Ireka lags rally due to defensive qualities

Ireka Corp's (72 sen) share price has lagged its peers and the broader market in the recent rally. The stock started the year at 66 sen, and has risen only 9.1% to 72 sen for the first half of 2009, as compared with a 20% gain for the KLCI.

From its March 2009 lows of 56 sen, the stock is up 29%, nowhere near the doubling of many construction and property stocks.

Ireka's lagging share price could be due to the fact that while it is a construction and property play, it is also relatively more defensive in nature.

Its earnings are decent relative to size, but will lack the strong growth that other property players will usually see during an economic recovery.

Nonetheless, its business model also ensures downside is limited during an economic downturn.

This is because the group's ongoing property projects in Malaysia and Vietnam are all parked under its London-listed property fund, Aseana Properties Ltd (ASPL).

ASPL is considered an investment and its earnings are not equity accounted, although Ireka's stake has recently increased from 19.6% to just over 20% after ASPL bought back 15% of its own shares. Any upside will be reflected in ASPL's share price or net asset value (NAV), rather than Ireka directly.

Ireka's unique business model ensures a steady stream of sustainable earnings from management fees from ASPL, balanced with cyclical construction profits.

The core construction arm's large order book will keep it busy for the next 2-3 years and margins should look better as building material costs, especially steel, have fallen.

Through ASPL it also has access to a large war chest for future investments in Malaysia and Vietnam. This gives Ireka a far larger scale of operations than otherwise possible relative to size.

Ireka's core construction arm has a large RM722 million order book, some 8.8 times its current market capitalisation of RM82 million. This is largely for projects undertaken by ASPL, which ensures negligible default or late payment risks, a common problem for the industry during a slowdown.

An asset-light balance sheet insulates the company from the current downturn.

As such, its balance sheet should remain reasonably healthy — and can sustain high dividends — with funding needed only for ongoing construction activities.

We maintain our buy recommendation. At 72 sen, its shares are trading at price-to-earnings (P/E) valuations of around 5.7 times for FY March 2010-11 and well below their latest book value of RM2.06.

We expect attractive dividend yields of 4.9% in FY10-11, based on a more conservative 28% payout ratio, as compared with the company's earlier stated 40% payout ratio.

Ireka Corp earnings forecast

YE Mar (RM m)	2008	2009	2010E	2011E
Turnover	330.6	323.7	369.7	369.7
Pre-tax profit	157.8	7.0	17.5	17.9
Net profit	157.6	6.0	14.3	14.3
EPS (sen)	138.3	5.3	12.6	12.5
P/E (x)	0.5	13.6	5.7	5.8
Dividend (sen)	10	2	3.5	3.5
Net yield (%)	13.9	2.8	4.9	4.9
NTA (RM)	2.08	2.06	2.14	2.22
Price/NTA (x)	0.35	0.35	0.34	0.32

Recent final results

Ireka's recently released final results for FY March 2009 were within expectations. The company was solidly in the black in the fourth quarter (4Q FY09) as the fall in building material and commodity prices benefited its construction arm.

The company posted net profit of RM6 million for the full year, on the back of turnover of RM323.7 million. This was within our forecast of RM6.4 million and RM316 million, respectively.

Its results would been better if not for a one-off loss of RM1.75 million for some IT investments. The effective tax rate was low at 13% due to allowances from previous losses.

A comparison with the previous year is not relevant as FY08 included RM175.8 million in exceptional gains from the disposal of several property companies to ASPL. As such, the company posted a net profit of RM157.6 million in FY08.

In 4QFY09, Ireka posted pre-tax profit of RM4.1 million, compared with a loss of RM6.6 million a year earlier. Net profit came in at RM4 million, compared with a net loss of RM5.7 million previously. The quarter's profits accounted for 67% of the full year total.

The construction arm has turned around well after several years of losses due to escalating building material costs. The construction arm posted revenues of RM286.5 million for FY09 accounting for 88% of Ireka's total.

Although this turnover was almost similar to FY08, the construction division reversed from a pre-tax loss of RM27.2 million to a pre-tax profit of RM7.5 million, with pre-tax margin of 2.6%. We expect margins to improve to 4.5% in FY10 as cost pressures ease.

As at March 2009, net debt stood at RM84.2 million, with gearing at a very manageable 36%.

Positive earnings outlook

There is growing consensus that we have already seen the worst for the global and domestic economy in 1Q09. However, the road to recovery is still patchy and a bottoming of the economy is only likely to happen in 4Q09.

Even then, the property sector tends to lag the economy. This could see fewer new jobs available for property-based construction players — even if the economy as a whole starts to recover.

Indeed, much of the recent upsurge in property sales has been from clearing existing stocks with attractive financing packages and discounts, rather than new launches.

Despite the more subdued outlook ahead, Ireka's revenues are largely assured and earnings should look quite positive for the next two years.

Revenue over the next few years will be supported by a large unbilled order book totalling RM722 million. The steep fall in building material and commodity prices from 4Q08 has also removed major cost pressures that crimped margins earlier.

The product mix of Ireka's order book will improve going forward and this will boost margins. The older projects were the ones most affected by higher costs due to lower original contract prices.

These include I-Zen@Kiara 1 (completed in June 2008), Tiffani by i-Zen (which will complete in 3Q09) and One Mont'Kiara (which will complete in 2Q2010).

As these older projects are being progressively completed, the order book is being replenished by newer and better-margin ones, priced when building material prices were much higher. Most notable is the RM539.8 million Seni Mont'Kiara contract secured in July 2008, which forms the bulk of the outstanding unbilled order book.

The construction order book is likely to grow further given the pipeline of ASPL's new projects, which includes two office towers and a hotel within KL Sentral and two joint-venture projects in Ho Chi Minh City, Vietnam — Queen's Place and Hi-Tech Healthcare Park. The timing of these projects will depend on market conditions.

Note: This report is brought to you by Asia Analytica Sdn Bhd, a licensed investment adviser. Please exercise your own judgment or seek professional advice for your specific investment needs. We are not responsible for your investment decisions. Our shareholders, directors and employees may have positions in any of the stocks mentioned.