

PEKAT GROUP BERHAD

(0233 | PEKAT MK) ACE | Industrial Products & Services

Prioritising Sustainable Growth

KEY INVESTMENT HIGHLIGHTS

- Among the early entrants into the solar PV business since 2008
- Focusses on order book sustainability instead of building large order book; manages to sustain RM200m of outstanding jobs at most times
- Strong recurring income from ELP and PPA which is set to enhance further
- Initiate with BUY at a TP of RM0.57

INVESTMENT THESIS

Surviving the test of time. Those in solar industry would agree that the business cycle is akin to the survival of the fittest due to the intense competition in the Malaysian market, which has seen some industry players going out of business over the years. On top of the competition comes the fluctuation of solar module prices and the exchange rate. Pekat Group Berhad (Pekat), which is among the early entrants of the solar photovoltaic (PV) business in the country back in 2008 even before the national implementation of the feed-in-tariff (FIT) in 2011, is confident that its strategies will enable it to survive every cycle. It does so by not over expanding and by only managing projects that are within its capacity.

Ensuring order book sustainability. Pekat prioritises the sustainability of its order book rather than focusing on building large order books. The group has consistently maintained its outstanding order book levels at about RM200m as it consistently takes on smaller, fast paced projects with durations of three to six months. Management expects its order book to continue growing, driven by commercial and industrial (C&I) projects and the residential market, undertaken by its two wholly-owned subsidiaries Pekat Solar Sdn Bhd and Solaroo Systems Sdn Bhd. Pekat Solar manages larger C&I customers while Solaroo is responsible for the smaller commercial and residential clientele. These are the segments that the group is focusing on as it provides better business continuity for the group. Management guided that Solaroo is currently working on a number of residential projects with several renowned property developers. It has also inked a two-year MoU with Proton Global Services Sdn Bhd to encourage the integration of solar PV systems among Proton's ecosystem and employees, creating opportunities for the Group to expand its presence in the solar energy reach.

Solid recurring revenue. Pekat's bread and butter before its entry into the solar business is in earthing and lightning protection and the division continues to provide a steady stream of income to the group, of about RM30m annually, making up 16% to 30% of the group's annual revenue. The group aims to focus on larger, fast-track projects as part of their strategy. The goal is to shorten the time it takes to execute projects and accelerate the group's revenue generation. Management is exploring

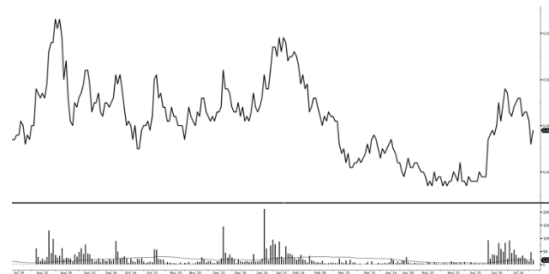
Initiate with BUY

Target Price: RM0.57

RETURN STATISTICS

Price @ 26 th July 2023 (RM)	0.445
Expected share price return (%)	+28.09
Expected dividend yield (%)	0.00
Expected total return (%)	+28.09

SHARE PRICE CHART



Price performance (%)	Absolute	Relative
1 month	1.1	-3.0
3 months	-1.1	9.9
12 months	2.3	3.3

INVESTMENT STATISTICS

FYE Dec (RM'm)	2023E	2024F	2025F
Revenue	184.6	190.1	199.6
Operating Profit	20.4	21.0	22.0
Profit Before Tax	20.0	20.6	21.6
Core Net Profit	12.0	14.9	15.9
Core EPS (sen)	1.9	2.3	2.5
PER (x)	30.6	25.0	23.1
DPS	-	-	-
Dividend Yield	-	-	-

KEY STATISTICS

FBM KLCI	1,449.29
Issue shares (m)	644.97
Estimated free float (%)	n/a
Market Capitalisation (RM'm)	287.01
52-wk price range	RM0.37-RM0.58
3-mth average daily volume (m)	1.91
3-mth average daily value (RM'm)	0.86
Top Shareholders (%)	
Chin Soo Mau	34.90
Teoh Siew Chin	20.16
Ong Soon Ho	20.16

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opportunities to expand the segment's business to Sabah and Sarawak and other countries in the region. Among projects it has secured are for the Johor Bahru-Singapore Rapid Transit System (RTS), LRT3, a semiconductor fabrication facility, a semiconductor manufacturing plant and a few data centres.

More recurring revenue stream to come. We expect more recurring income for Pekat starting FY24 through the Power Purchase Agreements (PPAs) that has been secured by its 45% associate MFP Solar Sdn Bhd. These will come from Proton's manufacturing facility in Tanjung Malim, VAT Manufacturing Malaysia Sdn Bhd's facility in Penang, Indah Water Konsortium Sdn Bhd's sewerage treatment plants throughout Malaysia and additional PPAs secured in FY22, which will bring MFP Solar's solar power plant capacity to over 35MWp. Upon the full operation of all plants, it is projected that the sales of solar energy will add more than RM10 million to the annual revenue of MFP Solar.

Initiate with BUY. We are initiating our coverage on **Pekat** with a **target price** of **RM0.57** by pegging a forward PER of 25x based on the average PER of Pekat and its peers in the solar industry, to the group's FY24F EPS of 2.3 sen. We like the management's cautious approach in ensuring a sustainable growth for the group as it navigates through a highly competitive environment that is set to become increasingly dynamic moving forward due to the draws towards the attractive green economy and the relatively low barrier to entry in terms of solar PV. Earnings prospects remain strong as Pekat continues to tackle the C&I and residential clients as more begin to adopt solar PV solutions.

BUSINESS OVERVIEW

Company background. The group was established in 1999 as a specialist in lightning protection systems, earthing systems, surge protection systems and related technologies. Its foray into solar began in 2010 when it began providing services to design, supply and install solar photovoltaic systems. Pekat was the first to attain accreditation for the "Solar PV Grid Connected System" from Pusat Tenaga Malaysia (now replaced by SEDA) and was honored by the Malaysian Book of Records as the initial installer of Solar Photovoltaic systems to be granted the ISO 50001:2011 Certification of Energy Management System. Pekat went public on the ACE Market of Bursa Malaysia on June 23, 2021. Currently, the group is principally involved in the design, supply and installation of solar photovoltaic (PV) systems and power plants as well as the supply and installation of earthing and lightning protection (ELP) systems. Its other business activities include distribution of electrical products and accessories.

Business divisions.

I. Solar

Pekat specialises in the design, supply and installation of on-grid and off-grid solar PV systems and power plants. It is responsible for the entire scope of works which includes testing and commissioning and in certain cases, operations and maintenance as stipulated in their contracted projects. They engage subcontractors to carry out, under its management and supervision, site preparation and earthworks, all installation works and interconnection to power transmission substations.

II. Earthing and Lightning Protection (ELP)

Pekat is also a specialist subcontractor for ELP where it supplies and installs ELP systems for buildings, facilities and structures, protecting against unintended electric current.

III. Trading

The group is also involved in the distribution of electrical products and accessories of own brands and third-party brands, from ELP products and accessories, solar PV related products, surge protection devices and aviation warning light systems.

LSS involvement. Pekat broke away from only C&I and residential projects when it secured a large-scale solar PV (LSSPV) project from Sun Estates Sdn Bhd to be the turnkey engineering, procurement, construction and commissioning (EPCC) contractor for a 10 megawatt alternating current (MWac) solar PV farm in Batang Padang Perak. The project is part of the

LSS Bidding Cycle 4 (LSS@MEnTARI). Pekati regards this as a significant milestone which will strengthen its track record in the LSS market, allowing it to compete in future LSS tenders. It has a dedicated team for solar farm projects and the group is capable of managing a 100Mw to 200Mw solar farm project.

Complementary maintenance business. The group's 100% owned maintenance arm Pekati RE Maintenance Sdn Bhd commenced operations in 4Q22 and has since secured clientele for operations and maintenance services, including a two-year maintenance contract for the Batang Padang LSSPV project.

Prospects remain bright. For both Pekati's solar and ELP businesses, we opine that the outlook remains positive in line with our sector thesis of the available pockets of opportunities particularly in the renewable energy (RE) space backed by the government's commitment to develop a "green economy" and the increased national RE adoption targets. Management is also optimistic that more RE quota will be offered by the Energy Commission in future, on top of new LSS tenders and more Net Energy Metering (NEM) quota, all of which Pekati is interested to participate in. The group is also among the applicants of the 800Mw Corporate Green Power Programme (CGPP), of which the awards are still pending. Meanwhile, the Energy Commission's mandatory enforcement on the safety standards on lightning protection systems also serves as a boon for Pekati's ELP business.

Figure 1: Recent notable contract wins

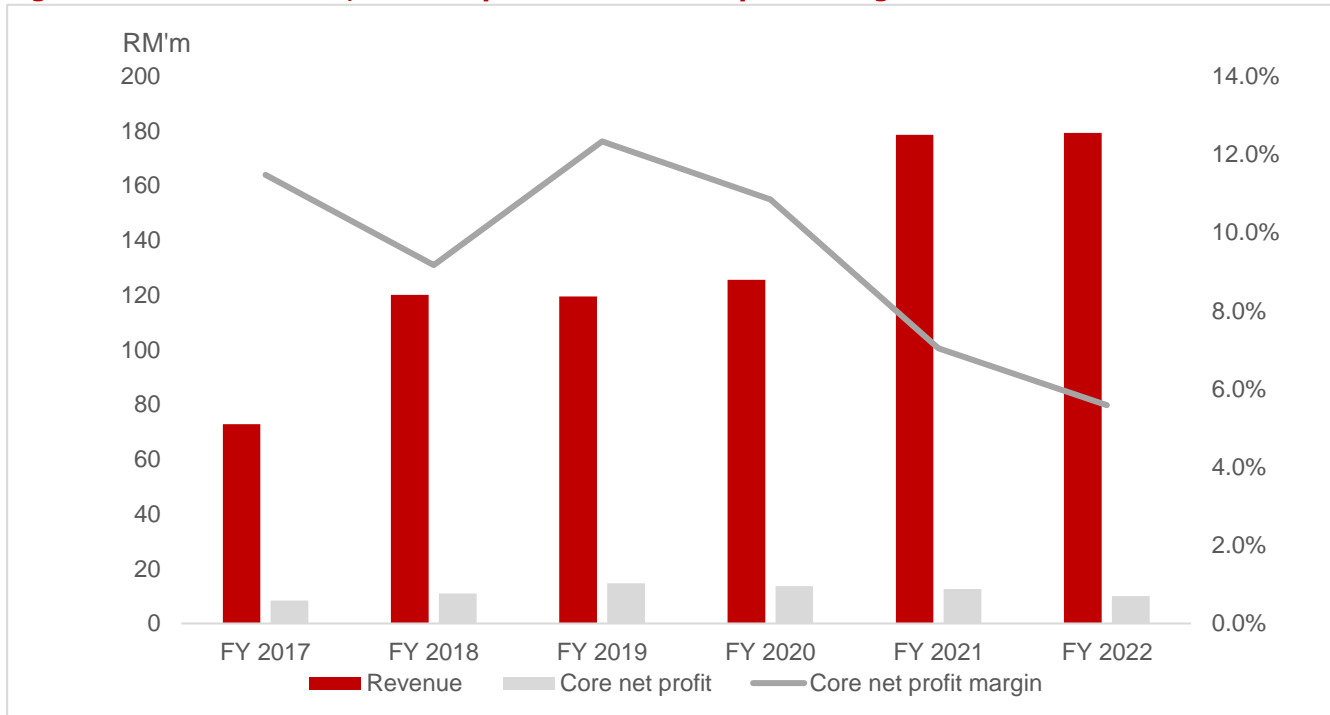
Client	Date of award	Project details	Contract sum (RM'm)	Completion Date
D & Y Textile (Malaysia) Sdn Bhd	25-04-23	Design, supply, install, test and commission grid connected solar PV systems under SELCO scheme at Taman Perindustrian Sedenak, Johor	29.1	24 Dec 2023
Hextar Chemicals Sdn Bhd	10-06-22	Design, supply, install, testing and commissioning of 185.3kWp Grid Connected Photovoltaic (GCPV) System using Net Energy Metering (NEM3.0) at Port Klang, Selangor	0.7	4 months upon receiving 30% down payment
Sun Estates Sdn Bhd	25-03-22	Turnkey Engineering, Procurement, Construction and Commissioning ("EPCC") contractor for the LSSPV with 10MWac capacity project at Daerah Batang Padang, Perak	38.3	15 Dec 2023

Source: Company, MIDFR

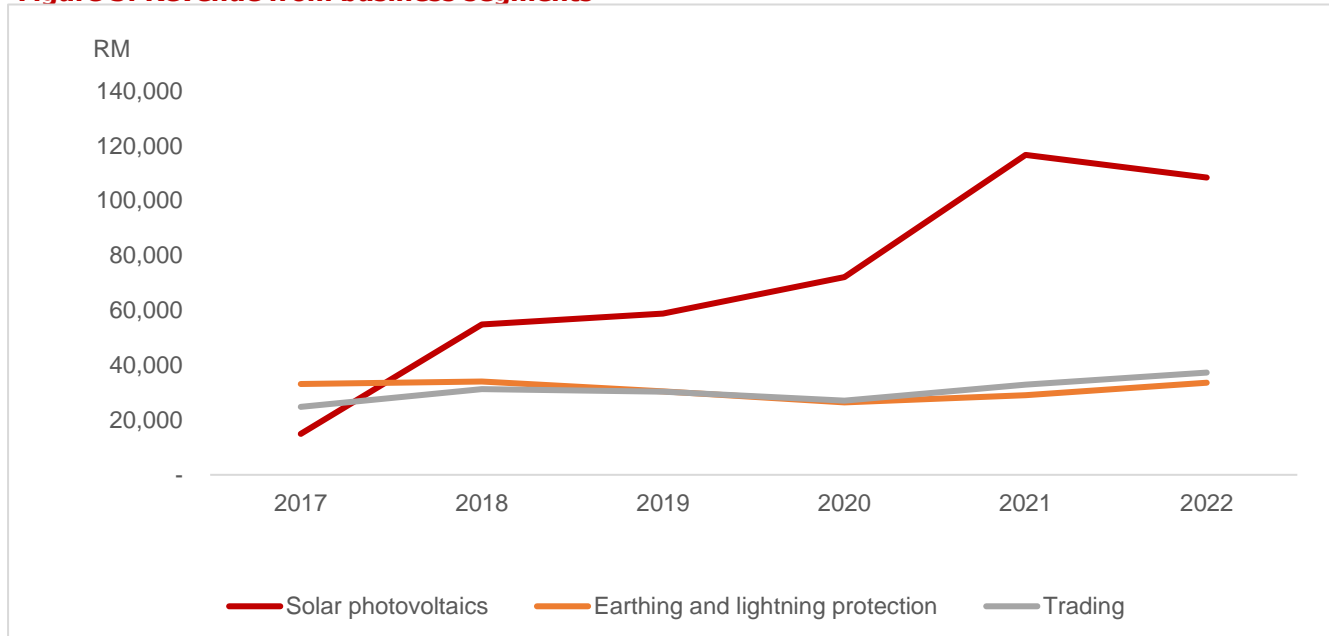
FINANCIALS

Snapshot of latest quarterly results. Pekati recorded a core net profit of RM3.2m in 1Q23, which was a reduction of -29.4%yoy. While the group's revenue grew +2.9%yoy to RM46.8m, bottom-line margins were lower on the back of higher material costs and lower margins across the solar industry due to intense competition. Solar PV remains the major contributor of the group revenue at 63.5%, followed by trading at 18.5% and ELP at 18.0%.

FY22 results snapshot. Pekati prides itself on its profitability as it has not made a single year of losses over the past 20 years. The group posted a core net profit of RM10.0m in FY22, which was a reduction of -20.3% from RM12.6m in FY21, although its revenue came in +0.4% higher at RM179.2m. This was attributable to higher staff costs as the group expanded its team to enhance production capacity, providing wider coverage nationwide and to undertake more concurrent projects. It also incurred higher finance cost as it took on more trade financing facilities for purchases of materials overseas.

Figure 2: Pekat's revenue, core net profit and core net profit margin

Source: Company, MIDFR

Figure 3: Revenue from business segments

Source: Company, MIDFR

Strong net cash position. Pekat currently sits on a cash pile of RM25.7m as at 1Q23. The group has yet to pay any dividends to date, though this does not affect our positive view on Pekat as this is vital to fuel the group's growth potential and as a cushion for it to fall back on during challenging periods for the sector.

To perform favourably in FY23 onwards. We project a 3% improvement in the group's FY23 revenue to RM184.6m, in line with management's strategy of not over expanding and a 19.9% improvement in core net profit to RM12.0m on the back of gradual improvement in margins. For FY24-FY25, we are projecting a 3%-5% growth in revenue and a 7%-24%

improvement in core net profit with the expectations of better cost control measures and stronger recurring income from its PPAs.


Target price and recommendation. We value Pekat at **RM0.58** as we ascribe a forward PER of 25x to its FY24F EPS of 2.3 sen. The PER is based on the average of Pekat's PER and that of some of its peers in the sector, namely Sunview, Solarvest and Samaiden. We are initiating our coverage on Pekat with a **BUY** recommendation. 

Figure 4: Peer comparison

	Peklat Group	Sunview Group	Solarvest Holdings	Samaiden
Market	ACE	ACE	Main	Main
Bloomberg ticker	PEKAT MK	SUNVIEW MK	SOLAR MK	SAMAIDEN MK
Share price (RM) @ 26/7/23	0.445	0.875	1.30	1.22
1-year range (RM)	0.375 - 0.58	0.36 - 0.985	0.665 - 1.32	0.60 - 1.25
Mkt cap (RM'm)	287.0	409.5	868.0	483.3
Financial year end	Dec	Mar	Mar	June
Latest Revenue (FY22/FY23)(RM'm)	179.2	347.0	365.5	150.7
EPS (sen)	1.6	3.4	2.9	3.2
Dividend yield (%)	-	-	-	-

Source: Bloomberg, MIDFR

RISKS TO BUSINESS AND INDUSTRY

Highly competitive industry. The low barrier to entry of the solar industry places Pekat in a highly competitive environment, which now has about 238 service providers, according to the Sustainable Energy Development Authority's (SEDA's) directory. This will therefore, result in stiff competition in terms of pricing when tendering for projects, which may not be worth the margins.

Claims against minimum power supply guarantees. Pekat provides a minimum power supply guarantee to its clients under the fixed lump sum plus variable periodic payment contract mode of operation for the contract duration period, usually up to 25 years from the acceptance of the handover. In unfortunate instances that the solar PV facility does not generate the performance guarantee, Pekat has to compensate the client for the shortfall based on the applicable TNB tariff.

Cost fluctuations. Among the main costs for Pekat's projects are solar modules, which usually comes up to about 50% of the cost. Any rise in costs will force Pekat to raise its tender and selling prices, which may affect its competitiveness in securing new jobs. Vice versa if it were to absorb the increases, the impact would be on Pekat's profit margins. The ability to pass on unexpected cost increases to clients would depend on clauses in the contract.

Dependence on third party manufacturers. Electrical products distributed by Pekat using its own brand name are produced by third party manufacturers under its specifications and quality control. There is a risk of material shortages or supply interruptions.

FINANCIAL SUMMARY

Income Statement (RM'm)	2021A	2022A	2023E	2024F	2025F
Revenue	178.5	179.2	184.6	190.1	199.6
Cost of sales	(133.0)	(134.1)	(134.8)	(138.8)	(145.7)
Gross profit	45.5	45.1	49.8	51.3	53.9
Administrative expenses	(28.3)	(30.2)	(30.3)	(31.2)	(33.0)
Share of profit in associates	0.5	(0.0)	0.5	0.7	0.8
Profit before tax	17.4	14.4	20.0	20.6	21.6
Tax	(4.8)	(4.4)	(5.5)	(5.7)	(5.6)
Reported net profit	12.6	10.0	12.0	14.9	15.9
Core net profit	12.6	10.0	12.0	14.9	15.9

Balance Sheet (RM'm)	2021A	2022A	2023E	2024F	2025F
Fixed assets	20.8	23.3	23.9	24.6	25.8
Intangible assets	0.4	0.3	0.3	0.3	0.3
Non-current assets	30.0	35.1	35.7	36.4	37.6
Cash	28.2	14.1	21.8	22.4	23.5
Trade debtors	33.1	40.9	34.5	35.6	37.5
Current assets	170.5	154.5	155.8	157.5	160.5
Trade creditors	34.8	9.2	13.5	10.8	9.7
Short-term debt	25.3	19.5	15.6	12.5	10.0
Current liabilities	77.4	55.8	46.6	34.3	22.6
Long-term debt	2.5	1.6	0.7	0.5	0.5
Non-current liabilities	3.6	4.3	3.4	3.2	3.2
Share capital	93.5	93.5	93.5	93.5	93.5
Retained earnings	75.9	86.0	98.0	112.9	128.8
Equity	119.4	129.5	141.5	156.4	172.3

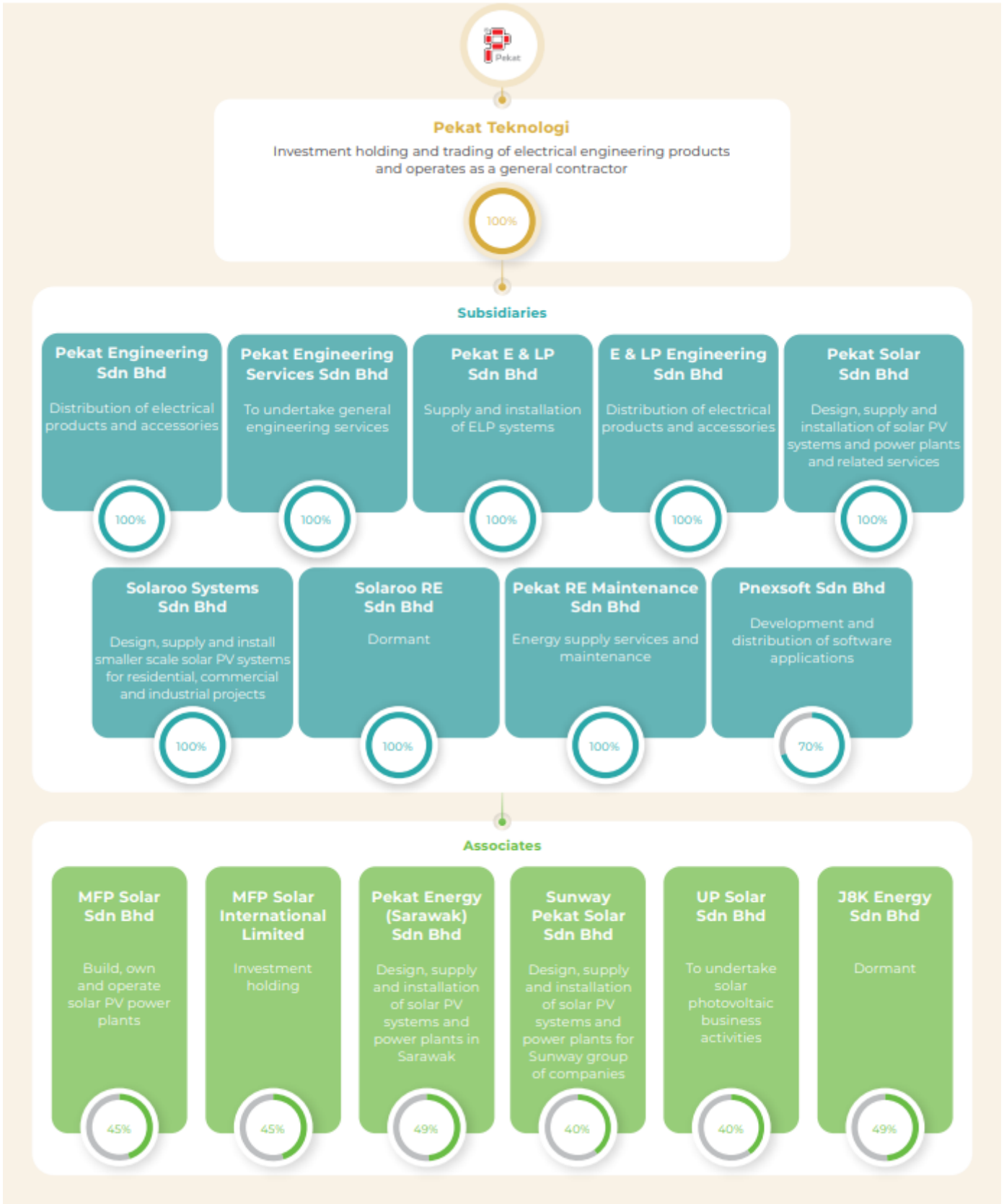
Cash Flow (RM'm)	2021A	2022A	2023E	2024F	2025F
PBT	17.4	14.4	20.0	20.6	21.6
Depreciation & amortisation	0.8	1.5	1.6	1.6	1.7
Changes in working capital	-10.1	-29.0	-39.7	-36.0	-32.9
Operating cash flow	3.2	-19.3	-2.9	1.4	5.6
Capital expenditure	-6.8	-3.2	-3.0	-2.0	-2.0
Investing cash flow	-26.9	14.3	14.5	15.5	15.5
Debt raised/(repaid)	-9.3	-2.1	-1.6	-1.1	-0.8
Equity raised/(repaid)	42.9	-	-	-	-
Dividends paid	-	-	-	-	-
Financing cash flow	36.9	-9.1	-9.6	-10.1	-10.4
Net cash flow	13.1	-14.1	2.0	6.8	10.7
Beginning cash flow	15.1	28.2	14.1	16.1	22.9
Ending cash flow	28.2	14.1	16.1	22.9	33.5

Profitability Margins	2021A	2022A	2023E	2024F	2025F
Gross profit margin	25.5%	25.2%	27.0%	27.0%	27.0%
Operating profit margin	9.8%	8.8%	11.0%	11.0%	11.0%
PBT margin	9.8%	8.1%	10.8%	10.8%	10.8%
PAT margin	7.1%	5.6%	6.5%	7.8%	8.0%
Core PAT margin	7.1%	5.6%	6.5%	7.8%	8.0%
PER (x)	34.9	29.6	30.6	25.0	23.1

Source: Bloomberg, MIDFR

APPENDIX

I. Corporate Structure



Source: Company, MIDFR

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MIDF AMANAH INVESTMENT BANK: GUIDE TO RECOMMENDATIONS

STOCK RECOMMENDATIONS

BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <-10% over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.

SECTOR RECOMMENDATIONS

POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.

ESG RECOMMENDATIONS* - source Bursa Malaysia and FTSE Russell

☆☆☆	Top 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆	Top 26-50% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆	Top 51%- 75% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
	Bottom 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell

* ESG Ratings of PLCs in FBM EMAS that have been assessed by FTSE Russell in accordance with FTSE Russell ESG Ratings Methodology