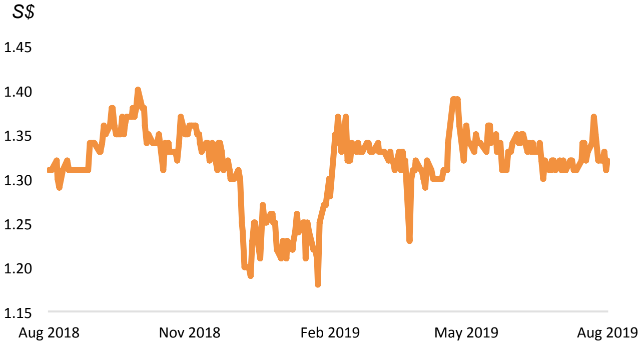
BRC Asia Limited

Date: 13 August 2019

BUY
(Maintained)

Target price: S$1.71
+29.5%

BRC SP
Price: S$1.320 (as at 8 August 2019)



Share price	1M	3M	6M	1Y
BRC Asia	3.1%	7.2%	0.8%	4.7%
Straits Times Index	5.0%	7.2%	13.6%	(5.8%)

Market capitalisation	S$314.8 million
Current price	S$1.34
Shares outstanding	234,961,689
Free Float	16.9%
Major shareholders	Esteel Enterprise 71.9%
Recommendation of other brokers	N/A

Source: Company data, SGX StockFacts, SAC Advisors

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BRC reported 70.6% qoq NPAT increase

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 9M19 net profit after tax of S$20.7 million, a 70.6% improvement on a quarter-on-quarter basis and a reversal of the S$4.5 million loss from last year in line with our expectations. For the quarter, the Group's revenue for 3Q19 increased S$209.7 million up 44% on a year-on-year basis. These were mainly attributable to full sales volume contributed by Lee Metal in the corresponding periods during the last financial year.

Gross and operating margin improvement from shift in higher value-added product mix and economies of scale. The Group's gross profit margin increased to 11.8% as compared to 3.1% from the previous year. The increase reflects the Group's shift toward a greater proportion of higher volume of value-added sales tonnage delivered as well as the cost synergies from bulk raw material purchases.

In the period, the Group's inventories declined by S$32.0 million, resulting in a corresponding decrease in bills payable. The Company's bank loans and borrowings also decreased significantly by S$77.8 million, due to net repayment to banks, which comprised mainly of bills payable of S$64.2 million and bank loans of S$12.0 million.

We maintained our Buy rating on BRC Asia with a BUY recommendation and a fair value target price of $1.71, based on 14x FY19E earnings (~19% discount to peers) or 11x FY20E. Overall margins are expected to inch higher with better pricing power from a strengthened market position post acquisition, and a recovery in the construction sector. Our target price implies a 29.5% upside to the last traded price, with a dividend yield of 3.8% for FY19E.

Key risk: Weaker economic sentiment.

Key Financials

Year ended September (S$'000)	FY2017	FY2018	FY2019E	FY2020E	FY2021E
Revenue	310,148	567,009	918,500	989,500	1,010,000
% Growth	(10.6%)	82.8%	62.0%	7.7%	2.1%
Gross profit	19,373	45,071	74,031	87,373	92,920
Gross profit margin	6.2%	7.9%	8.1%	8.8%	9.2%
Profit/(loss) before tax	3,024	15,650	34,910	44,177	50,281
Profit/(loss) before tax margin	1.0%	2.8%	3.8%	4.5%	5.0%
Profit/(loss) attributable to owners	1,811	12,043	28,626	36,225	41,230
EPS/(LPS) (S$ cents)	1.14	5.57	12.18	15.42	17.55
P/E (x)	173.9	26.1	11.0	8.7	7.6
Net Debt/Equity	23.3%	135.1%	152.5%	143.3%	125.1%

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

Investment Highlights

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.

We expect the Group to achieve a CAGR of 50.6% in net profit over the next 3 years, as the Group sees a recovery from the construction sector and a stronger market pricing power post-acquisition.

We expect BRC Asia to report higher revenues of S$918.5 million for FY19E, a 62% increase from FY18, with a full-year contribution from Lee Metal, and contract recognition from orders on hand. We understand from management that they have seen a continued recovery in their order book (about S$750 million as at end Mar 19) to be delivered and booked over the next three years. We also expect them to report new order wins to the top S$950 million, which will support earnings.

Consolidated Group on the cusp of recovery. While we are still in the early phase of the construction recovery, we are positive that the strong pipeline of projects announced by the Government – such as the Cross Island Line, developments at Jurong Lake District, stable demand from public residential developments, Changi Airport Terminal 5, and the two Integrated resorts expansion plans – will lift the outlook for the construction industry.

Prior to the decline in the construction sector, the historical combined net profit of BRC Asia and Lee Metal from FY13 to FY15 was S$75.9 million, S$61.5 million and S$31.1 million respectively. With improved synergy from a merged entity and healthier competitive environment, we expect the group can improved on its FY18's net profit of S$11.8 million when the sector turn upwards. BRC Asia is currently trading at 26x of FY18 earnings.

Industry turnaround in sight. According to data and estimates from the Building and Construction Authority, total construction demand which includes residential, commercial, industrial, institutional and others, and civil engineering is expected to increase and recover from S$30.54 billion in 2018 to an estimated S$27.0 billion - S$32.0 billion in 2019, and subsequently to S$27.0 billion - S$34.0 billion in 2020 and 2021 and S$28.0 billion - S$35.0 billion in 2022 to 2023.

Construction demand typically translates into contract award and progress payments in 18 months. The gradual uptick in construction activities are reflected in 1Q19 results: Group's revenue increased by 138% to S$238.0 million from S$100.1 million in the corresponding quarter. The increase in revenue was attributable to a higher volume of value-added sales tonnage delivered as well as the consolidation of results from Lee Metal.

Investment Highlights

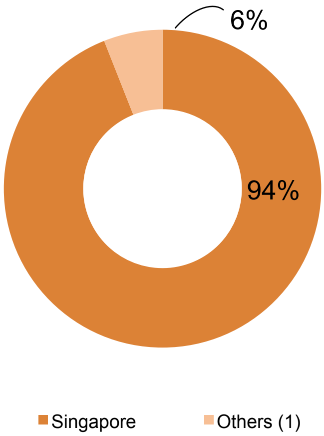
Leading steel reinforcement solutions provider in Singapore. BRC Asia is the market leader in steel reinforcement solutions in Singapore. Their competitive advantage is focused on their "Total Prefabricated Reinforcing Steel Solutions" programme which has a proven track record to help contractors build better, faster, and cheaper. At a time when the building and construction sector is looking to become more technologically advanced by transforming to become less labour-intensive, it is imperative to invest in new technologies such as robotics, digitisation, artificial intelligence to bring this industry forward into the future.

To this end, BRC Asia has a historical record of continually investing in the innovation to provide innovative solutions to their customers, and will continue to do so in this competitive industry. Moving forward, the Company will be looking to realise the synergies from their acquisition of Lee Metal and expand on their competitiveness in their home market.

We maintained our BUY rating on BRC Asia with a BUY recommendation and a fair value target price of $1.71 based on 14x PE on FY19E earnings (~19% discount to peers) or 11x FY20E PE as margins improved from a strengthened market position post-merger, and a recovery in the construction sector. Our fair value target price implies a 29.5% upside to the last traded price, with a dividend yield of 3.8% for FY19E.

Company Background

Revenue Breakdown (FY2018)



Source: Company data, SAC Advisors

(1) Others comprises Malaysia and China

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. Singapore is their main market and they currently operate 9 factories with a total manufacturing capacity of 1.2 million metric tons a year.

They have customers from the public sector (public housing), private sector (private condominiums), commercial and industrial space. They also perform civil engineering works such as tunneling works.

Source: Company data

Source: Company data, SAC Advisors

BRC Asia was incorporated in 1938, and was an early pioneer to set up in Jurong Industrial Estate in 1961 and they were granted the Singapore pioneer certificate in 1963. They subsequently listed on the Singapore Exchange's mainboard on the 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 proceeded to de-list the company.

The acquisition allowed BRC Asia to realise potential synergies from the acquisition. 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. They have the following main competitive advantags: (i) Just-in-time delivery, (ii) 24-hour express cut-and-bend services, and a (iii) full-suite of prefab reinforcing solutions.

As at 31 March 2019, order book stood at about S$750 million, to be delivered over the next 5 years. The bulk of this is expected to be recognised in the next two (2) years.

Competitive Advantage

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

BRC'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 their 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 Advisors

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 improve overall productivity and efficiency, which will then be translated into cost savings that can be passed on to their customers in terms of more competitive pricing when they bid for jobs. It will also allow them to offer their customers a full-suite of prefab reinforcing solutions, and become 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 previously did not have any expertise on.

BRC Asia have an annual processing volume of approximately 1 million tonnes. We think they will build on their competitive advantage 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.

Valuation

The global steel players from around the world with a market capitalisation above US$300 million is currently trading at an average price to earnings multiple of 17.1x on a trailing twelve months basis. Consequently, we have valued BRC Asia based on 14x of their FY19E earnings (~19% discount to peers) or 11x FY20E earnings as they look to improve their overall margins from their strengthened market position and ride the overall recovery in the construction sector. Our fair value target price implies a 27.6% upside to their last traded price, with a current dividend yield of 3.8% for FY19E.

Name	Ticker	Current Mkt Cap (US $mn)	Revenue T12M* (US $mn)	P/E (TTM*)
Global Brass & Copper Holdin	BRSS US	964.8	1,724.0	16.3x
Tiangong Intl Co Ltd	826 HK	792.5	758.0	20.3x
Omega Flex Inc	OFLX US	749.7	109.7	37.0x
Tsubaki Nakashima Co Ltd	6464 JP	696.9	663.5	10.8x
Shin Zu Shing Co Ltd	3376 TT	672.3	324.3	16.0x
Tredegar Corp	TG US	553.0	1,094.6	33.7x
Oiles Corp	6282 JP	513.2	553.5	13.7x
San Shing Fastech Corp	5007 TT	500.7	255.4	14.5x
Okabe Co Ltd	5959 JP	488.0	592.9	15.5x
Tocalo Co Ltd	3433 JP	481.3	357.0	9.2x
Park-ohio Holdings Corp	PKOH US	411.9	1,672.5	7.5x
Xingfa Aluminium Holdings	98 HK	410.7	1,491.4	5.7x
Insteel Industries Inc	IIIN US	409.5	464.1	15.7x
Singamas Container Hldgs	716 HK	381.8	1,807.8	5.3x
Neturen Co Ltd	5976 JP	368.4	478.4	39.8x
Xxentria Technology Material	8942 TT	354.5	158.4	7.8x
Trifast Plc	TRI LN	346.7	274.4	22.3x
Lawson Products Inc	LAWS US	342.5	356.5	35.2x
Nippon Thompson Co Ltd	6480 JP	337.5	519.5	9.6x
Daido Metal Co Ltd	7245 JP	300.6	971.4	6.6x
Average (ex. BRC Asia)		**504.0**	**647.6**	**17.1x**
BRC Asia	**BEC SP**	**307.8**	**567.0**	**19.2x**

Source: Bloomberg (data extracted on 4 July 2019), SAC Advisors

Future Plans – Positioning for the recovery at home and diversifying overseas

Focusing on earnings recovery in home market

Source: Company data

Management is beginning to see a recovery in the construction market in Singapore. They guided that their results will typically have an 18 months lag from the actual government spending, based on their first quarter results for FY19, and their current order book (which they do not disclose) they are beginning to see the effects of public and private spending, which is forecasted by the BCA to be in the range of S$27.0 billion to S$32.0 billion.

The recovery in their home market is good news for BRC Asia as Singapore accounted for 94% of the Group's revenue in FY18, and will continue to play an important role in the coming years. We think that the Singapore market will continue to play a strategic role in the Group's plans as the market is a cash cow for them as they expand on their strengths and competitive advantage as they integrate Lee Metal into their Group.

International expansion

The Group is targeting to speed up the pace of going global by expanding their presence in markets they are already in: Malaysia and China. In Malaysia, they design, manufacture and market mesh for the construction industry. They have 9.3 acres of freehold land in Senai, Johor which boasts a 110,000 sq.ft covered factory space. They also have a sales office in Subang, Kuala Lumpur and have plans to expand the covered factory space in Senai. Moving forward, management shared that they plans to expand to cover a full range of prefabricated reinforcing steel products.

In China, they currently have a joint-venture with state-owned steel mill Ma Steel (through a 50% stake in Anhui BRC & Ma Steel Weldmesh Co. Ltd), and they are involved in the design, manufacture and market mesh for the Chinese market.

Key Risks

Weak economic sentiment resulting in construction projects to thin
A weakening of the economic climate in Singapore, can have a knock on effect on the construction and manufacturing industries in Singapore. In 2016, rising home vacancy rates – hitting 8.7% compared to 7.8% in 2015 - and declining rentals – dropped by 10.7% vs. 2015 - for private homes across Singapore led to private home prices across Singapore declining. As the pipeline of building projects continued to thin, main contractors may be compelled to tender at increasingly cut-throat prices, sending a negative externality effect down the construction supply chain, which the reinforcing steel sector is an integral part of.

Income Statement (S$'000)

	Fiscal Year Ended				
	FY17	FY18	FY19E	FY20E	FY21E
Revenue	**310,148**	**567,009**	**918,500**	**989,500**	**1,010,000**
Less: Cost of sales	(290,775)	(521,938)	(844,469)	(902,127)	(917,080)
Gross Profit	**19,373**	**45,071**	**74,031**	**87,373**	**92,920**
Other income	995	2,482	2,000	2,000	2,000
Distribution costs	(4,815)	(5,129)	(6,430)	(7,916)	(8,080)
Administrative expenses	(6,275)	(13,346)	(17,452)	(19,790)	(20,200)
Other expenses/Share of JV profit	(4,718)	(8,226)	(6,206)	(4,500)	(4,300)
Finance costs	(1,536)	(5,202)	(11,034)	(12,990)	(12,059)
Profit before income tax	**3,024**	**15,650**	**34,910**	**44,177**	**50,281**
Less: Income tax	**(1,152)**	**(3,607)**	**(6,284)**	**(7,952)**	**(9,050)**
Profit/(loss), net of tax	**1,872**	**12,043**	**28,626**	**36,225**	**41,230**
Profit/(loss) attributable to owners of company	**1,811**	**12,043**	**28,626**	**36,225**	**41,230**
Earnings/(Loss) per share:					
-Basic (S$ cents)	**1.14**	**5.57**	**12.18**	**15.42**	**17.55**
-Diluted (S$ cents)	**1.14**	**5.57**	**12.18**	**15.42**	**17.55**

Cash Flow Statement (S$'000)

	Fiscal Year Ended				
	FY17	FY18	FY19E	FY20E	FY21E
Profit/(Loss) before tax	**3,024**	**15,650**	**34,910**	**44,177**	**50,281**
Depreciation & amortisation	7,646	10,864	14,591	10,998	10,998
Change in working capital	11,079	(30,440)	(49,321)	(36,110)	(10,566)
Others	9,004	(6,991)	(9,171)	4,538	2,309
Net Cash (used in)/ from operations	**30,753**	**(10,917)**	**(8,990)**	**23,603**	**53,022**
Purchase of PPE	(19,318)	(26,865)	(2,870)	(12,000)	(12,000)
Others	(4,571)	(140,104)	0	0	0
Net Cash (used in)/ from investing	**(23,889)**	**(166,969)**	**(2,870)**	**(12,000)**	**(12,000)**
Net increase in equity	0	46,990	0	0	0
Net increase in debt	11,263	152,459	17,931	(2,296)	(2,296)
Others	(6,072)	(4,490)	(13,367)	(23,914)	(24,534)
Net Cash (used in)/ from financing	**5,191**	**194,959**	**4,564**	**(26,153)**	**(26,724)**

Balance Sheet (S$'000)

	Fiscal Year Ended				
	FY17	FY18	FY19E	FY20E	FY21E
As at 30 September					
Property, plant and equipment	89,136	148,978	137,292	138,294	139,296
Investment properties	0	2,471	2,471	2,471	2,471
Other non-current assets	21,478	23,702	89,859	82,359	83,059
Non-current assets	**110,614**	**175,151**	**229,622**	**223,124**	**224,826**
Inventories	111,433	270,249	322,104	347,003	354,192
Trade and other receivables	75,516	180,725	207,215	223,166	227,771
Other current assets	1,277	31,537	36,826	44,826	44,826
Cash and cash equivalents	23,989	41,080	33,784	19,233	33,531
Current assets	**212,215**	**523,591**	**599,929**	**634,227**	**660,319**
Total assets	**322,829**	**698,742**	**829,551**	**857,351**	**885,145**
Share capital	68,011	125,001	125,001	125,011	125,011
Others	(2,984)	(3,323)	(3,323)	(3,323)	(3,323)
Retained earnings	102,728	115,358	141,651	166,966	195,747
Equity attributable to owners of the Company	**167,755**	**237,036**	**263,329**	**288,644**	**317,425**
Non-controlling interests	422	0	0	0	0
Total equity	**168,177**	**237,036**	**263,329**	**288,644**	**317,425**
Loan and borrowings	10,772	82,265	2,102	2,102	2,102
Other liabilities, non-current	7,193	35,960	192,503	192,503	192,503
Non-current liabilities	**17,965**	**118,225**	**194,605**	**194,605**	**194,605**
Loans and borrowings	52,376	255,838	253,542	251,246	248,950
Trade and other payables	69,049	58,959	89,390	94,129	95,358
Other liabilities, current	15,262	28,684	28,684	28,684	28,684
Current liabilities	**136,687**	**343,481**	**371,616**	**374,059**	**372,992**
Total liability	**154,652**	**461,706**	**566,221**	**568,664**	**567,597**

Ratios

	Fiscal Year Ended				
	FY17	FY18	FY19E	FY20E	FY21E
Profitability (%)					
Gross profit/(loss) margin	6.2%	7.9%	8.1%	8.8%	9.2%
Operating profit margin	3.0%	5.1%	5.7%	6.2%	6.6%
Profit/(loss) before tax margin (continuing ops)	1.0%	2.8%	3.8%	4.5%	5.0%
Liquidity (x)					
Current ratio	1.6	1.5	1.6	1.7	1.8
Quick ratio	0.7	0.7	0.7	0.8	0.8
Interest coverage ratio	6.0	5.6	4.7	4.7	5.5
Net Debt to Equity	23.3%	135.1%	152.5%	143.3%	125.1%
Valuation (x)					
P/S	1.0	0.6	0.3	0.3	0.3
P/E	173.9	26.1	11.0	8.7	7.6
Core P/E at target price	N/A	N/A	N/A	N/A	N/A
P/B	1.9	1.3	1.2	1.1	1.0
P/NTA	1.9	1.3	1.2	1.1	1.0
Cash Conversion Cycle					
Trade receivable days	83	82	77	79	81
Inventory days	127	133	128	135	140
Trade payable days	63	45	32	37	38
CCC days	147	171	173	178	183
Returns					
Return on equity	1.1%	5.9%	11.4%	13.1%	13.6%
Return on capital employed	0.6%	2.4%	3.7%	4.3%	4.7%
Dividend payout ratio	0%	18.0%	49.2%	30.0%	30.0%

n.m.: not meaningful

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Nil	Nil

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