



**INITIATION REPORT**

6 Apr 2011

<b>Handal Resources Berhad</b>		<b>Market Price:</b>	RM0.765
		<b>Market Capitalisation:</b>	RM122.4m
		<b>Board:</b>	Main Market
<b>Recommendation:</b>	BUY	<b>Sector:</b>	Trading / Services
<b>Target Price:</b>	RM0.89	<b>Stock Code/Name:</b>	7253 / HANDAL

*Analyst: Edmund Tham*



Source: Handal website

**BACKGROUND**

The history of Handal Group dates back to the year 1988 when Handal Engineering Sdn Bhd (HESB) was established by Dato' Mohsin Abdul Halim to operate as an agent to supply certain makes of offshore cranes manufactured overseas.

**“Supply of Offshore Cranes”**

As some of the oil platforms and equipments begun to age in the local oil and gas industry, HESB was contracted in 1995 by ExxonMobil to remove and recondition cranes which had degenerated or had been reduced to less than half its optimal capacity along with deteriorating safety standards. Prior to 1995, none of the local companies in Malaysia had performed or provided such services to the local oil and gas industry.

Handal Resources Berhad (HRB) was incorporated in Malaysia in May 2008 as a private limited company. HRB was then subsequently converted to a public limited company. HRB was incorporated to facilitate the group’s listing and commenced business as an investment holding company, following the acquisition of Handal Offshore Services Sdn Bhd (HOSSB) in May 2009.

**“4 core subsidiaries”**

Handal Group is currently comprised of its subsidiary companies namely Handal Offshore Services Sdn Bhd (HOSSB), Handal Engineering Sdn Bhd (HESB), Handrill Sdn Bhd (Handrill) and HandsComms Sdn Bhd (HandsComms).

Handal’s management team is led by its Executive Chairman Dato’ Mohsin Abdul Halim and Encik Mallek Rizal bin Mohsin (MD/CEO). Dato’ Mohsin is the founder of Handal and was first appointed to the Board in May 2009. Previously Dato’ Mohsin had various distinguished attachments within the Malaysian Civil Service.

Encik Mallek Rizal is also the Executive Director of Handal Offshore Services Sdn Bhd, Handal Engineering Sdn Bhd and Handrill Sdn Bhd. He was first appointed to the Board in May 2009. He is a qualified professional accountant. Previously, he was attached with a Big 4 accounting firm, a merchant bank and various publicly listed companies.

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**Handal: Principal Business Activities**

# Provision of overhaul and maintenance services
# Manufacturing or fabrication of new offshore pedestal cranes
# Other Services such as supply of manpower and parts
# Offshore crane Rental Business
# Workover Projects Lifting Solutions
# Supply and fabrication of industrial plant and equipment, tank system, piping and mooring system
# Providing consultancy and support services for engineering projects and topside maintenance jobs
# Drilling, workover and drilling management
# Providing System & Network Design Consultations
# System Integration and Implementation
# High Quality After-Sales Support

Source: Handal

While successfully reconditioning multiple offshore cranes for ExxonMobil, HESB had simultaneously set out to establish themselves as a local manufacturer of offshore pedestal cranes. In an effort to modernise their existing fleet of cranes and to maintain and improve their operating and lifting capacity, PETRONAS Carigali had in year 2000 awarded HESB a service contract similar to that awarded by ExxonMobil.

**“Local manufacturer of offshore cranes”**

In line with Petronas’ aspiration to develop “locally grown” companies in the oil and gas industry, HESB was restructured in 2001 via the injection of all its pedestal crane assets and personnel into Handal Offshore Services Sdn Bhd (HOSSB).

**HOSSB**

From the start, HOSSB has been an integrated offshore crane manufacturing and servicing company that specializes in offshore pedestal mounted cranes. Operating out of Kemaman Supply Base (KSB) and Telok Kalong Industrial Area in Kemaman, Terengganu, HOSSB’s comprehensive range of services include design and fabrication of new API 2C pedestal cranes, structural fabrication, operation, inspection, maintenance and repair programmes for all makes of cranes. HOSSB also provides in-situ upgrades, statistical analysis and structural modifications as well as lifting solutions for workover projects and crane rental services.

Being the only operator in the country which can provide a **one-stop service for API 2C cranes**, HOSSB is an approved API 2C fabricator and is sought after by the oil majors, which operate the numerous offshore platforms in Malaysia in relation to upstream oil and gas activities such as exploration, development and production.

**HESB and Handrill**

In November 2010, HRB acquired HESB and Handrill Sdn Bhd. Following the acquisition, the group is now involved in both the downstream and upstream segments of the oil and gas industry via its subsidiary, HESB. HESB is involved in the servicing, supply and fabrication of industrial plant and equipment, tank system, piping and mooring system, as well as providing consultancy and support services for engineering projects. HESB is also gearing for topside maintenance jobs, having acquired the license from Petronas for such services.

Handrill Sdn Bhd, a company registered with and licensed by Petronas as Rig Operator, Production / Drilling / Workover Associated Services for drilling rigs, offshore rigs and tender assisted, is mainly involved in the upstream oil and gas industry.

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## HandsComms

HandsComms Sdn Bhd (HandsComms), was established in May 2010. The company, a spin-off from the Communication Department of HESB, is involved in the supply of telecommunication and broadcasting systems for Radio Television Malaysia (RTM), Telekom Malaysia Berhad and other government agencies and the private sector since 1988.

HandsComms is also involved in the service maintenance contract of newly installed communication systems of various government agencies and in the private sector as well as the existing audio conferencing systems of Telekom Malaysia.

## PERFORMANCE – FY10

4Q/ 31 Dec	4Q10	4Q09	yoy %	3Q10	qoq%
Rev (RMm)	28.0	25.3	10.9	30.1	(6.7)
EBIT (RMm)	5.2	6.0	(13.1)	5.6	(6.1)
NPAT (RMm)	3.8	4.3	(10.8)	4.2	(9.6)
EPS (sen)	4.2	4.7	(10.8)	4.7	(9.6)

\*based on 90 million shares

12M/ 31 Dec	FY10	FY09	yoy %
Rev (RMm)	98.8	49.0	101.8
EBIT (RMm)	21.4	13.2	62.6
NPAT (RMm)	16.2	10.0	61.6
EPS (sen)	18.0	11.1	61.6

\*based on 90 million shares

The group had a 10.9% y-o-y increase in revenue for its 4Q/FY10 (RM28.0 million) ended 31<sup>st</sup> December 2010, as compared to the preceding year's 4Q/FY09 revenue of RM25.3 million.

### “Strong y-o-y revenue performance”

This increase in revenue was mainly due to the increase in work scope and activities under the current integrated crane services contract and workover projects lifting solutions. The increase was also attributable to the increase in revenue contribution by one of its subsidiary, HandsComms Sdn Bhd.

However, the group's profit before tax (PBT) of RM5.4 million in 4Q/FY10 is marginally lower compared to the PBT of RM5.5 million in the

preceding 3Q/FY10 (ended 30<sup>th</sup> September 2010), mainly due to the higher administrative costs incurred in 4Q/FY10. Comparing full year FY10 to FY09, the group's FY10 revenue of RM98.8 million and net profit after tax (NPAT) of RM16.2 million was higher by an astounding 101.8% and 61.6%, respectively.

## OUTLOOK/CORP. UPDATES

Handal's management is bullish on the prospects of the Malaysian oil and gas industry, as Petronas and other oil majors are committed to intensify exploration and production (E&P) efforts to enhance the country's reserves, underpinned by stabilizing oil prices and the need to retain energy sources. Furthermore, Petronas' commitment to re-direct capital expenditure to its home market will also provide spin-off benefits and positive prospects for the group.

Capital spending in the local upstream oil and gas sector is expected to remain relatively strong. This is based on the Malaysian Government's plan to improve Malaysia's oil and gas production as set out in its **Economic Transformation Programme (ETP)**. This includes enhancing recovery from existing fields and development of small and marginal fields.

### “ETP to spur demand for Oil & Gas services”

The Malaysian Prime Minister Datuk Seri Najib Tun Razak had announced a huge number of Entry Point Projects (EPP) since last year. These EPPs are meant to create jobs and spur economic growth. Of these EPPs, 12 are under the **“Oil, Gas and Energy” National Key Economic Areas (NKEAs)**.

Higher **crude oil prices** do generally correlate with higher expenditure by oil majors for oil E&P (exploration and production). Oil prices dropped from the highest level since September 2008 in New York on speculation U.S. inventories rose to the most in four months as prices depress fuel demand in the world's biggest crude oil consumer.

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Oil stockpiles at Cushing, Oklahoma, where New York contracts are delivered, had surged to a record last month. Prices also fell after the New York Times reported that sons of Libya's Muammar Qaddafi are seeking his ouster, stoking speculation the fighting that has crippled the country's oil exports may ease. Crude oil for May delivery fell as much as 55 cents to US\$107.92 a barrel on the New York Mercantile Exchange (NYMEX). Prices are up 25% from a year ago.

### Handal – Some recent Projects / Contracts

Date	Description
Dec 2010	LOI from Petrofac Energy Developments International Ltd to award HOSSB a purchase order for the supply of Diesel Powered Pedestal Cranes at a total cost of USD3.3 million.
Oct 2010	HOSSB received an extension of contract for the provision for crane maintenance contract for PM-3 CAA & PM-305 from Talisman Malaysia Ltd. The contracts will be extended for a further period of 2 years commencing from November 2010 to November 2012.
Aug 2010	HOSSB has jointly with PT Encona Inti Industri and PT Cakra Daya Energy submitted to Pertamina Hulu Energi ONWJ Ltd, a tender in respect of the technical services for crane and lifting equipments operations and maintenance services. Awarded by Pertamina with value of USD3.9 million.
June 2010	HOSSB received award from Kencana HL S/B for the project (provision of procurement and construction for topsides of PM329 East Piatu development projects) to supply 2 pedestal cranes valued at RM5.6 million. The cranes are to be delivered during Q1/2011.
May 2010	HESB received a 2-year award from Telekom Malaysia for the supply, delivery, installation, testing, commissioning, and support services for audio conferencing replacement valued at RM3.2 million.

Source: Handal/Bursa

### List of Oil, Gas & Energy NKEAs

EPP	Contribution to GNI up to 2010 (RM'mil)	Job creation
Deploying nuclear energy for power generation	212.3	2,637
Building up solar power capacity	457.5	1,906
Attracting MNCs to bring their global oil field service and equipment operations	6,124.8	20,000
Consolidating the domestic fabricators	4,108.8	5,000
Developing engineering, procurement & installation capabilities & capacity	4,028.8	15,000
Building a regional oil storage and trading hub	1,625.7	790
Unlocking premium gas demand in Peninsular Malaysia	2,404.1	-
Improving energy efficiency	13,925.7	-
Tapping Malaysia's hydroelectricity potential	5,693.9	590
Rejuvenating existing fields through enhanced oil recovery	8,469.7	411
Developing small fields through innovative solutions	-	-
Intensifying exploration activities	-	-

Source: Government's Pemandu website

### **VALUATION / CONCLUSION**

In September 2010, Handal had proposed a renounceable rights issue of 60.0 million new shares of RM0.50 each in Handal at an issue price of RM0.52 per rights share together with 60.0 million new free detachable warrants on the basis of 2 rights shares and 2 free warrants for



every 3 existing Handal shares of RM0.50 each held on 10<sup>th</sup> March 2011.

#### **“Rights & bonus issue”**

Handal also proposed a bonus issue of 10.0 million Handal shares on the basis of 1 bonus share for every 6 rights shares subscribed. Additionally, Handal had proposed an increase in its authorised share capital from RM50 million comprising 100 million Handal shares to RM250 million comprising 500 million Handal shares.

The rights shares were subsequently oversubscribed by 75.3% and will be listed on 8<sup>th</sup> April 2011. Proceeds from the rights issue would be used for the construction of a modular rig, the purchase of a new product line (together with the intellectual property rights), working capital and expenses incurred for the proposals.

#### **“Market positioning as OEM for offshore pedestal cranes”**

In February 2011, Handal’s wholly-owned subsidiary, HOSSB, had entered into a sharing of intellectual property rights (IPR) agreement with Excell Crane & Hydraulics Inc (ECHI) from the U.S. This involves the proposed acquisition of the use of the IPR of the "Seacrane" offshore pedestal crane product line (which includes the "Seacrane" trademark) in Asia, Africa, Europe and other countries (apart from those located in North America and South America) by HOSSB for a cash consideration of USD3.75 million.

Previously, HOSSB was unable to position itself as an Original Equipment Manufacturer (OEM) as it does not own its product line given that the IP Rights was the sole proprietary property of ECHI. With the proposed acquisition, HOSSB will be able to position itself as an OEM for offshore pedestal cranes and tap the market potential for the “Seacrane” offshore pedestal cranes in regions such as East Asia, Southeast Asia, Australia, Africa and Europe.

#### **“Reasonable dividends”**

Handal’s Board of Directors had proposed a first and final dividend of 3 sen per share (tax exempt) for its FY10 ended 31st December 2010. The proposed dividend is subject to the shareholders approval at the forthcoming AGM to be held in May 2011. According to Handal’s management, the group’s future dividends would be determined by the performance of the group. Since its IPO, Handal’s dividend payout ratios have been quite consistent near the 20% level. As such, we expect that Handal would be able to maintain a reasonable dividend payout ratio of at least 20-25% of its annual net earnings for its FY11.

Even with a high adjusted beta (correlation factor) of 1.59 to the KLCI, Handal has slightly underperformed the KLCI this year (by -12.9% vs. +2.5% year-to-date (YTD)). Market conditions have also been volatile lately, impacted by the recent political uprisings in the Middle East/North Africa and major earthquake in Japan. As Handal is not a particularly large market-cap stock, this may put a dampener on its market visibility and trading volume.

#### **“Buy Call”**

Based on our forecast of Handal’s FY11 EPS and an estimated P/E of 7 times, we set a FY11-end **Target Price (TP) of RM0.89**. This TP offers a 15.8% upside from its current market price. Our TP for Handal reflects a P/BV of 1.64 times over its FY11F BV/share. Meanwhile, the local “Oil and Gas Service” sector’s average P/E and P/BV is 56.2 times and 2.04 times, respectively.

#### **“Undemanding valuations”**

We find that Handal’s FY11F P/E valuations are not pricey at all, while it has reasonable P/BVs, dividend yields and ROEs. The group’s net gearing levels have turned into a net cash position during its FY10.

#### **“Concerns & Risk Factors”**

Meanwhile, Handal’s businesses also face possible risks such as weaker crude oil prices, delay in E&P capital expenditure by oil

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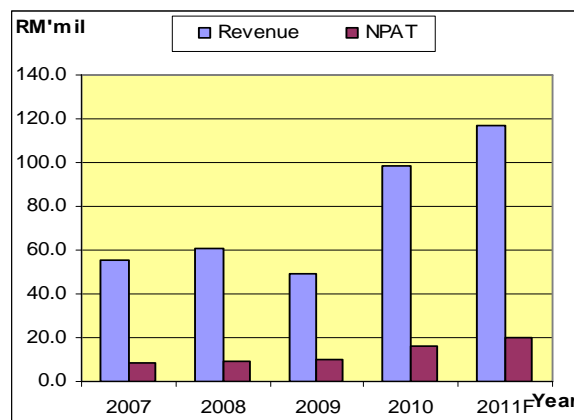
majors/Petronas, slow implementation pace of major Oil/Gas/Energy EPPs, higher steel costs for crane fabrication, foreign exchange fluctuations and also stiff competition with major international rival companies.

### Handal: Share Price



Source: NextView

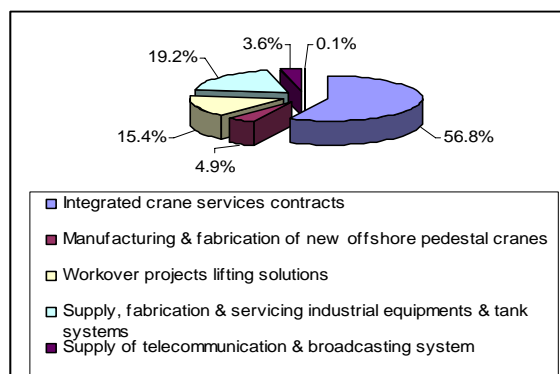
### Handal: Revenue and NPAT trend



Source: Handal

\*2011F figures are our estimates

### Handal: FY10 Revenue breakdown



Source: Handal

## KEY FINANCIALS

Key Stock Statistics	2011F
Earnings/Share (sen)	12.7
P/E Ratio (x)	6.0
Dividend/Share (sen)	4.0
NTA/Share (RM)	0.54
Book Value/Share (RM)	0.54
Issued Capital (mil shares)#	160.0
52-weeks share price (RM)	0.495 – 1.06
Major Shareholders:	%
.Dato' Mohsin Abdul Halim	15.8
.Zahari bin Hamzah	9.9
.Heaney Joel Emanuel	8.5
.Mallek Rizak bin Mohsin	7.8

\*RM0.50 par value

# including recent rights & bonus issue

Ratios Analysis^	2008	2009	2010	2011F
Book Value/Share (RM)	n.a.	0.35	0.44	0.54
Earnings/Share (sen)	n.a.	6.3	10.1	12.7
Dividend/Share (sen)	n.a.	1.1	2.3	4.0
Div. Payout Ratio (%)	n.a.	18.0	16.7	23.7
P/E Ratio (x)	n.a.	12.2	7.6	6.0
P/Book Value (x)	n.a.	2.2	1.7	1.4
Dividend Yield (%)	n.a.	1.5	2.9	5.2
ROE (%)	n.a.	17.7	22.8	23.4
Net Gearing (or cash) (x)	n.a.	0.15	(0.04)	(0.10)

\*2008 figures not available as company was listed in 2009

\*2011F figures are our estimates

^based on 160.0 million share base

P&L Analysis (RM mil)	2008	2009	2010	2011F
<b>Year end: Dec 31</b>				
Revenue	60.6	49.0	98.8	116.7
Operating Profit	15.7	14.7	23.4	31.3
Depreciation	n.a.	(1.4)	(3.8)	(4.9)
Interest Expenses	(1.9)	(1.0)	(2.3)	(3.2)
Pre-tax Profit	13.8	13.8	21.2	28.1
Effective Tax Rate (%)	32.8	27.2	23.5	27.9
Net Profit	9.2	10.0	16.2	20.2
Operating Margin (%)	25.8	30.1	23.7	26.8
Pre-tax Margin (%)	22.7	28.1	21.4	24.0
Net Margin (%)	15.3	20.5	16.4	17.3

\*2008 figures are pro-forma as company was listed in 2009

\*2011F figures are our estimates

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