

17 January 2024

TSA Group (TSA MK)

Your Friendly Steel Products Supplier

- **FV of MYR0.59 based on 5.5x FY24F P/E.** TSA Group plans to raise MYR42.5m from its IPO, primarily for capital expenditure related to its new manufacturing plant, working capital, repayment of bank borrowings, and listing expenses. We forecast a 3-year earnings CAGR of 1.2%. However, in the long run, the 5-year CAGR could be c.10%, post commencement of its Semenyih manufacturing plant, as we envisage further cost-savings with TSA having more control on the quality and availability of cold-rolled stainless steel coil.
- **A one-stop supplier for various products.** Aside from being a supplier of stainless steel rolled metal products, which made up 53% of its 8M23 revenue, TSA supplies other metal products like copper, aluminium, and carbon steel in the form of pipes, channels, and angles. The group has also been manufacturing stainless steel pipes for the past 15 years. TSA is geographically diverse, deriving revenue not just from Malaysia, but also from Singapore, Thailand, Bangladesh, China, and India, among others.
- **Prospects.** Despite the temporary blip we are expecting for FY23F – mainly due to lower ASPs for most of its products – we expect demand to pick up from various industrial fronts as its clients comprise fabricators, contractors, and part manufacturers that make up 47%, 8%, and 15% of revenue. This ties well with RHB Economics' higher GDP projection of 4.6% YoY in 2024 (2021: 4.1% YoY) for Malaysia with private investment activities to be buoyed by business-friendly policies, while public investment may expand further amid the continuation of development projects.
- **Major plans.** TSA plans to establish a manufacturing facility for stainless steel cold rolling in Semenyih, on a 435.6k sq ft land. Production of cold-rolled stainless steel coils is a new business for the group, and it will have a capacity of 4,000 tonnes per month on top of its annual capacity of 7,722 tonnes pa for the manufacturing of stainless steel pipes. TSA currently purchases cold-rolled stainless steel coils from third-party suppliers. The new facility should help TSA improve its inventory management.
- **Forecasts.** We estimate TSA's core earnings will drop by 44% YoY in FY23F before expanding by 51% and 23% YoY in FY24-25F amidst more stable ASPs and stronger demand for steel products. Likewise, net profit margins are expected to grow to 10% in FY25F from 6.4% in FY23F.
- **Valuation.** We ascribe a MYR0.59 FV based on 5.5x FY24F P/E. For peer comparison purposes, we chose companies that are involved in the trading of steel-related products and also the manufacturing of such related products. The target P/E is c.35% below the blended 8.6x FY24F P/E of the selected peers, based on TSA's smaller indicative market capitalisation.
- **Key risks** include slower-than-expected demand for steel products.

Forecasts and Key Data	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Total turnover (MYRm)	302.7	357.3	343.4	371.7	408.9
Gross profit (MYRm)	86.4	79.8	74.4	83.6	89.4
Recurring net profit (MYRm)	38.1	39.3	21.9	33.0	40.7
Recurring net profit growth (%)	>100	3.1	-44.3	50.8	23.3
Recurring EPS (sen)	12.3	12.7	7.1	10.7	13.2
Recurring P/E (x)	4.5	4.3	7.8	5.2	4.2
P/BV (x)	1.4	1.1	1.1	0.9	0.8
Dividend Yield (%)	20.6	8.8	11.8	2.9	3.6
EV/EBITDA (x)	3.2	3.7	5.8	3.7	3.0
ROE (%)	30.6	26.2	14.4	18.3	19.0
Net debt to equity (%)	7.1	22.7	-1.5	8.5	1.2

Source: Company data

Fair Value (Return):	MYR0.59 (+7%)
IPO Price:	MYR0.55
Closing Application Date:	17 Jan 2024
Indicative Listing Date	2 Feb 2024

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Company Description

TSA Group, founded in 1993, is a leading supply and manufacture provider of industrial hardware, having manufacturing facilities both in Malaysia and Singapore. The group commenced its business in the trading of stainless steel as well as other metal products, and in 2008, diversified into the manufacturing of stainless steel pipes,

IPO Details

Public Issue of shares (m)	77.3
Shares outstanding (m)	309.3
Implied market cap (MYRm)	170.1

Major Shareholders (%)

KVC Properties	37.6
Chew Kuan Fah	18.8
Barisan Jutawan	8.9

Utilisation of IPO Proceeds

	MYRm
Capital expenditure for the establishment of Semenyih manufacturing premises	5.1
Repayment of bank borrowings	20.0
Working capital	12.3
Estimated listing expenses	5.1
Total	42.5

Additional Data

Listing Market	Ace
Bursa Code	0297

Note:

Small cap stocks are defined as companies with a market capitalisation of less than USD0.5bn.

Financial Overview And Valuation

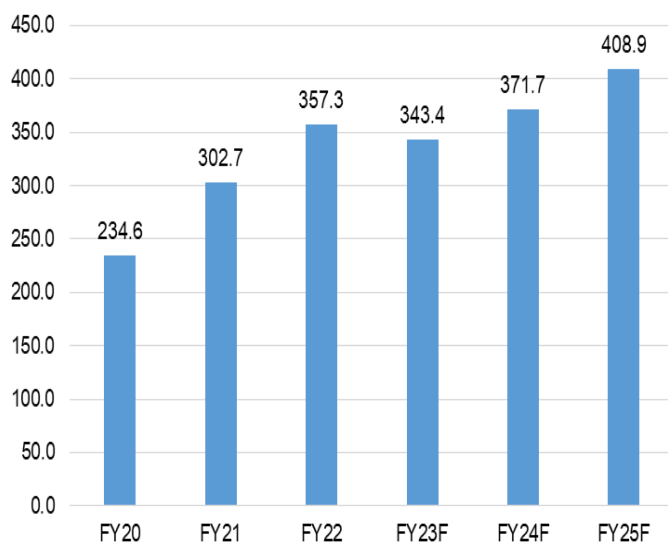
Results highlights. TSA reported an 11% YoY increase in 8M23 revenue to MYR220.3m vs MYR248.4m in 8M22. The decrease in total revenue was mainly attributed to lower ASPs for all its product categories except for the trading of pipes. On further scrutiny, while the ASP for the trading of pipes rose by c.MYR300 per tonne or 1.5%, the quantity sold decreased by 357 tonnes or 38.6% during the period. Alongside the drop in revenue, TSA's net profit slipped 67% YoY in 8M23 to MYR10.1m vs MYR40.7m in 8M22, causing net profit margin to be lower at 4.6% (8M22: 12.3%). Aside from lower ASPs in 8M23, the implementation of the Minimum Wages Order 2022 resulted in labour costs increasing by 28% during the same period, and a higher effective tax rate of 29.5%.

The trading of metal and other products (rolled metal products, pipes, channels, and angles) contributed the bulk of 8M23 revenue at 62.7%. Rolled metal products made up 85% of the metal products trading segment's revenue in 8M23. Meanwhile, the manufacturing of stainless steel pipes and processing of stainless steel products accounted for 30% and 7.3% of overall revenue.

Balance sheet and cash flow. TSA has a manageable balance sheet, with a net gearing ratio of less than 0.25x from FY20 to FY22. Such net gearing levels give the group ample headroom to expand further in the future, especially for its new Semenyih manufacturing plant. We are also forecasting free cash flows of MYR12-15m in FY23-25F with a capex of MYR5-10m pa during this period for its business expansion.

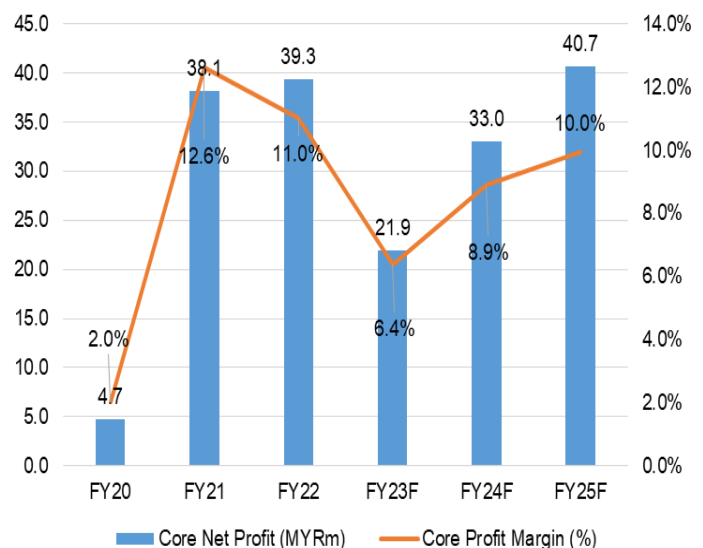
Dividend policy. TSA presently does not have a dividend policy but has been paying out dividends to shareholders from FY20 to FY22 with payout ratios ranging between 37% and 231%. With its commendable net operating cash flow, we expect TSA to continue paying out dividends. We pencil in a conservative 15% dividend payout ratio assumption for FY24-FY25F, which translates to prospective yields of 2-3% based on the IPO price of MYR0.55.

Figure 1: Revenue trend (MYRm)



Source: Company data, RHB

Figure 2: Core net profit (MYRm) and margin trends (%)



Source: Company data, RHB

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Earnings forecasts. We are forecasting a 3-year CAGR of 1.2% for TSA's earnings. Nevertheless, we estimate FY23F earnings will see a 44% YoY drop due to overall lower ASPs for its products before recording earnings improvements in FY24F and FY25F to the tune of 51% YoY and 23% YoY. This is to be underpinned by better demand from its wide client base as its top five customers collectively accounted for only 6.3% of total revenue in FY22. The group had 3,600 active customers with purchases of at least MYR2,000 in FY22. This is despite three of its five top customers dealing with TSA for 10 years or more – reflecting its constant efforts to gain new clients. Labour costs are also expected to normalise, as it will be the third year of the Minimum Wage Order 2022, by when TSA should already be well versed in managing manpower costs.

TSA's clients under the direct distribution channel mainly include fabricators, manufacturers, construction companies, and maintenance service providers. The anticipation of higher demand for industrial facilities, combined with the rollout of certain infrastructure projects such as the reinstatement of the Light Rail Transit 3 (LRT3) stations and Mass Rapid Transit 3 may give rise to higher demand for stainless steel products. For example, stainless steel products are used as part of constructing certain sections of stations, while manufacturers need such materials for manufacturing components such as precision parts and moulds. The expectation of a higher need for such materials augurs well with the RHB Economics team's view that the industrial production index may re-accelerate in 2024 in tandem with domestic and external demand.

On a bigger picture, the World Steel Association forecasts a 1.7% growth in global steel demand in 2024, according to its latest Short Range Outlook report, with ASEAN growing to the tune of 5.7% in the same year. The revival of tourism – especially as China opens up – and the resumption of delayed construction projects are also in line with the International Stainless Steel Forum's projection that global consumption of stainless steel will grow by 3.6% in 2024.

The establishment of a stainless steel cold rolling line at the Semenyih manufacturing plant will enable the cold-rolled stainless steel coils to be produced in-house for its trading business, and to be used as input material for the manufacturing and processing businesses. More importantly, the plant, which is expected to commence operations by 3Q26, may result in cost savings of up to MYR20m per year. TSA currently purchases cold-rolled stainless steel coils from third-party suppliers. Other synergies that can be derived from having its own cold-rolled stainless steel coil line may come in the form of having more control over quality, timing, and availability – this should enhance its efficiency in meeting clients' orders.

Valuation. We ascribe a MYR0.59 FV based on a target 5.5x FY24F P/E. For peer comparison purposes, we chose companies that are involved in the trading of steel-related products and also the manufacturing of pipes. These include Pantech Group (PHGB MK, NR), Ann Joo Resources (AJR MK, NR), United U-Li Corp (UULI MK, NR) and Engtex Group (ENGT MK, NR). Our target P/E of 14x is at a c.35% discount to the blended FY24F P/E of these selected companies of 8.6x, due to TSA's much smaller indicative market capitalisation. The discount is also warranted as TSA is just about to venture into the production of cold-rolled stainless steel.

Figure 3: Peer comparison

Company	Country	FYE	Mkt Cap (USDm)	Price	PER (x)			Div. Yld (%)	ROE (%)	EV/ EBITDA	NP Growth (%)	
				15-Jan-24 (Local Currency)	Actual	1 Yr Fwd	2 Yr Fwd	1 Yr Fwd	1 Yr Fwd	1 Yr Fwd	1 Yr Fwd	2 Yr Fwd
TSA Group	MA	Dec	36.4	0.55	4.3	7.8	5.2	11.8	14.4	5.8	-44.3	50.8
Peers												
Pantech Group	MA	Feb	0.91	0.67	6.2	7.4	6.9	6.6	2.7	4.7	-16.8	6.9
Ann Joo Resources	MA	Dec	1.07	1.07	-4.3	-6.7	9.0	0.0	-1.6	0.0	-36.3	-174.7
United U-Li Corp	MA	Dec	1.58	1.58	8.2	7.5	5.8	3.8	2.8	0.0	10.5	28.6
Engtex Group	MA	Dec	0.92	0.92	11.8	33.8	13.4	1.0	0.3	13.6	-65.2	153.1
Mkt. Cap Weighted Avg.			123.2		4.6	8.5	8.6	3.2	1.0	4.3	-27.2	-13.2
Simple Avg.			112.6		5.5	10.5	8.8	2.9	1.0	4.6	-26.9	3.5



Note: based on IPO price for TSA Group
Source: Bloomberg, RHB

Company Overview

TSA, founded in 1993, is a leading supply and manufacture provider of industrial hardware, with manufacturing facilities in Malaysia and Singapore. The group commenced business in the trading of stainless steel as well as other metal products, and in 2008, diversified into the manufacturing of stainless steel pipes. Now, over 30 years since its inception, TSA also provides value-added services through specialised customisations for businesses across Malaysia and globally. With its industrial experience as well as its intention to continue providing exceptional services, the group has managed to grow at a rapid rate, also receiving certificates and awards from various organisations. Its business segments comprise the following:

- i. **Trading (61.4% of FY22 revenue):** The trading of metal products including rolled metal lines, pipes, channels, and angles has always been the group's largest revenue contributor, accounting for over 60% of topline numbers for the past three years. Amongst these products, rolled metal items, which mainly consist of stainless steel, represent TSA's largest segment, accounting for c.50% of revenue. TSA's ability to generate this much revenue is a result of its wide range of options for buyers to choose from. For example, aluminium and stainless steel have around 10 variations, which have different classifications as well as purposes, allowing TSA to have a competitive advantage in terms of product flexibility.
- ii. **Manufacturing of stainless steel products (31.2% of FY22 revenue).** This segment is growing at a steady rate, with earnings growing from MYR64.4m in FY20 to c.MYR112m in FY22. Stainless steel products, in terms of product categories, are TSA's specialty, covering over 80% of the group's sales throughout the period. TSA manufactures welded ornamental stainless steel pipes – through its in-house polishing lines in Balakong, Selangor – which are used for decorative purposes.
- iii. **Processing of stainless steel products (7.4% of FY22 revenue).** TSA has recently ventured into this segment. The segment, albeit small, plays an important role in helping it to further differentiate itself from peers. Processing of stainless steel involves slitting, polishing and perforation, resulting in finished products such as PVD Titanium Coating and perforated metal, utilised to highlight architectural accents.

Figure 4: Business overview

Business activities and revenue streams	Products	Geographical markets	Distribution channel and customer base
Principal activities 	Main products traded <ul style="list-style-type: none"> Stainless steel plates, bars, coils, pipes, channels, and angles Copper bars Products manufactured <ul style="list-style-type: none"> Welded ornamental stainless steel pipes Main products processed <ul style="list-style-type: none"> Stainless steel plates and bars 	Principal markets  Other markets <ul style="list-style-type: none"> Thailand Others 	Main - direct <ul style="list-style-type: none"> Fabricators Construction companies Part manufacturers Plant maintenance companies Other - indirect <ul style="list-style-type: none"> Hardware wholesalers and retailers

Source: Company data

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Figure 5: Business products



Source: Company data

TSA is led by an experienced management team. Group Managing Director Chew Kuan Fah is assisted by Executive Director Chew Yik Wai, who is responsible for the group's overall operations related to production, procurement, and export markets. The management team is also supported by key senior personnel like Head of Finance Tan Bee Hong who has 28 years of experience in the fields of finance, administration, and accounting.

Over the past three FYs, TSA's top five major clients have consistently accounted for a small portion of the group's purchases, with contributions of 12.3%, 11%, and 6.3% for FY20-22. This minimises the client concentration risks faced by TSA.

Figure 6: TSA's major customers in FY22

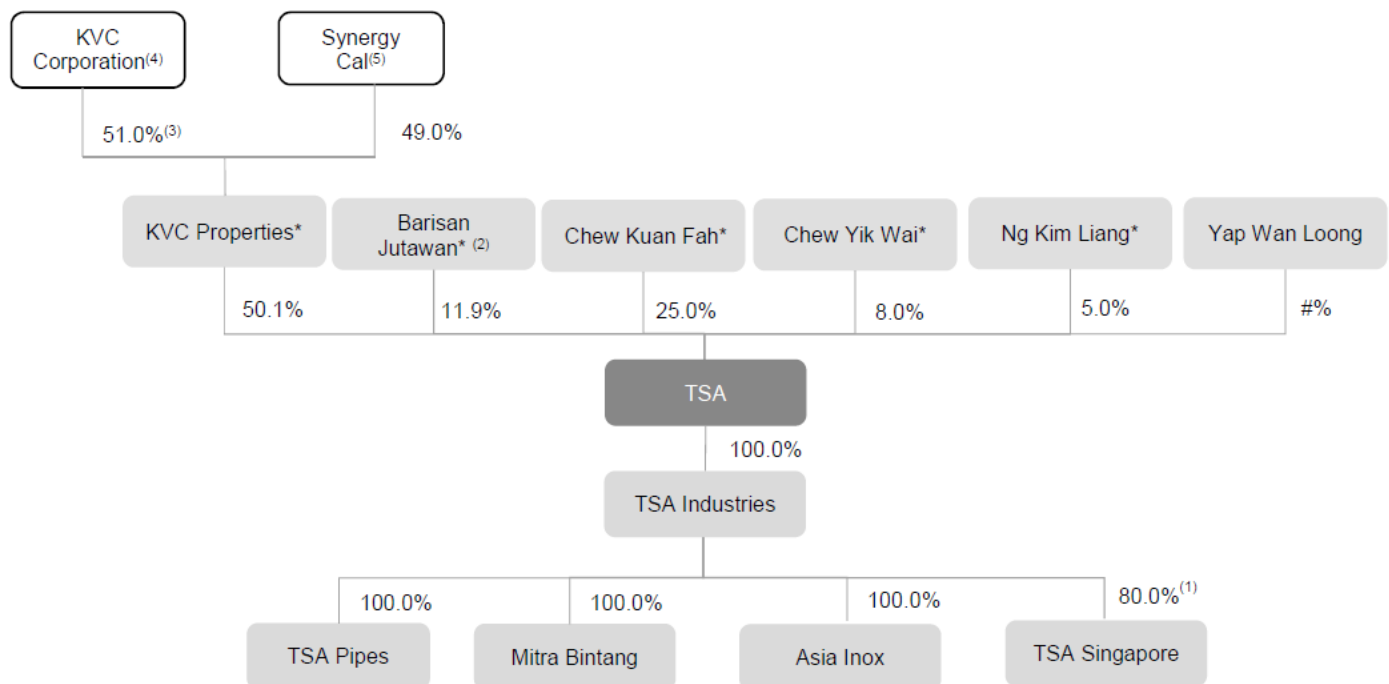
Supplier	Country	Type of products and services	Proportion of revenue	Approximate length of business relationship (number of years)
Customer A – involved in importing and sales of stainless steel and polyester with operations in Thailand.	Thailand	Stainless steel pipes	2.3	6
Customer B – involved in design, development or manufacture or assembly of various electronic equipment. It is a subsidiary of a holding company headquartered in Arizona, US.	Malaysia	Stainless steel products	1.8	11
Karnaphuli Shoes Industries.	Bangladesh	Stainless steel, other metal products, and hardware	0.8	4
Customer E – contractor for tiling and maintenance, and trading in construction materials.	Malaysia	Stainless steel products	0.7	16
Customer F – supply and servicing of electro mechanical parts for power generation plants and auxiliaries.	Malaysia	Stainless steel products	0.7	17

Source: Company data

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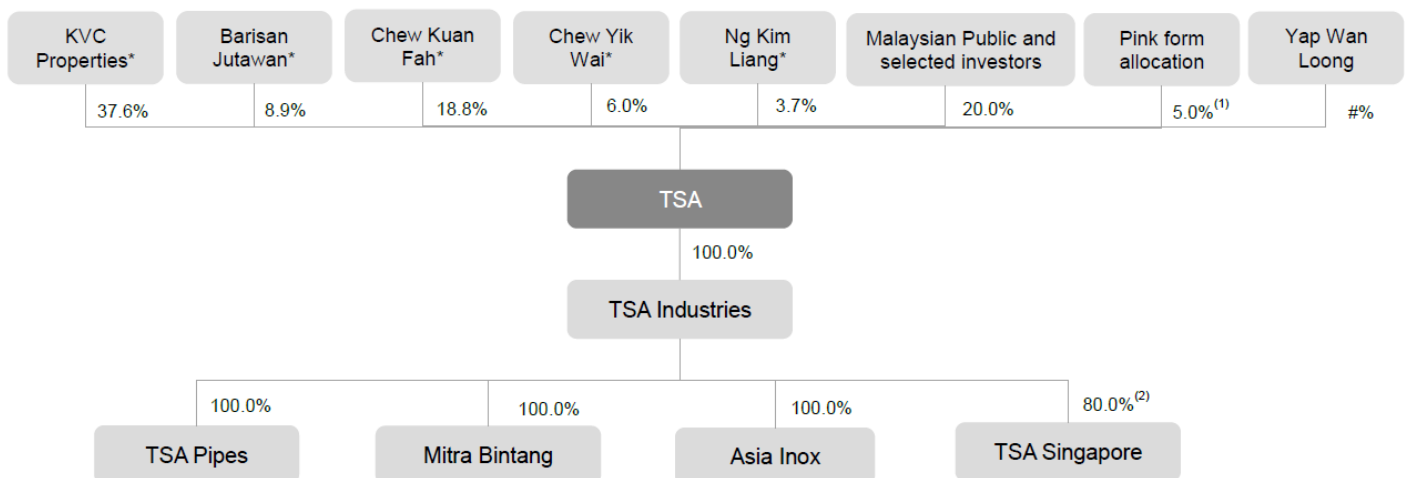
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Figure 7: TSA's group structure – pre IPO



Source: Company data

Figure 8: TSA's group structure – post IPO



Source: Company data

Future Plans And Strategies

Establishing a manufacturing facility in Semenyih. TSA plans to establish a manufacturing facility on a land in Semenyih that was purchased by subsidiary TSA Industries for MYR13m. The land is located at PT 1125, HS (D) 37423, Mukim Hulu Semenyih, Selangor. TSA Industries completed the acquisition of the land on 7 Oct 2022. The lease tenure is set to expire on 7 Aug 2093.

The land measures approximately 435,615sq ft in size. The manufacturing premises that TSA plans to construct on the vacant Semenyih land will include the following:

Figure 9: Land breakdown of Semenyih manufacturing premises

Type of Space	Approximate built-up area (sq ft)
Office	23,250
Production area	197,128
One block of workers' hostel	18,858
Total	239,236

Source: Company data

Figure 10: Rendering of Semenyih manufacturing facility and workers' hotel



Source: Company data

Establishing a stainless steel cold rolling line. The group plans to establish a stainless steel cold rolling line at the Semenyih manufacturing plant once construction of the facility is completed. TSA intends to commence the production of cold-rolled stainless steel coils, which is a new business for the group, with this line. The line that TSA plans to set up will have the capacity to produce 4,000 tonnes of cold-rolled stainless steel coils per month.

The total estimated cost to purchase, install, test, and commission the stainless steel cold rolling line – including the annealing furnace – is estimated at MYR52m. TSA has paid part of the purchase price for the reconditioned cold-rolling line – amounting to USD3.6m (equivalent to MYR15.8m as at 30 Nov 2023 – and some of the machinery and equipment are already in its possession (held in storage in Selangor).

The group purchased a reconditioned stainless steel cold rolling line rather than a new one, as the cost of the reconditioned line is approximately 60% lower when compared to a new line of comparable specifications. Consequently, this resulted in lower capital expenditure for establishing the stainless steel cold rolling line.

Figure 11: Indicative timeline for establishing Semenyih manufacturing facility

Type of Space	Approximate built-up area (sq ft)
3Q24	Engaged a main contractor to construct and commence construction works for the new premises.
1Q26	Complete construction of the premises and commence the setting up of the stainless steel cold rolling line.
3Q26	Commissioning of the stainless steel cold rolling line.

Source: Company data

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IPO Details

Figure 12: Indicative IPO timeline

Opening of application	27 Dec 2023
Closing of application	17 Jan 2024
Balloting of applications	19 Jan 2024
Allotment of IPO shares	30 Jan 2024
Listing day	2 Feb 2024

Source: Company data

Figure 13: Utilisation of IPO proceeds

	Estimated timeframe	MYRm	% of proceeds
Capital expenditure for the establishment of the Semenyih manufacturing premises	Within 24 months	5.1	12.0
Working capital.	Within 12 months	12.3	29.0
Repayment of bank borrowings.	Within five months	20.0	47.0
Estimated listing expenses.	Within one month	5.1	12.0
Total		42.5	100.0

Source: Company data

Figure 14: Shares issued under public issue

	No. of IPO shares	% of enlarged share base
Malaysian public	15,465,000	5.0
Eligible persons	15,465,000	5.0
Bumiputera investors approved by the Ministry of Investment, Trade & Industry	38,662,500	12.5
Private placement to selected investors	7,732,500	2.5
Total	77,325,000	25.0

Source: Company data

Key Risks

Volatile stainless steel price. As discussed previously, TSA's main products are stainless steel, amounting up to 80% of the group's revenue. Hence, should the market price of stainless steel start to increase for an extended period, it may have an adverse effect on the going concern of its financial performance. If TSA's buyers are not able to pass the incremental costs to their customers, they may seek other alternatives as substitutes – these include aluminium, carbon steel, and metal products with chrome plating. This results in two problems: i) The products might have lower margins and ii) the group's buyers may just procure these items from other sellers rather than TSA.

Absence of long-term contracts. It is a common practice in the industry to supply goods to customers based on purchase orders, and the group is no exception. Based on this, if TSA experiences purchase cancellations from any existing customer – primarily its major clients – and is unable to secure additional sales from other pre-existing ones, this will bring adverse impacts to the group's financial performance as well, in our view. Considering that the market price of stainless steel can fluctuate – and given the lack of forward-selling – it would be prudent to be wary of this scenario occurring.

Highly exposed to FX fluctuations. Since TSA has a subsidiary company in Singapore, it also faces FX gains or losses that result from timing differences when preparing statements for financial reporting and repatriation purposes. Regardless, it is important to note that, as of now, the fluctuations in exchange rates between the currencies do not bring about any adverse effects towards the group, mainly due to the MYR depreciating, but also because of the Monetary Authority of Singapore's reliable exchange rate policies.

Other than that, TSA is also exposed to FX risks associated with its costs, as a significant proportion of the group's purchases are denominated in USD. Hence, TSA will record higher revenues and assets in MYR after conversion in situations where the SGD appreciates and the USD depreciates against the Malaysian currency. Likewise, the group will also record lower revenues should the USD experience a major hike against the MYR.

New ventures may not be profitable. TSA intends to produce cold-rolled stainless steel coils from hot rolling, totalling up the cost of the new line to MYR52m. This includes the installation, testing, and commissioning of an annealing furnace, which will be financed by both retained earnings and bank borrowings. In 2022, the group acquired a piece of land in Semenyih, measuring at c.4ha, as a base to house the cold rolling line. In 2023, it incorporated Asia Inox, which will be responsible for this new venture. However, as TSA does not have any experience nor track record in this business, there is no guarantee that this new division will be profitable. It may also not be realised within the pre-determined set of time.

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