

MITA No. 010/06/2008

13 May 2009

Rotary Engineering Ltd

Downgrade to

HOLD

Previous Rating: BUY

S\$0.555

Fair Value: S\$0.51

Stock Code:

Reuters: ROTE.SI

ISIN Code: R07

Bloomberg: RTRY SP

Event:

Results

General Data	
Issued Capital (m)	568
Mkt Cap (S\$m/US\$m)	315 / 216
Major Shareholder	
Chia Kim Piow (29.14%)	
Oman Investment Fund (21.4%)	
Free Float (%)	39
NTA per share (S\$)	0.31
Daily Vol 3-mth ('000)	2,527
52Wk High (S\$)	0.945
52Wk Low (S\$)	0.190

Doubtful debts impacts bottomline

1Q09 profit impacted by doubtful debt. Rotary Engineering (Rotary) reported its 1Q09 results this morning with topline rising 13% YoY to S\$131.9m but net profit fell 57% YoY to S\$4m. The bad bottomline was primarily due to lower gross margins as compared to 1Q08 and a S\$5.7m bad debt provision as one of its customers has run into financial difficulties. Rotary is negotiating with the administrators with the aim of reaching a scheme of arrangement where it will hope to recover some of the outstanding debt due. As a precaution, we are assuming no recovery of the debt until it actually materialises to remove overhang from our estimates. Contracts secured was only S\$15m for 1Q09, reflecting the project owners' cautious view of how the economy will pan out.

Order book concerns. Order book at the end of 1Q09 is S\$360.3m (vs. 4Q08: S\$445.8m) and expects recognition of S\$250-280m for rest of the year. We note that a majority of projects will be ending in 3Q09 and are concerned about sustainability past FY09 if no projects of substantial magnitudes are won in the next 2-3 quarters. Margin preservation is also a key concern as project owners seek to get the best deals in a market desperate for jobs. Rotary continues to guide for group gross margin of 18-22%. We are confident that they are able to sustain project margins with possible exception of mega projects. We think slight margin trade-offs are balanced with significantly raising the group's visibility.

Still high in cash. Rotary has a strong net cash position of S\$0.256/share and we are expecting it to continue to keep itself flushed with cash in view of its upcoming bids for the large Jubail Refinery project. See Exhibit 3.

Maintain BUY. We have raised our estimates for FY09 as we factor projects ending in 2Q-3Q09 will have final milestone payments that will support Rotary's topline but with lower margins. In tandem with improvements in risk appetite, our fair value is raised to S\$0.51 (prev: S\$0.29) based on 8x FY09F EPS (prev: 5x FY09F). Rotary traded at an average of 20x EPS in FY06 prior to an escalation of its earnings. While the Jubail win would cause a significant re-rating of the stock, we remain conservative and will not jump the gun on Rotary's expected win. Meanwhile, the price has run up significantly and we are downgrading our rating to a **HOLD**.

Kelly Chia

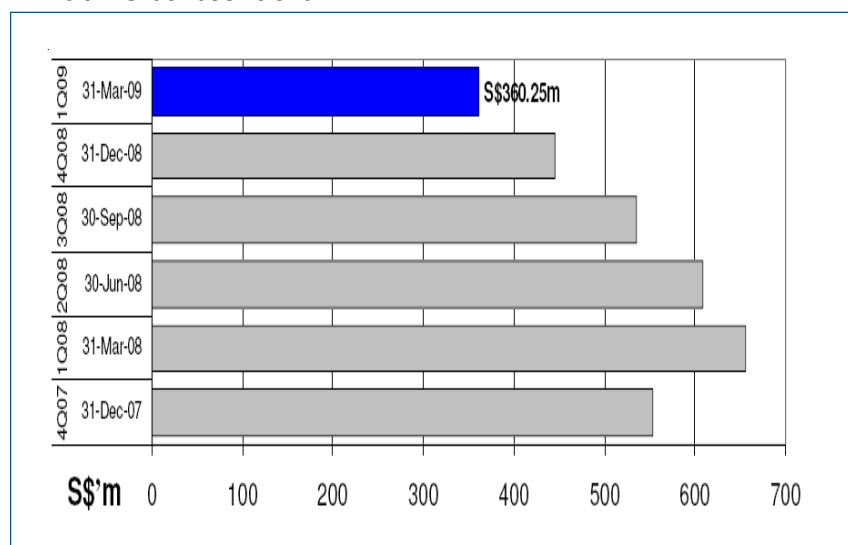
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Year to 31 Dec	Turnover (S\$m)	Gross Profit (S\$m)	Net Profit (S\$m)	EPS (cents)	EPS Growth (%)	PER (x)	Div Yield (%)
FY 07	510.2	124.6	56.0	9.9	9.1	5.8	7.3
FY 08	520.1	123.5	54.3	9.6	-3.0	6.0	4.0
FY 09F	426.3	87.8	36.3	6.4	-33.1	9.0	3.5
FY 10F	202.9	43.8	20.4	3.6	-43.9	16.0	3.5

Please refer to the important disclosures at the back of this document.

Exhibit 1: Order book trend



Source: Company

Exhibit 2: Projects on hand and completion dates

Client/Project	Location	Contract Value	Start Date	Expected Completion Date
Shell- Bukom Refinery modification	Pulau Bukom	S\$25m	Nov 2006	3Q2009
Shell- Ethylene Catalytic Cracker	Pulau Ular & Pulau Bukom	S\$24m	Jun 2007	3Q2009
Shell- Mono Ethylene Glycol	Jurong Island	S\$89m	Jun 2007	3Q2009
Oiltanking- Mono Ethylene Glycol & Propylene Oxide	Jurong Island	S\$46m	Nov 2007	3Q2009
Oiltanking- Chem 6	Jurong Island	S\$60m	Jun 2008	3Q2009
Oiltanking- Phase 10	Jurong Island	S\$42m	Jun 2008	2Q2009
Shell- Upgrading of 7 tanks	Pulau Bukom	S\$14m	Apr 2008	4Q2011

Client/Project	Location	Contract Value	Start Date	Expected Completion Date
Neste Oil- Bio fuel plant	Tuas	S\$37.9m	Sep 2008	2Q2010
Chevron- Penjuru Terminal	Jurong	S\$10.5m	Oct 2008	4Q2009
Tankstore- upgrading of storage tanks	Pulau Busing	S\$4.3m	Feb 2009	4Q2009
Singapore Petroleum Company- upgrading of storage tanks	-	S\$2.8m	Oct 2008	4Q2009

Source: Company

Update on Middle East

The Jubail Refinery in Saudi Arabia which partners Total with Saudi Aramco have closed portions of its bidding at the end of Mar 09. The evaluation period of the bids will then take 3-6 months prior to announcement of contract winners. With Rotary bidding for packages that are worth up to US\$1b, it could present a sizable swing in its earnings. Despite the competitive landscape, our hopes are kept up as Rotary has illustrated commitment to the region and project with its new facility located at Jubail itself.

Current time line for SATORP project

May 2006: Saudi Aramco and Total signed a MoU to develop the project.

August 2006: Technip was appointed to conduct FEED and EIA, prepare financing and marketing studies, capital operating cost estimates and bid packages, and provide procurement support.

June 2008: Saudi Aramco and Total signed the shareholders agreement in order to form Saudi Aramco Total Refinery and Petrochemical Company (SATORP).

3Q08: Five companies were pre-qualified for the EPC contract.

2Q09: Bidders are expected to submit proposals for the EPC contract. The deadline for the EPC bids submission was delayed from 23 February 2009. The project is expected to be completed in 4Q12.

Exhibit 3: Saudi Aramco-Total (62.5%-37.5%) Refinery Project (SATORP) project

Type	Project Name	Contract Value (US\$m)
Master project	SATORP - Jubail Refinery and Petrochemical Complex	10,000
Contract package	SATORP - Aromatics Package	650
Contract package	SATORP - Coker Package	1,200
Contract package	SATORP - Construction Facilities Package	93
Contract package	SATORP - Conversion Unit and Sulphur Package (Part 1)	1,700
Contract package	SATORP - Crude Storage Tanks Package 1	1,000
Contract package	SATORP - Crude Storage Tanks Package 2	300
Contract package	SATORP - Distillate and Hydrotreater Package	1,800
Contract package	SATORP - Interconnection, Gas Flaring and Electrical Systems Package	1,300
Contract package	SATORP - Marine Works Package	300
Contract package	SATORP - Pipelines and Offsites Package	300
Contract package	SATORP- Conversion Unit and Sulphur Package (Part 2)	500

Source: Zawya.

Exhibit 4: Jubail Industrial City



Source: Google Maps

Rotary's Key Financial Data

Rotary Results Year Ended 31 Dec (S\$ m)	1Q08 (S\$m)	1Q09 (S\$m)	% Chg (YoY)	4Q08 (S\$m)	% Chg (QoQ)
Total contract value won	188.0	15.2	-91.9%	48.5	-68.7%
Total revenue	117.1	131.9	12.6%	149.4	-11.8%
Cost of Sales	-92.0	-107.6	16.9%	-105.5	2.0%
Gross profit	25.1	24.3	-3.1%	44.0	-44.7%
Other income	1.1	0.6	-47.4%	1.0	-40.1%
Admin costs	-10.0	-8.0	-20.1%	-11.5	-30.0%
Other operating costs	-1.7	-10.2	NM	-7.3	39.0%
Profit from operations	14.4	6.7	-53.6%	26.2	-74.4%
Financial income (expense), net	-0.7	-0.1	-88.1%	-0.3	-70.0%
Share of associates	-0.1	-1.3	NM	-0.5	NM
Profit before income tax	13.6	5.3	-60.9%	25.4	-79.0%
Income Tax	-3.0	-1.3	-57.0%	-4.9	-73.7%
Profit after tax	10.6	4.0	-62.0%	20.5	-80.3%
Minority Interests	-0.5	0.3	NM	-1.2	NM
PATMI	10.2	4.3	-57.5%	19.2	-77.5%

EARNINGS FORECAST

Year Ended 31 Dec (S\$ m)	FY07	FY08	FY09F	FY10F
Revenue	510.2	520.1	426.3	202.9
Gross profit	124.6	123.5	87.8	43.8
Operating expenses	-51.4	-51.3	-40.1	-17.2
Operating profit	73.2	72.1	47.7	26.6
EBITDA	67.2	64.7	56.8	37.1
Other expenses/income	-1.7	-2.4	-1.7	-0.8
Pre-tax profit	71.5	69.8	46.0	25.8
Tax	-15.5	-15.5	-9.7	-5.4
Net profit	56.0	54.3	36.3	20.4
PATMI	52.8	50.9	35.2	19.8
Earnings per share (S\$cents)	9.9	9.6	6.4	3.6
Fully diluted earnings per share (S\$cents)	9.9	9.6	6.4	3.6
EPS growth	9.1%	-3.0%	-33.1%	-43.9%
Revenue revision	NA	NA	36.9%	-16.5%
PATMI revision	NA	NA	9.9%	-26.8%

BALANCE SHEET**As at 31 Dec (S\$ m)**

	FY07	FY08	FY09F	FY10F
Cash and equivalents	165.8	157.8	141.2	147.2
Other current assets	144.8	199.2	130.8	59.8
Fixed assets	47.2	65.6	81.5	86.0
Other long term assets	27.2	32.4	28.9	28.9
Total assets	385.0	455.1	382.4	322.0
Debt (ST and LT)	42.0	7.3	8.0	8.0
Other long term liabilities	1.9	2.0	0.9	0.5
Total liabilities	209.7	238.7	145.3	74.5
Shareholders equity (incl reserves)	175.2	216.4	237.1	247.5
Total equity and liabilities	385.0	455.1	382.4	322.0
NTA per share (US\$ cents)	30.9	37.7	41.4	43.2
NAV per share (US\$ cents)	30.9	38.1	41.8	43.6

CASH FLOW**Year Ended 31 Dec (S\$ m)**

	FY07	FY08	FY09F	FY10F
Profit/(Loss) before working cap. changes	88.6	82.7	44.6	34.9
Working capital changes	15.7	-6.0	-41.8	-9.4
Net cash from operations	104.3	76.7	2.8	25.5
Capex	-10.1	-25.0	-25.0	-15.0
Other investing flows	-6.1	0.2	16.3	6.9
Total investing cash flow	-16.2	-24.8	-8.7	-8.1
Change in equity	0.0	0.0	0.0	0.0
Net change in debt	-5.9	-35.9	0.7	0.0
Dividends and other payables	-24.6	-13.0	-11.4	-11.4
Total financing cash flow	-30.5	-49.0	-10.7	-11.4
Net cash flow	49.1	3.0	-16.6	6.0
Cash at beginning of year	105.3	154.4	157.8	141.2
Cash at end of year (incl FD pledged)	154.4	157.4	141.2	147.2

Key Ratios

PER (x)	5.8	6.0	9.0	16.0
Price/NTA (x)	1.9	1.5	1.4	1.3
Gross profit margin (%)	24.4	23.7	20.6	21.6
Net profit margin (%)	11.0	10.4	8.5	10.0
Dividend yield (%)	7.3	4.0	3.5	3.5
ROA (%)	14.5	11.9	9.5	6.3
ROE (%)	31.9	25.1	15.3	8.2
Net gearing (%)	Net Cash	Net Cash	Net Cash	Net Cash
PE growth (x)	0.6	-2.0	-0.3	-0.4

Source: Company data, OIR estimates

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The analyst/analysts who wrote this report holds NIL shares in the above security.

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