) an exemption from import duty (15%) on key input hot-rolled coils (HRC), by virtue of it being a CRC maker; and ii) low capital cost due to insourcing of metalwork machinery.**

- **We project Eonmetall's net profit to more than triple in FY16, and rise by a further 9.2% in FY17 driven largely by outstanding and potential new PFOE plant EPCC projects.**

- **We value Eonmetall at RM1.05 based on 8x FY17F EPS of 13.2sen, at a discount to the manufacturing sector's average 1-year forward PE of 10-11x to reflect Eonmetall's relatively small market capitalisation of less than RM150m. We initiate coverage on Eonmetall with a BUY call.**

BACKGROUND

Eonmetall is engaged in the production of metalwork machinery such as cold rolling mills, metal forming machines and continuous galvanising lines, and the EPCC of PFOE and PKOE plants. It also produces steel products comprising CRC, galvanised coils, and secondary flat steel products such as slotted angles, conduit pipes, purlins and filter meshes, and light-duty/heavy-duty racking systems.

In 1QFY16, metalwork machinery and the EPCC of solvent extraction plants contributed 45% of total turnover but 81% of total PBT, with the balance 55% and 19% of total turnover and PBT coming from the steel product division.

MANAGEMENT

At the helm of the company are founder and executive director Dato' Goh Cheng Huat and managing director/CEO Mr. Yeoh Cheng Chye.

Dato' Goh has been in the metalwork machinery and steel product sectors for three decades. He obtained an MBA from the National University of Singapore in 2013. He is an inventor and innovator with a forte in metalwork machinery. The "machines brains" of the organisation already holds the patents to several inventions including a process for the manufacturing of steel products and apparatus, a 4x2 high cold roll angle bar machine as well as the solvent extraction technology for residual palm oil and palm kernel oil.

Meanwhile, Mr Yeoh, who holds a Bachelor in Computer Science (Hons) from Universiti Pertanian Malaysia and an MBA from the University of Southern Pacific, United States, is the "IT brains" of the organisation. He started as a systems engineer and thereafter promoted to a project manager with hard disc drive maker Seagate in Penang, and subsequently joined Leader Steel (a sister company of Eonmetall) to head the IT division for automation and manufacturing. He thereafter moved on to become the executive director of the IT solutions unit of Eonmetall, and subsequently took the helm of Eonmetall.

PFOE – BLUE OCEAN, GROWTH DRIVER

Eonmetall owns the patents in Malaysia, Indonesia and India to a solvent extraction technology for residual oil from mesocarp fibre of the palm oil fruit, which is commercialised in the form of a PFOE plant (Exhibit 1). It also owns the patents in the three markets for the same technology for kernel cake, commercialised in the form of a PKOE plant.

While solvent extraction of palm oil is relatively new to this part of the world, the method is widely used in the production of oil from soybean, coconut, peanut, rapeseed, sunflower, cotton seed, castor seed, etc, around the globe.

In the PFOE plant, mesocarp fibres are first subjected to a solvent, i.e. food-grade hexane, in an enclosed chamber at 45-55□. In the process, residual oil in the mesocarp fibres dissolves into hexane to form a "miscella" (solution or mixture in layman's terms). Next, the miscella is extracted from the mesocarp fibres (which are now effectively de-oiled). This is followed with the separation of the miscella into oil (end-product), hexane (which is re-used) and moisture. In a PKOE plant, residual palm kernel oil is recovered from palm kernel cake in very much the same way.

Typically, the "screw press" process in a conventional palm oil mill only manages to extract 94-95% of total oil content of the mesocarp of the oil palm fruit, with the balance 5-6% remaining in the mesocarp fibre. The mesocarp fibre (along with this precious residual oil) is burned in a boiler to generate steam and power for the mill.

Eonmetall's patented solvent-based oil extraction technology is able to recover about 80% of the residual oil in the mesocarp fibre. This translates to a 0.7ppts gain in terms of oil extraction rate (OER), which is equivalent to 3.5% more CPO produced (based on the national average OER of about 20%). For a standard 60 tonne-per-hour (TPH) palm oil mill with an annual FFB throughput of about 360,000 tonnes (60 TPH x 24 hours x 360 days x 70% utilisation), this translates to an additional CPO gain of about 2,500 tonnes (360,000 tonnes x 0.7%).

Our calculation shows that based on the current CPO price of about RM2,300/tonne, the payback period for a palm oil miller's RM10m investment in a 60-TPH PFOE plant is 2.2 years. Alternatively, if the palm oil miller decides to venture into the 60-TPH PFOE plant via a JV with Eonmetall, based on the same CPO price assumption, the payback period for the JV's investment will be slightly longer at 2.5 years as the JV will be billed for the steam and electricity it sources for the palm oil mill (which will translate to extra incomes to the palm oil miller, outside of the JV) (Exhibit 2).

The strong commercial viability of the PFOE plant is reflected in a still relatively short payback period of 3.6 years under 100% ownership, and 4.6 years under the JV model, even if CPO prices are to fall to RM1,500/tonne based on our sensitivity analysis (Exhibit 3).

Apart from CPO prices, the profitability of a PFOE plant is also a function of the price of a main input hexane, although the impact is limited. The price of hexane generally tracks that of crude oil as it is a derivative of petroleum, as well as the demand from its main users, i.e. industries such as oil extraction, printing, textiles, furniture, footwear, rubber, petrochemical and pharmaceutical. At present, hexane can be sourced locally at about RM3.40/litre. Based on our sensitivity analysis, for every 10% change in the hexane price, earnings of the PFOE plant could vary by 1.3% under 100% ownership, and 1.6% under the JV model (Exhibit 4).

EXHIBIT 1: PFOE PLANT

Source: Company

EXHIBIT 2: MATHEMATICS OF PFOE PLANT

	100% Ownership	JV Basis	Assumption
Revenue	5,750,000	5,750,000	2,500 tonne of CPO @ RM2,300
Operating cost			
Hexane	(514,080)	(514,080)	151,200 litres @ RM3.40/litre, 50,400 tonnes of fibre,
			3 litres of hexane/tonne of fibre
Steam	-	(453,600)	5 tonnes/hour @ RM15
Maintenance	(188,000)	(188,000)	
Electricity	-	(158,760)	175kWh @ 15 sen
Staff	(168,000)	(168,000)	1 supervisor and 2 operators per shift,
			2 10-hour shifts per day
EBITDA	4,879,920	4,267,560	
Depreciation	(1,000,000)	(1,000,000)	10% per annum
PBT	3,879,920	3,267,560	
Tax	(279,354)	(235,264)	5-year tax exempt on 70% of statutory income,
			corporate tax rate of 24%
PAT	**3,600,566**	**3,032,296**	
EBITDA after tax	4,600,566	4,032,296	
Payback period (years)	2.2	2.5	Investment cost of RM10m

Source: AmInvestment Bank, Company

EXHIBIT 3: SENSITIVITY OF PAYBACK PERIOD TO CPO PRICE

CPO Price (RM/tonne)		**1,500**	**2,000**	**2,300**	**2,500**	**3,000**
Payback (Years)	- 100% Ownership	3.6	2.6	2.2	2.0	1.6
	- JV Basis	4.6	3.0	2.5	2.2	1.8

Source: AmInvestment Bank

EXHIBIT 4: SENSITIVITY OF EARNINGS TO HEXANE COST

Chg in Hexane Cost		**-20%**	**-10%**	**0%**	**+10%**	**+20%**
Earnings chg (%)	- 100% Ownership	-2.6	-1.3	0.0	+1.3	+2.6
	- JV Basis	-3.1	-1.6	0.0	+1.6	+3.1

Source: AmInvestment Bank

Since 2007, Eonmetall has completed and handed over 15 solvent extraction plants comprising 13 PFOE plants and two PKOE plants (14 in Malaysia and one in Indonesia). Presently, Eonmetall has in its orderbook six plants under various stages of completion comprising five PFOE plants and one PKOE plant (five in Malaysia and one in Indonesia). Eonmetall expects to complete and handover three of the plants in FY16 while the remaining three will underpin FY17 earnings. Eonmetall is currently in talks with existing and potential new clients for the EPCC of new palm oil and palm kernel solvent extraction plants in Malaysia and Indonesia.

Among Eonmetall's clients is a bellwether plantation company listed on Bursa Malaysia which took delivery of a PFOE plant in 2011 and a PKOE plant in 2014 in Malaysia from Eonmetall. Eonmetall is currently building a PKOE plant for the plantation giant in Indonesia.

We believe Eonmetall has created an exclusive blue ocean for itself with the EPCC of solvent extraction plants in the palm oil industry:

1. As it offers palm oil millers a hard-to-refuse proposition to boost their earnings via the investment in an ancillary facility to the palm oil mill with high return/short payback, even under adverse CPO and hexane price conditions as we have shown in our sensitivity analysis;
2. There is tremendous room for growth. We estimate that there are current 1,300-1,400 palm oil mills in Malaysia and Indonesia, out of which about 300 boast a rated capacity of 60 TPH and above – the minimum threshold for a PFOE plant. At present, only 18 PFOE plants have been built or under construction. This translates to a "penetration rate" of only 7%. Overtime, the demand for PFOE plants will increase further with more new palm oil mills being built and the smaller ones being upgraded; and
3. Eonmetall's patents for the technology in Malaysia, Indonesia and India mean a new player needs to seek permission from Eonmetall before it can use the technology in the markets, which is effectively an entry barrier.

INNOVATION AND RE-INVENTION

Eonmetall's bread and butter metalwork machinery unit is one of the last surviving export-oriented metalwork machinery makers in Malaysia. It has been able to garner a slice of action in the market dominated by Taiwanese, Chinese and Indian players through:

1. Product innovation and improvement, particularly, by integrating a higher level of IT applications into the products, making them "smarter" and more automated;
2. The provision of EPCC for new steel product factories including IT solutions (while most competitors only sell the machines);
3. The provision of consultancy and market intelligence to the clients (versus most competitors who are only keen to sell the machines);
4. Good after-sales services, particularly, the ease in getting spare parts; and
5. Participation in international exhibitions and trade fairs to showcase new products and innovation to existing and potential new customers – Eonmetall makes a point to take part in an international exhibition for metal working in Germany twice a year, although it did skip the most recent one due to the soft market conditions in Europe.

For its steel product segment, Eonmetall has in-invented itself by moving up the value chain, building racking systems (Exhibit 5) from slotted angles (Exhibit 6) it produces. The racking system is no doubt a much more value-added product as compared with the slotted angle. The demand for racking systems is strong underpinned by the proliferation of distribution hubs globally on the back the booming e-commerce sector. Racking systems now make up about three quarters of Eonmetall's total sales of steel products.

EXHIBIT 5: RACKING SYSTEM

Source: Company

EXHIBIT 6: SLOTTED ANGLE

Source: Company

LOW COST STRUCTURE

Eonmetall has two major cost advantages. Firstly, by virtue of it being a CRC maker, it is exempted from the 15% import duty on input HRC. These savings are effectively passed on to its secondary flat steel products along the value chain such as the slotted angle (shelving upright angle), and in turn, the racking system. Secondly, by insourcing or sourcing internally metalwork machinery at cost prices, the steel product unit enjoys discounted capital cost, resulting in enhanced competitiveness in the market. Similarly, the PFOE and PKOE plant EPCC unit is able to procure various machines internally at cost prices, boosting its margins.

RISKS

The key risks include: i) Plantation companies to put on hold their capex plans due to sustained low CPO prices; ii) The change in government policies with regards to steel imports; and iii) Shortage of labour and a steep rise in labour costs.

VALUATIONS

We project Eonmetall's net profit to more than triple in FY16, and rise by a further 9.2% in FY17 driven largely by outstanding and potential new PFOE plant EPCC projects. We value Eonmetall at RM1.05 based on 8x FY17F EPS of 13.2sen, at a discount to the manufacturing sector's average 1-year forward P/E of 10-11x to reflect Eonmetall's relatively small market capitalisation of less than RM150m. We initiate coverage on Eonmetall with a **BUY** call.

.

EXHIBIT 7: TURNOVER BREAKDOWN

YE to Dec	FY14	FY15	FY16F	FY17F	FY18F
Turnover	64.4	79.7	117.6	125.9	134.3
Machinery/Plants	11.9	16.4	51.3	56.3	61.3
Steel Products	52.5	62.2	65.3	68.6	72.0
Others	0.1	1.1	1.1	1.1	1.1

Source: AmInvestment Bank

EXHIBIT 8: EBIT BREAKDOWN

YE to Dec	FY14	FY15	FY16F	FY17F	FY18F
EBIT	1.0	8.9	24.0	24.4	26.5
Machinery/Plants	(4.6)	(0.0)	18.0	18.0	19.6
Steel Products	7.4	9.4	7.8	8.2	8.6
Others	(1.8)	(0.5)	(1.8)	(1.8)	(1.8)

Source: AmInvestment Bank

EXHIBIT 9: FINANCIAL DATA

Income Statement (RMmil, YE 31 Dec)	FY14	FY15	FY16F	FY17F	FY18F
Revenue	64.4	79.7	117.6	125.9	134.3
EBITDA	5.3	12.9	28.0	28.4	30.4
Depreciation/Amortisation	(4.3)	(4.0)	(4.0)	(4.0)	(4.0)
Operating income (EBIT)	1.0	8.9	24.0	24.4	26.5
Other income & associates	-	-	-	-	-
Net interest	(3.3)	(3.3)	(2.4)	(0.6)	(0.3)
Exceptional items	-	-	-	-	-
Pretax profit	(2.3)	5.6	21.6	23.8	26.2
Taxation	(0.5)	0.6	(1.0)	(1.3)	(1.6)
Minorities/pref dividends	-	-	-	-	-
Net profit	(2.8)	6.2	20.6	22.5	24.6
Core net profit	(2.8)	6.2	20.6	22.5	24.6

Balance Sheet (RMmil, YE 31 Dec)	FY14	FY15	FY16F	FY17F	FY18F
Fixed assets	103.2	102.2	103.2	104.3	105.3
Intangible assets	-	-	-	-	-
Other long-term assets	33.5	32.9	32.9	32.9	32.9
Total non-current assets	136.7	135.0	136.1	137.1	138.2
Cash & equivalent	1.6	2.1	17.4	34.6	53.9
Stock	44.2	51.4	51.4	51.4	51.4
Trade debtors	25.7	38.6	38.6	38.6	38.6
Other current assets	0.1	0.3	0.3	0.3	0.3
Total current assets	71.6	92.4	107.8	125.0	144.2
Trade creditors	7.5	18.8	18.8	18.8	18.8
Short-term borrowings	37.3	46.4	46.4	46.4	46.4
Other current liabilities	0.1	0.1	0.1	0.1	0.1
Total current liabilities	44.9	65.3	65.3	65.3	65.3
Long-term borrowings	16.3	10.7	10.7	10.7	10.7
Other long-term liabilities	3.3	2.4	2.4	2.4	2.4
Total long-term liabilities	19.6	13.1	13.1	13.1	13.1
Shareholders' funds	143.5	148.7	165.1	183.3	203.6
Minority interests	0.3	0.3	0.3	0.3	0.3
BV/share (RM)	0.84	0.87	0.96	1.07	1.19

Cash Flow (RMmil, YE 31 Dec)	FY14	FY15	FY16F	FY17F	FY18F
Pretax profit	(2.3)	5.6	21.6	23.8	26.2
Depreciation/Amortisation	4.3	4.0	4.0	4.0	4.0
Net change in working capital	(3.8)	7.9	-	-	-
Others	2.5	(13.5)	1.4	(0.7)	(1.3)
Cash flow from operations	0.6	3.9	27.0	27.1	28.8
Capital expenditure	(4.5)	(5.2)	(5.0)	(5.0)	(5.0)
Net investments & sale of fixed assets	9.2	2.7	-	-	-
Others	(1.6)	(0.1)	-	-	-
Cash flow from investing	3.1	(2.5)	(5.0)	(5.0)	(5.0)
Debt raised/(repaid)	(3.7)	4.6	-	-	-
Equity raised/(repaid)	-	-	-	-	-
Dividends paid	-	-	(4.3)	(4.3)	(4.3)
Others	(3.7)	(3.8)	-	-	-
Cash flow from financing	(7.4)	0.8	(4.3)	(4.3)	(4.3)
Net cash flow	(3.7)	2.2	17.7	17.8	19.5
Net cash/(debt) b/f	(0.4)	(4.3)	(3.1)	12.2	29.5
Net cash/(debt) c/f	(4.3)	(3.1)	14.6	30.1	49.0

Key Ratios (YE 31 Dec)	FY14	FY15	FY16F	FY17F	FY18F
Revenue growth (%)	(15.5)	23.7	47.7	7.0	6.7
EBITDA growth (%)	(67.8)	143.0	117.3	1.6	7.1
Pretax margin (%)	(3.6)	7.0	18.4	18.9	19.5
Net profit margin (%)	(4.3)	7.8	17.5	17.9	18.3
Interest cover (x)	0.3	2.7	10.2	39.4	103.8
Effective tax rate (%)	20.4	11.0	4.6	5.5	6.1
Dividend payout (%)	nm	-	20.7	19.0	17.4
Debtors turnover (days)	433	147	120	112	105
Stock turnover (days)	125	219	160	149	140
Creditors turnover (days)	257	60	58	55	51

Source: Company, AmInvestment Bank Bhd estimates

DISCLOSURE AND DISCLAIMER

This report is prepared for information purposes only and it is issued by AmInvestment Bank Berhad (“AmInvestment”) without regard to your individual financial circumstances and objectives. Nothing in this report shall constitute an offer to sell, warranty, representation, recommendation, legal, accounting or tax advice, solicitation or expression of views to influence any one to buy or sell any real estate, securities, stocks, foreign exchange, futures, investment or other products. AmInvestment recommends that you evaluate a particular investment or strategy based on your individual circumstances and objectives and/or seek financial, legal or other advice on the appropriateness of the particular investment or strategy.

The information in this report was obtained or derived from sources that AmInvestment believes are reliable and correct at the time of issue. While all reasonable care has been taken to ensure that the stated facts are accurate and views are fair and reasonable, AmInvestment has not independently verified the information and does not warrant or represent that they are accurate, adequate, complete or up-to-date and they should not be relied upon as such. All information included in this report constitute AmInvestment’s views as of this date and are subject to change without notice. Notwithstanding that, AmInvestment has no obligation to update its opinion or information in this report. Facts and views presented in this report may not reflect the views of or information known to other business units of AmInvestment’s affiliates and/or related corporations (collectively, “AmBank Group”).

This report is prepared for the clients of AmBank Group and it cannot be altered, copied, reproduced, distributed or republished for any purpose without AmInvestment’s prior written consent. AmInvestment, AmBank Group and its respective directors, officers, employees and agents (“Relevant Person”) accept no liability whatsoever for any direct, indirect or consequential losses, loss of profits and/or damages arising from the use or reliance of this report and/or further communications given in relation to this report. Any such responsibility is hereby expressly disclaimed.

AmInvestment is not acting as your advisor and does not owe you any fiduciary duties in connection with this report. The Relevant Person may provide services to any company and affiliates of such companies in or related to the securities or products and/or may trade or otherwise effect transactions for their own account or the accounts of their customers which may give rise to real or potential conflicts of interest.

This report is not directed to or intended for distribution or publication outside Malaysia. If you are outside Malaysia, you should have regard to the laws of the jurisdiction in which you are located.

If any provision of this disclosure and disclaimer is held to be invalid in whole or in part, such provision will be deemed not to form part of this disclosure and disclaimer. The validity and enforceability of the remainder of this disclosure and disclaimer will not be affected.