

Eastern Pacific Industrial Corporation

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LONG TERM BUY

KLCI	1206.67
Share Price	RM1.91
12-mth Target	RM2.50
Dividend (sen)	8.0
Dividend Yield	4.2%
Total Upside To Target	35.0%

Stock Codes	
BMSB	EPIC/8265
Bloomberg	EPIC MK

Stock and Market Data

Listing	Main Board
Syariah compliance	Yes
Shares In Issue @ RM1	169.2m
Market Cap	RM100.3m
3M Ave Daily Vol	50.4k
Est. Free Float	40.0%
52 Week Hi/Lo	RM3.32/RM1.65

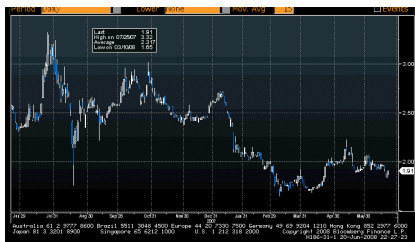
Fundamentals – FY07

ROA	9.2%
ROE	11.6%
Netcash	RM78m
Book value/share	RM1.74

Shareholders

Perbadanan Memajukan Iktisad Terengganu	38.2
Skim Amanah Saham Bumiputera	11.4%

1-Year Share Price Chart



A major beneficiary of the booming O&G sector and ready for a re-rating.

An undervalued gem with solid earnings visibility, sound management and strong backing from Government. As the stock market is again turning more cautious amidst the atrocious global economy, current market consolidation particularly on lower liners presents excellent opportunity to search for values. Beside the plantation sector, we opine that oil & gas sector offers the best earnings visibility amidst economic slowdown and dwindling consumer spending. In our view, EPIC is one of the laggard in the O&G stocks rally so far, given its solid earnings visibility, sound management, strong netcash and strong backing from Government.

Solid backing from state government. EPIC was listed on Bursa Malaysia on 8 November 1991. The group is 39% owned by Perbadanan Memajukan Iktisad Terengganu, the economic development arm of the state of Terengganu. Spurred by the booming O&G sector, we envisage EPIC to benefit from the continued support from the Federal and State Government to promote the development of the oil & gas industry, especially after the Federal Government has agreed to revert the management of the 5% oil royalty (estimated in the region of RM1bn pa) back to the state government in June 08. The payment of oil royalty to the state stopped in 2000 when the opposition took control of the Terengganu. Prime Minister Datuk Seri Abdullah Ahmad Badawi.

Strong institutional supports. EPIC has an institutionalized shareholding structure, with the Terengganu State Economic Development Corporation holding 38.2%, followed by Ahmad Zaki Resources (21%) and other local and foreign fund management companies (about 13%). This denotes strong investors' confidence on the group's track record, management and future growth potential.

A taken private play?. Last September, AZRB's chairman Raja Datuk Seri Aman Raja Ahmad was reported as saying that the company may consider increasing its stake in EPIC if the opportunity arises. He added that the decision would be on a "friendly basis," given the good ties between AZRB and EPIC. AZRB took up a 20.5% stake in EPIC from Lembaga Tabung Haji in Sep 08 for RM82.56m or RM2.40 each - was finalised in September, and resulted in EPIC becoming an associate company of AZRB. Since then, AZRB has been accumulating EPIC shares and now has a 21% stake in the company. We believe current price at RM1.91 (off 20.4% from its earlier RM2.40 price tag) is even more attractive for them to accumulate further.



It is no surprise then that AZRB wants to up its stakes as EPIC provides the construction company a steady stream of income. EPIC is a key logistics service provider to the oil and gas industry, and also operates Kemaman port in Terengganu. As for AZRB, it is susceptible to the sector's cyclical nature like any other construction company.

EPIC is the cheapest O&G play in Malaysia, offering undemanding valuations, as it trades at 7.9x FY09 earnings (and just 6.3x FY09 earnings ex-cash) against its peers at 12.8x. Moreover, EPIC is trading at significantly lower than its peers at 1.08x price/net assets value of RM1.80 (against industry 5.1x) and offers consistent earnings growth prospects of average 15% pa, together with decent dividends with yield in the region of 4.2%.

Hidden jewels of O&G - Sole provider of petroleum supply-base services in Peninsular Malaysia. The key asset of EPIC is its 99.07%-owned subsidiary, Pangkalan Bekalan Kemaman Sdn Bhd (PBK). PBK owns, manages and operates Kemaman Supply Base (KSB), which is a monopoly in Peninsular Malaysia's onshore support base servicing the oil and gas companies offshore Terengganu. KSB hosts 288 companies supporting the petroleum industry. The other supply base in the country is in Labuan. In FY07, KSB contributed about 67% to EPIC's total revenue and over 56% to its pre-tax earnings. The prospects of KSB are underpinned by the on-going exploration and production activities at the oil and gas fields offshore Terengganu. Facilities at PBK include berthing facilities, rental facilities, cargo handling services, bunkering facilities, silos etc.

Port management services. EPIC has also been the project manager for Kemaman Port since 1998 (ie the East Wharf and the Liquid Chemical Berth), via a 61.5% stake in Korsortium Pelabuhan Kemaman S/B (KPK). With a length of 648m and depth of 17m, the port is the deepest seaport in Malaysia, capable of handling vessels of up to 150,000 deadweight tonnes and various types of cargo ranging from general cargo and dry bulk to liquid bulk. The port serves as a platform for EPIC to provide logistic services to international trades and this has proven to be successful. The port service business is already the second largest contributor to EPIC in terms of profit before tax of 13% in FY07.

- **East Wharf, Kemaman Port.** EPIC operates the East Wharf of Kemaman Port following the privatisation agreement entered into with the Government of Malaysia represented by the Ministry of Transport and the Kemaman Port Authority. The East Wharf is the gateway for dry bulk products of industries located in the vicinity such as Pewaja Steel, crude oil terminals, gas processing plants, refineries and petrochemical complexes.



- **Liquid Chemical Berth, Kemaman Port.** EPIC operates the Liquid Chemical Berth of Kemaman Port following the privatisation agreement entered into with the Government of Malaysia represented by the Ministry of Transport and the Kemaman Port Authority. The Liquid Chemical Berth is the gateway for liquefied products of industries located in the vicinity as well as for the crude oil terminals, gas processing plants, refineries and petrochemical complexes.

A one-stop oil & gas player in the making. Having built its foundation as a key logistics service provider such as petroleum supply base operations and port management to the oil & gas industry in Malaysia, EPIC is expanding into related activities to broaden its earnings base in its quest to become an integrated oil & gas service provider. Besides enhancing the supply base operations, EPIC has moved into upstream activities involving steel fabrication business. The future is indeed bright for the Group as it pursues its borderless reach to add shareholders value. The higher world demand for energy translates to greater demand for exploration and therefore the need for expertise and services to build offshore oil platforms and drilling rigs.

For the oil and gas and logistics industry; EPIC offers an array of services for its clients and partners. The services include highly established petroleum logistics and port management services; tubular threading and running; sludge management services; minor and major fabrication; plant shutdown and maintenance. A significant development is the establishment of a vessel repair and maintenance hub at Pulau Kuching in Kemaman with the capability to cater for major fabrication.

Aspiring to become one of the biggest fabricator in Malaysia. On top of organic growth alone and therefore the best option is to look out and acquire what's already up and running. The first purchase has already taken place with the RM21m acquisition of a 70% stake in Mushtari Engineering & Trading S/B (MET). MET is a company well established for minor fabrication, plant shutdown and maintenance expertise. This will give EPIC Group additional might as a minor fabricator catering for the requirements of the oil and gas industry both offshore and onshore.

In order to become a respective fabricator ultimately, EPIC has secured a piece of land in Kemaman, Terengganu with the signing of a 60% JV agreement to establish Terengganu Fabricators S/B (T-Fab). T-Fab was established with the aim of creating a vessel repair and maintenance facility and ultimately enhance the EPIC Group with the capability to offer major fabrication services in Kemaman, Terengganu. Indeed, the EPIC Group now has a stable of companies that provides the synergy and impetus towards growth.



The group had registered its interest with Petronas to undertake more major fabrication jobs as it has the facilities with the latest acquisition of MET and a JV with T-Fab. Petronas is reviewing the current capacity and capabilities of existing fabricators, giving the booming O&G sector. MET is a Petronas-licensed onshore and offshore minor fabricator, providing mostly subcontracting works for major fabricators. Mushtari owns and operates two yards in Telok Kalong, Kemaman, and in EPIC's KSB for its fabrication works.

Ready for a re-rating. We are strongly positive on the O&G services sector:

- (1) Crude oil prices have continued to spike over 40% YTD to above USD\$130/bbl.
- (2) Petronas' preference for domestic companies creates a large defensive market for Malaysian oil&gas services companies.
- (3) We expect Petronas to increase oil exploration activities given that Malaysia will become a net oil importer by 2014. Petronas capex could exceed RM25bn pa, with 8 new deepwater fields to be developed over 2010-2013.
- (4) EPIC has the potential to turn into the second largest fabricator in the country once Terengganu Fabricators starts operations by end-2009 at its 120 to 130-acre yard. The acquisitions of MET (completed in Oct 07) and T-Fab (JV completed in Jan 08) are in line with EPIC's strategic growth direction to enlarge its earnings base and its involvement in the O&G industry. According to EPIC, it will benefit from projects planned for the East Coast Economic Region, which has earmarked the Kemaman area for boat building and repairs and heavy industries.

12-month target price at RM2.50/share. We anticipate EPIC to enjoy core net earnings growth of CAGR 15% in 2008-09, driven mainly by higher contributions at its supply base operations, port services and other O&G services, as well as robust fabrication activities. We project EPIC to record EPS of 20.7sen in 2008 and a higher 41sen in 2009, which translates into 9.2xPER08 and 7.9xPER09, respectively.

Our indicative fair value for EPIC is pegged at RM2.50/share, based on 10.3x FY09 EPS. We are valuing EPIC at a 33% discount to the industry average due to its illiquidity, less spectacular growth and smaller market cap against its peers.

Solid financial position and stepping-up dividend payment. Total dividend rate rose from 3.5sen in FY98 to average 7sen in FY12/07, on top of a special dividend of 10sen in FY05 (ie total FY05 was 17sen). We are projecting a final gross dividend of 7.5sen for FY08 and 8sen for FY09, yielding 3.9% and 4.2%, respectively due to the improving outlook coupled with strong



operating cashflow of averaging RM30-35m p.a. for 2008-09, even though with high capex of RM25-30m pa.

In addition, EPIC is sitting on net cash of RM64m or 38sen/share as at end March 08, which puts EPIC in a prime position to gear up for possible acquisitions that complement its businesses. Overall, EPIC's financial standing is solid compared to some oil and gas companies that are highly geared.

EARNINGS PROFILE												
31-Dec	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008E	2009E
Turnover (RM'm)	81.9	46.4	45.2	59.2	66.3	70.5	80.1	84.3	112.3	175.7	215.0	240.0
Net profit (RM'm)	17.6	27.9	23.5	17.2	10.8	20.0	23.4	2.3	7.8	30.7	35.0	41.0
EPS (RM)	0.104	0.165	0.139	0.102	0.064	0.118	0.138	0.014	0.046	0.181	0.207	0.242
Issued shares (m)	169.2	169.2	169.2	169.2	169.2	169.2	169.2	169.2	169.2	169.2	169.2	169.2
PER (x)	18.4	11.6	13.8	18.8	29.9	16.1	13.8	140.5	41.7	10.5	9.2	7.9
DPS (sen)	3.5	5.0	5.0	6.0	6.0	7.0	7.0	17.0	6.0	7.0	7.5	8.0
Yield (%)	1.8	2.6	2.6	3.1	3.1	3.7	3.7	8.9	3.1	3.7	3.9	4.2
E=Bloomberg, consensus estimates												

PEERS COMPARISON								
Companies	FYE	Price (RM)	mkcap (RM'm)	P/NAV	Netcash/shr	Netdebt/shr	FY09 EPS (sen) ^a	PER (x)
EPIC	31-Dec	1.910	323.17	1.06	0.38	-	0.242	7.9
TGOFFS	31-Dec	2.25	460.33	11.25	-	(1.19)	0.230	9.8
ALAM	31-Dec	1.97	956.30	3.18	-	(0.76)	0.190	10.4
DIALOG	30-Jun	1.42	2,006.76	5.36	0.03	-	0.091	15.6
BIPORT	31-Dec	6.30	2,520.00	2.67	1.28	-	0.360	17.5
KENCANA	31-Jul	1.79	1,614.58	6.17	0.10	-	0.150	11.9
WASEONG	31-Dec	2.10	1,343.46	1.93	-	(0.36)	0.180	11.7
Average				5.09				12.81
*Bloomberg, consensus estimates								



Definition of Investment Ratings

Stocks ratings used in this report are defined as follows:

- BUY** Share price expected to appreciate 10% or more over a 12-month period
HOLD Share price expected to be between 0% and 10% over a 12-month period
SELL Share price expected to depreciate over a 12-month period

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