

INVESTING IDEAS

Bigger and stronger BRC Asia poised to benefit from construction upturn

BY JEFFREY TAN

jeffrey.tan@bizedge.com

During the last construction downturn from 2016 to 2018, steel fabricators, piling service providers and construction companies had it tough. Margins were squeezed as competition for the few available jobs in the market intensified. As a result, some companies went under, while others pivoted into property development.

In a bid to weather the downturn, steel reinforcement solutions provider BRC Asia acquired Lee Metal. The latter is a distributor and fabricator of steel products, as well as an international trader of steel and steel-related products in Southeast Asia. BRC Asia completed the \$200 million acquisition in July 2018, less than a year after the company underwent a major change of shareholders.

Seah Kiin Peng, CEO and executive director of BRC Asia, says the acquisition provided the company with several advantages. The obvious one is size. "For us to operate effectively and efficiently, we need to have size. BRC Asia and Lee Metal by themselves are too small to operate effectively going forward, especially as the industry becomes more dominated by big [steel mills and contractors]," he tells *The Edge Singapore* in a recent interview.

As Seah explains, an enlarged BRC Asia allows the company to negotiate for better pricing on raw materials from the steel mills. As the company runs about 200 projects at any one time, different steel products are required.

Secondly, the company can obtain better rental rates for its warehouses, which are needed to stock up inventory. "If you are a small player, you have inefficiency in renting or buying inventory space," he says. "That makes the combined entity more cost effective."

Finally, the acquisition provides the company with a diversification of sorts, albeit within the steel and construction industries. According to Seah, BRC Asia's steel products are supplied for the construction of buildings, such as HDB flats, hotels and industrial property. On the other hand, Lee Metal's main clients are in the construction of transportation infrastructure, such as expressways, MRT lines, airport terminals and ports.

As a result of the acquisition, BRC Asia's top and bottom lines have gained significantly. Revenue surged 44% and 91% y-o-y to \$146 million and \$355.1 million respectively, in 3Q and 9MFY2019 ended June 30. Gross margins widened to 11.8% and 8.2% respectively, from 3.1% and 5.3%, as the company benefited from a higher volume of value-added sales tonnage delivered and cost synergies from bulk raw material purchases. The company returned to the black with earnings of \$9.1 million and \$20.7 million in 3Q and 9MFY2019, respectively, versus net losses of \$6.8 million and \$3.8 million a year ago.

'Survival' mode

The acquisition of Lee Metal could be seen as a matter of survival for BRC Asia. According to Seah, the company was forced to take up jobs with razor-thin margins, just so it could cover its fixed costs and keep its workers occupied. The company was barely

scraping by, eeking out a net margin of just 0.6% in FY2017 ended Sept 30, he recalls. Yet, crucially, the company managed to avoid a retrenchment exercise, Seah says.

"We didn't lose money. But which shareholder would accept [that level of margin]?" says Seah, who was then an executive at the company. He was appointed CEO in September last year.

Given the predicament, the company's controlling shareholders — You Zhenhua and Liu Bin — knew they had to do something if they wanted to stay invested in BRC Asia, says Seah. You is sole director and shareholder of Advance Venture Investments, while Liu is sole director and shareholder of Toptip Holding. Their companies control Esteel Enterprise, which holds a 71.7% interest in BRC Asia.

According to Seah, You and Liu toyed with the idea of the company's diversifying into other industries. They eventually decided it should continue operating in the steel industry, but on a bigger scale. To that end, they met with several parties to discuss a merger and acquisition. "[They] went into serious discussions with a number of them. Based on [what they thought was the best option], our major shareholders made an offer [for Lee Metal]," he says.

On Lee Metal's part, there were several factors that enabled the acquisition to go through. According to Seah, the Lee siblings who controlled the company were receptive to the offer as they did not have a successor — most of them were unmarried and in their 60s. Also, as Seah understands, they had a tendency to run the company like a family business and, thus, were not in favour of professional managers. These factors "pushed them to be more receptive when the offer came", he says.

At the same time, BRC Asia took the opportunity to divest non-core businesses, which were no longer part of its focus. The company disposed of its 10% interest in Nuform Singapore for \$1.5 million, and 51% interest in Nuform Malaysia for about \$1.03 million. The former is involved in the provision of formwork systems and solutions to the construction industry in Singapore, while the latter is principally engaged in sales and leasing of construction and civil engineering machinery and equipment in Malaysia.

BRC Asia is looking to dispose of its 17% interest in associate company Pris-

BRC Asia



Seah says BRC Asia had net positive operating cash flow of \$69.6 million as at June 30 and is thus able to meet its debt obligations

time Islands Investments because it is not part of the company's core business. PII is 49%-owned by construction company Keong Hong Holdings and operates an airport, hotel and resort in Maldives. Seah says the company was in talks with a potential buyer, but a deal was not reached, as the latter did not want to pay a "premium".

Construction upturn

Now, with the local construction industry showing signs of recovery, the enlarged BRC Asia is poised to benefit from the upturn. According to advanced estimates by the Ministry of Trade and Industry, Singapore's construction sector grew 2.7% y-o-y in the third quarter, extending the 2.8% expansion in the preceding quarter. This is the third consecutive quarter of growth, after 10 consecutive quarters of decline. MITI says this growth was supported by a pickup in both public and private sector construction activity.

These positive numbers could be the realisation of the higher end of forecasts by the government, or possibly exceed them. At the start of the year, the Building and Construction Authority projected that the total value of construction contracts to be awarded this year would range between \$27 billion and \$32 billion. This is comparable to the preliminary estimate of \$30.5 billion awarded in 2018. BCA estimated construction demand from the private sector would remain steady at between \$10.5 billion and \$12.5 billion. This is expected to come from the redevelopment of en-bloc sales sites concluded prior to 2H2018 and new industrial developments, it says.

Beyond 2019, the outlook appears positive. BCA forecasts a steady improvement in construction demand over the medium term. Demand is projected to reach between \$27 billion and \$34 billion a year for 2020 and 2021, and could increase to between \$28 billion and \$35 billion a year for 2022 and 2023.

BCA expects the public sector to contribute \$16 billion to \$20 billion annually from 2020 to 2023, driven equally by building projects and civil engineering works. This is also expected to be supported by public residential developments and big infrastructure projects such as the Cross Island Line, developments at Jurong Lake District and Changi Airport Terminal 5. In the private sector, BCA expects construction demand to gradually increase in the medium term, boosted by further growth in the other economic sectors.

Seah says the company sees strong demand ahead in the light of various construction projects. This includes the extension and refurbishment of Singapore's two integrated resort developments — Marina Bay Sands and Genting Singapore's Resorts World Sentosa — and the Greater Southern Waterfront. The latter project, which extends from Pasir Panjang to Marina East, is set to be transformed into a new major gateway and location for urban living along Singapore's southern coast.

Asked whether BRC Asia has clinched contracts for any of these projects, Seah says: "It's too early. We are still at the conceptual stage." But he says he is confident it will be able to do so because of its track record and size.

Still, Singapore's growth is slowing. Market observers are predicting a downturn that could result in a recession. Will this dampen the construction sector? Seah says the effects of a recession on the sector, if any, would be lagged as the sector is typically 18 months behind the property cycle. Right now, the construction industry is enjoying the boom from en-bloc projects, he points out. As at June 30, BRC Asia's order book stood at about \$1 billion.

In any case, Seah says the company's immediate challenge is to embark on a deeper integration with Lee Metal, in particular in terms of company culture and values. "We already benefited from superficial integration. But to do this well, we need to integrate deeply."

Seah also dismisses concerns about the company's net debt position of \$264.4 million as at June 30, which was the result of acquiring Lee Metal. He says this is a one-off event and not the gradual accumulation of debt over time. He notes that the company had a net positive operating cash flow of \$69.6 million as at June 30 and is thus able to meet its debt obligations.

Seah says BRC Asia has plans to expand into foreign markets. While there are substantial construction projects in Singapore, these will not see an "explosion" in demand, he explains. Thus, the company needs to venture abroad to seek new growth avenues. "We are looking for opportunities in the region," he says.

Shares in BRC Asia are up 8% so far this year to close at \$1.34 on Oct 24. However, the stock is still relatively cheap at 9.2 times earnings and 1.25 times book value. UOB Kay Hian has a "buy" call for the stock, with a price target of \$1.75, while SAC Advisors has a "buy" rating and price target of \$1.71. ■