5 October 2020

Industrial | Electrical Equipment

Southern Cable (SCGBHD MK)

Southern Charm

Fair Value (Return):	MYR0.40 (+18%)
IPO Price:	MYR0.34
Closing Application Date:	6 Oct 2020
Indicative Listing Date:	16 Oct 2020

- **Fair value of MYR0.40 based on 11x FY21F P/E.** Southern Cable is seeking to raise MYR71.2m via new shares issuance in order to fund its business expansion plans – entailing the construction of new production facilities, which will also house its product development endeavours. We see steady growth prospects for the company on the back of secular industrial demand growth, enhanced product portfolio as well as burgeoning export sales prospects at developing ASEAN markets.
- **Key supplier to power and telco operators, alongside other industrial sectors**. SCG is an established manufacturer and a supplier of cables and wires, primarily serving customers from the power and telco infrastructure space, in addition to other industries such as the construction and oil & gas sectors. Amongst its key customers are Tenaga Nasional (TNB MK, NEUTRAL, TP: MYR11.62) and Telekom Malaysia (T MK, BUY, TP: MYR4.90) with over 10 years of business relationships. While the bulk of its revenue was derived domestically, SCG is also looking to boost its exports sales going forward.
- **Past 3-year revenue CAGR of 11.7% outpaced industry growth rate.** This implies market share gains for SCG in recent years – alluding to its inherent competitive strengths in a mature domestic market and also the appeal of diversifying its product offerings. With that in mind, we are positive on its expansion plan entailing the commercialisation of new product offerings in FY21F as well as capacity addition in FY22F, which should help to sustain its growth trajectory in the medium term.
- **Stable growth for cables and wires driven by electrification trends.** We expect the company to record steady business growth in the mid-long term, underpinned by secular growth of electricity demand in Malaysia. This is also supplemented by the opportunities to tap into other industrial sectors alongside strong market potential seen in other emerging ASEAN nations such as Cambodia and Myanmar, which are undergoing rapid urbanisation in recent years. We project SCG to record sales and core earnings CAGR of 5.5% and 8.4% over FY19-22F.
- **Ascribed fair value of MY0.40.** This is pegged to 11x target P/E on FY21F EPS. We arrive at our target multiple after applying a 30% small-cap discount to the Bursa Industrial Production Index's 16x forward P/E while also benchmarking to comparable peers' P/E range of 9-13x. Key risks include unfavourable fluctuations in copper and aluminium raw material costs affecting profitability as well as macroeconomic uncertainties relating to its end-customers' businesses.

Analyst

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Company Description

Founded in 1993, Southern Cable Group is a manufacturer of cables and wires used for power distribution and transmission, communications, as well as control and instrumentation applications.

IPO Details

Public issue (%)	52.8
Share base	800.0m
Implied market cap	MYR272m

Major Shareholders

Sino	35.7%
Semangat	32.0%
Tung Siew Luan	1.6%

Utilisation of IPO Proceeds

Capital expenditure	MYR30.0m
Working capital	MYR27.5m
Repayment of borrowings	MYR9.2m
Estimated listing expenses	MYR4.5m
Total	**MYR71.2m**

Additional Info

Listing Market	ACE
Stock Code	0225

Forecasts and Valuation	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Total turnover (MYRm)	683	657	558	670	770
Recurring net profit (MYRm)	26	29	23	29	37
Recurring net profit growth	44.3	11.7	(20.8)	24.9	28.8
Recurring EPS (MYR)	0.03	0.04	0.03	0.04	0.05
Recurring P/E (x)	10.4	9.3	11.7	9.4	7.3
P/BV (x)	1.8	1.5	1.0	0.9	0.8
P/CF (x)	11.1	-	3.7	12.7	9.3
Dividend Yield (%)	-	-	1.2	1.5	2.1
EV/EBITDA (x)	8.1	7.2	7.3	5.3	3.9
ROAE (%)	19.5	18.1	10.6	10.5	12.3
Net debt to equity (%)	73.3	55.8	5.6	Net cash	Net cash

Source: Company data, RHB

Note:
Small cap stocks are defined as companies with a market capitalisation of less than USD1bn.

Financial Overview And Valuation

Earnings grew over two-fold within three years

Revenue CAGR of 11.7% from FY16-19. SCG's topline grew at a CAGR of 11.7% over the past three years, led by the increased contribution from its cable and wire (C&W) manufacturing segment as well as sales of related products and services (Others). The former represents its primary sales driver, accounting for c.90% of group revenue. Geographically, Malaysia has been its principal market (98% of FY19 revenue).

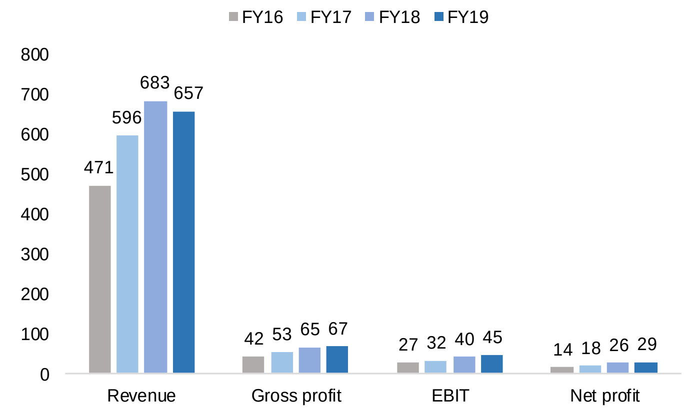
Product-wise, sales of power cables and wires accounted for the bulk of its business, representing 85% of FY19's C&W revenue (76% of group). This is followed by Control & Instrumentation's (C&I) and Communications' sales of cables and wires, which accounted for 10% and 5% of FY19 segmental sales.

Approximately 60% of its sales are generated via direct distribution – mainly to EPCC and other contractors as well as utilities companies – where some of its main customers include Tenaga, TM and Petronas. The rest are sold to third-party distributors, wholesalers, trading companies as well as other cable and wire manufacturers.

Raw materials constitute the largest cost component. As a percentage of COGS, raw materials used for manufacturing are by far the largest cost item as compared to factory overheads, labour expenses and other purchases. This mainly stems from its usage of copper and aluminium-based materials as key inputs, amounting to 75% of COGS in FY19. In turn, COGS accounts for c.90% of the company's revenue. On the other hand, operating expenses (administrative, selling and general expenses) remained relatively stable at MYR24-26m or c.4% of sales in FY17-19.

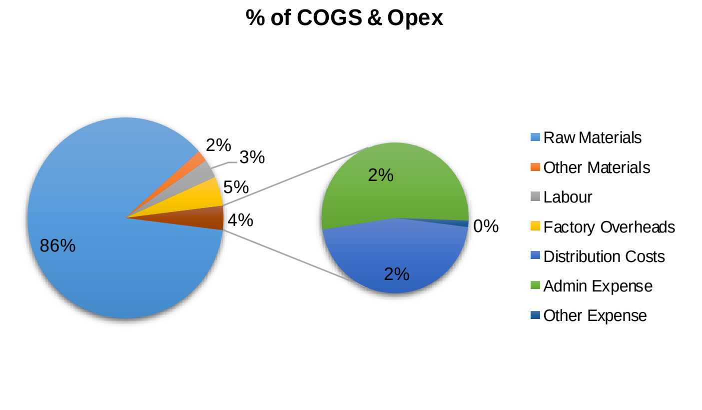
Margin expansion flowed through from the GP level. During FY17-19, SCG recorded successive improvement in GPM (8.8%, 9.6% and 10.2%) attributed to a combination of economies of scale and better raw materials cost pass-through, amongst other things. This subsequently flowed through to the EBIT level, whereby margin rose by 1.5ppts over the same period.

Figure 1: FY16-19 revenue and profitability growth



Source: Company data

Figure 2: Operating cost structure, FY19



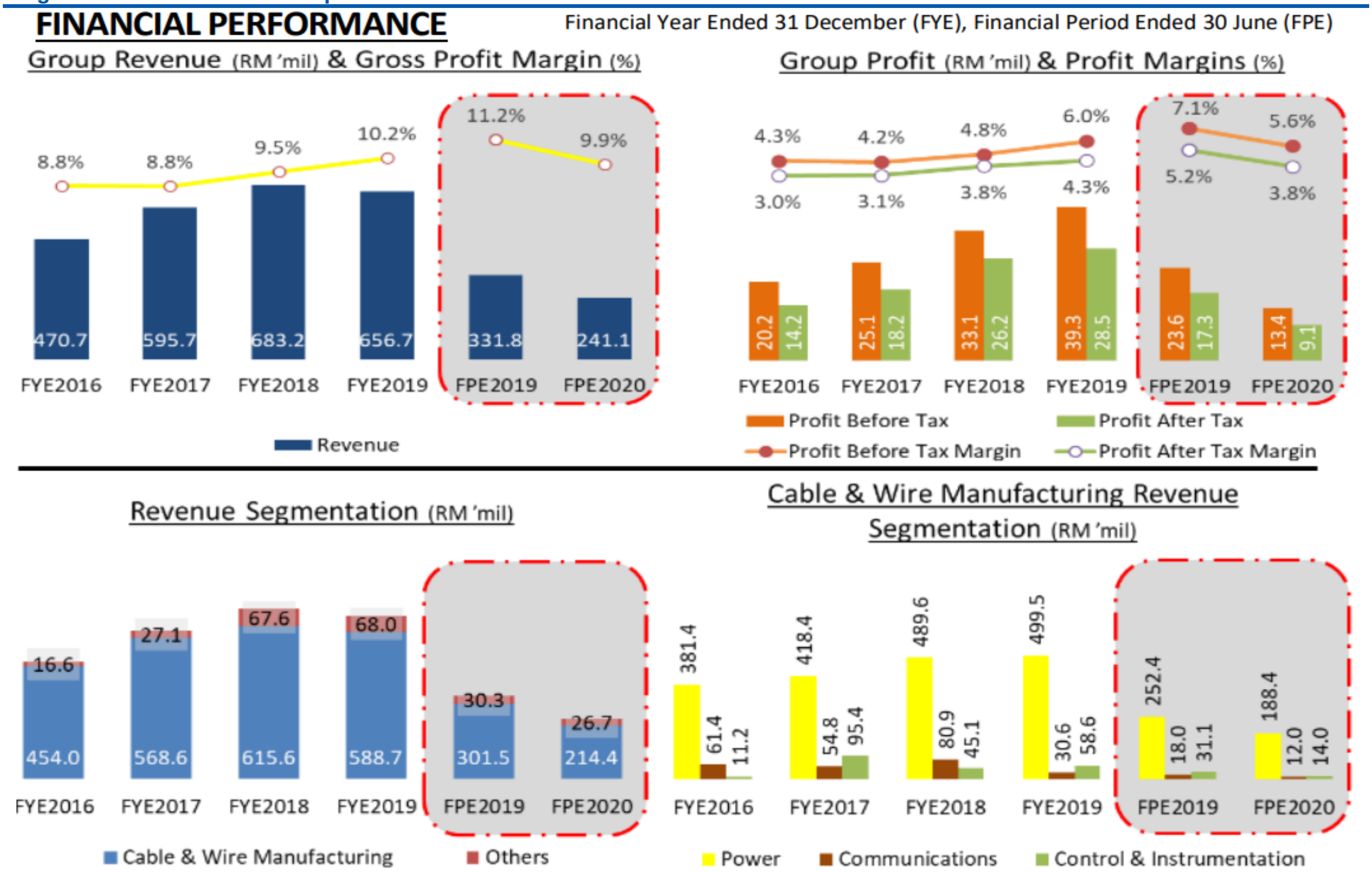
Source: Company data

Net profit more than doubled within three years. In line with revenue and margin expansion, SCG's net profit grew at a 3-year CAGR of 26.3% to MYR28.5m in FY19. Over the same period, net margin also steadily improved from 3.0% to 4.3%.

Healthier balance sheet. SCG's financial position correspondingly improved over the past three years, with its net gearing dropping to 0.56x as at end-2019 (end-2016: 1.01x) while maintaining a healthy liquidity position throughout the same period. Cash balance stood at MYR56.6m as at end-2019 relative to borrowings of MYR154.6m, where the bulk of its debt was tied to short-term bankers' acceptances supporting its working capital requirements.

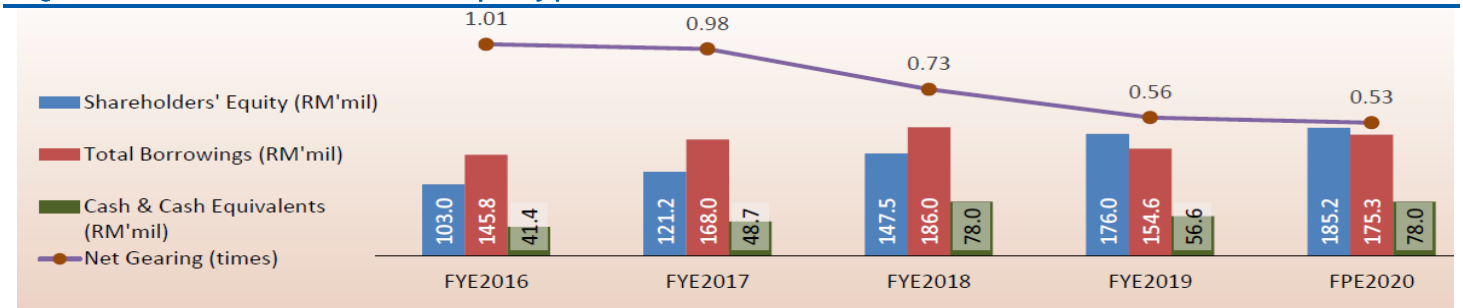
1H20 results review. For the six months ended 30 Jun 2020 (FPE2020), SCG's net profit declined 47% YoY to MYR9.1m, as its businesses were briefly impacted by the Movement Control Order (MCO). This was reflected in the 27% YoY decline in revenue, as its operations were temporarily suspended for 11 days while only partially operating for 31 days, while GPM declined 1.3ppts as a result of fixed costs, which were incurred even during the MCO. Given operations are back in full swing once again post-MCO, management is hopeful in delivering a stronger performance in 2H20.

Figure 3: Historical financial performance



Source: Company data

Figure 4: Historical balance sheet and liquidity position



	FYE2016	FYE2017	FYE2018	FYE2019	FPE2020
	RM 'mil	RM 'mil	RM 'mil	RM 'mil	RM 'mil
PPE	59.9	56.1	58.0	18.2	16.9
Right-of-use Assets	-	-	-	53.3	52.6
Current Assets	230.2	290.9	312.2	299.1	333.9
Current Liabilities	173.4	217.3	211.2	174.4	199.3
Non-Current Liabilities	20.0	15.6	17.3	20.7	19.5
Shareholders' Equity	103.0	121.2	147.5	176.0	185.2
Net Gearing Ratio (times)	1.01	0.98	0.73	0.56	0.53

Source: Company data

Projected core earnings CAGR of 8.4% over FY19-22F. Notwithstanding the estimated listing expenses alongside the MCO lull, we expect SCG to record steady business performance over the next three years. This is premised on the secular growth in demand for cables and wires from domestic industrial customers, whilst supported by the company's production facility expansion, which will also cater to its continued product portfolio development and exports sales potential at neighbouring ASEAN markets. Post-listing, SCG intends to set a dividend policy of at least 15% of group PAT going forward.

Valuation

Fair value of MYR0.40 based on 11x FY21F P/E. We arrive at our target multiple upon consideration of the peer comparison as well as a 30% small-cap discount applied to the Bursa Industrial Products & Services Index's 16x 2021F P/E. We believe our ascribed valuation is justified given the company's strong historical track record and positive earnings growth trajectory going forward.

Of the direct peers in Malaysia mentioned in the Independent Market Research (IMR) report, the sole direct-listed company is Sarawak Cable (SRCB MK, NR) which is in a loss-making position since 2017. Instead, we refer to SRCB's past acquisition of its cable manufacturing businesses in 2014 for a total consideration of MYR210m at 13.3x trailing P/E.

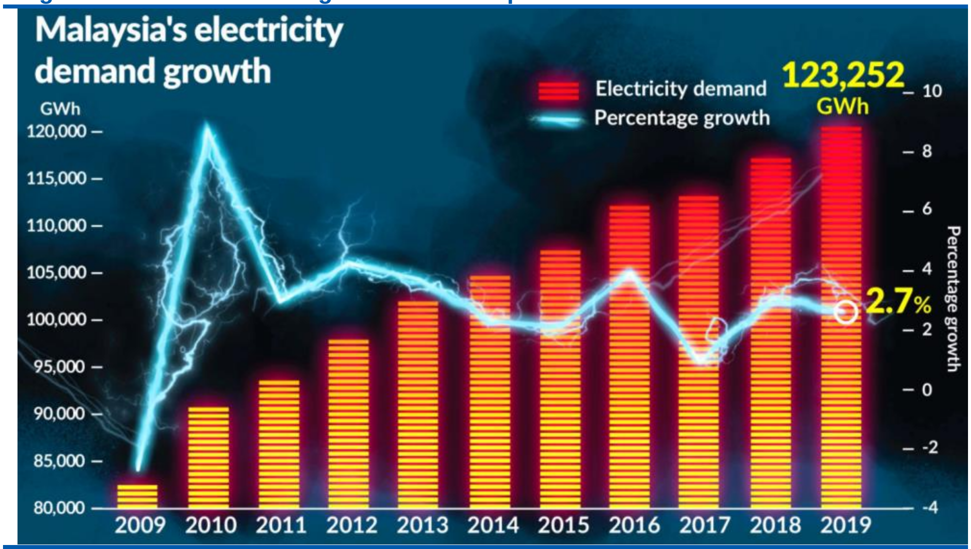
Based on the recent IPO listings, we earmark ACO Group (ACO MK, NR) as the closest comparable as a distributor of electrical products (including cables and wires). We estimate ACO's trailing P/E (ex-listing expenses) to be 9.3x based on its issue price of MYR0.28.

In relation to SCG's issued price of MYR0.34 per share at 9.5x FY19 P/E, this implies that the stock is listing at the lower-end given its trailing multiple is closer to that of ACO's – which is only a distributor – and could potentially command a higher multiple closer to the 13.3x P/E paid for SRCB's cable business acquisition.

Outlook

Power sector likely to remain as its base growth driver. According to the Energy Commission, electricity demand in Peninsular Malaysia is expected to consistently grow at a CAGR of 1.8% from 2020-2030, which should continue to underpin baseline growth for SCG's power cables and wires sales – which constitute over 75% of its revenue base – in tandem with more electrification projects undertaken.

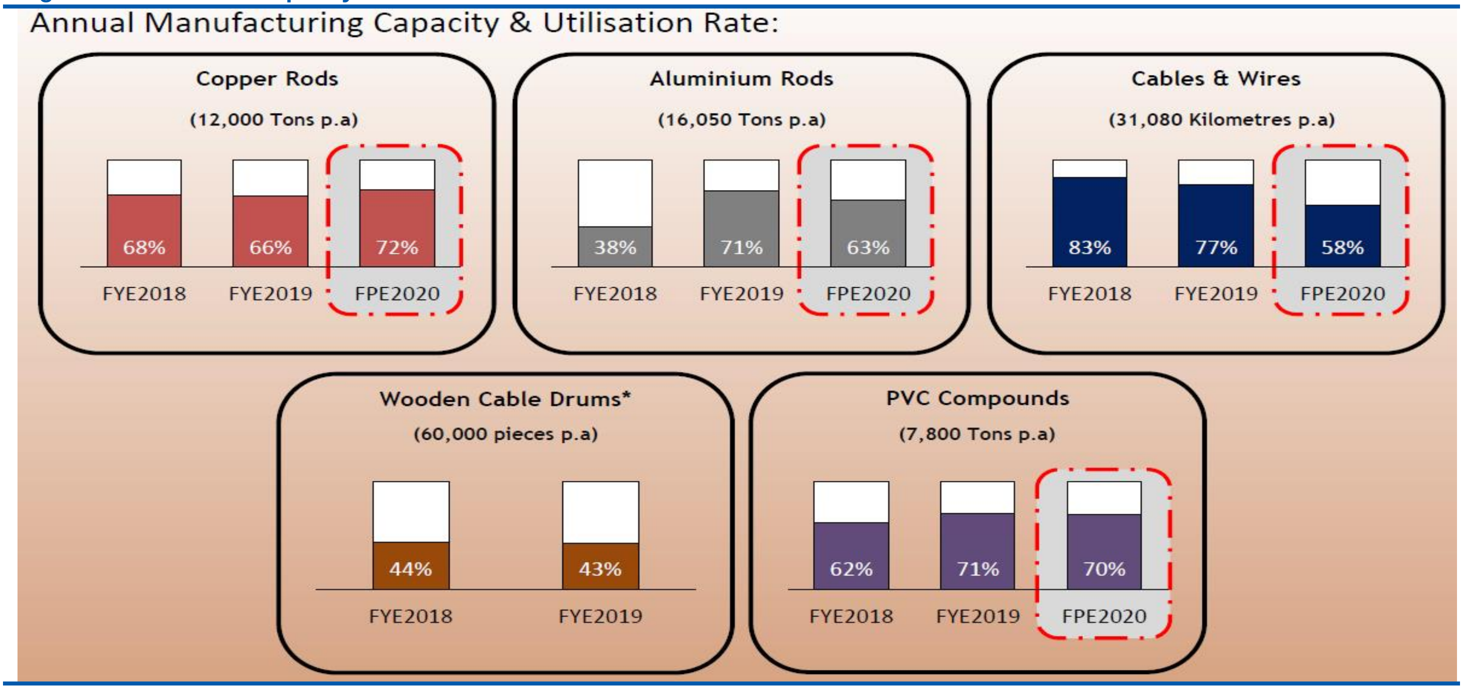
Figure 5: Secular demand growth from the power sector



Source: TheStar, TNB

To cater for future growth, SCG is planning to expand its C&W manufacturing capacity by constructing two new factories by 1H22, which are expected to provide an additional 6,350km of annual production capacity on top of the existing 31,080km annual output, in addition to the purchase of an adjacent vacant land for subsequent years' expansion. In the interim, another 2,700km-rated factory is ready to come online (pending manufacturing license) to fulfil the company's immediate-term production plans.

Figure 6: Production capacity



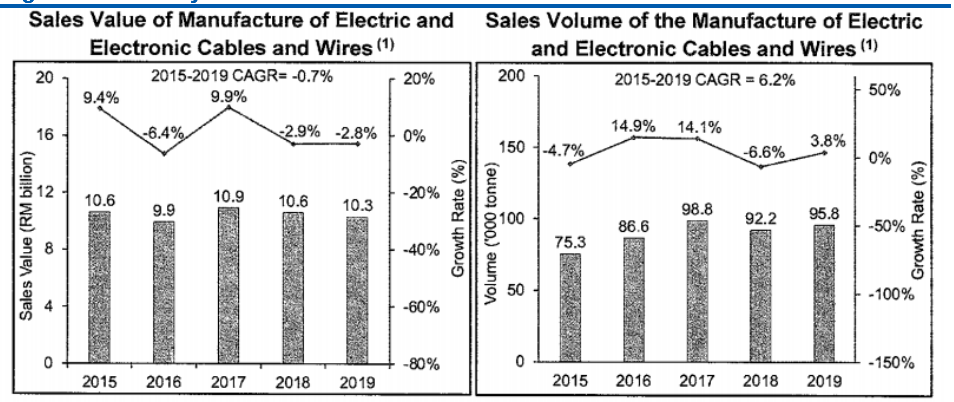
Source: Company data

MYR405m orderbook on hand. As at Sep 2020, SCG's orderbook stood at MYR405.4m, which is expected to be recognised up until 2022, which provides for some sales visibility amid current economic uncertainties. This mainly comprises of ongoing contracts with Tenaga and TM, with unbilled amounts of MYR289.6m and MYR41.9m for the supply of power and communications cables and wires as well as rectifiers.

Expansion of product range. Aside from the capacity expansion, management also intends to further develop its product portfolio to capture additional growth opportunities via cross-selling as well as catering to new potential customers. By 1H21F, management is targeting to commercialise a new range of high voltage thermal resistant aluminium conductor cables and industrial cables with synthetic rubber sheathing, aimed at serving the power sector. Subsequently, management also plans to commercialise cables and wires for application within the automotive and elevator sectors. For its own internal production needs, 2H22F should also see the production of new plastic compounds commence – currently outsourced from external parties.

We view this move positively; given the market expansion potential afforded by its development of new products, we believe SCG would be able to continue outpacing the industry's growth rate and garner a greater share of the domestic market – from its estimated 6% share of the MYR10.3bn market as at 2019. In addition, we believe a broader product portfolio would also serve to enhance SCG's appeal to its customer base, particularly its major clientele with various project-centric needs such as Tenaga, TM and Petronas.

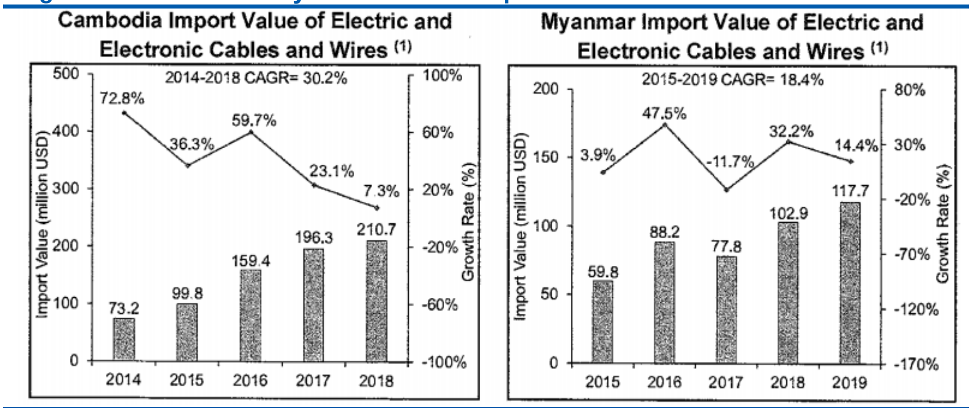
Figure 7: Industry historical sales trends



Source: Independent Market Research (Vital Consulting)

Cambodia and Myanmar may serve as lucrative export markets. With the additional 2,700km capacity set to kick in soon, SCG believes it would also have more leeway to tap into the exports front. In particular, developing countries Cambodia and Myanmar have been earmarked as promising markets for the company due to their fast-growing demand for cables and wires which are partially fulfilled via imports at present. We understand that SCG has one appointed distributor within each of the two countries, as well as Indonesia.

Figure 8: Cambodia & Myanmar's demand potential



Source: Independent Market Research (Vital Consulting)

Key risks

Highly dependent on the power industry. Given SCG's heavy business reliance on the power sector, any slowdown in capex and electrification projects may pose a significant challenge to the company's prospects. We understand that its major customer, Tenaga has been discussing with the Energy Commission to set 2021 as a gap year before it transitions to the next Regulatory Period 3 (RP3), due to the uncertainty with certain key variables underpinning its base tariff and capex planning.

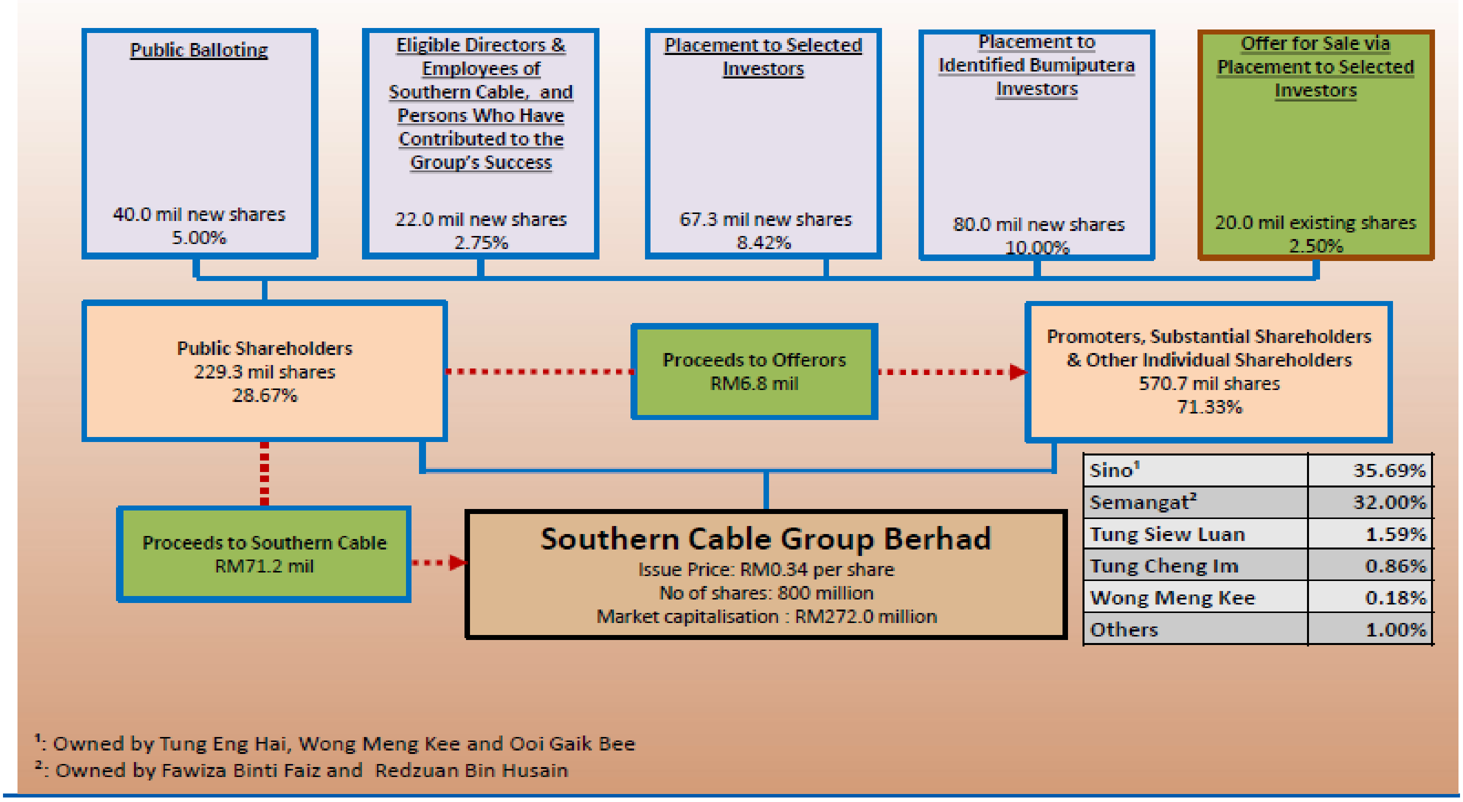
COVID-19 continues to pose operational and market risks. The aggravation of the pandemic may bring about supply chain disruptions and/or further suspension orders on its operations and adversely impact its financial performance owing to various considerations such as a fall in revenue, raw material cost pressures, and failure to deliver on contractual orders leading to liquidated and ascertained damages (LAD) penalties. Furthermore, the pandemic may have a lasting negative impact on its end-customers' industries, consequently leading to a drop in cable and wire demand and/or payment shortfall by the company's debtors.

Raw material cost and FX fluctuations may impact margins. As the primary cost component, the company is susceptible to unfavourable fluctuations in key raw material costs – with c.40% of purchases denominated in the USD – such as aluminium and copper, which may not be adequately passed on to its customers. Customers with contracted cost pass-through mechanism accounted for 25% of group revenue in FY19.

Competition and regulation. While the competitive landscape is partially ring-fenced by various certificates and approvals necessitated to qualify as a supplier of electrical products to the market alongside large customers such as Tenaga and TM – thereby acting as a barrier to entry – any failure by SCG to obtain renewals for its existing certifications may jeopardise its relationship with customers as well as future business opportunities.

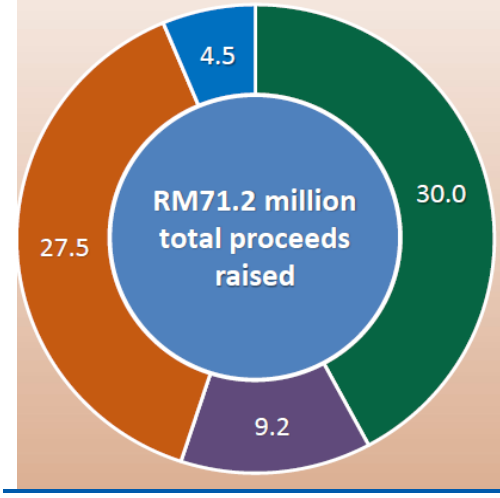
IPO Salient Details

Figure 9: IPO issue structure



Source: Company data

Figure 10: Use of the IPO proceeds



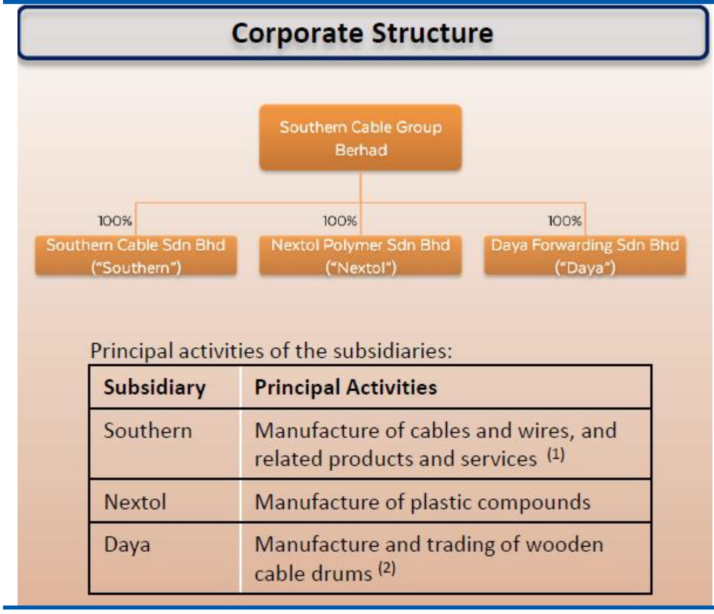
	Amount (RM 'mil)	Estimated Timeframe for Utilisation Upon Listing
Capital Expenditure & Expansion	30.0	Within 36 Months
Repayment of Bank Borrowings	9.2	Within 6 Months
Working Capital	27.5	Within 6 Months
Estimated Listing Expenses	4.5	Within 3 Months
Total	**71.2**	

Source: Company data

Company Overview

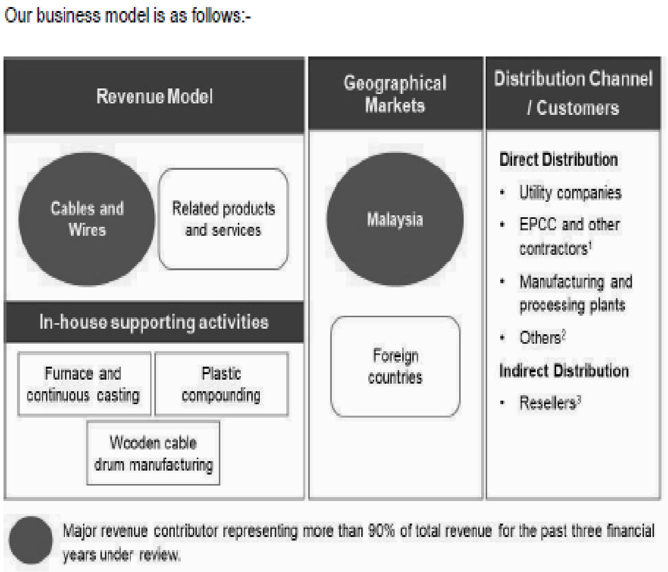
Southern Cable was founded in 1993, and incorporated in Malaysia on 4 Apr 2019. Its main business is focused on manufacturing of cables and wires utilised in power distribution, communications, as well as control and instrumentation applications. Other related products and services include in-house manufactured aluminium rods, plastic compounds and wooden cable drums; trading of cable and wires, and copper strips; and supply and installation of rectifiers. In addition, its key supporting activities are furnace and continuous casting, as well as plastic compounding. These in-house capabilities enable the company to have control over the quality and timing of the availability of key input materials, which reduces its dependency on external parties for the sourcing of key input materials in the manufacturing process.

Figure 11: Corporate structure



Source: Company

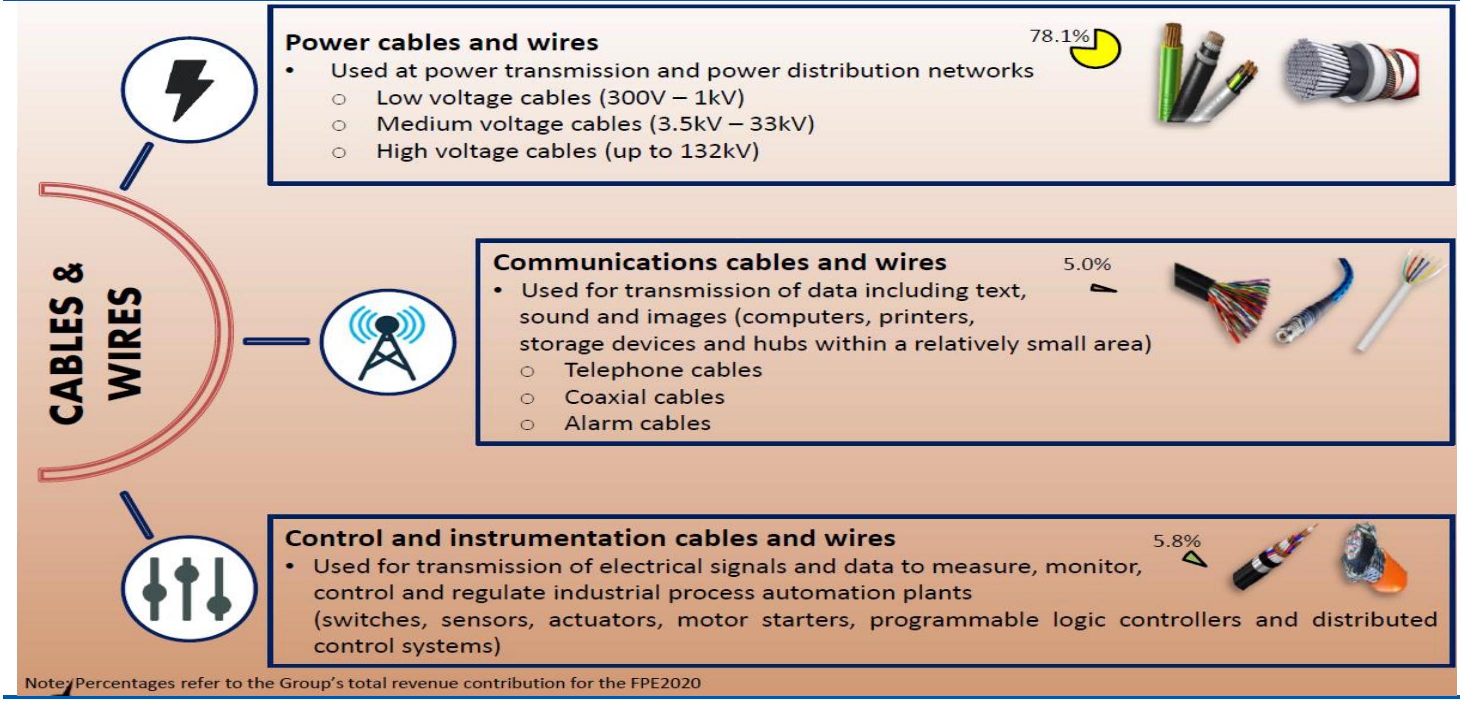
Figure 12: Business model



Source: Company

Operational track record. Southern Cable has an established track record of 27 years of experience in the manufacturing of cables and wires. The company's main market is in Malaysia, where it services various industry sectors such as power distribution and transmission, building and construction, infrastructure, manufacturing and processing industries including oil & gas processing and petrochemical plants, as well as oil and gas platforms and marine vessels. It is currently the registered supplier of cables and wires for major utilities and oil & gas companies such as Tenaga, Sabah Electricity SB, TM and Petronas. Southern Cable has formed long relationships with its top clients, which have been in business with it for a period ranging from seven to 20 years. Other notable projects include RAPID in Pengerang, Johor and MRT Sungai Buloh – Kajang (MRT1).

Figure 13: Cables & wires manufacturing segment



Source: Company

Strong management team. Southern Cable is led by an experienced management team. Its managing director at the helm, Tung Eng Hai, has over 40 years of experience in the cable and wire manufacturing industry. Its executive director, Wong Meng Kee meanwhile has 33 years of experience in business management. In addition, both its Group general manager and Plant Operations general manager, Ooi In Keong & Zen Azhar respectively have over 20 years of relevant experience in the cable and wire industry.

Figure 14: Key management

Tung Eng Hai	Wong Meng Kee	Ooi In Keong	Song Swee Kim	Zen Azhar
Managing Director	Executive Director	Group General Manager	Group Financial Controller	Plant Operations General Manager
• 41 years of experience in cable and wire industry • Responsible for overall performance of the Group	• 33 years of experience in business management • Responsible for overall business management and administration of the Group	• 21 years of experience in cable and wire industry • Responsible for overseeing the overall operations of the Group	• 27 years of experience in accounting and finance • Responsible for overseeing Group's financial matters	• 28 years of experience in cable and wire industry • Responsible for design and development of new cables to meet the requirements

Source: Company

RHB Guide to Investment Ratings

Buy:	Share price may exceed 10% over the next 12 months
Trading Buy:	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
Neutral:	Share price may fall within the range of +/- 10% over the next 12 months
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