

EEI Corporation

BUY

February 24, 2010

Steady growth for a leading industrial construction company

Price (19Feb)	P2.55
Target	P5.30
Market Cap	P2.65B
O/S Shares	1.04B
52-week High	P3.00
52-week Low	P0.83

EEI is expected to achieve strong growth as it pursues overseas and local operations and completes ongoing projects. Global and local economic conditions may work to the advantage of the firm while some factors may limit its growth this year.

DIVERSIFIED: EEI began as a machinery supplier more than 70 years ago. It has boomed into a larger industrial and civil construction company with projects in the country and in various parts of the world. Its core strengths are in the construction, fabrication, and electro-mechanical industries.

OVERSEAS PROJECTS. Most overseas constructions are in the Kingdom of Saudi Arabia (KSA) where there is a rich amount of oil deposits. The firm is also exploring more electro-mechanical projects this year. Revenues from the KSA are estimated to range between P17-20 billion yearly. Aside from the Arab country, EEI is also actively pursuing projects in other areas such as New Caledonia and Singapore.

LOCAL OPPORTUNITIES: Upcoming bidding for projects includes high rise structures, mining infrastructure, and power plants for the private sector.

SHIELD FROM INFLATION: Depending on the contract signed, steel and cement costs incurred are usually covered by the owner. Price fluctuations in materials such as steel and cement do not have a significant impact on the company's expenses. These construction materials are provided by the owner.

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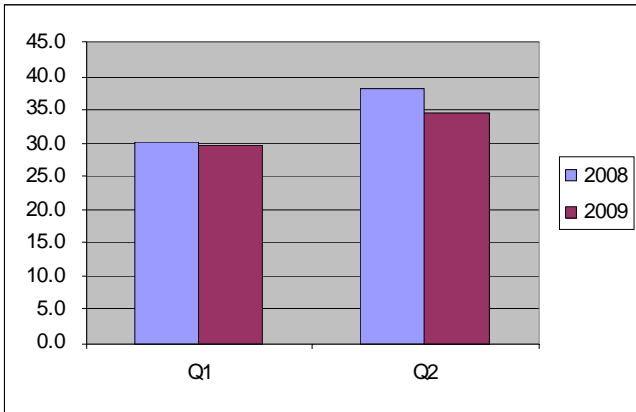
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OIL PRICE. The price of crude oil will not return to the high levels of 2008 in the near future nor will it drop to a sharp bottom. A higher price is favorable for the company since this leads to more installation projects for oil drilling and exploration. The current trend shows oil price will not be as volatile as the previous years.

Property and Construction Drag

In the past year, the Property Sector experienced a slight weakening. Construction activities slowed down as weak demand prevailed. The pressure stemming from the crisis pulled back the bustling industries to more languid moves. It was on the same year when private building construction in the Philippines experienced a mild slowdown as an effect of the Property sector's weakening. The first two quarters of 2009 as shown in Figure 1 prove that there was a decline in activity compared to the two quarters of the previous year. As the economy improves this 2010, both Property and Construction will regain growth and activity.

FIGURE 1: Phil. Private Building Construction



Source: NSO

The weak performance of the industry, especially the private sector, affected EEI's local construction activity. Weak industry and economic activity post a risk to the company's performance. EEI's projects under Properties are mostly high rise structures for the private sector. But revenue growth opportunities in the private sector are also seen in the construction of mining infrastructure, power plants, and high rise structures. This can be attained this year as EEI participates in the upcoming bidding of projects for the said type of infrastructure. The St. Francis Shangri-La Place is among the company's latest projects.

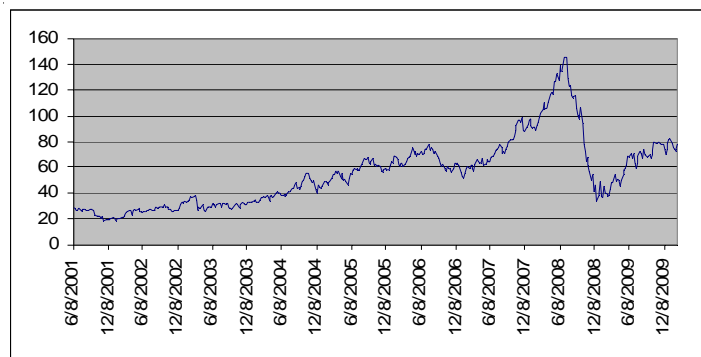
Meanwhile, interest rates are considered another factor that could affect the Property industry. Interest rates are currently kept steady, encouraging more activity and demand for building and purchase of properties. Though this is the case, it is unlikely that the sector would return to pre-crisis levels immediately. Monetary tightening is imminent as the economy slowly moves toward better growth.

Global economic conditions still in favor of EEI

Higher price of oil translates to more projects for EEI. As per our estimate, oil is not expected to end the year with a price above \$100 per barrel. Tracing the price trends in the past years, oil will be trading at a limited range this 2010. It will be retracing its path upwards after successive declines in the latter parts of 2008. Our price estimate falls at around \$75 per barrel by the end of the year.

Oil price change will be less volatile this year. Although it will not be as high as 2008 levels, the steady price of oil will work favorably for EEI. Stable to higher oil prices translates to sustained projects. The largest overseas market of EEI is in the Kingdom of Saudi Arabia. Yearly revenue estimate from the KSA are equal to or a little below P20B. The company will benefit from the development of the western part of KSA since the eastern area is already developed.

FIGURE 2: Monthly Oil Price



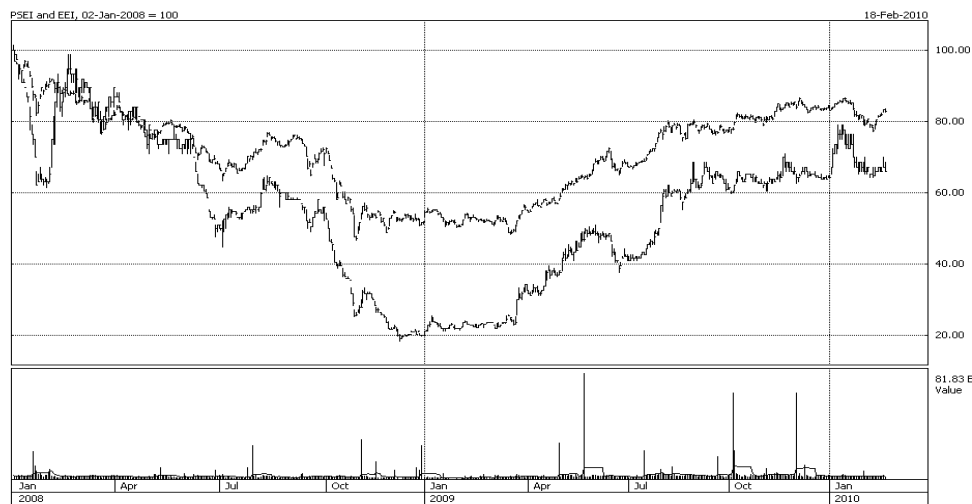
Source: Technistock

The company also undertakes more electro-mechanical projects in the region. Meanwhile EEI is exploring opportunities outside the KSA. New locations such as New Caledonia, Papua New Guinea, Singapore and Guam will be adding value to the firm. Aside from the ongoing projects in some of the areas mentioned, EEI will also be bidding for contracts this year.

EEI stock soon to outperform the market.

EEI has been moving along with the PSEi since 2008. The index is expected to follow a sideways path for now, encountering a mid term resistance of 3,100. As shown in Figure 3, the PSEi is the one on top while the one below it is the price trend of EEI. The high growth potential of the company as reflected in our revenue and earnings estimates and improved margins for both 2009 and 2010 will have a significant bearing on the stock’s price movement. The PSEi will not have large swings in its moves. But EEI’s stock price, with its growing presence locally and in other markets, will improve and reflect the company’s true value.

FIGURE 3: EEI and PSEi



Source: Technistock

Overseas Projects will drive growth and strength.

EEI has tapped other countries to fuel its overseas growth. Not only does it have Saudi Arabia, it is also building its presence in New Caledonia and Singapore among others. With the gradual improvement in the local economy, industries will again boom, causing the firm’s local construction operations to gain strength and growth. Over the next few years, EEI will achieve a steady growth in profits along with improvement in its margins.

FIGURE 4: EEI Projected Revenue and Net Income

(in millions)	2006	2007	2008	2009F	2010F
Revenue	5,260	7,482	9,190	6,511	8,464
Equity in Net Earnings	197	356	631	767	831
Net Income	200	304	507	658	698

Domestic operations are recorded in EEI’s revenues while its Saudi Arabia operations are equitized. Domestic earnings is forecasted to drop by 29% in 2009 due to a slow down in local construction activities. This came as an effect of the crisis which peaked in 2008. Despite the drop in oil prices, earnings from foreign activities will still grow by 21% for 2009. Costs are expected to be lower due to less domestic construction activities. Full year 2009 profit growth is 30% for EEI.

Steady Growth Ahead

Compared to the previous years' net income growth, EEI will record a more steady and sustainable growth in the coming years. For 2010, we estimate a profit growth of 6%. More contracts for both markets will pour in by the second half of the year causing a trimmer and single digit growth for the company. As local operations recover and overseas operations improve, income will grow significantly better. EEI will actively participate in bidding for several local construction projects this year while its presence in other countries is beginning to be established.

Upgrades and Supplies

EEI will be upgrading its equipment and facilities for steel fabrication. Depending on the equipment requirement, the company estimates a CAPEX amount of P150M. There is an option for the company to fund such requirements through bank loans or through supplier's credit. Materials and other supplies are assured and provided, allowing operations to run smoothly.

Significantly Undervalued

The company's potential for growth has not been reflected in its valuations in the past years. Due to market and economic weakness, the firm's value plunged. With growth fueled by more projects and wider markets, EEI's value would gradually return to pre-crisis level.

FIGURE 5: EEI Valuation

	2006	2007	2008	2009F	2010F
EPS	0.19	0.29	0.49	0.63	0.67
BVS	1.45	2.17	2.67	2.97	3.64
PE	16.21	13.63	1.55	3.84	7.86
PB	2.15	1.85	0.29	0.82	1.45

EEI's PE historically lies above 10x. While the crisis caused the slow down in projects in the years 2008 and 2009, the company was still able to maintain the growth of its net income. Increasing opportunities for local construction and more markets for overseas projects will result to even higher revenues and profits. Based on our earnings estimates and the firm's historical valuations, we have computed a target price of **P5.30** per share. This has an upside of 107% from its current price (19Feb2010) of P2.55 apiece. The target price of P5.30 translates to a PE of 7.86x and a PB of 1.45.

EEI's price will break out of its current trend and even outperform the market. The recovery in local construction activities and improved overseas operations will drive better value for the company.

We are confident that EEI will meet a sustainable growth this year. The target price reflects the strength of the company and improved operating conditions. A company that established a firm niche in the construction industry, EEI will grow strongly and sustainably in the near future.