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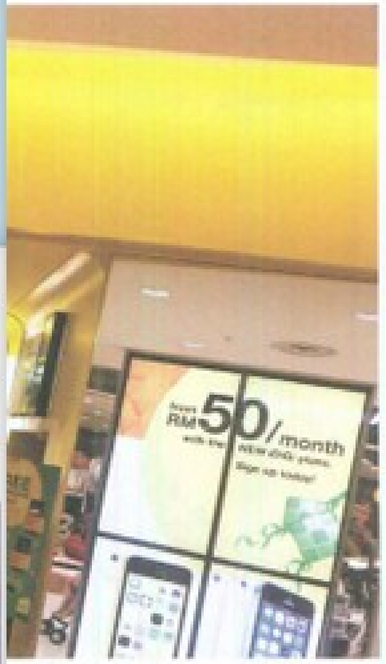
STATE OF THE NATION 2015

Top stock picks for the year

Corporate earnings in 2015 will likely be dragged down by the economy's weaker performance. Yet, there are stocks with good fundamentals that will ride out the challenges, and others that will benefit from some of the current developments, such as falling crude oil prices and a weaker ringgit. We asked several fund managers and heads of research to come up with their top stock picks for the year.



DZULKARNINE KAZIM
FUND MANAGER,
APEX INVESTMENT SERVICES BHD

Tenaga Nasional Bhd
RM14.40

In the short to medium term, corporate earnings growth is expected to remain solid as a direct result of lower coal prices — from US$100 (RM356.32) per tonne in FY2011 to US$75 per tonne in FY2014 — and as the company increases the utilisation of its hydro segment for power generation.

In addition, the expiry of YTL Power's independent power producer contract will provide further power purchase agreement savings. Consumption of electricity, especially by the industrial and commercial sectors, is expected to remain positive on the back of a high correlation with the country's economic growth.

The country is expected to maintain positive economic growth of around 5% for 2015. From a valuation perspective, as one of the key FBM KLCI-linked counters, Tenaga is still trading at a reasonable valuation at a PER of 11.74 times based on FY2015 EPS and price-to-net tangible assets ratio (P/NTA) of 1.80 times.

Unisem Bhd
RM2.11

Unisem can be considered a laggard among its peers in the semiconductor sector, the others being Globetronics, MPI and Inari. Last year was a turning point for Unisem as the company reported its third straight quarter of profit in 3Q2014, which was a direct result of a corporate restructuring programme undertaken by management. The revamp involved divesting loss-making subsidiaries and focusing more on smartphone-related products.

Similar to other semiconductor-related companies, Unisem is expected to benefit from the ongoing recovery of the technology sector. Thus, the current positive earnings momentum is expected to continue in the short to medium term. At the current price, the company is trading at an undemanding price-earnings to growth (PEG) valuation of 0.34 times compared with a sector PEG of 0.75 times. On a P/NTA basis, it is trading at 1.39 times compared with 4.54 times and 5.71 times for Globetronic and Inari respectively.

In summary, Unisem is well positioned to benefit from the strong demand from the smartphone industry. Coupled with undemanding valuations, it should provide significant upside potential for investors.

DiGi.Com Bhd
RM6.32

DiGi has been one of the best-performing companies in the telcommunications sector in terms of share price appreciation, dividends reinvested and return on equity. However, in the prepaid market segment, which is DiGi's stronghold, the company is being challenged by U Mobile, Celcom and Maxis. These players have been targeting the youth and foreign worker segments, which traditionally have been DiGi's turf.

As a result of the stiff competition, DiGi's service revenue growth started to slow in 2QFY2014 (+2.8% y-o-y) and 3QFY2014 (+2% y-o-y). Its rivals will continue to be aggressive in 2015 and this will reduce some of DiGi's revenue growth potential.

A likely re-rating catalyst is if the company's board recommends that shareholders pursue a business trust structure. Nevertheless, we believe DiGi's plans to establish a potential business trust structure are unlikely to materialise in the near future as it will need more time to fully consider the implications. Therefore, due to limited retained earnings, DiGi will only be able to pay out 100% of earnings, which translates into a relatively decent yield of around 4.5%.

Kossan Rubber Industries Bhd
RM5.30

The business model of Kossan is slightly different from that of other rubber glove companies in the country as it also manufactures technical rubber products (TRP), in addition to natural and nitrile rubber gloves.

The company has also benefited from its balanced product mix of natural and nitrile rubbers. This product mix structure has enabled it to capitalise on higher-margin nitrile demand growth and consistent demand for natural rubber gloves from developing countries.

From a valuation angle, based on FY2015 EPS estimates, Kossan is trading at a PER of 16.5 times against an EPS growth rate of 29%. This translates into a PEG ratio of 0.6 times. Thus, we see further upside potential in Kossan at current valuations.

Spritzer Bhd
RM2.08

Spritzer Bhd is the only fully integrated natural mineral water manufacturing company listed on Bursa Malaysia. It is located on approximately 300-acre parcel of land with a 999-year leasehold and that has an ample supply of high-grade natural mineral water.

The difficulty in finding a large piece of land with ample supply of high-grade mineral water provides a barrier to entry for new players to compete with the company. In addition, as the factory is highly automated, it is less dependent on manual labour and foreign workers. It is currently trading at a relatively reasonable valuation of 1.5 times on a P/NTA basis and 17 times on FY2015 earnings.

Bumi Armada Bhd
RM1.21

With nine floating, production, storage and offloading (FPSO) vessels, Bumi Armada remains the world's fifth largest FPSO operator by fleet size. The recent finalisation of the Madura FPSO contract has pushed its order book to a record high of around RM23.4 billion, second to SapuraKencana (RM26 billion). The company also has extension options worth RM11.8 billion, which will ensure long-term earnings visibility.

Currently, it is bidding for four FPSO contracts in Ghana, Nigeria, Namibia and Angola. Despite the current oil price weakness, investors should take advantage of the share price correction to accumulate shares on the back of its solid earnings visibility given the long-term nature of FPSO contracts, and its good leverage in the international market. Furthermore, all its FPSO contracts are outside Malaysia and will not be affected by Petroliam Nasional Bhd's (Petronas) capital expenditure programme.

Valuation-wise, Bumi Armada is trading at a 30% discount to its net tangible asset (NTA) value of RM1.56 per share and a FY2015 PER of 14 times. Recent news about its major shareholder's plans to divest part of his stake to a strategic partner is expected to create interest among investors.

GDex Bhd
RM1.61

GDex's prospects appear promising in the light of the growth of the online business and shopping in Malaysia. The company is linked to Singapore Post and Alibaba, which provide stability to its business and shareholding structure.

GDex has seen five years of strong revenue and earnings growth, at around 18% and 39% respectively. This is expected to remain steady in the medium to long term against the backdrop of the rapid capacity expansion of its express delivery service and logistics arms, coupled with low oil prices. The company has been able to generate strong returns of around 50% on retained earnings over the past five years.

Dialog Bhd
RM1.59

Dialog is a well-run company and its Pengerang project is expected to provide a growing recurring income base. The company's value mostly lies in its tank terminals which, in the long run, could benefit from the current weakness in oil prices.

Further recurring income will come from the Balai cluster risk service contract. Balai is located off Sarawak and is a joint venture between Australia-based Roc Oil Co Ltd (48%), Dialog (32%) and Petronas Carigali (20%).

In addition to its own development in Pengerang, Dialog is eyeing engineering, procurement and construction contract (EPCC) opportunities from Petronas' US$20 billion Refinery and Petrochemical Integrated Development (RAPID) project, which is located in the same area.

Dialog's shares are currently trading at a PER of 28 times on FY2015 earnings, but its valuation is expected to decline gradually as contributions from its Pengerang project come into the picture.

Uzma Bhd
RM2.04

Uzma started as a provider of drilling project management services, and geoscience and reservoir-engineering software services. Unlike other oil and gas companies, Uzma has an asset-light business model, focusing on innovation and technology to propel its growth and transform itself into a regional leader in O&G upstream services. It provides solutions for exploration, development and production.

The company is aggressively adding new businesses to capitalise on the fastest growing areas of the O&G industry. Furthermore, its Tanjung Baram marginal field is expected to commence oil production in 2QFY2015. This should provide a new source of recurring income and set the stage for positive earnings performance in FY2015. Its order book is estimated at RM2 billion and it is bidding for an additional RM2.6 billion.

The counter is trading at a PER of 9.77 times on FY2015 earnings and its EPS growth is around 30%. It is trading marginally above its NTA value of RM1.34 per share.

Careplus Bhd
RM0.44

Careplus has been in the glove industry for more than 20 years and was listed on Bursa Malaysia's ACE Market in December 2010. The company initially focused on latex-based gloves, but recently expanded its nitrile glove capacity due to its higher margins.

A year after its flotation, it formed a joint-venture company called Careglove Global with Descarpark, a Brazilian-based entity. Careplus has divested 50% of its equity interest in Careglove to Descarpark for RM44 million, which it used to expand capacity by nine production lines. At the moment, most of Careplus' sales are channelled to Brazil via Descarpark, which has vast expertise in the country's rubber glove market.

Careplus' profit margin is relatively lower than those of its peers because it is on an expansion phase with substantial commissioning and pre-commissioning works being carried out. The stock is trading at an FY2015 PER of 7.26 times against an EPS growth rate of 15%. This translates into a PEG ratio of 0.52 times. Thus, we see upside potential at its current valuation.