Suria Capital (6521): HOLD

Huge dependency on Sabah's success

Share price: RM2.07
Target Price: RM2.20 (+6.3%)

September 29, 2017
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Initial Coverage

- **We initiate coverage on Suria Capital (Suria) with a HOLD call as we are cautious over its near term growth potential albeit casting a positive view in the long term amidst various initiatives to boost Sabah's economy.**
- **While the government's initiatives to boost Sabah's economy are positive for Suria's port operations, we believe the impact could be protracted, leading to ROE dilution in the interim.**
- **We expect earnings to grow remain flattish in the next few years as potential gains from the recovery of the plantation sector would be offset by higher depreciation arising from its new investments.**
- **Initiate with a HOLD based on DCF-derived TP of RM2.20 which implies FY18PE of 9.7x.**

A proxy for Sabah's industrialization

Suria being the sole concessionaire of major ports in Sabah makes a good proxy for direct exposure to Sabah industrializations. Various economic impetuses conceptualized for the State such as the Pan Borneo Highway, Sipitang Oil & Gas Industrial Park (SOGIP) and Sabah Oil & Gas Terminal (SOGT) in Kimanis create more investments in the state and more activities at the ports.

Expansions to complement Sabah's economic ambitions

In tandem with the government's plan to spend RM11.42bn in Sabah under the 11th MP, Suria has allocated capex worth RM640m. This would go to expand port facilities and services as well as consolidate its existing operations to the Sapangar Bay Port. The capex spending complements ongoing and future initiatives to boost Sabah's economy. The expansion of SBCP positions the port as a transhipment hub as it leverage on its strategic location along the main shipping routes of the East Asian sea trade as well as being at the centre of the Brunei-Indonesia-Malaysia-Philippines East ASEAN Growth Area (BIMP-EAGA). Suria is in talks with MMC to tap the latter's expertise in container port operations.

Higher CAPEX to moderate earnings growth

While we expect revenue to improve from FY18 onwards in tandem with the recovery in CPO production, we see limited growth in earnings due to the higher depreciation charge following Suria's planned capex spending. In the immediate term, we expect FY17 earnings to remain weak due to lingering effects of the El Nino which sees lower CPO production as well as higher operating costs incurred.

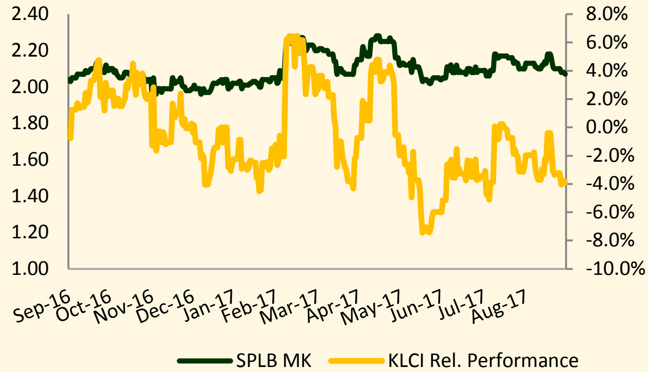
Initiate with HOLD recommendation at TP RM2.20

We initiate coverage on Suria with a HOLD recommendation and a DCF-derived TP of RM2.20 (WACC: 8.2%). Our TP implies an FY18F PE of 9.7x which we see as fair. While we are positive on the potential growth in Sabah's economy in view of the various initiatives by the government, we believe the impact to Suria could be protracted.

Stock Data

Bloomberg Ticker	Suria MK	Altman Z-score	2.4
Market Cap	596.5	YTD price chg	4.0%
Issued shares	288.2	YTD KLCI chg	7.1%
52-week range (H/L)	2.20/1.92	Beta	0.7
3-mth avg daily vol	43,852	**Major**	
Free Float	41.6%	WARISAN HARTA	45.4%
Shariah Compliant	Y	LTH	9.3%
Financial Derivatives	n.a.	YAYASAN SABAH	3.7%

Share Price (RM)



Share Performance	1mth	3mth	12mth
Absolute	(1.4)	1.5	5.0
vs. KLCI	(0.8)	2.2	(3.9)

Financial Highlights (RM m)

FY 31 Dec (RM m)	2015	2016	2017E	2018E	2019E
Revenue	496.7	258.5	279.6	367.0	367.9
Construction rev.	(9.3)	(31.0)	(50.0)	(100.0)	(100.0)
Operation revenue	487.4	227.5	229.6	267.0	267.9
EBITDA	193.1	127.6	122.5	132.7	137.2
EBIT	152.3	87.7	80.1	88.8	92.4
Pretax profit	148.2	83.5	76.1	82.9	85.3
Net Profit	**126.4**	**66.7**	**60.1**	**65.5**	**67.4**
EPS (sen)	43.9	23.1	20.9	22.7	23.4
PER (x)	4.8	9.1	10.1	9.2	9.0
DPS (sen)	7.0	7.0	7.0	8.0	8.0
Div. Yield (%)	3.3%	3.3%	3.3%	3.8%	3.8%
Margins					
EBIT margin	31%	34%	29%	24%	25%
Pretax margin	30%	32%	27%	23%	23%
Net margin	25%	26%	22%	18%	18%
ROE	13%	7%	6%	6%	6%
ROA	9%	5%	4%	4%	4%
Net Gearing (x)	net	net	net	0.02	0.05

Source: Bloomberg, BIMB Securities Research

Preparing to set sail

Being the sole port operator in Sabah, Suria Capital Holdings Bhd (Suria) would make a good proxy for direct exposure to Sabah's industrialisation. This is in view of the various economic impetuses planned for the state. Under the 11th Malaysia Plan (11MP), the government has allocated RM11.42bn for various projects that include road upgrades, improving reliability of electricity, water supplies and broadband coverage as well as the much anticipated Pan Borneo Highway (PBH) Sabah. Other major development plans that have been outlined include the Sipitang Oil & Gas Industrial Park (SOGIP) and the Sandakan Palm Oil Industrial Complex (POIC) – the second complex after Lahad Datu POIC.

Despite the promising economic impetuses, we initiate coverage on Suria with cautious optimism especially in the near to medium term while holding a more positive outlook in the long term. In our view, the industrialisation initiatives would be positive for Suria's port operations but we believe the impact could be protracted.

Sabah's GDP has grown at 5.3% CAGR over 2013-16. However, records in recent years show that Sabah remains the third poorest state in Malaysia. In nominal GDP per capita terms, it is only ahead of Kedah and Kelantan at RM21,081 in 2016. At this juncture, Suria's port revenues (makes up 96% of total revenue) provide limited leverage to the growth in Sabah's GDP. Over the same period, port revenues have been declining at a compounded rate of 0.6%. We believe the huge disconnect is largely due to several key factors such as:

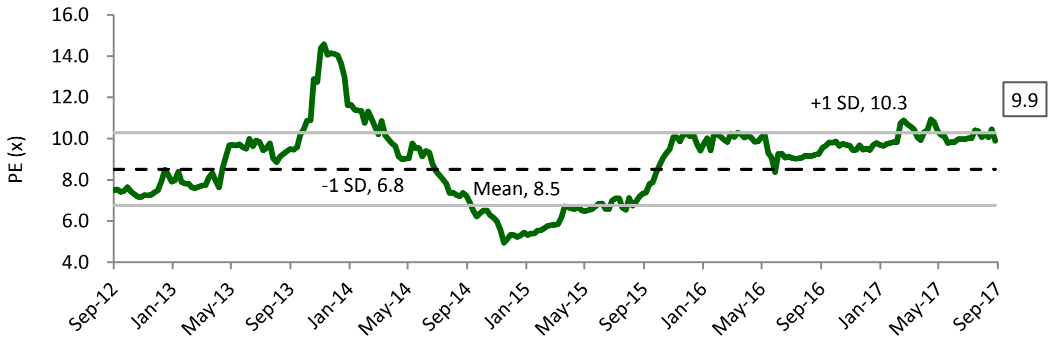
- Shrinking manufacturing industry which has led to lower containerised cargoes; we believe this is also attributed to the decline in the timber sector as companies switch to oil palm cultivation;
- Low rates for conventional cargo despite higher yoy throughputs; we believe this is mainly due to the throughput volume being driven by higher cargo throughputs at anchor (ie. within jetty/port waters instead at the wharf) which incurs significantly lower tariffs;
- Revenue loss for the supply of bunker fuel due to contract termination by Star Cruise Liner in 2015 which made Kota Kinabalu port its home port;

In the interim, Suria has planned capex spending of about RM640m for upgrades and consolidation of its port operations particularly at the Sapangar Port such as:

- Expansion of the Container Port which would be positioned as a transhipment hub
- Construction of a Conventional Cargo Terminal to relocate Kota Kinabalu (KK) port operations; KK port would be positioned to tap the boom in tourism via the mixed developments
- Extension to the Oil Jetty in Sapangar Port
- Also included in the capex is wharf extension at the Sandakan port concurrent with the ongoing development of the Sandakan Palm Oil Industrial Complex (POIC).

We also expect edible oil throughput to improve in tandem with production recovery for the plantation sector as yields have deteriorated in 2015 and 2016 due to the El Nino weather phenomenon. Against our estimates, the stock trades at 9.9x 12-month forward PE which is within +1SD of its mean of 8.5x.

Chart 1 : Suria 5-year historical forward PE (12-month rolling)



Source: Bloomberg, BIMB Securities

The company recently announced that it is in talks with MMC for the latter to acquire a stake in Sabah Port SB (SPSB). We believe the strategic divestment to MMC is aimed at tapping the latter's expertise in operating the Sapangar Bay Container Port (SBCP). Suria aims to position SBCP as the "Transhipment Hub of the East", leveraging on its strategic location which is at the centre of the Brunei, Indonesia, Malaysia and the Philippines – East ASEAN Growth Area (BIMP-EAGA) economic region. If materialise, we expect MMC to boost cargo throughput and enhance transhipment business which is relatively small at this juncture.

On its property division, the company has also entered into two joint ventures with SBC Corporation and Gabungan AQRS for the developments of a 23.25 acres of land within the Kota Kinabalu Port.

Initiate with a HOLD

We initiate coverage on Suria with HOLD recommendation and a DCF-derived target price (TP) of RM2.20. Our DCF assumes a WACC of 8.2% (risk-free rate of 4% and risk premium of 5%) and a conservative terminal growth rate of 0% which implies an FY18F PE of 9.7x (Table 1). We believe this is fair as we expect Suria is poised to better benefit from the future growth of Sabah's economy. Our TP and forecasts does not factor in potential contributions from future proceeds from its property joint ventures with Gabungan AQRS.

Table 1: DCF breakdown

Items	RM m	Remarks
WACC (%)	8.2%	
Long term growth rate (%)	0%	
NPV of forecast	161.1	
NPV of terminal value	508.6	
Total Enterprise value	**669.8**	
Less: (net debt) / cash	(26.15)	
Total Equity value	**643.6**	
No. of shares (m)	288.2	
Equity value per share (RM)	**2.20**	Implies FY18F PE of 9.7x

Source: BIMB Securities

Against its peers

We compared Suria against other port operators in the region and around the world and found that the stock trades at a huge discount to its peers in PE terms despite its impressive EBITDA margin and relatively decent yields. We believe the discount accorded is attributed to its limited earnings catalyst. Even with the planned RM640m capex, we believe there is inherent earnings risk due to the high reliance on the successful execution of economic impetuses outlined by the government.

Table 2: Peer comparison

Company	Mkt Cap (USD m)	P/E (x)		PEG (x)	EBITDA mar. (%)		ROE (%)		Dvd Yield (%)	
		FY17	FY16	FY16-18	FY17	FY18	FY17	FY18	FY17	FY18
Suria Capital Holdings	144.5	9.9	9.1	-10.9	43.8	36.2	5.7	6.0	3.8	3.8
Westports Holdings	3159.6	22.5	23.4	-3.5	42.7	51.7	25.3	22.6	3.3	3.1
Bintulu Port Holdings	648.1	19.0	18.3	-16.7	44.2	43.8	11.7	11.6	3.5	3.8
MMC Corp	1636.2	18.9	15.2	-1.9	32.0	31.8	3.5	4.2	1.7	1.7
Shanghai International	23352.2	18.8	16.2	1.1	43.1	41.6	11.5	12.2	2.7	3.0
DP World	19256.0	15.9	14.4	0.0	51.6	52.1	11.2	11.3	1.9	2.1
Adani Ports And Special Econ	13186.2	22.6	23.5	1.8	64.2	64.0	15.5	12.9	0.5	0.8
China Merchants Port	10984.5	16.6	16.6	-5.2	52.0	52.7	7.0	6.9	5.9	2.8
Intl Container Term Svcs	4220.2	27.3	20.1	3.5	47.2	47.4	12.1	16.0	1.9	1.9
Hutchison Port	3920.0	25.0	24.4	-1.7	56.8	56.8	3.1	3.2	6.0	6.2
Cosco Shipping Ports	3358.7	14.4	12.4	3.0	59.8	58.2	4.7	5.3	3.3	3.3
Qinhuangdao Port Co Ltd-H	7187.1	45.5	47.6	0.7	42.1	40.4	47.3	43.1	4.0	3.7
Weighted Average	**91053.2**	**21.2**	**20.0**	**1.6**	**50.1**	**50.0**	**14.1**	**13.7**	**2.8**	**2.6**

Source: Bloomberg, BIMB Securities

Review of Suria's Shariah Status

We reviewed Suria's Shariah status in accordance with the screening methodology and processes adopted by the Shariah Advisory Council of Securities Commission Malaysia (SACSC) which is via its two-tier quantitative approach: (i) business activities benchmark (BAB) and (ii) financial activities ratio benchmarks (FARB). For BAB, Suria's non-permissible income (NPI) to turnover (TO) is only 0.9% in FY16, well below the 5% threshold. Similarly, under the FARB, the allowable benchmark for cash in conventional financial institution (C) to total asset (TA) and debts through conventional financial instruments (D) to TA are 15.2% and 8.3% respectively, well below the 33% limit. (Table 3).

Table 3: Suria's Shariah status review as of FY16

Business Activity Benchmark	Suria Capital	SC Benchmark
Revenue/ Turnover TO (RM'000)	258.5	
Non Permissible Income (NPI): Interest Income (RM'000)	2.4	
NPI/TO (%)	0.9%	5%
Financial Ratios Benchmark		
Total Assets (TA)	1,348.8	
Cash in conventional financial institution (C)	205.1	
Debts through Conventional financial instruments (D)	112.4	
C/TA	15.2%	33%
D/TA	8.3%	33%

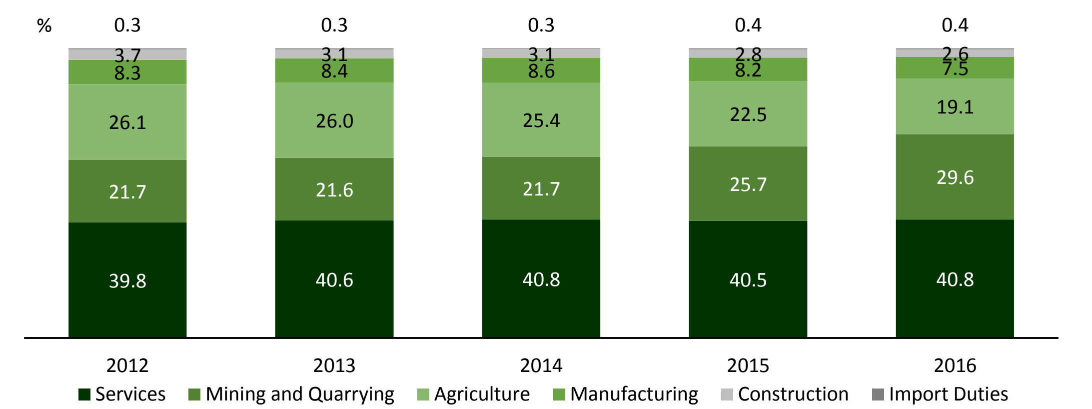
Source: SC, Company, BIMB Securities

Capitalising on Sabah's industrialisation ambitions

Sabah's GDP has grown at an impressive 5.3% CAGR over 2013-16 to RM73.8bn in 2016. The state ranks as one of the top 6 states in the country with a 6.7% contribution to national GDP. Despite the strong growth and being the second largest state in Malaysia (in terms of land size), the state is the third poorest in Malaysia with nominal GDP per capita of only RM21,081.

The main contributor to Sabah's GDP is the Services sector, reflecting the growth in tourism industry there. This is followed by Mining & Quarrying on the back of the huge investments in the Oil & Gas sector (Chart 2). With Sabah having the largest oil palm cultivation acreage and CPO output in the country, the Agriculture sector is the next largest GDP contributor (Chart 2, 3 & 4). Meanwhile, GDP contribution from the Manufacturing and Construction sectors continue to ease with import duties being stable at c.0.3-0.4% (Chart 2).

Chart 2: Sabah GDP by economic activities



Source: Department of Statistic Malaysia, BIMB Securities

Chart 3: CPO production by state as at Jul 2017

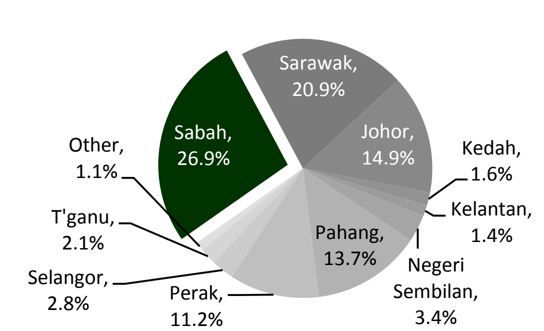
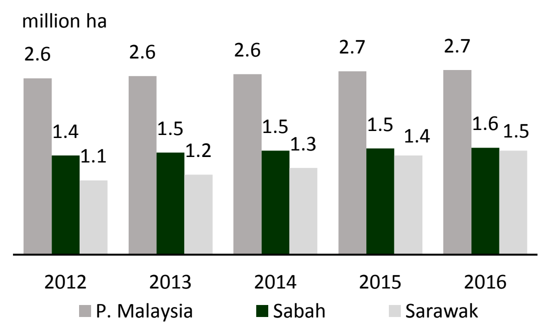


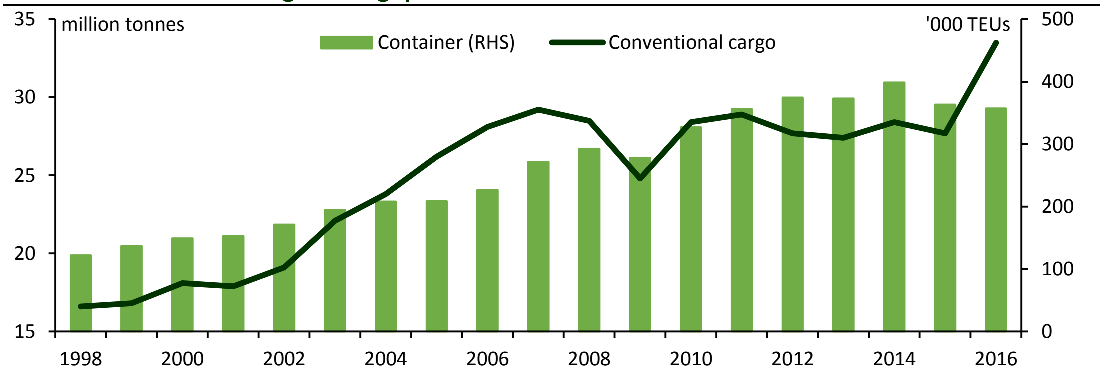
Chart 4: Oil Palm planted area



Source: MPOB, BIMB Securities

In tandem with the GDP growth, conventional cargo throughput has increased over the same period (Chart 5). The sharp rise in conventional cargo for 2016 was driven by the Oil & Gas (including Petrochemical) sector. However, revenue growth was limited as throughput occurs at anchor (ie. jetty/port waters) which incurs much lower fees to that at the wharf while container volume also fell.

Chart 5: Suria's total cargo throughputs



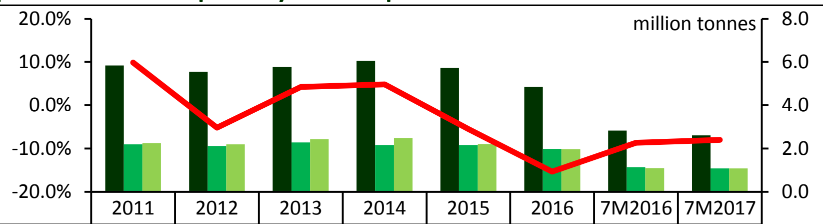
Source : Company, BIMB Securities

The government has allocated RM11.42bn under the 11MP to fund various infrastructure projects and re-strategize the economic growth of the state. Some of these projects would be funded by the private players such as Suria Capital. In essence, the economic drivers would be split between the Agriculture sector which would boost income for communities in East Sabah while drivers for West Sabah would be underpinned by investments in the Oil & Gas sector, Manufacturing and Services (to some extent, it also includes the Tourism sector). Linking up these developments would be the Pan Borneo Highway Sabah which would expedite the movement of goods and service. Further details on the government initiatives are as follow:

- **Expanding Oil & Gas activities generating higher throughputs.** The rapid development of the O&G (including Petrochemical) sector in Sabah in recent years have largely underpinned the throughput volume growth for the conventional cargoes at Suria's port in Kimanis. This is in the wake of the Gumusut-Kakap (GK) field hitting first oil in Oct 2014 with peak production of 148,000bpd being channelled to the Sabah Oil & Gas Terminal (SOGT) in Kimanis and the commissioning of Petronas Chemical's Ammonia and Urea plant, SAMUR, in Aug 2016 which is within the Sipitang Oil & Gas Industrial Park (SOGIP).
- **Another Palm Oil Industrial Complex (POIC) in Sandakan.** The first POIC initiative in Lahad Datu commenced in 2005 and secured investments amounting over RM1bn in the first 16 months of its launch. Being the larger of the two, the Lahad Datu POIC covers land area of 2,023 hectares (ha) with the latest total investments in the POIC since inception amounting to RM4.5bn. In the wake of the strong interest in Lahad Datu POIC, development of the Sandakan POIC was launched in 2007 and spearheaded by SAWIT Kinabalu. Developed over a smaller area of 1,120 ha, the cluster targets higher value-added downstream processing of palm oil. In early Aug, the Deputy Chief Minister was quoted by *Borneo Post* that cumulative investment in the cluster which amounted to only RM335m would be complemented by a new 300MW CCGT power plant. Part of the RM640m capex planned by Suria would go to extend the wharf at the Sandakan port.

In the near to medium term, we also expect GDP contribution from the Agriculture sector to see some respite after declining to just over 19% in 2016 (from 25-26% over 2012-13; refer to Chart 2). CPO production in 2015 and 2016 was impacted by the El-Nino phenomenon and exacerbated by high acreage of immature trees resulting from replanting activities. As a result, Sabah's CPO production fell at a compounded annual rate of 5.7% over 2013-16 to just 4.8 million tonnes (Chart 6).

Chart 6: Sabah's CPO production and exports by Sabah's ports



	2011	2012	2013	2014	2015	2016	7M2016	7M2017
CPO production	5.84	5.54	5.78	6.06	5.72	4.85	2.84	2.61
Lahad Datu export	2.19	2.12	2.28	2.16	2.17	1.99	1.14	1.09
Sandakan export	2.26	2.20	2.44	2.49	2.21	1.97	1.10	1.08
% CPO production chg (LHS)	9.9%	-5.1%	4.2%	4.8%	-5.5%	-15.3%	-8.6%	-8.0%

Source: MPOB, BIMB Securities

The lingering effect from El-Nino is still evident in 1H17 as CPO exports at Lahad Datu and Sandakan ports are still lower (Chart 6). We expect a more meaningful recovery in 2018 on higher yields with more planted areas maturing.

We also see the removal of the cabotage policy which came to effect on 1 Jun 2017 as another catalyst for higher port throughput. This should lower prices of goods imported into Sabah. While it provides a relief to disposable income, we believe the impact is fairly minimal relative to the many economic impetuses outlined to spur Sabah's economy.

Growth initiatives in tune with government measures

Suria has been the exclusive port operator for the 8 main Sabah ports for the last 13 years since 1 Sep 2004. Its concession lasts for 30 years (ie. up to 1 Sep 2034) with the company having an option to extend the concession for another 30 years. Apart from its port operations, Suria is also involved in logistics, bunkering services, contract and engineering services as well as property development.

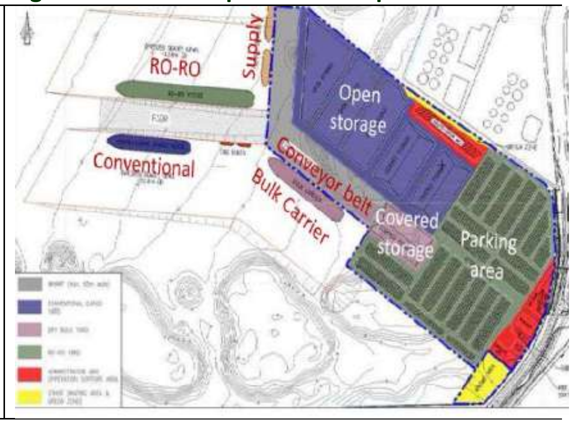
The port operations remain its core business, contributing about 96% and 83% to revenue and pretax profits respectively. Sabah's ports support the most widely used transportation medium i.e. shipping for imports and exports within the state and regional areas. In enhancing the services of its port operations, several initiatives which complements the master plan to redevelop the state have been conceptualised such as:

- **Expansion of Sapangar Bay port.** The Sapangar Bay port would be the main port for the state as the existing conventional cargo operation at Kota Kinabalu Port (KK Port) would be relocated to Sapangar Bay Port which also comprises the Container Port (SBCP) and the Oil Terminal (SBOT). Overall, the development in Sapangar Bay would incur capex of about RM490m with the Federal government adding another RM1bn. Meanwhile, the KK Port would be focused on supporting the tourism industry as it retains the cruise terminal there. This would complement the two joint development projects – Jesselton Quay and One Jesselton Waterfront.

  Phase 1 expansion of SBCP (spanning over 2017 to 2022) would see: i) the number of quay cranes increased to 12 units (from 2), ii) deepening draft to 15 meters (from 12m), iii) extending the quay length to 1km (from 500m) and iv) raising TUE handling capacity to 1.25 million (from 500,000).

Figure 1: SBCP Expansion Proposed Plan

Figure 2: SBCCT Proposed Development



Source: Company, BIMB Securities

  The expansion of the Sapangar Bay Container Port (SBCP) is to leverage on its strategic location along the main shipping routes of the East Asian sea trade as well as being at the centre of the Brunei-Indonesia-Malaysia-Philippines East ASEAN Growth Area (BIMP-EAGA). Suria plans to turn SBCP into the Transhipment Hub of the East.

  To boost its capabilities, management plans to tap the expertise of MMC Corporation. It is currently in talks with the conglomerate for possible collaboration in port operations. On its own, Suria has, in Jan 2017, upgraded its IT infrastructure and network at SBCP with implementation of the Autostore Terminal Operating System (TOS). This provides real time tracking of containers in order to speed up the handling process. SBCP will be receiving 2 new quay cranes by November 2017 making a total of 4 quay cranes to handle wharf operations.

- **Sandakan Port expansion to complement the SAWIT POIC.** Suria have also earmarked capex spending worth RM150m for the wharf extension and to provide Barge facilities at the Sandakan Port. This is to cater for the growing port activity in tandem with the growing investment in SAWIT POIC. Currently, the port accounts for among the highest number of vessels at wharf (1,522 vessels) and anchor (1,637 vessels) in 2016. It also handles the largest crude palm oil export and PKE bulk main export at 1.3m tonnes and 0.2m tonnes respectively.

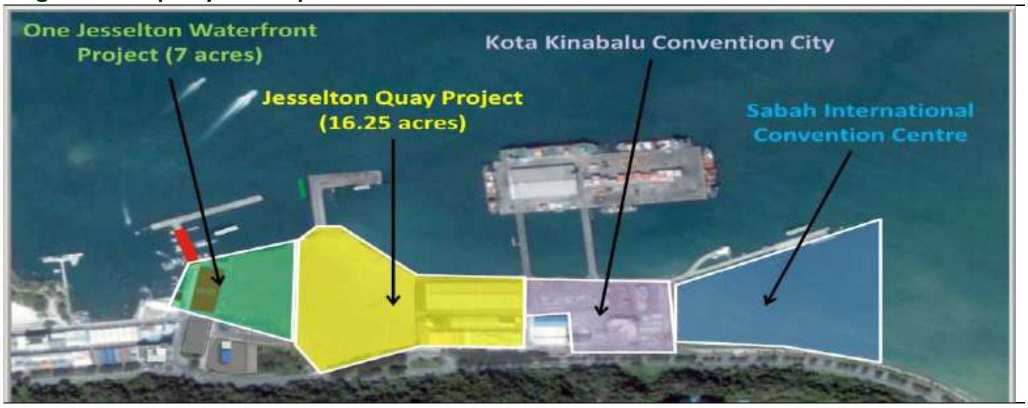
- **Tariff adjustments a key re-rating catalyst going forward.** Management indicated that it has proposed to the government a new tariff structure for its port facilities. However, we are not expecting any new adjustments in the near future as we are made to understand that authorities are reluctant for an increase. Despite the last tariff adjustment was made in 1997 and select tariffs on bulk oil were revised in 2005, we view the government's decision to hold back positively from a strategic standpoint. In our view, the decision is largely made to ensure Sabah would continue to attract major investments that are needed to boost the state's economy. A new tariff structure could see 30% tariff increases across the board.

- **Redevelopment of KK Port to improve gains from tourism boom.** Much of the growth in Sabah's tourism industry was largely untapped by Suria Capital. However, management has embarked on the plan to redevelop the land within the port grounds to improve its exposure to the sector. This is via two joint development projects which it ventured with SBC Corporation, for development of the Jesselton Quay, and with Gabungan AQRS for development of the One Jesselton Waterfront.

  The Jesselton Quay development sits on a 16.25-acre land which guarantees Suria a minimum payment worth RM324m or 18% of the NSV. After facing some regulatory delays, the project is now underway since Dec 2016. According to the JVA with SBC Corporation, payments are spread over 8 tranches with a mix of cash payment and payment in-kind.

  Meanwhile, the One Jesselton Waterfront development sits on a 7-acre plot. It entails a minimum payment worth RM198m, also 18% of the NSV. The project is expected to commence in 2018 with the settlement made through combination of cash payment amounting RM31.6m and payment in-kind (in the form of completed units) worth RM166.4m spread over 4 tranches.

Figure 3: Property developments at KK Port Land



Source: Company, BIMB Securities

  Both of these projects are poised to benefit from one of the entry point projects (EPP) identified by the federal government which would see the construction of Sabah International Convention Centre and KK International Cruise Terminal (operated by Suria).

While we believe Suria's capex spending positions the company well to benefit from the future growth in Sabah's economy, we note that the impact could be protracted and thus diluting ROEs in the interim. On the flipside, we are fairly positive on its strategic plan to bring MMC Corp on board as this could provide SBCP the opportunity to leverage on MMC's expertise in container port operations. This, of course, assumes that MMC's participation could boost container cargo throughput by enhancing the contribution from the transhipment business which is currently fairly small.

We also note that there could be further risk to its joint property development projects. For example, Suria was supposed to receive the second tranche payment in cash worth RM80m for the Jesselton Quay development project. Instead, due to the softening property market, Suria only received cash payment of RM20m with the remaining RM60m to be paid in-kind (ie. in the form of completed units). There are a further 6 future payments. Nevertheless, the bulk of the amount, worth RM229.2m was already accrued upfront in 2015.

Flattish outlook in store

We expect Suria's earnings remain flattish over the next 3 years, growing at 0.4% CAGR over FY16-19F. The growth is expected to be underpinned by structural revenue growth from ports' operations despite higher costs as well as higher amortisation and depreciation.

Table 4: Earnings forecast

FYE 30 Dec (RM m)	FY14	FY15	FY16	2017F	2018F	2019F
Revenue	**273.1**	**496.7**	**258.5**	**279.6**	**367.0**	**367.9**
Construction revenue	0.0	9.3	31.0	50.0	100.0	100.0
Operation revenue	**273.1**	**487.4**	**227.5**	**229.6**	**267.0**	**267.9**
EBITDA	123.5	193.1	127.6	122.5	132.7	137.2
EBIT	79.9	152.3	87.7	80.1	88.8	92.4
PBT	72.8	148.2	83.5	76.1	82.9	85.3
Net Profit	**52.1**	**126.4**	**66.7**	**60.1**	**65.5**	**67.4**
EBITDA margin %	*45%*	*40%*	*56%*	*53%*	*50%*	*51%*
PBT margin %	*27%*	*30%*	*37%*	*33%*	*31%*	*32%*
Ports operation						
Port revenue (RM m)	226.5	248.8	269.7	327.2	337.8	369.1
Port operation revenue (RM m)	217.2	217.8	219.7	227.2	237.8	249.1
Conventional cargo (MT'000)	22,669	22,957	28,700	29,131	30,120	31,669
Containers (TEUs'000)	398.8	363.2	357.4	354.1	361.6	369.7

Source: Company, BIMB Securities

Over the past 3 years, Suria's revenue shrunk, on average, at 0.6% p.a. over FY16-19F. We believe this was due to several key factors such as:

- Shrinking manufacturing industry which has led to lower containerised cargoes; we believe this is also attributed to the decline in the timber sector as companies switch to oil palm cultivation;
- Low rates for conventional cargo despite higher yoy throughputs; we believe this is mainly due to the throughput volume being driven by higher cargo throughputs at anchor (ie. within jetty/port waters instead at the wharf) which incurs significantly lower tariffs;
- Revenue loss for the supply of bunker fuel due to contract termination by Star Cruise Liner in 2015 which previously made Kota Kinabalu Port as one of its home ports;

However, we believe Suria's revenue would continue to grow driven by recovery in the palm oil sector as more trees under replanting matures while production recovers on diminishing effects of the El-Nino. We also expect stable revenue stream from the O&G segment (incl. SAMUR) as well as higher throughput as major infrastructure projects e.g. Pan Borneo Highway Sabah gets underway. We also note that Suria was recently awarded a construction job for railway upgrade works on Gorge Line between Halogilat Station (KM111) to Tenom station (KM137.9). The contract is worth RM49.5m over 18 months. We have assumed revenue accrual from this contract to be split 60:40 over FY18 and FY19 respectively.

Despite the encouraging revenue growth expected, our earnings forecasts imply 0.4% CAGR over FY16-19F. Our earnings outlook are detailed as follow:

- **FY17F outlook.** We expect earnings to remain weak in FY17F. This is on the back of higher operating costs as well as higher depreciation and amortisation. Additionally, oil palm plantation production in FY17 is still affected by lingering El-Nino effects.
- **FY18-19F outlook.** We expect earnings to improve slightly to RM65.5m and RM67.4m in FY18 and FY19 respectively as revenue growth from higher palm oil throughput and bulk oil cargo would be partially offset by higher depreciation and amortisation arising from the huge investments to fund the port expansions. Additionally, the new contract award for railway upgrading works would provide some earnings uplift.

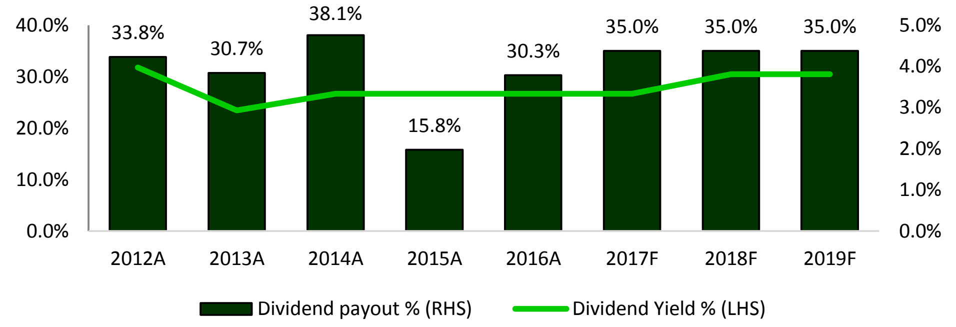
Currently Suria has a healthy net cash balance of RM69.7m as of 1HFY17, which provides ample headroom for the company to raise its gearing. Moreover, Suria also generates a healthy operating cash flow which averages at RM63m p.a over the past 3 years. However, with the planned capex spending of RM640m, we understand that management would take on borrowings. Based on our estimates, Suria's would be in a net debt position albeit at only 0.04x-0.06x over FY18 and FY19. We have assumed capex spending to average c.RM120m p.a for FY17-FY19.

Dividend payout

Suria adopts a dividend payout policy of up to 35% of its earnings. In the past 5 years, Suria's dividend payout ranges from 16% to 38% of its earnings. This translates to dividend yields ranging 2.9%-4% at current market price. As at 1HFY17 an interim DPS of 4sen/share was declared.

Going forward, and in-line with their dividend payout policy, we have assumed payout of c.35% in FY17-19F which implies DPS of 7sen-8sen. At current market price, this implies yields of 3.3%-3.8% for FY17-19F.

Chart 7: Dividend payout



Source: Company, BIMB Securities

Initiate with HOLD due to protracted impact from Sabah master plan

We initiate our coverage on Suria with HOLD recommendation and a DCF-derived target price (TP) of RM2.20. Our DCF assumes a WACC of 8.2% (risk-free rate: 4% and risk premium: 5%) and a conservative terminal growth rate of 0%, implying FY18F PE of 10.1x (Table 5).

Table 5: DCF breakdown

Items	RM m	Remarks
WACC (%)	8.2%	
Long term growth rate (%)	0%	
NPV of forecast	161.1	
NPV of terminal value	508.6	
Total Enterprise value	**669.8**	
Less: (net debt) / cash	(26.15)	
Total Equity value	**643.6**	
No. of shares (m)	288.2	
Equity value per share (RM)	**2.20**	Implies FY18F PE of 9.7x

Source: BIMB Securities

We believe this is fair given its monopoly of Sabah port operations which provides direct exposure to benefit from the Sabah's economic growth. However, this is balanced off by our view that the impact from the various economic impetuses would be protracted. Over longer term, we see additional upside potential to our target price catalysed by:

- Port tariff adjustments which is currently being put on hold by the state government
- Potential upside from due payments from its property project partners as well as remaining 7 acres of KK port land which is still untapped

Key risks

- **Security risk involving terrorism and instability in southern Philippines.** Terrorism and instability in southern Philippines create fear for those living and visiting Sabah. Sabah's economy especially tourism would suffer if security in the state is not maintain.
- **Palm Oil outputs remain low.** Continued low palm oil outputs and yields will lower cargo throughput volume at the ports. Suria earnings would be affected as port operations is its core business and palm oil products form a major share of its cargo volume.

Key catalyst

- **Upgrading and expansion of ports will improve efficiencies and competitiveness.** Better facilities and improved services provide Suria a competitive edge for its ports as more business could be generated through increase in handling capacity and cost efficiencies.
- **SBCP transhipment business takes off.** SBCP transformation as a "Transhipment Hub of the East" could boost future earnings potential as more transhipment throughput arising from increase regional trade.

APPENDIX

Company Background

Suria Capital Holdings Berhad (Suria) was incorporated in 1983 and has grown steadily into a diversified entity. Listed in 1996 on the Main Market of Bursa Malaysia Berhad, the company was originally established as a financial conglomerate. In 2004, the company shifted its business focus to port operation services after the successful acquisition of business operations of Sabah's key ports from Sabah Ports Authority. This was through a major privatization exercise with a concession period of 30 years, starting from 1st September 2004 and comes with a 30-years extension option. Capitalizing on earnings potential from Kota Kinabalu port land that could be converted into a 99 years leasehold commercial land (1st January 2010 to 31st December 2108) for the purpose of mixed commercial/ tourism related development, Suria in 2013 diversified into the property development sector. Currently, Suria group provide services in Ports Operations, Logistics and Bunkering Services, Contract & Engineering and Ferry Terminal, and Property Development.

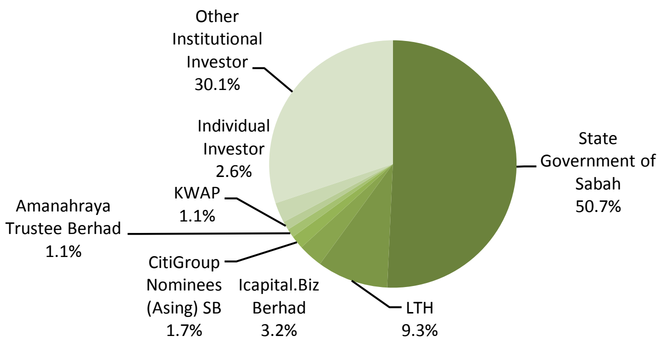
Figure 4: Corporate Structure

Source: Company, BIMB Securities

Major Shareholders

As of April 2017, majority of Suria's shares are owned by Sabah State Government through holdings by Warisan Harta Sabah SB (45.4%), Yayasan Sabah (3.7%) and Chief Minister, State of Sabah (1.7%) giving a total of 50.8%. The other two largest shareholders are LTH (9.3%) and I-Capital Biz (3.2%). Others institutional investors both local and foreign hold 34.1%, while individual investors constitute 2.6%.

Chart 8: Shareholding as at Apr 2017



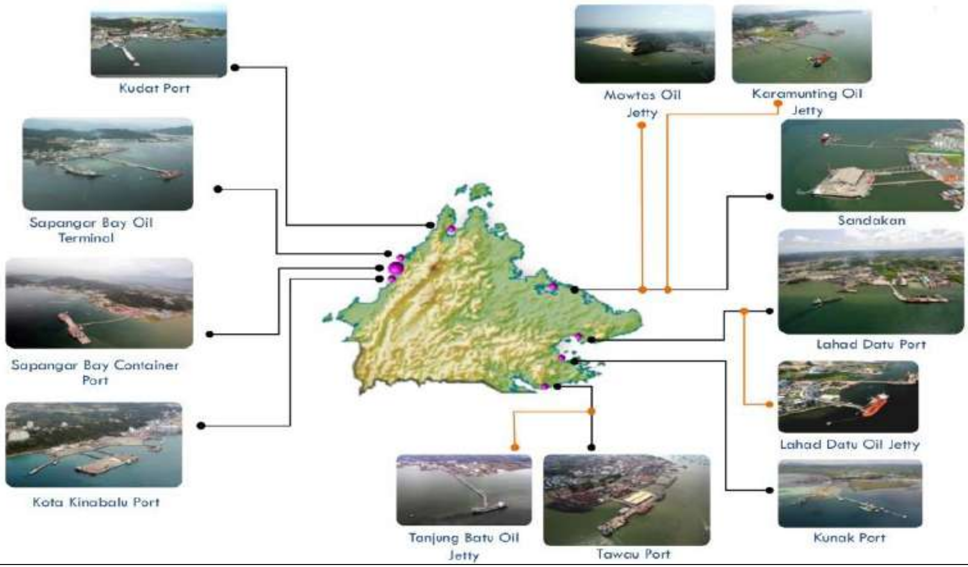
Source: Company, BIMB Securities

Operational Highlights

i. Port Operations

Through its subsidiary Sabah Ports SB (SPSB), it operates a total of 8 major ports in the State of Sabah. The ports are Kota Kinabalu Port, Sapangar Bay Container Port, Sapangar Bay Oil Terminal and Kudat Port located on the West Coast of Sabah while Sandakan Port, Tawau Port, Lahad Datu Port and Kunak Port are on the East Coast. Services offered by SPSB include i) Berthing and unberthing of ships, ii) Mooring, pilotage and tug boat services, iii) Stevedoring services, iv) Reefer containers, v) Storage of containers, vi) Container freight station, and vii) Water supply and bunkering.

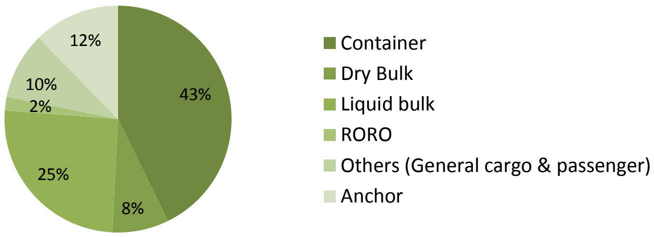
Figure 5: Ports operated by Suria Capital



Source: Company, BIMB Securities

All 8 ports under SBSP operate and handle different types of cargoes and commodities. In general Suria's ports business could be divided into container cargo, conventional cargo (liquid cargo, dry cargo, general cargo, RORO) and anchor operations. Container is the largest revenue contributor to Suria's port operations with 43% share in FY16. Cargo at Suria's ports are mostly for imports/exports, unlike ports in Semenanjung Malaysia where transhipment volumes are relatively much higher. The total throughput handled by Suria's ports in 2016 amounted to 33.5m tonnes with a total of 357.4k TEUs (twenty-foot equivalent units). Sapangar Bay Container Port (SBCP) which is a dedicated container port handled 68% of the overall TEUs. In addition, with regard to cruise tourism, a total of 28 cruise vessels called at Sabah port with a total of 43,197 passengers in FY16. Of this total, 19 cruise ship docked at Kota Kinabalu port with 40,929 passengers.

Chart 9: FY16 revenue by type of cargo



Source: Company, BIMB Securities

Table 6: FY16 port cargo handling & throughput

Ports	Cargo Handle	Cargo throughput (MT & TEUs)		No. of Berth
		2015	2016	
SBCP	Container	TEUs = 252k	TEUs = 244k	2
		MT = 627	MT = 775	
SBOT	Cargo: Liquid Bulk	MT = 2339.9k	MT = 2425.7k	1
Kota Kinabalu Port	Cargo: Break bulk, Dry bulk, RO-RO, Passengers	MT = 3611.5k	MT = 11,036.7k	8
Kudat Port	Cargo: Timber & Related products	MT = 320k	MT = 200k	1
Sandakan Port	Cargo: Container, Break bulk, Dry bulk, Liquid bulk, Transhipment Cargo, Passengers	TEUs = 39.7k	TEUs = 42.2k	9
		MT = 6869.7k	MT = 6012.1k	
Tawau Port	Cargo: Container, Break bulk, Dry bulk, Liquid bulk, Transhipment Cargo	TEUs = 71.8k	TEUs = 71.3k	5
		MT = 3848.3k	MT = 3760.0k	
Lahad Datu Port	Cargo: Dry bulk, Liquid bulk, Break bulk, Transhipment Cargo	MT = 4530.7k	MT = 4021.2k	6
Kunak Port	Cargo: CPO & PKE	MT = 1435.6k	MT = 1241.1k	3

Source: Company, BIMB Securities

Among all the ports operated by SPSB, Sapangar Bay Container Port (SBCP) registered the highest revenue of RM73.1m or 29% of overall port revenue in FY16. This is in line with the highest revenue percentage of container cargo handled by SPSB. However, SBCP only contributed RM11.2m or 14% of the total port PBT in FY16 mainly due to high overheads and depreciation charges. In addition, Sandakan port and Lahad Datu port contributed 23% and 14% of the total ports PBT respectively in FY16. These two ports are among the highest PBT margin providers constituting 33% and 46% respectively. Both of these are the major conventional cargo handling ports and are located in East Coast of Sabah where crude palm oil is the largest export produce handled.

Table 7: Revenue and PBT by ports

Port	Revenue	PBT	PBT margin
	(RM'000)		%
Sapangar Bay Container Port	73,139	11,188	15%
Sandakan	54,967	17,873	33%
Tawau	36,145	10,359	29%
Kota Kinabalu	31,767	15,300	48%
Lahad Datu	25,043	11,423	46%
Sapangar Bay Oil Terminal	14,639	8,070	55%
Kunak	12,772	4,756	37%
Kudat	312	-623	-200%
Total	**248,784**	**78,346**	**31%**

Source: Company, BIMB Securities

ii. **Logistics and bunkering services**

Services under this segment include bunkering services which involves the supply of fuel to the ports, vessels and industries/factories as well as supply of fresh water. This segment has not being performing well over the past few years with PBT registering a negative RM0.5m in FY16 due to insufficient sales volume to cover expenditure. However, the Group is confident of reviving the segment as SPSB recently signed an agreement with KA Petra SB for the leasing of Sapangar Bay Oil Storage Depot.

iii. Contract & Engineering and Ferry Terminal Operation

Currently, Suria's subsidiary SCES main activities are the maintenance of Kota Kinabalu ferry terminal operations at Jesselton Point and the "Meet & Greet" facilities for cruise ship passengers at Kota Kinabalu port. Revenue in this segment is mainly derived from Jesselton Point ferry terminal (public ferry terminal) and handling international cruise ship passengers at Kota Kinabalu port. A slight increase of 3% was observed in the segment revenue in FY16. The main source of revenue come from passengers fees for the Jesselton Point operations which contributed 53% of this section FY16 revenue as compared to 48% in FY15.

As for contract and engineering section, this section has not been very active and had provided only minimum contribution to the Group's revenue for the past years. Nevertheless, recently this section has secured a contract for railway upgrading works valued at RM50m. This contract is for additional upgrading works on the Gorge Line between Halogilat station (KM111) to Tenom station (KM137.9) for the Sabah State Railway Department. The project is schedule to be completed within 18 months from date of signing of the contract.

iv. Property Development

Suria in 2013, diversified its business activities into the property segment by entering into a Joint Venture Agreement (JVA) with SBC Corporation (SBC) to develop 16.5 acres out of 23.25 acres in KK port land with a minimum NSV of RM 1.8bn. The project is known as Jesselton Quay (JQ) project and consists of commercial suites, retail mall, hotel and office towers. Projected development period is 8 years from 2014 to 2021. As per JVA, SBC is responsible for all the cost and related matters with regards to the development of Jesselton Quay project. Suria as the land owner will receive a minimum guaranteed sum of RM324m or 18% of total NSV (whichever is higher). Construction for phase 1 of JQ project only started in December 2016 after a delay in getting authorities approval.

Plans to develop the balance 7 acres of KK land materialised when Suria in 2015 penned a JVA with Gabungan AQRS to jointly develop the said land with an estimated minimum NSV of RM 1.1bn. Under this project which is to be known as "One Jesselton Waterfront", Suria is entitled to receive RM198m or 18% of the project NSV (whichever is higher). Expected completion date is within 6 years from the commencement of the construction which is targeted to start in 2018.

Figure 6: Jesselton Quay Project illustration

Source: Company, BIMB Securities

Figure 7: One Jesselton Waterfront project illustration

Source: Company, BIMB Securities

Income Statement

FYE June (RM m)	FY14	FY15	FY16	2017F	2018F	2019F
Revenue	**273.1**	**496.7**	**258.5**	**279.6**	**367.0**	**367.9**
Construction revenue	**0.0**	**9.3**	**31.0**	**50.0**	**100.0**	**100.0**
Operation revenue	**273.1**	**487.4**	**227.5**	**229.6**	**267.0**	**267.9**
Operating costs	-149.6	-294.2	-100.0	-107.1	-134.3	-130.7
EBITDA	**123.5**	**193.1**	**127.6**	**122.5**	**132.7**	**137.2**
Depreciation & amortisation	-43.6	-40.8	-39.8	-42.4	-43.9	-44.8
EBIT	**79.9**	**152.3**	**87.7**	**80.1**	**88.8**	**92.4**
Net interest income	2.7	3.6	2.4	2.1	2.0	2.1
Net interest expense	-9.3	-7.6	-5.9	-6.0	-8.2	-9.5
Exceptional items	-0.5	-30.6	-0.7	0.0	0.0	0.0
Pretax profit	**72.8**	**148.2**	**83.5**	**76.1**	**82.9**	**85.3**
Taxation	-20.7	-22.5	-16.9	-16.0	-17.4	-17.9
Net profit	**52.1**	**126.4**	**66.7**	**60.1**	**65.5**	**67.4**
Core Net profit	**52.6**	**157.1**	**67.4**	**60.1**	**65.5**	**67.4**

Source: BIMB Securities

Balance Sheet

FYE June (RM m)	FY14	FY15	FY16	2017F	2018F	2019F
Property, plant and equipment	64.0	63.4	62.2	60.8	59.5	58.3
concession assets	773.8	734.9	728.6	808.6	887.1	964.5
Deferred tax assets	0.0	19.9	30.8	30.8	30.8	30.8
Other assets	0.0	0.0	33.9	33.9	33.9	33.9
Trade receivable	0.0	162.0	230.8	230.8	230.8	230.8
Non-current assets	**958.7**	**980.2**	**1086.3**	**1165.0**	**1242.1**	**1318.3**
Inventories	5.1	3.8	4.0	3.8	5.0	5.0
Trade and other receivables	32.4	104.2	48.8	68.9	90.5	90.7
Other current assets	3.3	2.0	3.6	3.6	3.6	3.6
Income tax refundable	18.8	0.8	0.9	0.9	0.9	0.9
Investment securities	107.9	127.0	144.1	124.1	124.1	124.1
Cash and cash equivalents	122.5	114.3	61.0	60.4	62.2	79.6
Current assets	**290.0**	**352.1**	**262.4**	**261.8**	**286.3**	**304.0**
Total assets	**1248.7**	**1332.3**	**1348.8**	**1426.7**	**1528.4**	**1622.3**
Share capital	283.3	288.2	288.2	288.2	288.2	288.2
Share premium	62.8	70.6	70.6	70.6	70.6	70.6
Other Reserves	-0.1	2.2	1.9	1.9	1.9	1.9
Retained earnings	502.2	608.3	654.8	693.9	736.5	780.3
Non-controlling interest	2.0	1.7	0.0	0.0	0.0	0.0
Total equity	**850.3**	**971.0**	**1015.5**	**1054.6**	**1097.1**	**1141.0**
Borrowings	20.0	10.7	0.2	50.2	100.2	150.2
Loan from Sabah Ports Authority	101.9	77.9	52.9	52.9	52.9	52.9
Amount due to Sabah State Government	29.6	23.7	17.8	17.8	17.8	17.8
Concession liabilities	119.4	117.7	115.8	115.8	115.8	115.8
Employee defined benefit liability	14.3	0.3	0.2	0.2	0.2	0.2
Deffered tax liabilities	23.7	41.8	54.2	54.2	54.2	54.2
Other payable	0.0	0.0	0.0	0.0	0.0	0.0
Non-current liabilities	**308.9**	**272.1**	**241.1**	**291.1**	**341.1**	**391.1**
Borrowings	10.4	10.8	10.6	10.6	10.6	10.6
Loan from Sabah Ports Authority	23.1	24.0	24.9	24.9	24.9	24.9
Amount due to Sabah State Government	5.9	5.9	5.9	5.9	5.9	5.9
Concession liabilities	9.8	10.0	10.2	10.2	10.2	10.2
Trade and other payables	38.2	38.6	40.2	29.1	38.2	38.3
Income tax payable	0.2	0.0	0.3	0.3	0.3	0.3
Current liabilities	**89.5**	**89.3**	**92.2**	**81.0**	**90.2**	**90.2**
Total liabilities	**398.4**	**361.3**	**333.3**	**372.2**	**431.3**	**481.4**
Total equity and liabilities	**1248.7**	**1332.3**	**1348.8**	**1426.7**	**1528.4**	**1622.3**

Source: BIMB Securities

Cashflow Statement

FYE Jun (RM m)	FY14	FY15	FY16	2017F	2018F	2019F
Cashflow from operations (CFO)						
Pretax profit	72.8	148.2	83.5	76.1	82.9	85.3
Non-cash items	130.6	214.7	119.8	122.5	133.0	137.5
Net change in working capital	-80.4	-127.1	-47.2	-31.0	-13.7	-0.1
Tax paid	-1.4	-1.9	-8.1	-16.0	-17.4	-17.9
CFO	**49.9**	**81.6**	**57.8**	**75.4**	**102.0**	**119.5**
Cashflow from investing (CFI)						
Increase in concession assets	-10.7	-11.7	-31.2	-120.0	-120.0	-120.0
Purchase of PPE	-0.6	-0.6	-1.3	-1.0	-1.0	-1.0
Interest received	2.8	3.1	1.9	2.1	2.0	2.1
Others	21.6	-60.0	19.0	20.0	0.0	0.0
CFI	**13.1**	**-69.2**	**-11.5**	**-98.9**	**-119.0**	**-118.9**
Cashflow from financing (CFF)						
Dividends paid to shareholders	-19.8	-20.0	-20.2	-21.0	-22.9	-23.6
Interest paid	-9.4	-7.8	-6.0	-6.0	-8.2	-9.5
Others	-38.1	-39.3	-40.4	50.0	50.0	50.0
CFF	**-67.5**	**-67.1**	**-66.6**	**22.9**	**18.8**	**16.9**
Net change in cash and cash equivalents	**-4.4**	**-54.7**	**-20.2**	**-0.6**	**1.8**	**17.5**

Source: BIMB Securities

DEFINITION OF RATINGS

BIMB Securities uses the following rating system:

STOCK RECOMMENDATION

BUY	Total return (price appreciation plus dividend yield) is expected to exceed 10% in the next 12 months.
TRADING BUY	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain.
HOLD	Share price may fall within the range of +/- 10% over the next 12 months
TAKE PROFIT	Target price has been attained. Fundamentals remain intact. Look to accumulate at lower levels.
TRADING SELL	Share price may fall by more than 15% in the next 3 months.
SELL	Share price may fall by more than 10% over the next 12 months.
NOT RATED	Stock is not within regular research coverage.

SECTOR RECOMMENDATION

OVERWEIGHT	The Industry as defined by the analyst's coverage universe, is expected to outperform the relevant primary market index over the next 12 months
NEUTRAL	The Industry as defined by the analyst's coverage universe, is expected to perform in line with the relevant primary market index over the next 12 months
UNDERWEIGHT	The Industry as defined by the analyst's coverage universe, is expected to underperform the relevant primary market index over the next 12 months

Applicability of ratings

The respective analyst maintains a coverage universe of stocks, the list of which may be adjusted according to needs. Investment ratings are only applicable to the stocks which form part of the coverage universe. Reports on companies which are not part of the coverage do not carry investment ratings as we do not actively follow developments in these companies.

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