Ryobi Kiso Holdings Ltd.

Showing Signs of Improvement

Ryobi Kiso Holdings Ltd's (Ryobi) 2Q FY12 (ended Dec 2011) results showed marked improvement over 1Q FY12. Revenue grew by 42% quarter-on-quarter to a record S$40.3m. Likewise, earnings before interest and tax grew by 49.2% QoQ, in spite of higher material costs. These data suggest robust demand and tight cost control by the management. These improvements, if sustained, will bode well for the company's share price. ***Maintain Increase Exposure based on an intrinsic value of S$0.215.***

Key Developments:

What's Changed? The higher revenue base in 2Q FY12 came as a pleasant surprise to us – yet another way to offset profit pressure from intense competition. The higher revenue earned did not come at the expense of order book exhaustion. The company ended Dec 2011 with a net order book of S$76.1m, within the expected range of S$70m to S$80m at the end of each quarter.

Will 3Q FY12 Show Similar Sales Level? The norm within the construction industry is to take a one to two week break for the Chinese New Year. However, we are optimistic that revenue will most likely be in excess of the usual S$30m per quarter. Some contracts secured in 2Q FY12 were worth substantially higher than the expected S$2m to S$5m per job, in the range of S$5m to S$10m. The execution of these jobs will help to support Ryobi's revenue base.

Overseas Expansion: Ryobi has an active presence in Vietnam, where it is undertaking both piling and industrial property development activities. The company is also looking to "expand its geographic footprint in the region", and is currently negotiating an acquisition in Australia, but no definitive agreement has been entered into.

An Undervalued Counter: Ryobi's results over the last three quarters have shown signs of stability. In addition, the company maintains a positive dividend policy and has been buying back shares. With its plans to expand regionally, we believe that Ryobi provides an attractive risk/reward profile to investors.

Increase Exposure

- Intrinsic Value S$0.215
- Prev Close S$0.134

Main Activities

Ryobi Kiso Holdings Ltd. provides piling services and ground engineering solutions. Its projects include both public and private sectors' infrastructure and building developments. Ryobi's customers include government bodies, statutory boards, property owners, developers and main contractors.

Financial Highlights			
(Y/E Jun) S$ m	**FY10**	**FY11**	**FY12F**
Revenue	120.8	123.3	129.5
Gross Profit	46.7	24.4	16.2
Operating Profit	33.9	12.2	6.2
Earnings	27.4	7.8	4.3
EPS (S cts)	3.57	1.02	0.57

Source: Company, SIAS Research

Key ratios (FY12F)	
PER	23.4
P/BV	0.9
Return on Common Equity	3.8%
Return on Assets	2.2%
Gross Debt to Common Equity	43.9%
Current ratio	1.9

Source: SIAS Research

Indexed Price Chart

Green (FSSTI)
White (RYOBI)

Source: Bloomberg

52wks High-Low	*S$0.175 /S$0.105*
Number of Shares	*757.55m*
Market Capitalization	*S$101.5m*

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Improving Financials: 2Q FY12 was the second quarter in a row for Ryobi to record growing gross profit. While net margins fluctuate from quarter to quarter depending on prevailing costs and one-off items such as S$0.5m of tax credits in 2Q FY12, the company has been able to maintain its quarterly EBITDA in excess of S$4m. Ultimately, we believe that the likelihood of further negative earnings surprises has been substantially lowered.

Ryobi's operating cash flow also improved significantly in 2Q FY12. While it recorded operating cash outflow of S$2.0m at the end of 1Q FY12, Ryobi reversed the situation with operating cash inflow of S$10.5m in 2Q FY12.

While borrowings grew by S$2.1m quarter-on-quarter, debt to common equity remained at a comfortable 41%. Average trade receivable days fell from 165 days (as at Sep 2011) to 141 days (as at Dec 2011).

Ryobi Tech Hub: Ryobi now has the mandate to enter into property development projects following its EGM in January 2012, when its shareholders voted to expand the company's core business activities. The Ryobi Tech Hub involves Ryobi leasing a parcel of land within the Ascendas-Protrade Singapore Tech Park (APSTP) to undertake the development of ready built factories and built-to-suit projects for small and medium enterprises. Ryobi also has the right of first refusal to develop subsequent phases of the APSTP.

Competitive Advantage in Vietnam: The management sees Vietnam as a long term commitment. Accordingly, it enjoys better contacts in Vietnam than in for instance, China. From time to time, the company also enjoys referral business from international consultants and Singapore companies in Vietnam. For more complex projects, some Vietnamese customers will consider Ryobi as a subcontractor as it has better equipment and is perceived as more reliable than certain local competitors.

From a holistic perspective, there is scope for Ryobi to expand into construction and property development in Vietnam where projects are typically of smaller value (and hence less risky) than in Singapore. The Ryobi Tech Hub is an example of how Singapore investment in Vietnam and the company's strengths are benefiting Ryobi overseas.

Robust Industrial Space Demand: Vietnam is currently enjoying higher demand for industrial space from companies that were previously affected by floods and disasters in Japan and Thailand. The entire industrial park, where the Hub is situated, has the added advantage of being located on elevated ground.

The project is in the Bin Duong province which has one of highest industrial space occupancy rate in Vietnam. Rent is about US$3.50 to US$4.50 per month per square meter. The Ryobi Tech Hub has a total development and land cost of US$8.9m and the conservative projected yield is about 8% to 10% annually. We believe that actual yield is likely to be higher. Construction is expected to be completed within two years and marketing has already started.

Outlook: Ryobi's order book at the end of 2011 consisted of HDB projects, schools and factories as well as private residential projects. While construction activity in the private sector may be affected by property market cooling measures, the public sector is expected to make up for the slack via HDB housing projects, institutional and infrastructural projects.

As Ryobi has demonstrated that it is able to secure projects from different sectors, we expect the company to show some extent of resilience if the economic situation worsens. Conversely, the company's efforts to build a substantial presence overseas will set the stage for strong growth in the future. Within the Singapore market, its fleet of self-owned cranes will allow the company to capture margin typically lost to higher rental rates when the economy recovers.

Valuation: As we are now more convinced that Ryobi's financial performance has stabilized, we reduced our required risk premium on Ryobi's future excess profits and arrived at an intrinsic value of S$0.215.

Figure 1: Results Analysis

Y/E Jun	1Q FY11	2Q FY11	3Q FY11	4Q FY11	1Q FY12	2Q FY12
Revenue	31.0	31.5	29.7	31.2	28.4	40.3
Gross Profit	7.9	7.9	6.1	2.6	3.8	4.3
Operating Profit	4.7	4.1	1.5	1.9	1.1	1.6
Net Attributable Profit	3.7	2.9	0.7	0.5	0.5	1.4
EBITDA	7.1	6.4	4.1	4.9	4.2	4.4
Gross Margin	25.5%	25.1%	20.5%	8.2%	13.5%	10.7%
Net Margin	12.1%	9.2%	2.3%	1.7%	1.8%	3.5%
EBITDA Margin	23.1%	20.4%	13.7%	15.8%	14.6%	11.0%

Source: Company, SIAS Research

Figure 2: Economic Profit Valuation Model

S$m	FY12F	FY13F	FY14F
Revenue	129.5	142.4	156.6
EBIT	6.2	10.7	12.8
Tax on EBIT	-0.8	-1.4	-1.7
NOPLAT	5.4	9.3	11.1
Invested Capital	162.1	159.9	154.1
% of Debt	26.5%	29.9%	31.1%
% of Equity	73.5%	70.1%	68.9%
WACC (%)	6.0%	5.9%	5.8%
Capital Charge	9.7	9.4	9.0
Economic Profit	-4.3	-0.1	2.1
Terminal Value			57.0
Discount Rate	0.94	0.89	0.84
Present Value	-4.1	-0.1	1.8
Book Value	116.2	Risk Free Rate	1.5%
Explicit Value	-2.4	Beta	1.0
Terminal Value	48.1	Risk Premium	5.5%
Value of Equity	161.9	Cost of Equity	7.0%
Number of Shares (m)	757.5	Cost of Debt	3.7%
Value per share (S$)	0.215	LT Growth	2.0%

Source: SIAS Research

Figure 3: Financial Forecasts and Estimates

S$m	FY09	FY10	FY11	FY12F	FY13F	FY14F
Revenue	160.3	120.8	123.3	129.5	142.4	156.6
Gross Profit	52.4	46.7	24.4	16.2	21.4	23.5
Operating Profit	41.6	33.9	12.2	6.2	10.7	12.8
Net Profit	34.3	27.4	7.8	4.3	8.2	10.1
Attributable to Shareholders						
Total Current Assets	65.5	110.5	107.5	98.6	105.1	109.0
Total Non-Current Assets	45.4	72.5	91.5	96.6	96.6	95.9
Total Current Liabilities	52.4	50.2	48.0	51.2	63.6	66.9
Total Non-Current Liabilities	15.2	17.9	31.9	31.9	31.9	31.9
Total Equity	43.4	114.9	119.2	112.1	106.2	106.2
Cash from Operating Activities	54.3	17.1	-4.3	7.6	44.6	5.9
Cash from Investing Activities	-5.1	-27.9	-20.6	-15.0	-10.0	-10.0
Cash from Financing Activities	-37.1	26.7	10.5	-6.5	-14.1	-10.0
Net Change in Cash	12.1	15.9	-14.5	-14.0	20.5	-14.2
Inventory Days	1	1	2	2	2	2
Receivable Days	71	112	156	160	130	120
Payable Days	147	193	122	90	120	120
Return on Common Equity	92.4%	35.5%	6.8%	3.8%	7.8%	9.8%
Return on Assets	31.4%	18.8%	4.6%	2.2%	4.1%	5.0%
Gross Debt / Common Equity	45.0%	15.9%	37.0%	43.9%	46.4%	46.4%
Current Ratio	1.3	2.2	2.2	1.9	1.7	1.6
EPS (S cents)	4.48	3.57	1.03	0.57	1.09	1.33
BV / Share (S cents)	5.4	14.7	15.3	14.4	13.6	13.6
PER	3.0	3.7	13.1	23.4	12.3	10.1
P/BV	2.5	0.9	0.9	0.9	1.0	1.0

Source: Company, SIAS Research

Rating Definition:

Increase Exposure – The current price of the stock is significantly lower than the underlying fundamental value. Readers can consider increasing their exposure in their portfolio to a higher level.
Invest – The current price of the stock is sufficiently lower than the underlying fundamental value of the firm. Readers can consider adding this stock to their portfolio.
Fairly Valued – The current price of the stock is reflective of the underlying fundamental value of the firm. Readers may not need to take actions at current price.
Take Profit – The current price of the stock is sufficiently higher than the underlying fundamental value of the firm. Readers can consider rebalancing their portfolio to take advantage of the profits.
Reduce Exposure - The current price of the stock is significantly higher than the underlying fundamental value of the firm. Readers can consider reducing their holdings in their portfolio.