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Steel & Tube Holdings
Rewards of Rationalisation

ROHAN KOREMAN-SMIT CFA
rohan.koreman-smit@forsythbarr.co.nz
+64 9 368 0085

ASHTON OLDS
ashton.olds@forsythbarr.co.nz
+64 9 368 0127

NEUTRAL

Steel & Tube (STU) has delivered a solid trading update for the first five months of FY21, with recent staff and site rationalisation leading to a better operating result, despite a slight decline in revenue. 1H21 normalised EBIT guidance of NZ$6.5m–7.5m compares to 1H20 normalised EBIT of NZ$5.7m (a +23% improvement at the mid-point). While the benefits of cost out initiatives are encouraging, optimism is tempered by the uncertain trajectory of non-residential construction activity. We remain NEUTRAL rated, but raise our target price to NZ$0.91 as we lift near-term earnings forecasts.

NZX Code	STU
Share price	NZ$0.84
Target price	NZ$0.91
Risk rating	High
Issued shares	163.1m
Market cap	NZ$137m
Avg daily turnover	116.3k (NZ$77k)

Financials: Jun/	20A	21E	22E	23E
NPAT* (NZ$m)	-7.8	6.7	7.4	7.8
EPS* (NZc)	-4.8	4.1	4.5	4.8
EPS growth* (%)	n/a	n/a	10.2	6.0
DPS (NZc)	2.0	4.0	4.0	4.0
Imputation (%)	100	100	100	100
*Based on normalised profits				

Valuation (x)	20A	21E	22E	23E
PE	n/a	20.5	18.6	17.5
EV/EBIT	n/a	15.4	14.6	14.4
EV/EBITDA	12.6	7.0	7.0	7.2
Price / NTA	0.8	0.8	0.7	0.7
Cash div yld (%)	2.4	4.8	4.8	4.8
Gross div yld (%)	3.3	6.6	6.6	6.6

What's changed?

- **Earnings:** EBIT lifted +46.4%/+4.0%/+4.0% in FY21/FY22/FY23
- **Target price:** Lifted +21cps to NZ$0.91

Cost base reduction flows to bottom line

STU has spent recent months right-sizing its cost base, involving a significant reduction in headcount, reducing the number of sites in its network, and divesting some of its property holdings. These actions have resulted in EBIT guidance ahead of last year, despite "slightly" lower revenues. STU will also benefit from below the line one-offs, having sub-leased an old site faster than it originally expected and selling its Gisborne site above book value. Underpinning a solid operating outcome was strong cash generation, with STU's cash balance standing at c.NZ$24m, up from NZ$7.4m at 30 June 2020. This was due to ongoing working capital discipline and includes proceeds from property sales. STU will seek further operational improvements from its ongoing digital investment.

Uncertainty lingers, but activity has surprised to date

While construction activity has been more resilient out of lockdown than most expected, the outlook remains highly uncertain, particularly in the non-residential and commercial sector, with many projects being deferred or cancelled. Additionally, the pipeline remains thin in these sectors, with non-residential consents (by sqm) down -23% on a rolling 12-month basis as at October 2020. While anecdotes suggest the steel market is behaving more rationally than it has in recent years, and STU has won some longer term contracts, we remain NEUTRAL rated given medium-term demand uncertainty coupled with STU's high operating leverage.

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Steel & Tube Holdings Limited (STU)

Priced as at 17 Dec 2020 (NZ$)	**0.84**

12-month target price (NZ$)*	**0.91**
Expected share price return	8.3%
Net dividend yield	4.8%
Estimated 12-month return	13.1%

Key WACC assumptions	
Risk free rate	1.30%
Equity beta	1.50
WACC	7.9%
Terminal growth	1.5%

Profit and Loss Account (NZ$m)	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Sales revenue	499.1	425.4	433.2	420.5	425.2
Normalised EBITDA	**23.6**	**15.0**	**31.2**	**30.5**	**29.9**
Depreciation and amortisation	(7.3)	(20.5)	(16.9)	(15.9)	(15.0)
Normalised EBIT	**16.3**	**(5.5)**	**14.3**	**14.7**	**14.9**
Net interest	(2.8)	(6.7)	(5.0)	(4.4)	(4.0)
Associate income	0	0	0	0	0
Tax	(3.6)	4.3	(2.6)	(2.9)	(3.0)
Minority interests	0	0	0	0	0
Normalised NPAT	**10.0**	**(7.8)**	**6.7**	**7.4**	**7.8**
Abnormals/other	0.5	(52.2)	0	0	0
Reported NPAT	**10.4**	**(60.0)**	**6.7**	**7.4**	**7.8**
Normalised EPS (cps)	6.5	(4.8)	4.1	4.5	4.8
DPS (cps)	5.0	2.0	4.0	4.0	4.0

Growth Rates	**2019A**	**2020A**	**2021A**	**2022A**	**2023A**
Revenue (%)	0.5	-14.8	1.8	-2.9	1.1
EBITDA (%)	n/a	-36.7	>100	-2.0	-2.1
EBIT (%)	n/a	n/a	n/a	2.8	1.4
Normalised NPAT (%)	11.2	n/a	n/a	10.2	6.0
Normalised EPS (%)	-36.7	n/a	n/a	10.2	6.0
Ordinary DPS (%)	-28.6	-60.0	100.0	0.0	0.0

Cash Flow (NZ$m)	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
EBITDA	**23.6**	**15.0**	**31.2**	**30.5**	**29.9**
Working capital change	(0.2)	31.5	(6.0)	3.9	(1.4)
Interest & tax paid	(4.9)	(7.9)	(12.7)	(11.9)	(11.3)
Other	(4.4)	(5.2)	0	0	0
Operating cash flow	**14.1**	**33.3**	**12.5**	**22.6**	**17.3**
Capital expenditure	(7.0)	(7.1)	(7.3)	(7.4)	(7.6)
(Acquisitions)/divestments	2.3	5.9	1.3	0	0
Other	0	(13.0)	(11.5)	(10.3)	(9.4)
Funding available/(required)	**9.4**	**19.1**	**(5.0)**	**4.9**	**0.3**
Dividends paid	(5.9)	(2.5)	(3.3)	(6.5)	(6.5)
Equity raised/(returned)	78.8	0	0	0	0
(Increase)/decrease in net debt	**82.3**	**16.6**	**(8.3)**	**(1.6)**	**(6.2)**

Balance Sheet (NZ$m)	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Working capital	163.6	135.8	141.8	137.7	139.1
Fixed assets	52.0	41.0	42.8	45.7	48.5
Intangibles	56.9	11.9	10.5	9.3	8.3
Right of use asset	0	87.1	78.4	70.6	63.6
Other assets	3.5	14.0	13.6	13.6	13.6
Total funds employed	**276.1**	**289.7**	**287.1**	**276.9**	**273.0**
Net debt/(cash)	15.0	(7.4)	(4.3)	(7.3)	(5.2)
Lease liability	0	95.1	81.2	73.3	66.1
Other liabilities	7.2	20.8	20.4	20.2	20.3
Shareholder's funds	253.9	181.3	191.2	192.1	193.4
Minority interests	0	0	0	0	0
Total funding sources	**276.1**	**289.7**	**288.6**	**278.4**	**274.5**

* Forsyth Barr target prices reflect valuation rolled forward at cost of equity less the next 12-months dividend

Spot valuations (NZ$)	
1. DCF	0.70
2. Sector peer relative	0.72
3. Market relative	1.32

DCF valuation summary (NZ$m)	
Total firm value	301
(Net debt)/cash	7
Less: Capitalised operating leases	(194)
Value of equity	114

Valuation Ratios	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
EV/EBITDA (x)	8.3	12.6	7.0	7.0	7.2
EV/EBIT (x)	12.0	n/a	15.4	14.6	14.4
PE (x)	12.9	n/a	20.5	18.6	17.5
Price/NTA (x)	0.7	0.8	0.8	0.7	0.7
Free cash flow yield (%)	5.2	19.1	3.8	11.1	7.1
Net dividend yield (%)	6.0	2.4	4.8	4.8	4.8
Gross dividend yield (%)	8.3	3.3	6.6	6.6	6.6

Capital Structure	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Interest cover EBIT (x)	5.8	n/a	2.9	3.3	3.7
Interest cover EBITDA (x)	8.4	2.2	6.3	6.9	7.4
Net debt/ND+E (%)	5.6	-4.3	-2.3	-3.9	-2.8
Net debt/EBITDA (x)	0.6	n/a	n/a	n/a	n/a

Key Ratios	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Return on assets (%)	5.0	-1.6	4.2	4.4	4.5
Return on equity (%)	3.9	-4.3	3.5	3.8	4.0
Return on funds employed (%)	4.1	-2.7	4.9	5.0	5.1
EBITDA margin (%)	4.7	3.5	7.2	7.3	7.0
EBIT margin (%)	3.3	-1.3	3.3	3.5	3.5
Capex to sales (%)	1.4	1.7	1.7	1.8	1.8
Capex to depreciation (%)	150	40	47	51	54
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	77	-42	97	88	83

Operating Performance	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Operating revenue	**498.1**	**417.9**	**431.4**	**418.7**	**423.4**
Cost of sales	387.1	333.8	336.5	326.6	330.2
Gross margin	**111.0**	**84.1**	**94.9**	**92.1**	**93.1**
Gross margin %	22.3%	20.1%	22.0%	22.0%	22.0%
Other revenue	1.0	7.4	1.8	1.8	1.9
Expenses					
Operating expenses	88.3	76.6	65.5	63.4	65.1
Depreciation and amortisation	7.3	20.5	16.9	15.9	15.0
Total expenses	**95.6**	**97.1**	**82.4**	**79.3**	**80.1**
EBIT	**16.3**	**(5.5)**	**14.3**	**14.7**	**14.9**
EBIT margin %	3.3%	-1.3%	3.3%	3.5%	3.5%
Expenses % of sales	**19.2%**	**23.2%**	**19.1%**	**18.9%**	**18.9%**

Earnings changes

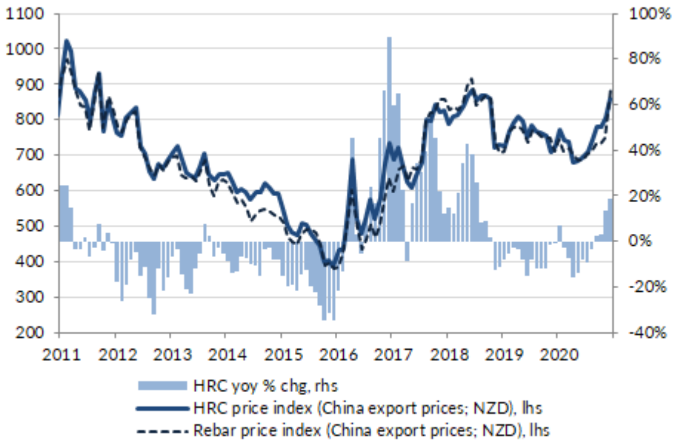
Figure 1. Earnings changes

NZ$m	FY21E			FY22E			FY23E		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
Revenue	433.2	433.2	0.0%	420.5	420.5	0.0%	425.2	425.2	0.0%
EBIT	9.7	14.3	46.4%	14.1	14.7	4.0%	14.3	14.9	4.0%
Adjusted NPAT	3.3	8.2	146.8%	6.7	7.4	9.5%	7.2	7.8	8.7%
Adjusted EPS (cps)	2.0	5.0	146.8%	4.1	4.5	9.5%	4.4	4.8	8.7%
Dividend (cps)	2.0	4.0	100.0%	3.0	4.0	33.3%	4.0	4.0	0.0%

Source: Forsyth Barr analysis

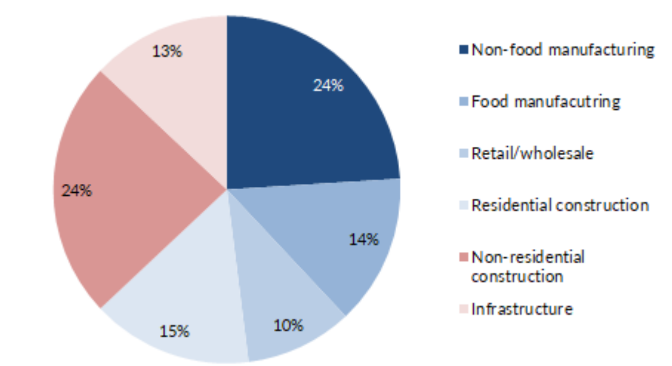
Charts of interest

Figure 2. Global steel prices



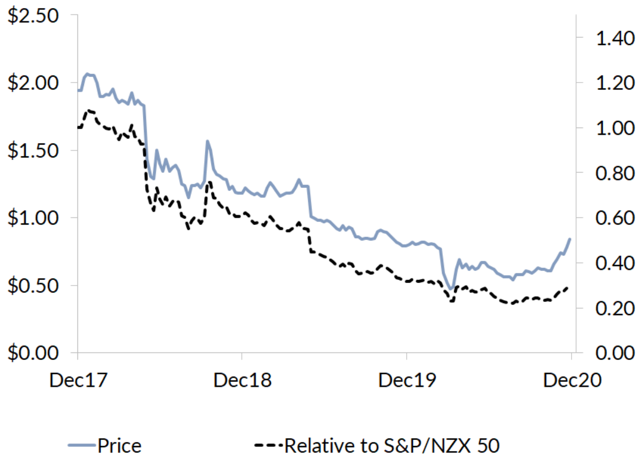
Source: Forsyth Barr analysis, Bloomberg

Figure 3. STU FY20 revenue exposure



Source: Forsyth Barr analysis, Company reports

Figure 4. Price performance



Source: Forsyth Barr analysis

Figure 5. Substantial shareholders

Shareholder	Latest Holding
New Zealand Steel Limited	15.8%

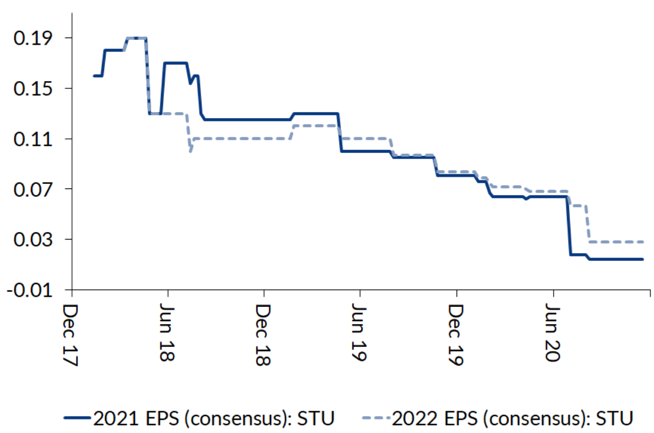
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 6. International valuation comparisons

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect STU's balance date - June)			(m)	2021E	2022E	2021E	2022E	2021E	2022E	2022E
Steel & Tube Holdings	**STU NZ**	**NZ$0.84**	**NZ$137**	**20.5x**	**18.6x**	**4.2x**	**4.2x**	**9.1x**	**8.8x**	**4.8%**
FLETCHER BUILDING *	FBU NZ	NZ$5.64	NZ$4,649	12.9x	15.0x	5.6x	5.9x	9.0x	9.7x	4.8%
METRO PERFORMANCE GLASS	MPG NZ	NZ$0.42	NZ$77	7.2x	8.7x	4.6x	5.3x	9.0x	10.7x	1.1%
ADBRI	ABC AT	A$3.33	A$2,172	21.8x	21.7x	10.7x	10.5x	17.6x	17.5x	3.6%
BORAL	BLD AT	A$4.78	A$5,859	24.8x	19.2x	9.6x	8.7x	20.8x	17.7x	3.2%
BLUESCOPE STEEL	BSL AT	A$16.85	A$8,489	12.8x	12.7x	5.3x	5.4x	7.6x	8.1x	0.9%
CSR	CSR AT	A$5.10	A$2,475	16.8x	18.2x	7.8x	8.2x	11.2x	12.0x	3.7%
WAGNERS HOLDING CO	WGN AT	A$1.89	A$353	n/a	31.9x	13.4x	12.2x	26.7x	22.7x	1.5%
GWA GROUP	GWA AT	A$3.36	A$888	21.7x	20.2x	13.9x	12.5x	17.4x	15.5x	3.8%
JAMES HARDIE INDUSTRIES-CDI	JHX AT	US$28.65	US$12,717	29.1x	25.3x	18.4x	16.6x	22.6x	20.3x	2.1%
REECE	REH AT	A$15.78	A$10,194	40.2x	37.1x	17.8x	17.1x	27.1x	25.6x	1.2%
SIMS	SGM AT	A$12.50	A$2,516	46.6x	22.1x	9.5x	7.4x	31.3x	16.2x	1.9%
			Compco Average:	**23.4x**	**21.1x**	**10.6x**	**10.0x**	**18.2x**	**16.0x**	**2.5%**
EV = Current Market Cap + Actual Net Debt			**STU Relative:**	**-13%**	**-12%**	**-61%**	**-57%**	**-50%**	**-45%**	**88%**

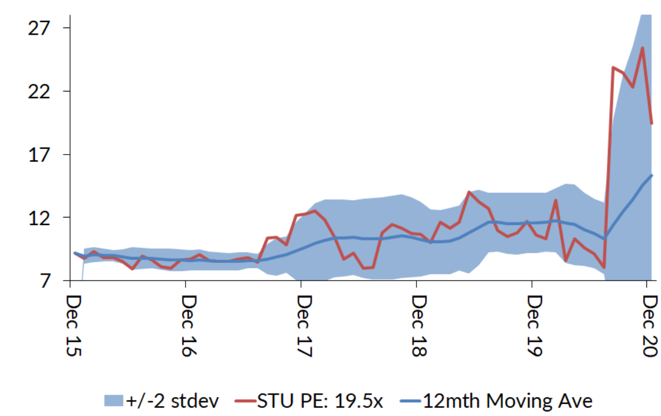
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (STU) companies fiscal year end

Figure 7. Consensus EPS momentum (NZ$)



Source: Forsyth Barr analysis

Figure 8. One year forward PE (x)



Source: Forsyth Barr analysis

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