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# Finding 'jewels' among small-cap stocks

*If investors look deep enough, they can find small companies with a stable income stream, healthy track record and reasonable dividend payout that are worth a closer look*

**By LEE CHERNG WEE**

SMALL-CAPITALISED stocks are often overlooked and sidelined by investors due to unfamiliarity with their business models and low trading liquidity. However, if investors look deep enough, they can find small companies with a stable income stream, healthy track record and reasonable dividend payout that are worth a closer look.

In search of "jewels" among the small-cap stocks, OSK Investment Bank's research team launched the OSK Top Malaysian Small Cap Companies 2009 Edition, its fifth publication in the series that started in 2005. The latest version of the research publication features the top 50 of Bursa Malaysia's small-cap stocks with market capitalisation of less than RM1 billion.

"When the market recovers, blue chips will be overvalued and investors will start looking at second liners. Some small-cap stocks under our coverage went on to become big-cap stocks, such as KNM Group Bhd," said OSK deputy head of research Jeffrey Tan.

Using OSK's methodology, the stocks are screened and ranked based on market capitalisation, return on equity (ROE), estimated price-to-earnings ratio (PER) for FY09, and dividend yields. Of the 50 companies that were featured, OSK has "buy" recommendations on 35 of them. Below are OSK's Top 10 small-cap picks.

## ALAM MARITIM RESOURCES BHD (RM0.92)

Alam Maritim is the market leader with a young fleet of 28 vessels in the 5,000 brake horse power (bhp) category. It has the competitive advantage to secure more long-term contracts from Petroliam Nasional Bhd as all its vessels are Malaysian-flagged.

The company's gross profit margin of 40%-50% remains attractive despite expected lower charter rates of US$1.80/bhp to US$2.00/bhp (RM6.53/bhp to RM7.25/bhp). Alam maritime manages to differentiate itself from peers Petra Group Bhd and Tanjong Offshore Bhd by providing underwater services for deepwater jobs. Target price: RM1.40

## HAI-O ENTERPRISE BHD (RM3.62)

It is one of the leading healthcare multi-level marketing (MLM) companies with over 30 years of experience. Hai-O is seen to remain resilient despite the sluggish economy, given its single digit decline in revenue during the Asian financial crisis.

Its halal certification gives it an edge over traditional Chinese medicine halls and enables it to tap the Bumiputera market. Hai-O is targeting the right market segment with 90% of its MLM members comprising Bumiputeras. Its share price has outperformed the KL Composite Index by more than 70% in the past 12 months. Its dividend yield is at 12%. Target price: RM4.16

## HEKTAR REIT (RM0.88)

Hektar REIT's portfolio comprises three shopping centres in Subang Jaya, Malacca and Muar. With a well-diversified and healthy mix of consumer-driven tenants, it is more focused on providing daily necessities to the resident in their vicinities.

Excluding Parkson, no other tenant contributes more than 3% to Hektar's total monthly income. On a worst-case scenario of a 30% decline in rental rates, earnings will only fall by about 7% in 2009. Additionally, Hektar is backed by Fraser Centrepoint Trust, the leading suburban retail Singapore-based REIT, with a 31% stake in Hektar. Target price: RM0.99

## KOSSAN RUBBER INDUSTRIES BHD (RM3.34)

Kossan is one of the world's largest powder-free medical glove makers. Some 75% of its annual capacity of 11.5 billion pieces being powder-free gloves. With utilisation rates above 90%, its plants are the most highly utilised in Malaysia due to the management's prudent planning in capacity expansion.

About 99% of its gloves are for the medical segment, which is resilient to the global recession. Financially, Kossan has consistently delivered ROE of more than 20% since 2005 and the quantum is expected to be maintained going forward. Target price: RM4.48

## KPJ HEALTHCARE BHD (RM2.88)

KPJ is the largest private hospital group in Malaysia with 19 hospitals nationwide. KPJ is poised to weather the economic downturn given that healthcare is considered a necessity. This is supported by the scarcity of medical services and long queues at public hospitals.

KPJ also has the ability to expand its hospital network without stretching its balance sheet by injecting hospital building assets into Al-'Aqar REIT, in which KPJ owns close to a 50% stake.

It is the cheapest healthcare stock in the region, trading at an undemanding estimated FY09 PER of 7.1x against that of regional peers at 10-15x FY09 PER. Target price: RM4

## MALAYSIA STEEL WORKS (KL) BHD (Masteel) (RM0.80)

Masteel produces niche products that command better margins amid less intensified competition. Despite being the smallest integrated long steel miller in the country, it is the only player that is profitable throughout the various steel cycles due to its prudent stance of keeping a short inventory cycle.

This helped the company to escape from two consecutive industry-wide impairment exercises in the second half of 2008 as steel prices slumped more than 50% from the peak in July 2008. Investors should position themselves for the potential upsurge in steel demand, expected in second half of 2009, emanating from the stimulus packages. Target price: RM1.03

## MUDAJAYA GROUP BHD (RM1.37)

Mudajaya is best known for its expertise in building power plants, having built more than 10 plants. Its order book stands at RM5.6 billion, a huge feature that is rare among small cap contractors, which typically have order books of less than RM1 billion.

Mudajaya stands to benefit from jobs such as the LRT extension and new lines as it had previously constructed three of the existing LRT stations and the KLIA aerotrain line. In India, Mudajaya's 26% owned special purpose vehicle, RKM Powergen Pte Ltd, signed a power purchase agreement (PPA) with the Chhattisgarh State Electricity with another PPA set to be signed soon. The project's internal rate of return is expected to be between 16% and 17%. Target price: RM1.58

## NEW HOONG FATT BHD (RM1.65)

New Hoong Fatt (NHF) is the country's sole replacement steel auto components maker that also imports about 7,000 other components. Its extensive product portfolio ranges from metal body parts to plastic parts.

The replacement parts segment of the autopart industry is resilient given the huge price difference between replacement parts and original parts. It went through the 1998 financial crisis unscathed posting a 2% growth in revenue despite a 59% contraction in total industry volume.

Its net profit margins are expected to improve in 2009 as the price of cold rolled coil, its key raw material, has declined by 45% since late November 2008 from its all-time high in June 2008. Currently, NHF is the cheapest among its closest peers, with a PER of 5x against the autoparts industry PER of 8.16x. Target price RM1.80

## QL RESOURCES BHD (RM2.52)

QL is a diversified agriculture-based company involved in marine products manufacturing (MPM), oil palm plantation and milling and feed commodities and livestock farming.

It has a track record of posting profit for the last 20 years running and is viewed to be fairly resilient, given its integrated role in the industry and ability to grow amidst crisis.

Earnings expansion is expected to come from the MPM segment from 2010 onwards as QL is doubling its annual production capacity of 10,000 tonnes. Meanwhile, QL's 20,000ha oil palm plantation in East Kalimantan is projected to account for 40% of its pretax profit in 6-10 years' time. It is also investing RM28 million over two years to install egg production capacity of 400,000 eggs. Target price: RM3.32

## WAH SEONG CORP BHD (RM1.55)

Wah Seong is the largest pipe coater in Asia with a 50% market share and the third largest in the world. Its pipe coating and corrosion protection plant in Kuantan is the most advanced facility in the world.

The company's orderbook of RM1.4 billion will keep it busy over the next 12 months. It is also bidding for large projects from oil giants Chevron Gorgon, Exxon PNG/LNG and Woodside Browse between 2010 and 2012. Target price: RM1.93

| | 52-wk high | 52-wk low | Current price | PER | NTA/ share |
|---|---|---|---|---|---|
| | RM | | | (times) | RM |
| Alam Maritim | 2.15 | 0.52 | 0.92 | 5.9 | 0.80 |
| Hai-O | 3.90 | 2.86 | 3.62 | 5.2 | 1.42 |
| Hektar REIT | 1.49 | 0.73 | 0.88 | 7.8 | 1.26 |
| Kossan | 3.82 | 2.01 | 3.34 | 9.0 | 1.87 |
| KPJ Healthcare | 3.70 | 2.23 | 2.88 | 0.3 | 2.20 |
| Masteel | 1.59 | 0.50 | 0.80 | 1.8 | 2.21 |
| Mudajaya | 1.52 | 0.92 | 1.37 | 11.3 | 0.81 |
| New Hoong Fatt | 1.90 | 1.13 | 1.65 | 6.8 | 2.43 |
| QL Resources | 3.07 | 2.08 | 2.52 | 9.1 | 1.08 |
| Wah Seong | 2.52 | 0.99 | 1.55 | 9.6 | 1.15 |