

GKE Corporation Limited

5 August 2021

BUY
(Maintained)

Price: S\$0.146 (as at 4 August 2021)

Target Price: S\$0.171 (+17.1%)

BBG	GKEC SP
Market cap	S\$113.2m
Price (4 August 2021)	S\$0.146
52-week range	S\$0.072 – S\$0.179
Target Price	S\$0.171
Shares Outstanding	775.1m
Free Float	48.1%
Major Shareholder	Yong Hua Chen 8.7% Chen Li Rong 7.5% Qian Wen Hua 7.3% Zhu Jun Wen 7.3%
P/BV (05/21)	1.3x
Net Debt to EBITDA (05/21)	0.9x

Source: Company data, Bloomberg, SAC Capital

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Building up balance sheet, brick by brick

Good FY21, expect to continue into FY22. Revenue and profit were 1.9%/2.7% below our estimates, with lower-than-expected revenue due to reduction in sales from aviation sector customers, and higher-than-expected ECL allowance posted. Revenue saw a 10.9% increase yoy from S\$107.3m to S\$119.0 million in FY21 ended 31 May, with the higher revenue supported by i) higher utilisation of warehouse space at better rental rates; ii) increase in trucking volume, and iii) higher revenue from ready-mix concrete plant. Gross margin increased from 20.4% to 24.1%.

The Group also booked one-off S\$2.5m gain on disposal of 65% stake in Van Der Horst Logistics and its subsidiary, and G-Chem Logistics. Overall FY21 PATMI surged by 2.5x from S\$4.7m to S\$11.5m. GKE declared a 0.40 Singapore cent dividend, a first in five years.

Total capacity for RMC plants sitting at 1.6 million m³. In FY21, the Wuzhou Xing Jian and the Cenxi Xing Jian RMC plants added 400,000 m³ each, doubling production capacity from 0.8 million m³ before FY21 to 1.6 million m³. Combined fleet of concrete mixer trucks for both Wuzhou and Cenxi Xing Jian have increased from around 40-50 to 70.

Revise our estimates. We revised FY22E/FY23E revenue estimates down 5.9% and 8.8% to S\$127.6m and S\$136.3m respectively on cautious optimism, with China's strengthening of commodity price controls which could cap RMC sale prices. This translates to an overall +7.2%/+6.8% yoy revenue growth. However, we remained optimistic on the stability of the warehousing logistics segment, and the growth potential of the infrastructural segment. As start-up capital costs for Cenxi's RMC plant had been accounted for in FY21, we lower our capex forecasts for FY22 and FY23.

Maintain BUY rating at higher target price of S\$0.171 (from S\$0.163). Our DCF-derived target price translates into a FY22E/FY23E P/E of 11.8x and 11.1x respectively. We expect high warehouse utilization rates to remain in FY22 as a significant portion are for medical supplies, with which demand would likely not waver in the short-term. Higher production capacity will increase Group's infrastructural segment contribution in the face of sustained demand. Our target price implies a 17.1% upside to the last traded price.

Key Risks: Short expiry contract terms for warehousing segment, China commodity price controls

Key Financials

FY ended 31 May	FY2019	FY2020	FY2021	FY2022E	FY2023E
Revenue (S\$m)	88.2	107.3	119.0	127.6	136.3
EBIT (S\$m)	2.7	11.7	19.9	19.0	19.7
Net profit (S\$m)	(2.1)	4.7	11.5	11.3	12.0
Basic EPS (S cents)	(0.31)	0.61	1.49	1.45	1.54
Dividend per share (S cents)	-	-	-	0.40	0.39
Net cash / (debt)	(57.6)	(41.8)	(32.0)	(15.4)	(2.6)
Valuation					
EBIT margin (%)	3.1	10.9	16.8	14.9	14.5
ROIC (%)	0.4	5.8	10.0	9.8	10.1
EV/EBITDA (x)	13.7	5.7	4.1	3.5	3.0
P/E (x)	NA	24.1	9.8	10.1	9.5
Dividend yield (%)	-	-	-	2.7	2.7

Investment Summary

Good FY21, expect to continue into FY22

Revenue (\$m)	Third party logistics	Infrastructural (RMC)
FY2021	66.4	52.8
FY2020	70.4	36.9
FY2019	63.8	24.5

Source: Company data

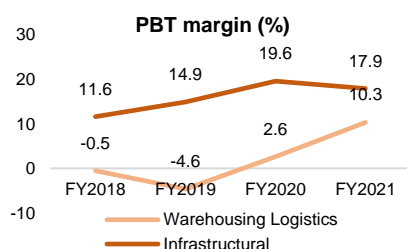
Revenue and profit were 1.9%/2.7% below our estimates, with lower-than-expected revenue due to reduction in sales from aviation sector customers, and higher-than-expected allowance for expected credit loss posted, increasing administrative expenses.

Revenue saw a 10.9% increase yoy from S\$107.3m to S\$119.0 million in FY21 ended 31 May, with the higher revenue supported by (i) higher utilisation of warehouse space at better rental rates; (ii) increase in trucking volume, and (iii) higher revenue from ready-mix concrete plant. Gross margin increased from 20.4% in FY20 to 24.1% in FY21 as a result, lifted also by Singapore government support schemes and higher contribution by infrastructural segment (44.4% in FY21 vs 34.4% in FY20) which generally has higher margins comparatively.

The Group also recorded higher other income, largely due to government grants, and one-off S\$2.5m gain on disposal of 65% stake in Van Der Horst Logistics and its subsidiary, and G-Chem Logistics. Half the consideration had been received in FY21, with the other half expected in FY22.

Share of loss from associates increased to S\$0.09m with start-up costs of Cenxi Haoyi Recycling in China. As it turns operational, we expect slight gain in FY22 and FY23.

Overall FY21 PATMI surged by 2.5x from S\$4.7m to S\$11.5m. After 5 years, GKE's turnaround saw a 0.40 Singapore cent dividend declared, or 26.8% of FY21 net profit. We expect dividend payout could continue with strong results anticipated.



Source: Company data

Steady increase in profit before tax margin

Third party logistics (warehousing) segment is likely to continue to benefit from Covid stockpiling and improved utilization and rental rates in FY22. Infrastructural segment is the historically higher profit margin segment, clocking 17.9% in FY21, though this was a drop from 19.6% due to higher expenses incurred on the new Wuzhou Xing Jian plant.

Total capacity for RMC plants sitting at 1.6 million m³

In FY21, Wuzhou Xing Jian RMC plant added 400,000m³ per annum in capacity, bringing total production capacity of Wuzhou's plants to 1.2 million m³ per annum. The new Cenxi Xing Jian automated RMC plant (~80km from Wuzhou) has begun trial production in July 2021, and would see production capacity of 400,000m³ per annum. We expect downtime is needed for more testing, and that it will contribute more substantially to 2HFY22 results.

Combined fleet of concrete mixer trucks for both Wuzhou Xing Jian and Cenxi Xing Jian have increased from around 40-50 to 70.

Rapid urbanisation plans to upgrade the infrastructure of the cities will continue support the demand for the Group's infrastructural segment, creating a sustained demand for ready-mixed concrete as it is one of the building blocks for construction.

Investment Summary

Stronger balance sheet; acquisition of non-controlling interest

The Group acquired the remaining 30% stake in Marquis services, a specialty chemicals storage and management specialist that handles chemical products and flammable materials. GKE paid S\$2.7m for the acquisition and will now see full contribution of net profit from 1 May 2021. Net tangible assets of Marquis was S\$5.5m.

With strong FY21, retained earnings position currently sits at S\$4.5m, a turnaround from accumulated losses of S\$6.3m a year ago. Net gearing ratio decreased from 0.51x to 0.36x with an increase in cash and the reduction in debt. We expect lower net gearing ratio going forward as the GKE generates higher cash flows.

Diversification into Agri-tech

In FY21, Agri-tech segment contributed S\$20K in revenue, and incurred a S\$0.1m pretax loss. However, most of this came in as depreciation expense, which meant there was no cash outflow. Furthermore, no rental expense is incurred as GKE is making use of unutilized office space, even as it looks to expand cultivation area from 2,400 sqft to 12,500 sqft. GKE can also apply for government grants to subsidise a portion of the expenses. We see the diversification into Agri-tech as a potential new revenue stream, although the impact on the Group is small.

Adjustments to our earnings estimates

We revised FY22E/FY23E revenue estimates down 5.9% and 8.8% to S\$127.6m and S\$136.3m respectively on cautious optimism, with China's strengthening of commodity price controls which could cap RMC sale prices. However, we remained optimistic on the stability of the warehousing logistics segment, and the growth potential of the infrastructural segment, especially seeing that production capacity has doubled from before FY21 (0.8 million m³) to now (1.6 million m³).

Accordingly, PATMI estimates are revised down by 7.4% and 11.7% for FY22/FY23, taking into account the Group's acquisition of non-controlling interest. This translates to an overall +7.2% / +6.8% yoy revenue growth or +15.0% / +5.0% yoy net profit growth, excluding the one-off S\$2.5m gain from disposal of subsidiaries in FY21.

As start-up capital costs for Cenxi's RMC plant had been accounted for in FY21, we lower our capex forecasts for FY22 and FY23.

Investment Summary

Maintain BUY rating at higher target price of S\$0.171

We maintain a BUY rating on GKE Corporation, and increase fair value to S\$0.171 (from S\$0.163). Our DCF-derived target price translates into a FY22E/FY23E P/E of 11.8x and 11.1x respectively. Our target price implies a 17.1% upside to the last traded price.

We see upside potential as we expect high warehouse utilization rates to remain in FY22 as a significant portion of it is for medical supplies, with which demand would likely not waver in the short-term. In addition, the Cenxi RMC plant will contribute positively to the Group's infrastructural segment, in the face of sustained demand for RMC.

We expect capex to stabilize, although we more conservatively accounted for some potential acquisitions and business opportunities, looking at their current strategic investments (*more details in previous report*). We also note Management's comments on the possibility of acquiring space to expand warehousing segment.

Income Statement

S\$'mil	Fiscal Year Ended 31 May				
	FY2019A	FY2020A	FY2021	FY2022E	FY2023E
Revenue	88.2	107.3	119.0	127.6	136.3
Cost of sales	(73.0)	(85.4)	(90.3)	(96.9)	(103.6)
Gross profit	15.3	21.8	28.7	30.6	32.7
Other income	3.7	3.1	7.3	3.1	2.7
Marketing and distribution costs	(0.3)	(0.2)	(0.3)	(0.4)	(0.4)
Administrative expenses	(15.6)	(13.0)	(15.8)	(14.7)	(15.7)
Finance costs	(2.6)	(3.4)	(2.8)	(3.2)	(2.9)
Other income/(expenses)	(0.2)	0.1	0.1	0.1	0.1
Share of results of associates	(0.2)	-	(0.1)	0.1	0.2
Profit before tax	0.2	8.4	17.2	15.9	16.9
Tax expense	(2.1)	(3.6)	(5.3)	(4.6)	(4.9)
Profit/(loss) for the year	(1.9)	4.8	11.9	11.3	12.0
Profit/(Loss) attributable to owners of company	(2.1)	4.7	11.5	11.3	12.0
Minority Interests	0.2	0.1	0.3	0.0	0.0

Ratios

	Fiscal Year Ended 31 May				
	FY2019A	FY2020A	FY2021	FY2022E	FY2023E
Profitability (%)					
Gross profit/(loss) margin	17.3	20.4	24.1	24.0	24.0
Profit/(loss) before tax margin	(2.4)	4.4	9.7	8.8	8.8
Liquidity (x)					
Current ratio	1.5	1.4	1.9	2.0	2.2
Quick ratio	1.5	1.4	1.9	2.0	2.2
Interest coverage ratio	1.1	3.5	7.1	5.9	6.7
Net Debt to Equity (%)	78.1	51.3	36.2	15.9	2.5
Valuation (x)					
P/E	NA	24.1	9.8	10.1	9.5
P/B	1.5	1.4	1.3	1.2	1.1
EV/EBITDA	13.7	5.7	4.1	3.5	3.0
Cash Conversion Cycle					
Trade receivable days	130	120	149	141	135
Inventory days	2	1	3	3	3
Trade payable days	70	59	49	46	44
CCC days	63	62	102	97	93

Balance Sheet

S\$'mil	Fiscal Year Ended 31 May				
	FY2019A	FY2020A	FY2021	FY2022E	FY2023E
Property, plant and equipment	114.8	129.8	123.4	127.5	129.1
Intangible assets	4.8	5.6	4.9	4.6	4.3
Investments in associates	-	1.0	1.9	1.9	1.9
Financial assets at FVTPL/AVS assets	0.3	0.3	0.3	0.3	0.3
Others	5.5	-	-	-	-
Non-current assets	125.5	136.7	130.4	134.2	135.5
Inventories	0.4	0.3	0.7	0.7	0.7
Trade and other receivables	31.5	35.2	48.4	49.4	50.4
Prepaid operating expenses	1.0	1.3	1.7	1.7	1.7
Cash and short-term deposits	11.7	23.1	30.9	43.4	52.6
Others	-	-	-	-	-
Current assets	44.5	60.0	81.7	95.2	105.4
Total assets	170.0	196.7	212.1	229.5	240.9
Other liabilities	3.0	2.5	2.3	2.3	2.3
Borrowings	60.0	55.2	52.9	49.3	46.3
Lease liabilities	2.5	13.3	24.6	33.0	37.2
Deferred tax liabilities	0.4	0.6	1.2	1.2	1.2
Non-current liabilities	65.9	71.6	81.1	85.8	87.0
Trade and other payables	13.9	13.9	12.1	12.3	12.6
Other liabilities	5.1	8.6	12.4	12.4	12.4
Derivative financial liabilities	-	2.0	1.4	1.4	1.4
Lease liabilities	-	8.0	5.7	6.9	8.2
Borrowings	9.3	9.7	9.9	9.5	8.9
Tax payable	0.8	1.3	1.1	4.6	4.9
Others	1.2	-	-	-	-
Current liabilities	30.3	43.5	42.6	47.1	48.5
Total liabilities	96.3	115.1	123.7	132.9	135.5
Share capital	78.2	85.1	85.1	85.1	85.1
Treasury shares	(0.7)	(1.1)	(1.5)	(1.5)	(1.5)
Retained earnings	(9.2)	(6.3)	4.5	12.7	21.6
Other reserves	0.5	(1.1)	0.3	0.3	0.3
Non-controlling interests	4.9	4.8	-	-	-
Total equity	73.8	81.6	88.4	96.5	105.5

Cash Flows Statement

S\$'mil	Fiscal Year Ended 31 May				
	FY2019A	FY2020A	FY2021	FY2022E	FY2023E
Cash flows from operating activities					
Profit/(loss) before tax	0.2	8.4	17.2	15.9	16.9
Depreciation and amortisation	9.8	15.7	15.9	17.5	19.3
Interest expense	2.6	3.4	2.8	3.2	2.9
Interest income	-	(0.1)	(0.0)	(0.1)	(0.1)
Share of results of associates	0.2	-	0.1	(0.1)	(0.2)
Others	0.3	-	(1.1)	0.0	0.0
OCF before changes in working capital	12.9	27.4	34.9	36.3	38.8
Changes in working capital	(4.6)	(1.1)	(5.1)	(0.8)	(0.8)
Interest received	-	0.1	0.0	0.1	0.1
Tax paid	(2.2)	(3.0)	(4.6)	(4.6)	(4.9)
Net cash from operating activities	6.2	23.4	25.2	31.1	33.2
Cash flows from investing activities					
Capital contribution into investment in associate	-	(1.0)	(0.9)	0.0	0.0
Net cash outflow from disposal of subsidiary	-	(0.2)	5.6	6.1	0.0
Proceeds from disposal of subsidiary	-	-	5.6	6.1	0.0
Purchase of property, plant and equipment	(2.3)	(1.9)	(4.3)	(4.8)	(5.0)
Others	3.0	0.2	(5.2)	(6.1)	0.0
Net cash used in investing activities	0.6	(2.9)	0.8	1.3	(5.0)
Cash flows from financing activities					
Dividends paid to owners/NCI	(0.4)	(0.2)	(0.2)	(3.1)	(3.0)
Repayment of lease liabilities	(1.6)	(8.4)	(8.4)	(8.4)	(8.4)
Interest paid	(2.6)	(3.4)	(2.8)	(3.2)	(2.9)
Proceeds from borrowings	3.4	4.3	6.6	4.8	5.2
Repayment of borrowings	(8.9)	(8.7)	(8.9)	(8.8)	(8.8)
Others	(0.2)	7.2	(3.3)	(1.1)	(1.1)
Net cash (used in)/from financing activities	(10.2)	(9.2)	(17.0)	(19.8)	(19.0)
Net increase in cash	(3.4)	11.3	9.0	12.5	9.2
Beginning cash	12.6	9.3	20.7	29.5	42.0
Ending Cash	9.3	20.7	29.5	42.0	51.2

* Cash and short-term deposits include cash at bank and other short-term deposits.

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