SAC CAPITAL

This is SAC weekly newsletter for 6 Apr 2022. Thank you for reading.

Market Moves

The odds of a 50bp US rate hike and balance sheet runoff in early May have risen. In Europe, ECB is also expected to raise rates to bring down inflation. However, part of the pressure is caused by energy prices. European authority has suggested providing targeted aids to affected industries. Higher energy costs are also expected to eat into the margins of Singapore companies, though large business energy users could secure one-month contracts at capped rates. MAS is also expected to strengthen the S$ in its next review this month. A stronger S$ would help to lower the cost of imports.

China rolled out the Financial Stability Fund to help struggling financial institutions and lift domestic consumption. It is also pushing ahead with a RMB2.3tn infrastructure plan. The country is expected to further ease monetary policies to address the economic slowdown triggered by COVID lockdowns and regulatory clampdowns. What's alarming is SMOORE (6969 HK) reported that COVID lockdown in Shenzhen lowered 1Q21 net profit by 55.3% to RMB526.6m. It does appear that Shanghai manufacturers might face similar blow as the lockdown has been extended.

March property sales in China remained weak. Chinese developers reported sales decline of -26% to -87% yoy (average -50%) in contracted sales and - 16% to -82% yoy in GFA. This implies that ASPs continued to fall. Yanlord Land reported +0.8% yoy in sales and -23% in GFA. We believe the sector might improve with recent relaxations of property rules in most cities: 1) lifting of Hukou restrictions on property purchases; 2) lower down-payment; and 3) lower mortgage rates. Cash flow of Chinese developers remains the biggest concern. Improvement in sales will alleviate these concerns and lift sentiments, with a spill-over for Singapore-listed Yanlord, First Sponsor, lender Yangzijiang and other Chinese developers.

Singapore, on the other hand, is expected to accelerate construction activities to meet housing needs and ease infrastructure backlog. In spite of rising material prices, development work will not stop as rising interest rates work against the developers and construction companies. Material suppliers Pan United, BRC Asia and HG Metal will enjoy strong demand and stable margins as higher costs can be passed on.

Analysts' Notes

SPH REIT | <Analyst briefing> We noted several points from the briefing. 1) Higher electricity costs will impact landlords in the near term. Under the fair tenancy frame work, operating costs in the common area are classified under service charges, which are pre-determined and fixed during the lease term. Landlords will therefore have to bear any increase in costs during the term. It is estimated that the increase in electricity costs will have ~1% erosion on NPI margin. 2) Rental rate increase is expected to be gradual. The retail scene will be boosted by the ease of COVID measures, particularly the increase in dine-in group sizing to 10 persons, which is expected to increase discretionary spending amongst patrons. However, having suffered from COVID over the past two years, tenants will likely remain cautious about committing to higher rental rate. 3) Resumption of atrium sales to boost bottom line. Landlords will be able to generate income by renting out these idle spaces, which will flow directly through to net income without incurring significant operating costs. Barring any unforeseen circumstances, we expect retail REITs performance to gradually pick up and see significant improvement in 2023. *(Lam Wang Kwan)*

HG Metal | <Management meeting> HGM supplies rebars (72% of revenue) and structural steel (28%) to the construction industry in Singapore (93% of sales), Myanmar (4.6%) and Indonesia (1.4%). The size of its rebar business is about 10% that of BRC Asia's. It has pivoted towards rebars in the last 5 years as 1) ASPs of rebars are governed by BCA guidelines, ie higher prices can be passed on to customers. This reduces risk of price swings on its earnings; 2) structural steel is a distribution business and faces keen competition.

FY21 revenue rose 55.2% led by +14.5% in volume and +35.5% in ASP. Gross margin rose 8.4% pt to 20.5% as it drawn down lower-cost inventory, but we expect forward GM to be about 10-12% with increase in procurement cost. Steel prices are expected to hold up given output cut at China mills, Russia/ Ukraine conflict, higher iron ore and coke prices and shipping costs. Demand is underpinned by firm construction awards (BCA estimates at S$25-32bn from 2022-2025), and ramp-up in construction work post reopening. Myanmar operations have been curtailed by the coup since Feb 2020.

HGM trades at FY21 0.5x book, 2.5x EV/EBITDA, 4.5x PE and 9.3% dividend yield. Balance sheet has net cash and investments of S$11.8m (22% of market cap). Proposed dividend amount to S$5.1m. *(Peggy Mak)*

Company News

Oiltek International Limited | Oiltek has secured a new contract to construct 2 new refinery plants in Indonesia, adding to the total new contracts secured year to date to RM49.2m. This new contract is expected to contribute positively to FY22 results. In total, the Group currently has an order book of RM198.1m to be recognised over the next 18 to 24 months.