

# Chip Eng Seng

**PRICE S\$0.135**
**Buy**
**Key Stock Statistics**

NRA EPS Est. 2005	2.6
P/E on NRA Est. 2005	5.1
NRA EPS Est. 2006	2.8
P/E on NRA Est. 2006	4.8
Dividend/Share	1.5
Dividend yield (%)	11%
Issued shares (m)	606.8
Market capitalisation \$m	81.9
Avg. daily vol (m)	2.209
Book Value/Share	0.12
Shareholders:	
Lim Family	57.9%
Pheim	4.7%

**Per share data**

YE Dec	2002	2003	2004	2005E	2006E
Book Value (S\$)	0.11	0.12	0.12	0.14	0.16
Cash Flow (cts)	1.04	1.99	2.05	2.78	2.95
Earnings (cts)	0.81	1.73	1.83	2.65	2.82
Dividend (cts)	0.75	2.00	1.50	1.50	1.50
Payout Ratio	93%	116%	82%	57%	53%
PER (x)	16.7	7.8	7.4	5.1	4.8
P/CF (x)	13.0	6.8	6.6	4.9	4.6
P/BV (x)	1.21	1.1	1.1	1.0	0.9
Dividend yield %	5.6%	14.8%	11.1%	11.1%	11.1%
ROE (%)	7.2%	14.1%	13.8%	19.0%	18.2%

**P&L analysis (\$m)**

YE Dec	2002	2003	2004	2005E	2006E
Revenue	176.0	159.8	141.8	160.1	156.5
Operating Profit	4.7	11.6	8.1	16.2	11.4
Depreciation	1.1	1.2	0.8	0.8	0.8
Interest Expense	-0.1	-0.2	-0.1	-0.2	-0.2
Pretax Profit	6.5	11.3	12.8	20.1	21.4
Effective tax rate	-38.8%	-24.1%	-18.1%	-20.0%	-20.0%
Net Profit	4.0	8.6	10.4	16.1	17.1

**Margins**

Gross	5.0%	10.5%	8.2%	12.5%	9.8%
Operating	2.6%	7.1%	5.6%	10.0%	7.2%
Pre tax	3.7%	7.1%	9.0%	12.5%	13.6%
Net	2.3%	5.4%	7.4%	10.0%	10.9%

**FY04 results in line; dividend yield 11%**

- Chip Eng Seng's (CES) FY04 net profit rose 23% to S\$10.4m, in line with our forecast of S\$9.7m. The group declared a total dividend of 1.5¢, including a special of 0.75¢. This brings gross dividend yield to 11%.
- Construction revenue declined 19% to S\$96.1m and accounted for a smaller proportion of group revenues, 68% compared to 74% a year ago.
- Development profit rose 5% to S\$6.8m, with 30%-owned Grandeur 8 as the key contributor. Rental income improved from S\$0.7m to S\$1m due mainly to the absence of impairment loss in FY04.
- Progressive recognition of development projects should underpin growth. A further kicker could come from the construction sector which CES noted in its outlook commentary is seeing some signs of a recovery. But it may be premature to expect margins expansion due to competition and higher raw material costs.
- We are heartened by the group's sustained high dividend policy. It suggests a proactive approach towards capital management to ensure a high ROE. It also lends credence to our view that CES is akin to a recovery stock with a REIT tacitly stapled to the mother share. Its high dividends are funded by cashflows from its rental properties.
- We see a unique investment theme in CES – a recovery play (construction sector) stapled with to a REIT which yields high dividend. Maintaining our Buy rating. We are pegging our price target at S\$0.19 or 7x (30% discount to the 10x fair PE we had put for UEL to reflect CES' illiquidity) its FY05 earnings.

## Development arm anchors near term growth

Going forward, development projects alone should drive near term growth. In FY05, 100% sold One Fort is the key contributor. Further out, much would depend on the success of clearing the remaining inventory in Riviera Residences (45% sold as at end FY04) and Shanghai One (48% sold), and the launch of Quelin Gardens (which has a lower breakeven compared to MCL Land's The Metz).

Projects	Location	Selling pr S\$psf	Estimated margin	% sold at end-04
Grandeur 8 (30%)	Ang Mo Kio	475	10%	99%
Riviera Res (40%)	East Coast	620	26%	45%
Quelin Gdns (40%)	St Thomas	900	15%	0%
One Fort (100%)	Fort Rd	792	36%	100%
Shanghai Rd (100%)	River Valley	805	26%	48%

Source: CES and NRA estimates

## Construction recovery?

CES noted that there are some encouraging signs of a recovery in the construction sector, which has undergone 6 years of contraction. This sectoral recession has weeded out significant competition. The number of BCA A1-graded general contractors has dwindled from 81 to 32, CES being one of the survivors. Such grading allows the recognized contractors to tender for public projects of unlimited value.

Value-added in Singapore's construction sector plummeted 39% from S\$12.8 billion in 1998 to \$7.8 billion in 2003 as property prices collapsed and corporations tightened their belts in the aftermath of the Asian currency crisis. Three projects due to start construction by the end of 2005 have a combined construction cost of S\$1.2 billion (US\$712 million), according to BCI Asia research: The Marina Barrage dam, Shopping Mall Cum Bus Interchange At Ang Mo Kio Centre, Duxton Plain Public Housing (Stage 1) and the Novartis Manufacturing Plant.

BCI Asia also estimated in Oct-04 that some 805 projects with an estimated total construction costs of S\$19.8 billion were in early stages of planning, design, tender and early construction. This signals a relative busy 2005 for the construction industry.

Of these projects, CES is one of the top two contenders for a large government building works tender closed on Jan 12 – 1,848 units at The Pinnacle@Duxton. It put in a bid of S\$313m versus China Construction (lowest bidder) of S\$299m. However, its bid for its alternative proposal is the lowest, at S\$279m versus China Con's S\$294m (second lowest for the alternative proposal). Given the tender statistics, CES appears to stand a good chance of clinching this contract. We have, however, not included this contract in our forecasts.

The concern, however, is that margins could remain competitive in the nascent stages of recovery. Higher raw material costs could also cap margin expansion.

### Top 6 tenderers for Pinnacle@Duxton

	Bid (S\$m)	Alternative Bid (S\$m)
China Construction	299	294
<b>Chip Eng Seng</b>	<b>313</b>	<b>279</b>
Straits Construction	317	NA
Sim Lian	320	310
SembCorp	331	316
Tiong Aik	344	294

Source: URA

## High dividend policy

In Feb-04, PHEIM Asset Management had acquired a 4.7% stake (23.5m shares at 14 cents per share) from the various members of the founding Lim family. PHEIM's participation is likely to sustain a high dividend policy.

Indeed, CES has sustained its high dividend policy based on its 1.5¢ declared total dividend for FY04. It suggests a proactive approach towards capital management to ensure a high ROE. It also lends credence to our view that CES is akin to a recovery stock with a REIT stapled to the mother share.

Its high dividends are funded by cashflows from its rental properties. Management has explored but decided against divesting its portfolio of unencumbered investment properties worth some S\$23m. It believes it will serve its shareholders better by maintaining a high dividend policy, funded by its steady rental income. It has been augmenting its regular DPS of 0.5¢ with generous special payout over the last three years: 0.375¢ in 2000, 0.5¢ in 2002 and 1.5¢ in 2003.

### Balance Sheet & Other Fin. Data(\$m)

YE Dec	2001	2002	2003	2004
Plant and equipment	3.0	3.1	1.7	1.3
Investment property	26.7	24.5	24.0	22.8
Long term assets	32.4	35.4	35.5	37.5
Current assets	92.1	134.0	132.8	165.7
Current liabilities	71.5	90.0	82.2	116.0
Long term liabilities	0.0	24.7	24.9	11.6
Total net assets	53.0	54.7	61.2	75.7
Shareholders funds	53.0	54.7	61.1	75.6
Net debt	Net cash	12.9	27.1	63.3
Gearing	Net cash	23.5%	44.3%	83.7%

## Valuation

We see a unique investment theme in CES – a recovery play (construction sector) stapled to a “REIT” based on its tacit commitment to paying out high dividend funded by its investment portfolio. It will only divest its unencumbered investment properties if there is more productive usage of the proceeds. Gross dividend yield based on the latest declared dividend is high at 11%.

PE valuation is also undemanding, at about 5x for both FY05 and FY06. We are maintaining our Buy rating. We are pegging our price target at S\$0.19 or 7x (30% discount to the 10x fair PE we had put for UEL to reflect CES' illiquidity) its FY05 earnings. We maintain our Buy rating.

### Earnings Forecasts

YE Dec (\$m)	2002	2003	2004	2005E	2006E
<b>EBIT</b>	<b>1.8</b>	<b>8.8</b>	<b>8.2</b>	<b>16.3</b>	<b>11.6</b>
Building construction	3.9	3.9	4.9	2.9	3.3
Property development	(1.0)	4.0	2.1	12.6	7.5
Rental	(0.1)	0.7	1.0	0.7	0.7
Others	(0.5)	0.2	0.2	0.2	0.2
Interest expense	(0.1)	(0.2)	(0.1)	(0.2)	(0.2)
Operating profit	1.7	8.6	8.1	16.2	11.4
Associates	4.8	2.7	4.7	3.9	9.9
<b>Pre tax profit</b>	<b>6.5</b>	<b>11.3</b>	<b>12.8</b>	<b>20.1</b>	<b>21.4</b>
Taxation	(2.5)	(2.7)	(2.3)	(4.0)	(4.3)
<b>Net profit</b>	<b>4.0</b>	<b>8.6</b>	<b>10.4</b>	<b>16.1</b>	<b>17.1</b>
Wtd no of shares	490.2	490.9	545.9	606.8	606.8
EPS	0.8	1.8	1.9	2.6	2.8
DPS-regular	0.25	0.50	0.75	0.75	0.75
DPS-special	0.50	1.50	0.75	0.75	0.75
DPS-Total	0.8	2.0	1.5	1.5	1.5

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