Ryobi Kiso Holdings Ltd.

Rich Cash Flows and Gains Anchor Value

Ryobi Kiso Holdings Ltd. (Ryobi) recently reported 1Q FY14 (ended Sep 2013) PATMI of S$0.34m compared to a loss of S$0.46m in 4Q FY13. We noted that Ryobi is actually much more profitable on a cash flow basis and that it has been accumulating future gains of some S$6m to S$8m from property development projects in Vietnam and Singapore. As such, we maintain that Ryobi is undervalued.

High Cash Flow Profits: Ryobi generated net operating cash flow of S$2.5m, or 7.5x PATMI, in 1Q FY14. The high cash flow to profit ratio is due to tight cost control and earlier investments in PPE, which minimized cash outflow from machine rental. As a result of these cash flows, Ryobi has been able to declare annual dividends of 0.3 S cents and to repurchase S$0.8m and S$1.0m of shares in each of FY12 and FY13.

Subtly Scoring Gains in Property Development: Ryobi's industrial property development project in Vietnam has an estimated fair value gain in excess of net book value of S$5.05m that has yet to be recognized in the company's financial statements, based on disclosed notes in its FY13 Annual Report. Furthermore, Ryobi has a small, but undisclosed, indirect stake in the Yuan Ching/Tao Ching Road executive condominium. We estimate that Ryobi may reap cumulative gains of S$1.6m to S$3.3m over the completion of this project in the next few years. In spite of such "hidden value", the company currently trades at only S$0.110 or 70% of its NAV per share of S$0.1565.

Overall Strategy to Build Multiple Profit Centers: At the same time, overseas revenue has grown from S$0.6m (0.5% of total) in FY11 to S$32.5m (20.9% of total) in FY13. Following expansion into Australia in 2012, Ryobi has, in 2013, established subsidiaries in Cambodia, Myanmar and Indonesia, possibly to scout business opportunities in these countries. Group business growth in 1Q FY14 has been particularly obvious with a net order book of S$111.4m versus the FY13 quarterly average of S$87.4m. Over the next 12 months, we are hopeful of new contracts or business developments from either Cambodia, Myanmar or Indonesia, as the company sets up operations in these countries.

Increase Exposure

- Intrinsic Value S$0.179
- Previous Close S$0.110

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	FY13	FY14F	FY15F
Revenue	155.2	163.0	179.3
Gross Profit	22.4	24.4	28.7
EBIT	2.0	3.2	8.3
PATMI	0.4	1.3	5.7
EPS (S cents)	0.06	0.18	0.76

Source: Voyage Research Estimates

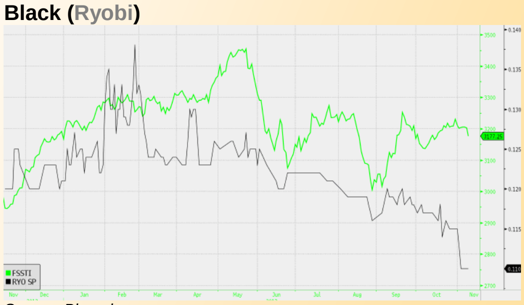
Key ratios (FY15F)

PER	14.5
P/BV	0.71
Return on Common Equity	4.9%
Return on Assets	2.6%
Gross Debt to Common Equity	33.9%
Current ratio	1.4

Source: Voyage Research Estimates

Indexed Price Chart

Green (FSSTI)
Black (Ryobi)



Source: Bloomberg

52wks High-Low	*14.0 cents/ 11.0 cents*
Number of Shares	*747.6 m*
Market Capitalization	*S$82.2m*

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Dissecting the Gains from Property Development: The industrial development in Vietnam Ryobi Tech Hub (Phase 1A) has been completed and has been partially leased out. The fair value of these factories have been estimated by the management to be S$10.15m based on valuation made by a 3rd party professional valuer.[1] Nonetheless, the company carries these assets at a value of S$5.1m on its balance sheet as at end FY13. As such, the company is sitting on potential gains of S$5.1m that can be realized at a later stage.

In 1Q FY14, Ryobi has also invested S$6.3m in a property development project, recorded on its balance sheet as available-for-sale financial assets. The investment is most likely an indirect stake in the executive condominium site at Yuan Ching Road/Tao Ching Road, which was sold by the HDB for S$273m. Assuming a conservative net profit of S$100 per sq. ft., Ryobi may reap between S$1.6m to S$3.3m of gains based on a 5% to 10% stake as the project reaches completion several years later.

The site has been said to be the first EC offering in the Jurong West area for some time and we reckon that higher floor units may be able to enjoy views of the Jurong Lake, Chinese Garden and Japanese Garden. As such, demand may not be weak. In all, potential gains that have yet to be recognized add up to about S$6.7m to S$8.4m.

Australia to Be a Key market: In the piling and geo-technique businesses, Ryobi has been relatively successful at capturing market share in Australia, with maiden revenue contribution of S$17.2m in FY13. In 1Q FY14, Ryobi sustained its momentum with new projects such as Kings Square 1 and 4. The outlook for Ryobi in Australia is positive due to an improving property market whilst the country maintains GDP growth of around 2.5% in 2014 due to lower mining investment and fiscal restraint.[2] We expect Ryobi to ship more equipment to overseas markets such as Australia to support the ramp up of local operations and to reduce equipment rental costs, in line with the historical trends shown in Figures 1 and 2.

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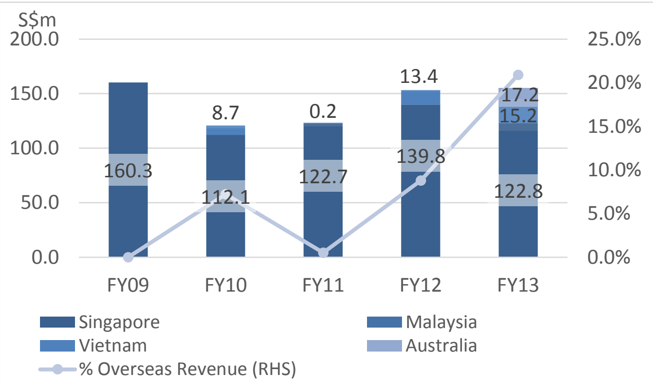
[1] Note 14 of Notes to the Financial Statements , Pg 65 of FY13 Annual Report,

[2] "The number of private residential building approvals rose by 9% in the September quarter", while "non-residential building approvals have moved higher since the start of the year." (Extracted from the Reserve Bank of Australia Statement of Monetary Policy, Nov 2013, Domestic Economic Conditions)

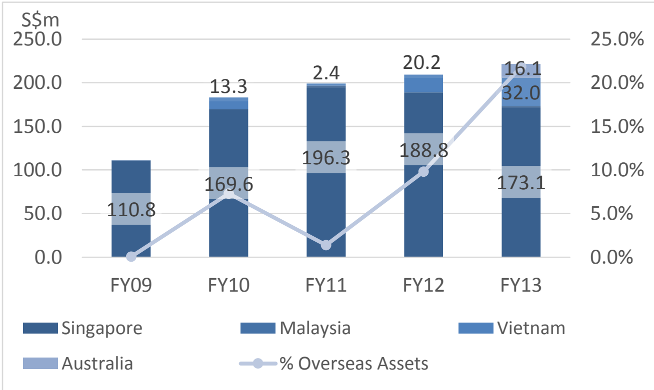
"GDP growth is now expected to remain below trend at close to 2.5 per cent through to the end of 2014, before picking up," but "the recovery in dwelling investment is expected to continue and to accelerate somewhat". (Extracted from the same statement, Economic Outlook)

Figure 1: Revenue, By Region



Source: Company, Voyage Research

Figure 2: Total Assets, By Region



Source: Company, Voyage Research

Enlarging Regional Footprint: The recent addition of subsidiaries in Cambodia, Myanmar and Indonesia suggests that Ryobi is eyeing an even wider presence in the region. The addition of more markets will help to diversify exposure to a slowdown in any single geography, such as Singapore in FY10 and Vietnam in FY11. Skeptics may argue that Ryobi lacks the local knowledge in regional markets. Nonetheless, Ryobi has in the past been able to recruit or acquire talent with local experience, and we argue that Ryobi's regionalization strategy is a long term one, thus it can afford time for the cultivation of more significant local connections.

Well-Funded to Support Investments and Expansion Plans: Moreover, Ryobi has secured S$32.8m of bank facilities in Aug 2013, including an eight-year S$20m secured term loan, thus providing the company with the capital to take advantage of available opportunities. In addition, Ryobi does not come across as highly leveraged as it ended 1Q FY14 with a net gearing ratio of only 34.5% compared to 27.5% as at end FY13. Net borrowings amounted to only S$38.8m (S$30.8m as at end FY13).

Results Overview: Ryobi reported revenue of S$36.25m for 1Q FY14, up 24.8% from the 3Q FY13 low of S$29.05m and up 13% from 4Q FY13. Revenue remained low compared to a year ago (1Q FY12: S$53.7m) as the company continued to be selective about its projects amidst a competitive environment in Singapore.

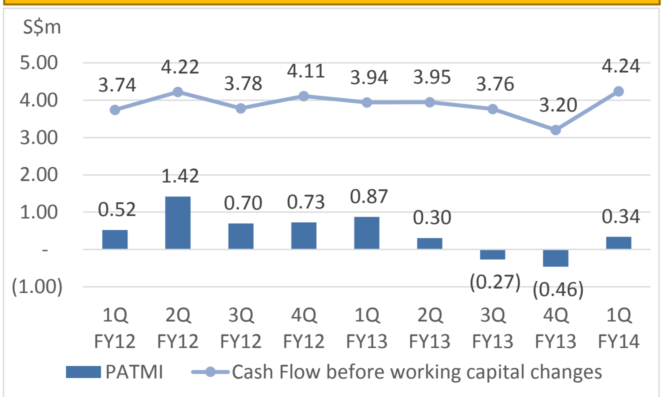
Gross profit remained stable at about S$5.5m, comparable to that of 4Q FY13. Gross margin remained relatively high at 15.2%, partly due to lower concrete and rebar prices, as well as lower subcontracting costs and transportation costs. Administrative expenses remained stable, at S$5.45m, compared to a year ago, lending evidence of tight cost control.

Figure 3: Results Overview

	1Q FY13	2Q FY13	3Q FY13	4Q FY13	1Q FY14
Revenue	53.74	40.35	29.05	32.07	36.25
Gross Profit	7.05	4.34	5.45	5.57	5.52
EBITDA, excl. FX gains/losses	5.61	3.63	3.56	4.22	3.98
PATMI	0.87	0.30	-0.27	-0.46	0.34
Cash Flow before Changes in Working Capital	3.94	3.95	3.76	3.20	4.24
Net Operating Cash Flow	6.44	2.69	2.14	-2.84	2.54
Gross Margin	13.1%	10.7%	18.7%	17.4%	15.2%
EBITDA Margin	10.4%	9.0%	12.3%	13.2%	11.0%
Gross Cash Flow to EBITDA	70%	109%	106%	76%	107%

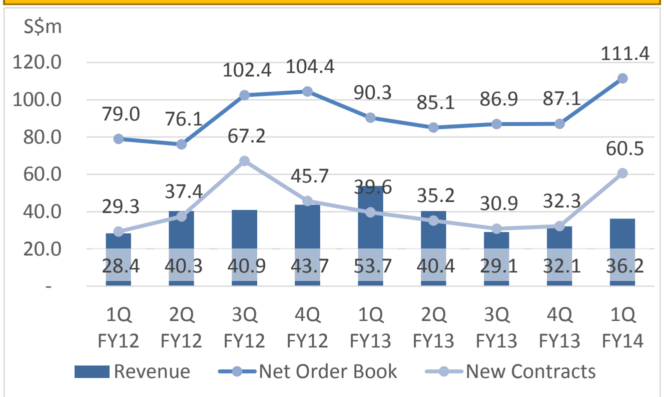
Source: Company, Voyage Research

Figure 4: Cash Flow versus PATMI



Source: Company, Voyage Research

Figure 5: Order Book & New Contracts



Source: Company, Voyage Research

Forecasts and Valuation: In all, Ryobi has not been reporting high profits due to low piling margins in the competitive Singapore market, high depreciation expenses, as well as foreign exchange losses (-S$1.2m in FY13) arising from higher overseas exposure. We do not expect a quick turnaround in local market and thus conservatively forecast FY14F PATMI of S$1.3m on revenue growth of 5% and gross margin of 15%.

That said, we expect the company to report steadily higher profitability over our forecast horizon in line with the business development efforts that we have highlighted and that the company should pay off the bulk of its debts in FY17F. We rolled forward our forecasts to FY18F to maintain a five year horizon and have kept our valuation of the company at S$0.179.

We have not incorporated the unrecognized fair value gains from investment property in our valuation, which works out to about 0.7 S cents per share of value. We maintain our view that the company is in the process of building multiple profit centers and that its share price does not reflect these efforts.

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Figure 6: Economic Profit Valuation

S$m	FY14F	FY15F	FY16F	FY17F	FY18F
Revenue	163.0	179.3	197.2	207.1	217.4
EBIT	3.2	8.3	12.0	14.5	15.7
Tax on EBIT	-0.5	-1.2	-1.8	-2.2	-2.4
NOPLAT	2.7	7.1	10.2	12.3	13.3
Invested Capital	169.0	169.6	159.6	164.1	140.0
% of Debt	30.9%	30.8%	24.7%	24.1%	7.1%
% of Equity	69.1%	69.2%	75.3%	75.9%	92.9%
WACC (%)	6.7%	6.7%	6.9%	7.0%	7.7%
Capital Charge	-11.3	-11.3	-11.1	-11.4	-10.8
Economic Profit	-8.6	-4.2	-0.9	0.9	2.6
Terminal Value					45.9
Discount Rate	0.94	0.88	0.82	0.76	0.69
Present Value	-8.02	-3.72	-0.71	0.70	1.77
Book Value	112.0		Risk Free Rate		1.5%
Explicit Value	-10.0		Beta		1.0
Terminal Value	31.7		Risk Premium		6.5%
Value of Equity	133.8		Cost of Equity		8.0%
Number of Shares (m)	747.6		Cost of Debt		3.7%
Value per share (S$)	0.179		LT Growth		2.0%

Source: Voyage Research

Figure 7: Financial Forecasts and Estimates

S$m	FY11	FY12	FY13	FY14F	FY15F	FY16F	FY17F	FY18F
Revenue	123.3	153.3	155.2	163.0	179.3	197.2	207.1	217.4
Gross Profit	27.4	19.1	22.4	24.4	28.7	33.5	37.3	40.2
Operating Profit	12.2	4.8	2.0	3.2	8.3	12.0	14.5	15.7
PATMI	7.8	3.4	0.4	1.3	5.7	8.8	11.0	11.9
Total Current Assets	107.5	115.5	111.8	105.9	109.7	124.6	110.6	128.7
Total Non-Current Assets	91.5	93.8	109.7	112.8	109.4	103.0	96.2	86.3
Total Current Liabilities	48.0	66.6	86.3	82.9	80.5	84.7	67.8	70.0
Total Non-Current Liabilities	31.9	24.8	18.4	18.4	18.4	18.4	8.9	8.9
Total Equity	119.2	117.9	116.8	117.3	120.2	124.6	130.0	136.0
Cash from Operating Activities	-4.3	8.3	8.5	12.7	32.1	2.8	37.9	0.0
Cash from Investing Activities	-20.6	-8.3	-18.8	-15.4	-10.0	-5.0	-5.0	0.0
Cash from Financing Activities	10.5	-8.5	-1.9	-0.7	-15.6	-4.4	-35.0	0.0
Net Change in Cash	-14.5	-8.4	-12.2	-3.5	6.5	-6.6	-2.0	0.0
Inventory Days	2.0	2.6	5.3	3.0	3.0	3.0	3.0	3.0
Receivable Days	156	154	184	180	150	150	150	150
Payable Days	122	84	103	100	120	120	120	120
Return on Common Equity	6.8%	2.9%	0.4%	1.2%	4.9%	7.4%	8.9%	9.2%
Return on Assets	4.6%	2.1%	0.4%	0.6%	2.6%	3.9%	5.0%	5.7%
Gross Debt / Common Equity	37.0%	41.1%	46.6%	46.0%	33.9%	32.7%	7.9%	7.6%
Current Ratio	2.2	1.7	1.3	1.3	1.4	1.5	1.6	1.8
EPS (S cents)	1.02	0.44	0.06	0.18	0.76	1.18	1.46	1.60
BV / Share (S cents)	15.3	15.1	15.0	15.2	15.6	16.2	16.9	17.7
PER	10.8	25.0	186.5	61.8	14.5	9.3	7.5	6.9
P/BV	0.72	0.73	0.73	0.72	0.71	0.68	0.65	0.62

Source: Voyage Research

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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.
