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8 stock picks

Here are several companies with strong underlying fundamentals that should withstand the economic storm

Confidence in global equities has rebounded smartly, with key bellwether indices around the world chalking up double-digit gains since hitting multi-year lows in early March.

Investors are banking on the fact that the aggressive and, at times, unprecedented fiscal and monetary measures taken by governments will be successful in arresting the global economic free fall.

Indeed, there are encouraging signs that the recession in the US is abating. Recent data showed upticks in US housing starts and sales of existing homes, which suggest that buyers are surfacing on the back of falling prices and low mortgage rates. Consumer spending recovered after falling sharply in 4Q2008, perhaps bolstered by the stock-market rebound. While exports numbers for most Asian economies remain in the red, the pace of decline is also slowing.

The recent surge in confidence is also attributable, in part, to some better-than-expected earnings results posted by major corporations, including troubled US banking giants such as Citigroup and Goldman Sachs. This has lent credence to hopes that the global financial system is finally on the mend and will soon resume normal lending activities. This will, in turn, underpin the broader economic recovery.

Buoyed by a rosier outlook and falling bank-deposit rates, investors are looking at bashed-down stocks for better returns. In this article, we highlight a handful of stocks, big- and small-caps, from a cross-section of the economy.

It bears to note that although confidence has improved, investors are still jittery. Even if the global economy is nearing a bottom, the path to recovery is likely to be long and slow-going. Indeed, the domestic economy is expected to get worse before it gets better and no sector will escape unscathed.

Thus, our stock picks are heavily geared towards companies with strong underlying fundamentals and relatively more resilient businesses. Strong balance sheets, sound business models and management are keys to survival in difficult economic times.

Bursa Malaysia

Bursa will be among the first to show earnings improvement on the upturn given that its earnings are closely tied to the market-trading volume. And the market will typically lead an underlying economic recovery.

The stock exchange operator has solid underlying fundamentals. Its recurring income — such as those from listing and depository fees — and other incomes, including interest, are estimated to cover more than nine-tenths of its operating expenses yearly. Hence, despite the sharp drop in exchange-based revenue — due to lower equities and derivatives trading volumes — the company should stay comfortably in the black.

Bursa is also sitting on about RM431 million in financial resources that are available for use, of which about one-third should be freely distributable as dividends after excluding working capital, security deposits and margins as well as clearing guarantee fund contributions.

Hence, the company should be able to maintain its high dividend payout. Bursa distributed almost 91% of net earnings in 2008. Assuming a similar payout, dividends will total 19.2 sen per share this year. This translates into a fairly decent gross yield of 3.1% for shareholders.

Tanjong plc

Tanjong's key businesses — power generation and gaming — are relatively resilient even in an economic downturn. Its earnings are also geographically diversified.

In addition to three local power-generating plants, the company has power assets in Egypt, Bangladesh, Sri Lanka and Pakistan. All the power plants operate under long-term purchase agreements with state utilities. As such, earnings are steady and predictable throughout the entire concession periods. One-off windfall taxes and other provisions last year hit the company's local power earnings. We expect earnings to recover in the current financial year.

Tanjong's numbers forecast totalisator business too is fairly recession-proof. Sales per draw have been trending higher over the past few years, albeit at a slow pace. We estimate sales per draw will grow by another 1.5% in FY2010. Although earnings could still be affected by the luck factor, overall profitability should remain fairly steady.

Tanjong is one of the most attractively valued blue-chip stocks on the local bourse, trading at only nine times our estimated earnings for FY2010. It also pays fairly good dividends. Yields are estimated to gross 7.1% at the current share price.

Resorts World should ride out the slowdown fairly comfortably, thanks to its strong balance sheet

Resorts World

Resorts was among the most heavily sold-down blue-chip stocks over the past year. This could be due, in part, to its relatively high foreign shareholdings. The company's earnings were hit by impairment losses for its investment in Star Cruises in 2008. Its 19.6% stake in the unit has been marked to market and is up for sale. But Resorts' underlying leisure and hospitality business remains strong. Excluding one-off items, pre-tax profit was up about 23% last year.

To be sure, business will be affected by the current economic downturn as consumers tighten their belts. However, Resorts should ride out the slowdown fairly comfortably, thanks to its strong balance sheet. It is sitting on cash totalling almost RM4.6 billion — or equivalent to about 77 sen per share. Net assets per share stood at RM1.45 at end-2008.

Valuation comparison

	Price (RM)	Estimated net profit (RM mil)	EPS (sen)
Bursa	6.15	83.2	15.8
Tanjong	14.10	634.9	157.4
Resorts World	2.42	1,256.5	21.3
HELP	1.31	14.3	16.1
Three-A	0.35	10.4	3.4
Pantech	0.59	42.9	11.4
Tanjong Offshore	1.18	41.2	16.7
Masteel	0.81	10.9	5.6

Three-A Resources

Three-A is a less well-known, small-cap stock with a sound underlying business. The company is the country's leading producer of ingredient products such as caramel colour, glucose and maltodextrin. These products are crucial components in a wide range of food and beverage products, the demand for most of which is fairly recession-proof.

We expect volume sales to grow with increasing utilisation at its newly commissioned glucose and maltodextrin plants. Although lower selling prices will reduce overall sales, margins should stabilise with lower feedstock — primarily tapioca starch — costs. Growth is expected to pick up pace in 2010 — net profit is forecasted to grow 40% to RM14.6 million.

Three-A shares are trading at modest valuations of 10.2 and 7.3 times our estimated earnings for 2009-2010, compared with its prospective growth rates. In addition to potential capital gains, shareholders will also earn fairly decent yields. We estimate net yield of 2.9% assuming a 1 sen per share dividend, the same level as that paid in 2008.

HELP International Corp

HELP's earnings are relatively resilient and recession-proof and the company has a very strong balance sheet and business franchise. It is one of Malaysia's leading providers of education services and is highly regarded for its academic quality and innovative products.

HELP has a very strong brand name, which has helped to expand its student base, extend its presence overseas and increase the appeal of its own home-grown degrees. From just 8,600 students in October 2007, the group now has about 11,500 students, as well as more than 1,000 students studying for its courses overseas.

The group has been growing its student base through acquisitions and new colleges (HELP-ICT and soon, the new campuses at Fraser Business Park and Subang 2), organic student growth and overseas tie-ups. Its home-grown degrees, granted under the "HELP University College" brand name, are also gaining popularity, and will help improve overall margins.

We expect its net profit to rise 21.1% to RM14.3 million in FY2009 ending Oct 31, with low price-to-earnings ratios (PERs) of 8.1 and 7.4 times for FY2009-FY2010 respectively.

Pantech Group Holdings

Pantech's latest earnings results for

PER (x)	NTA (RM)	P/NTA (x)
38.9	1.39	4.4
9.0	7.96	1.8
11.4	1.41	1.7
8.1	1.06	1.2
10.2	0.26	1.3
5.2	0.53	1.1
7.1	1.42	0.8
14.4	2.21	0.4

FY2009 ended Feb 28 showed strong growth momentum, despite significant uncertainties triggered by the global economic downturn. Net profit was up 74.4% to RM59.6 million, a record high for the company.

To be sure, most customers are still cautious, buying just enough for their immediate consumption. But demand for the company's pipes, fittings and flow control products remains solid, especially from the domestic oil and gas sector. The sector accounts for roughly 70% of Pantech's sales.

Orders in hand estimated at over RM180 million should keep busy until the third quarter. Even though prices have fallen well off the record highs, crude oil remains the world's primary fuel source for the foreseeable future. And oil exploration and development activities are typically based on a long-term outlook.

Earnings in FY2010 are expected to contract from last year's level, which were exceptional due to record steel demand and prices, but should resume its double-digit growth pace in FY2011. Pantech's shares are trading at a very attractive forward PER of only 5.2 times. Dividend yields are estimated to be 3.4% this year.

Tanjong Offshore

Similarly, Tanjung Offshore offers good value and its long-term prospects remain positive. Inflationary pressures will kick in from aggressive stimulus policies, which will lead to an eventual depreciation of the US dollar and higher crude oil prices, probably by 2H2009.

The company has a large fleet of 11 marine vessels, and five more will be delivered in the next two years. It is assured of a pool of sustainable earnings over the next few years from its existing locked-in vessel charters, maintenance and rig contracts.

We expect net profit to rise 29% to RM41.2 million this year and 25% to RM51.5 million in 2010. PERs are very attractive at just 7.1 and 5.6 times for 2009-2010. The stock even trades below its book value of RM1.23 — despite minimal chances of losses and substantial entry barriers to the industry.

Malaysia Steel Works

The steel sector is going through a down cycle. Globally, demand and prices have collapsed since hitting record highs in mid-2008.

Domestic demand for steel bars is estimated to have halved

Outlook is still clouded. Demand from government stimulus packages is unlikely to offset the sharp contraction in automotives, electrical and electronics and property sectors.

World crude steel production fell 1.2% in 2008 and is expected to fall further this year, perhaps by as much as 10% to 15%. Output contracted 22.8% y-o-y in the first quarter. Excess production capacity and falling raw material prices — primarily iron ore and metallurgical coal — will keep a lid on steel prices in the foreseeable future.

Domestic demand for steel bars is estimated to have halved. Although Masteel has had some success in the export markets, sales are likely to drop sharply this year. Lower utilisation will also hurt margins.

The company may fall into the red in the near term but operating conditions should stabilise in 2H2009 and improve going into 2010. Masteel shares are trading well below its net tangible assets of RM2.21 per share. Coming from such depressed valuations, we expect good upside potential in the next up cycle. ■

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