DELEUM

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Deleum offers attractive yields

| BY CINDY YEAP |

Oil and gas-related stocks went from being sexy in the middle of last year, when crude oil looked like it was headed for US$200 a barrel, to being dropped like hot coal when oil prices tumbled to as low as US$33.87 in mid-December 2008 as fears of a global recession spread.

Oil has since recovered to US$70 levels — enough for the O&G sector to capture the attention of investors again. CIMB Research, for instance, is "overweight" on the sector, favouring Kencana Petroleum Bhd, Petra Perdana Bhd, SapuraCrest Petroleum Bhd and Wah Seong Corp Bhd. These players, it reckons, will benefit from the over 60 production sharing contracts that Petroliam Nasional Bhd (Petronas) has signed to further develop untapped resources.

Slipping just below the radar screen of investors amid the renewed optimism is Deleum Bhd, which primarily provides specialised engineering equipment, services and oilfield chemicals to O&G players in Malaysia. Its relatively thin margin of about 10% is one reason the company has been overlooked. Analysts say other players could see gross margins reaching some 30% to 40% for turnkey EPCC (engineering, procurement, construction and commissioning) contracts, vessel chartering or even fabrication works.

Deleum's smallish 100 million share base, thin trading volume and RM153 million market capitalisation are also dampeners, which may be among the reasons it is trading at lower multiples than its peers.

Still, its stock is up 33% year to date and there are positive points for the outfit, which was named Second Best Smallcap Company by *Finance Asia* magazine in its 2008 Asia's Best Companies survey.

Deleum has projects worth over RM1 billion, which will keep the company busy up to 2016, managing director Chandran Aloysius Rajadurai told reporters in April. It is also reportedly bidding for contracts worth RM300 million to RM400 million this year, of which 50% to 60% were existing contracts that had expired and were up for tender again. The bulk of the bids put in is for jobs in Malaysia.

Deleum has 27 years of experience in the O&G service industry.

Management is committed to maintaining a 50% dividend payout, Standard & Poor's (S&P) points out in a recent note. It estimates an 11 sen dividend for FY2009, the same as in FY2008, putting dividend yield at 7.9% with Deleum shares going for RM1.40 apiece in late May.

"We continue to recommend a 'buy' on Deleum, mainly because of its attractive valuations relative to the O&G sector, at 5.2 times 2009 earnings versus the Malaysian energy sector multiples of 8.5 times 2009 earnings. Deleum is also trading below the market average multiple of 9.8 times for small and mid-cap issues in Malaysia.

"Excluding net cash of about 30 sen per share as at 1QFY2009, Deleum is trading at an ex-cash 2009 PER of 4.2 times. Dividend yield remains attractive," S&P says in a note dated May 26.

The estimated dividend of 11 sen per share looks decent, yielding 7.2% at its RM1.53 close last Wednesday. However, there is only 4.6% upside left in capital appreciation if measured against S&P's RM1.60 target price for the stock. S&P raised its target price for Deleum from RM1.20 to RM1.60 at the end of May, having incorporated a prospective 11 sen dividend and an increase in peer valuation multiples to 8.5 times 2009 earnings from about 4.2 times previously. This level of yields is way above that of its peers, which offer 0.3% to 4.2%, according to Bloomberg data.

In April, Chandran reportedly said the company is looking forward to "at least maintain" earnings this year, given that oil prices have stabilised.

Deleum reported RM6.1 million in net profit for 1QFY2009 — up only 3.5% y-o-y — despite a 76% increase in revenue to RM147.3 million, driven by higher revenues from the specialised equipment and services as well as the oilfield equipment and services divisions.

Deleum

Price: RM1.53 (as at June 24)

Issued shares: 100 million

Estimated free float: 33%

Major shareholders (as at Feb 27, 2009): Lantas Mutiara Sdn Bhd (20.42%), Hartapac Sdn Bhd (12.04%), IM Holdings Sdn Bhd (6.09%).

(Deputy executive chairman Datuk Vivekananthan M V Nathan and executive chairman Datuk Izham Mahmud are deemed interested in Lantas Mutiara's holdings. Vivekananthan has another 10.63% direct stake. Izham has 2.79% direct stake and is deemed interested in IM Holdings' stake.)

Profit projections year-end Dec 31

	NET PROFIT (RM MIL)		EPS (SEN)	
	FY09	FY10	FY09	FY10
Standard & Poor's	26.8	26.8	28	28

On an annualised basis, 1Q2009 results were 9% below S&P's expectations of a RM26.8 million net profit for FY2009. This was mainly attributed to lower-than-expected pre-tax margins of 7.2% versus its assumption of 8.8% for 2009, as well as lower associate contributions due to lower fuel compensation from its Cambodian independent power producer — Cambodia Utilities Pte Ltd, which delivers electricity to Phnom Penh — given the fall in fuel prices.

Still, S&P expects "a stronger showing in subsequent quarters, given recent strength in oil prices, which may spur greater oilfield activities and boost Deleum's bottom line". S&P also notes that the consolidation of newly acquired subsidiary — Penaga Dresser Sdn Bhd, its first merger and acquisition (M&A) exercise — helped improved 1Q2009 margin versus that in 1Q2008. Penaga Dresser, which supplies valve products and management services to the oil and gas sector, complements Deleum's integrated wellhead maintenance business.

"Deleum will continue to look diligently for opportunities to form strategic alliances or joint ventures or M&A, which are viable and synergistic to our core business," its executive chairman Datuk Izham Mahmud said in its 2008 annual report.

Deleum, which debuted on the Main Board in June 2007, aspires to be "the preferred service company" focusing on the O&G and power generation industries and aims to expand beyond its current markets, but within the scope of its core products and services, said Izham.

The company has reportedly been on the lookout for strategic partnerships that will reinforce its core capabilities, including potential M&A in Southeast Asia like Indonesia, Brunei and Vietnam, as well as in the Middle East.

Acquisitions that are instantly earnings accretive would be a plus for Deleum, the net cash position of which stood at RM30 million end-March. Its size, however, may make it a target for bigger companies. The company's net asset stands at RM1.53 per share.

CIMB Research, which does not cover Deleum, pointed out in June that declining revenues and shrinking margins could result in asset sale and industry consolidation, and that beneficiaries would be bigger, cash-rich companies that get to expand their capacity at cheaper asset valuations. It cited Sime Darby Bhd's proposed acquisition of Ramunia Holdings Bhd.

Risks to S&P's "buy" recommendation on Deleum and its RM1.60 target price include prolonged weak crude oil prices, which may prompt capital expenditure and reinvestment cuts by Petronas and oil majors operating in the region.