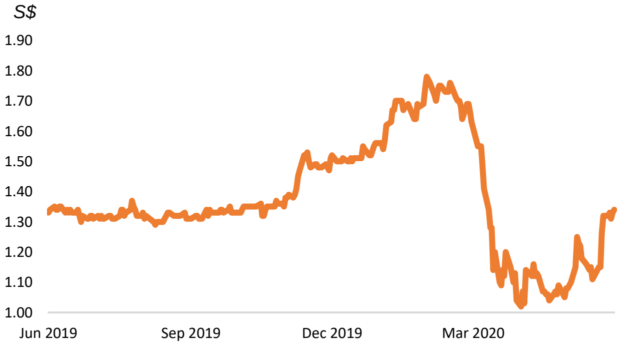
BRC Asia Limited

Date: 12 June 2020

BUY (Maintained)

Target price: S$1.64
+29.1%

BRC SP
Price: S$1.270 (as at 11 June 2020)



Share price	1M	3M	6M	1Y
BRC Asia	11.3%	-17.3%	-14.7%	-4.5%
Straits Times Index	4.4%	-2.5%	0.1%	4.3%

Market capitalisation	S$296.3 million
Current price	S$1.270
Shares outstanding	233,335,089
Free Float	16.9%
Major shareholders	Esteel Enterprise 71.9%
Recommendation of other brokers	N/A

Source: Company data, SGX StockFacts, SAC Capital

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1HFY20 NPAT beats our estimates

Post the acquisition of Lee Metal in June 2018, BRC Asia is now the largest steel reinforcement supplier in Singapore with a dominant market share.

BRC Asia reported an 86% 2QFY2020 NPAT increase, from last year driven by cost synergies from bulk raw material purchases and a decline in finance costs despite flat revenue. Overall, 1HFY20 net profit of S$22.7 million formed 62.7% of our original FY2020E estimates.

Stop work notice for construction worksites to adversely impact Group's operations. Most of the Group's manufacturing operations in Singapore were suspended from April till 1 June 2020. Accordingly, we adjust our FY2020E and FY2021E revenue projections lower by 28.6% and 6.9% respectively to account for the stop work order on their customers. We expect the Group to report weaker 3QFY2020 results but to slowly see a recovery from 4QFY2020. We lowered our estimates for FY2020E and FY2021E earnings by 36.7% and 7.3% respectively.

We maintained Buy rating on BRC Asia but lower fair value to $1.64 (from $1.71), based on 10x FY2021E earnings (~41% discount to peers) as we roll forward our earnings estimates. Though we expect lower 3QFY2020E earnings, we think investors will look towards a staggered recovery from 4QFY2020E and beyond. We remain positive that the Group's overall margins will continue to improve with better pricing power from a strengthened market position post acquisition, and a recovery in the construction sector. Our target price implies a 29.1% upside to the last traded price, with a dividend yield of 2.3% based on last closing price.

Key risk: Weaker economic sentiment.

Key Financials

Year ended September (S$'000)	FY2017	FY2018	FY2019	FY2020E	FY2021E
Revenue	310,148	567,009	913,287	706,500	939,800
% Growth	(10.6%)	82.8%	61.1%	(22.6%)	33.0%
Gross profit	19,373	45,071	76,570	62,384	86,462
Gross profit margin	6.2%	7.9%	8.4%	8.8%	9.2%
Profit/(loss) before tax	3,024	15,650	38,435	27,954	46,630
Profit/(loss) before tax margin	1.0%	2.8%	4.2%	4.0%	5.0%
Profit/(loss) attributable to owners	1,811	12,043	31,562	22,922	38,236
EPS/(LPS) (S$ cents)	1.14	5.57	13.53	9.82	16.39
P/E (x)	163.6	24.6	13.8	12.9	7.8
Net Debt/Equity	23.3%	135.1%	100.3%	90.3%	83.0%

^EPS is computed based on the profit from continuing operations attributable to owners of the company divided by total shares outstanding

Investment Highlights

Group faces uncertainty amidst COVID-19 outbreak

Business Overview:

BRC Asia is an established pioneer in prefabricated steel reinforcement. Since their incorporation in 1938, they have developed their expertise to become a leading steel reinforcement solutions provider in Singapore. Today, they have operations in Singapore, Malaysia and China.

BRC Asia reported an 86% increase in 2QFY2020 NPAT, driven by cost synergies from bulk raw material purchases and decline in finance costs despite revenue coming in flat. Revenue was 2% lower yoy to S$458.6 million, as lower average selling prices offset higher sales volume. Correspondingly, gross margin nearly doubled from 6.6% in 1HFY2019 to 12%, and net margin from 2.5% in 1HFY2019 to 4.9%, reflecting economies of scale derived from the acquisition of Lee Metal's operations. 1HFY2020 net profit of S$22.7 million formed 62.7% of our original FY2020 estimates.

Stop work notice for construction worksites to adversely impact Group's operations. Most of the manufacturing operations in Singapore were suspended until 1 June 2020. This would mean little or no revenue from Singapore operations for 2 months (April and May 2020) for the June quarter. Additionally, after the CB is lifted, it is unlikely for operations to return to pre-lockdown levels immediately due to resource constraints, especially labour, and new conditions for work resumption in the post-CB era.

On a positive note, the Group has obtained approval to restart earlier in Malaysia and has resumed operations since 4 May 2020. In China, the Group's 50-50 joint venture with MA Steel has resumed full operations from 9 March 2020 following the country's re-opening from the COVID-19 induced lockdown.

We expect the Group to see some of its customers adversely affected by the Covid-19 outbreak, we have increased the allowance for expected credit loss in our model. Accordingly, we adjust our FY2020E and FY2021E revenue lower by 28.6% and 6.9% respectively to account for the stop work order on their customers. We expect the Group to report weaker 3QFY2020 results but to slowly see a recovery from 4QFY2020. We lowered our estimates for FY2020E and FY2021E earnings by 36.7% and 7.3% respectively.

Strong balance sheet to weather COVID-19 woes. Despite the current uncertainty and outlook, the Group remains fundamentally sound and boasts a strong balance sheet, with net assets of S$267.9 million or S$1.15 as at 31 March 2020 after paying dividends of S$18.7 million on 26 March 2020. Based on the Group's 1HFY2020 balance sheet, the Group has cash and cash equivalents of S$28.9 million. Moreover, the Group is currently working closely with banks to improve its liquidity positions.

Investment Highlights

Recovery expected from 4QFY20 onwards

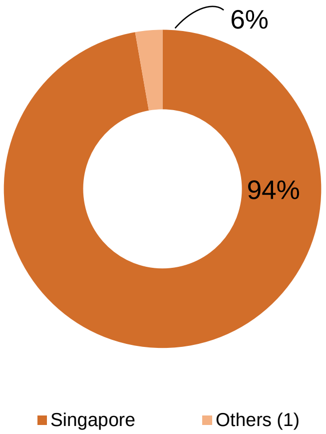
We expect the impact caused by COVID-19 to be temporary and the Group to bounce back incrementally in the coming months as CB measures ease and operations return to pre-CB levels. Given the tough conditions for work resumption in Singapore, it might be appropriate for the Group to focus on its expansion plans in Malaysia and China during these transitory times.

As at 31 March 2020, order book stands at about S$980 million. The duration of project in their sales order book ranges up to 5 years.

We maintained our Buy rating on BRC Asia with a BUY recommendation but peg down our fair value target price to $1.64 (previously $1.71), based on 10x FY2021E earnings (~41% discount to peers) as we roll forward our estimates. Even though we expect BRC Asia to report lower 3QFY2020E earnings, we think investor's are willing to look beyond the near-term impact, and we pencil in a staggered recovery in our estimates for the Group's 4QFY2020E and beyond. We remain positive that the Group's overall margins will continue to improve from here with better pricing power from a strengthened market position post acquisition, and a recovery in the construction sector. Our target price implies a 29.1% upside to the last traded price, with a dividend yield of 2.3% based on last closing price.

Company Background

Revenue Breakdown (FY2019)



Source: Company data, SAC Capital

(1) Solely represents Malaysia as China is not yet contributing revenue

BRC Asia is an established pioneer in prefabricated steel reinforcement. Since their incorporation in 1938, it has developed into a leading steel reinforcement solutions provider, with operations in Singapore, Malaysia and China. Singapore is its main market with 9 factories of total manufacturing capacity of 1.2 million metric tons a year.

It has customers from the public sector (public housing), private sector (private condominiums), and commercial and industrial projects. It also performs civil engineering works such as tunneling works.

Source: Company data

Source: Company data, SAC Capital

BRC Asia was incorporated in 1938, and was an early pioneer to set up in Jurong Industrial Estate in 1961 and it was granted the Singapore pioneer certificate in 1963. It was listed on the Singapore Exchange's mainboard on 24 July 2000.

BRC Asia underwent a major change of shareholders exercise in September 2017, when a takeover for the Group was successfully launched and completed by Esteel Enterprise at S$0.925 per share. In 2018, the Company made an offer to acquire fellow steel player Lee Metal Group for $199.3 million and de-listed the company.

The acquisition allowed BRC Asia to realise potential synergies. These include economies of scale, improvement in productivity and cost-efficiency.

BRC Asia is now a market leader in providing pre-fabricated steel reinforcement solutions. It has the following competitive advantages: (i) just-in-time delivery, (ii) 24-hour express cut-and-bend services, and (iii) a full-suite of prefab reinforcing solutions.

As at 31 March 2020, order book stood at about S$980 million, to be delivered over the next 5 years.

Competitive Advantage

Acquisition of Lee Metal Group boosted the Group's manufacturing capability and market share

BRC Asia's acquisition of Lee Metal, a recognised international trader of steel and steel related products in Southeast Asia, lifted the estimated overall market share capacity from about 20 – 30% to 40 – 50% in terms of capacity (for more details on market share, see Industry Overview section).

Company	Estimated market share by capacity (%) in 2017
BRC Asia	40 – 50%
NatSteel	20 – 30%
Angkasa	10 – 20%
Ribar	0 – 10%
Super Bend	0 – 10%
Lian Bee Metal	0 – 10%

Source: Competition Commission of Singapore, SAC Capital

The acquisition allowed BRC Asia to achieve cost efficiencies through:

1) Improved unit costs at various stages in the supply chain, including raw materials, logistics, sub-contractors, spare parts and scrap metal;
2) Lower wastage (i.e. scrap metal generated); and
3) Lower man hour per metric ton of steel processed.

We think the acquisition will enable BRC Asia to further improve overall productivity and efficiency, translating into cost savings that enable them to be more competitive in tendering for projects. It will also allow them to offer their customers a full-suite of prefab reinforcing solutions, and to be a one-stop shop for their customers. BRC Asia has adopted a rolling hedge to hedge against raw material prices.

In addition, Lee Metal had traditionally focused on infrastructure projects, which requires more of the cut and bend steel, while BRC Asia focused on HDB projects, which utilises more mesh. The acquisition allowed BRC Asia to enter into a new field they did not previously have expertise.

BRC Asia have an annual processing volume of approximately 1 million tonnes. We think they will build on their competitive edge in the next few years as they realise the full synergies from their acquisition of Lee Metal. These competitive advantages include but are not limited to, (i) providing best-in-class products at sustainable pricing, (ii) institutionalised hedging capabilities and (iii) effective procurement and price certainty.

Income Statement (S$'000)

	Fiscal Year Ended				
	FY17	FY18	FY19	FY20E	FY21E
Revenue	**310,148**	**567,009**	**913,287**	**706,500**	**939,800**
Less: Cost of sales	(290,775)	(521,938)	(836,717)	(644,116)	(853,338)
Gross Profit	**19,373**	**45,071**	**76,570**	**62,384**	**86,462**
Other income	995	2,482	2,842	2,842	2,842
Distribution costs	(4,815)	(5,129)	(5,934)	(5,652)	(7,518)
Administrative expenses	(6,275)	(13,346)	(12,967)	(14,130)	(18,796)
Other expenses/Share of JV profit	(4,718)	(8,226)	29,321	22,954	41,630
Finance costs	(1,536)	(5,202)	(9,575)	(12,990)	(12,059)
Profit before income tax	**3,024**	**15,650**	**38,435**	**27,954**	**46,630**
Less: Income tax	**(1,152)**	**(3,607)**	**(6,873)**	**(5,032)**	**(8,393)**
Profit/(loss), net of tax	**1,872**	**12,043**	**31,562**	**22,922**	**38,236**
Profit/(loss) attributable to owners of company	**1,811**	**12,043**	**31,562**	**36,916**	**41,920**
Earnings/(Loss) per share:					
-Basic (S$ cents)	**1.14**	**5.57**	**13.53**	**9.82**	**16.39**
-Diluted (S$ cents)	**1.14**	**5.57**	**13.53**	**9.82**	**16.39**

Cash Flow Statement (S$'000)

	Fiscal Year Ended				
	FY17	FY18	FY19E	FY20E	FY21E
Profit/(Loss) before tax	**3,024**	**15,650**	**38,435**	**27,954**	**46,630**
Depreciation & amortisation	7,646	10,864	16,007	10,998	10,998
Change in working capital	11,079	(30,440)	23,621	103,143	(26,913)
Others	9,004	(6,991)	1,230	7,458	2,966
Net Cash (used in)/ from operations	**30,753**	**(10,917)**	**79,293**	**149,553**	**33,681**
Purchase of PPE	(19,318)	(26,865)	(2,298)	(12,000)	(12,000)
Others	(4,571)	(140,104)	(9,015)	0	0
Net Cash (used in)/ from investing	**(23,889)**	**(166,969)**	**(11,313)**	**(12,000)**	**(12,000)**
Net increase in equity	0	46,990	0	0	0
Net increase in debt	11,263	152,459	(31,606)	(2,296)	(2,296)
Others	(6,072)	(4,490)	(11,743)	(19,866)	(23,530)
Net Cash (used in)/ from financing	**5,191**	**194,959**	**(43,349)**	**(22,162)**	**(25,826)**

Balance Sheet (S$'000)

	Fiscal Year Ended				
	FY17	FY18	FY19	FY20E	FY21
As at 30 September					
Property, plant and equipment	89,136	148,978	134,110	138,294	139,296
Investment properties	0	2,471	2,402	2,402	2,402
Other non-current assets	21,478	23,702	26,255	68,118	68,818
Non-current assets	**110,614**	**175,151**	**162,767**	**208,814**	**210,516**
Inventories	111,433	270,249	231,891	247,759	270,353
Trade and other receivables	75,516	180,725	195,315	159,588	181,103
Other current assets	1,277	31,537	38,179	48,130	48,130
Cash and cash equivalents	23,989	41,080	65,778	181,168	177,022
Current assets	**212,215**	**523,591**	**531,819**	**637,300**	**677,264**
Total assets	**322,829**	**698,742**	**694,586**	**846,114**	**887,780**
Loans and borrowings	10,772	82,265	60,658	2,102	2,102
Other liabilities, non-current	7,193	35,960	13,142	192,026	192,026
Non-current liabilities	**17,965**	**118,225**	**73,800**	**194,128**	**194,128**
Loans and borrowings	52,376	255,838	245,839	251,246	248,950
Trade and other payables	69,049	58,959	67,164	72,923	90,119
Other liabilities, current	15,262	28,684	44,855	48,844	48,844
Current liabilities	**136,687**	**343,481**	**357,858**	**373,013**	**387,913**
Share capital	68,011	125,001	125,001	125,001	125,001
Others	(2,984)	(3,323)	(3,259)	(3,259)	(3,259)
Retained earnings	102,728	115,358	141,186	157,232	183,997
Equity attributable to owners of the Company	**167,755**	**237,036**	**262,928**	**278,974**	**305,739**
Non-controlling interests	422	0	0	0	0
Total equity	**168,177**	**237,036**	**262,928**	**278,974**	**305,739**
Total liability	**154,652**	**461,706**	**408,558**	544,041	**558,941**
Total equity and liability	**322,829**	**699,491**	**694,586**	**846,114**	**887,781**

Ratios

	Fiscal Year Ended				
	FY17	FY18	FY19E	FY20E	FY21E
Profitability (%)					
Gross profit/(loss margin	6.2%	7.9%	8.4%	8.8%	9.2%
Operating profit margin	3.0%	5.1%	6.6%	6.4%	6.7%
Profit/(loss) before tax margin (continuing ops)	1.0%	2.8%	4.2%	4.0%	5.0%
Liquidity (x)					
Current ratio	1.6	1.5	1.5	1.7	1.7
Quick ratio	0.7	0.7	0.8	1.0	1.0
Interest coverage ratio	6.0	5.6	6.3	3.5	5.2
Net Debt to Equity	23.3%	135.1%	100.3%	90.3%	83.0%
Valuation (x)					
P/S	1.0	0.5	0.3	0.4	0.3
P/E	163.6	24.6	9.4	12.9	7.8
Core P/E at target price	N/A	N/A	N/A	N/A	N/A
P/B	1.8	1.3	1.1	1.1	1.0
P/NTA	1.8	1.3	1.1	1.1	1.0
Cash Conversion Cycle					
Trade receivable days	83	82	75	92	66
Inventory days	127	133	110	136	111
Trade payable days	63	45	28	40	35
CCC days	147	171	157	188	142
Returns					
Return on equity	1.1%	5.9%	12.6%	8.5%	13.1%
Return on capital employed	0.6%	2.4%	4.5%	3.0%	4.4%
Dividend payout ratio	0%	18.0%	59.1%	30.0%	30.0%

n.m.: not meaningful

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