

Steel & Tube Holdings

1H21 Result — Reinforcing the Foundations

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NEUTRAL

Steel & Tube's (STU) 1H21 EBIT of NZ\$7.6m was slightly above the top end of its guidance range supported by recent staff and site rationalisation and a strong December quarter. STU resumed distributions with a 1.2cps interim dividend largely supported by its healthy balance sheet which boasts NZ\$24m of cash (15cps). While the benefits of cost out initiatives are encouraging, our optimism is tempered by the uncertain trajectory of non-residential construction activity. We remain NEUTRAL rated, but raise our target price to NZ\$1.00 as we lift medium-term earnings forecasts, largely reflecting stronger-for-longer residential activity.

NZX Code	STU	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$0.99	NPAT* (NZ\$m)	-7.8	6.5	8.9	9.6	PE	n/a	24.8	18.1	16.8
Target price	NZ\$1.00	EPS* (NZc)	-4.8	4.0	5.5	5.9	EV/EBIT	n/a	15.7	13.1	12.8
Risk rating	High	EPS growth* (%)	n/a	n/a	36.4	8.1	EV/EBITDA	14.2	7.4	6.8	6.9
Issued shares	163.1m	DPS (NZc)	2.0	3.0	4.0	5.0	Price / NTA	1.0	0.9	0.9	0.9
Market cap	NZ\$161m	Imputation (%)	100	100	100	100	Cash div yld (%)	2.0	3.0	4.0	5.1
Avg daily turnover	123.8k (NZ\$87k)	*Based on normalised profits					Gross div yld (%)	2.8	4.2	5.6	7.0

What's changed?

- **Earnings:** FY21–23 EBIT +0.5%/+8.7%/10.2%
- **Target price:** +9cps to NZ\$1.00

Cost base reduction and property sales sees cash pile up

STU right-sized its cost base after the first lockdown, involving a significant reduction in headcount, reducing the number of sites in its network, and divesting some of its property holdings. These actions, as well as lower bad debt provisioning, resulted in EBIT ahead of last year, despite slightly lower revenues and a modest decline in gross margins. STU also benefitted 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 NZ\$24m, up from NZ\$7.4m at 30 June 2020. Cash is likely to increase further over the 2H21 despite restocking inventory at higher prices with the settlement of another property sale (NZ\$7m) in March.

Non-residential uncertainty lingers

With a greater weighting towards non-residential activity, STU's outlook is more uncertain than some of its residential focussed peers. Non-residential remains challenging with many projects being deferred or cancelled. Additionally, the pipeline remains thin in these sectors, with non-residential consents (by sqm) down -19% on a rolling 12-month basis as at December 2020. Government led infrastructure investment should provide some medium-term offset, but there will be a lag before projects commence. While anecdotes suggest the steel market is behaving more rationally than it has in recent years, rising steel prices will likely pressure margins if volumes decline and competitive intensity picks up. As such, despite STU's strong balance sheet, we remain NEUTRAL rated given medium-term demand uncertainty coupled with STU's high operating leverage.

Steel & Tube Holdings Limited (STU)

Priced as at 26 Feb 2021 (NZ\$)

0.99

12-month target price (NZ\$)*

1.00

Expected share price return

1.0%

Net dividend yield

3.7%

Estimated 12-month return

4.7%

Spot valuations (NZ\$)

1. DCF

0.78

2. Sector peer relative

0.77

3. Market relative

1.42

Key WACC assumptions

Risk free rate

2.30%

Equity beta

1.50

WACC

8.2%

Terminal growth

1.5%

DCF valuation summary (NZ\$m)

Total firm value

308

(Net debt)/cash

7

Less: Capitalised operating leases

(189)

Value of equity

127

Profit and Loss Account (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Sales revenue	499.1	425.4	436.0	430.6	436.4
Normalised EBITDA	23.6	15.0	31.0	31.0	30.6
Depreciation and amortisation	(7.3)	(20.5)	(16.4)	(14.9)	(14.1)
Normalised EBIT	16.3	(5.5)	14.6	16.1	16.5
Net interest	(2.8)	(6.7)	(4.7)	(3.7)	(3.2)
Associate income	0	0	0	0	0
Tax	(3.6)	4.3	(3.4)	(3.5)	(3.7)
Minority interests	0	0	0	0	0
Normalised NPAT	10.0	(7.8)	6.5	8.9	9.6
Abnormals/other	0.5	(52.2)	2.3	0	0
Reported NPAT	10.4	(60.0)	8.8	8.9	9.6
Normalised EPS (cps)	6.5	(4.8)	4.0	5.5	5.9
DPS (cps)	5.0	2.0	3.0	4.0	5.0

Growth Rates	2019A	2020A	2021A	2022A	2023A
Revenue (%)	0.5	-14.8	2.5	-1.2	1.3
EBITDA (%)	n/a	-36.7	>100	-0.1	-1.2
EBIT (%)	n/a	n/a	n/a	10.0	2.8
Normalised NPAT (%)	11.2	n/a	n/a	36.4	8.1
Normalised EPS (%)	-36.7	n/a	n/a	36.4	8.1
Ordinary DPS (%)	-28.6	-60.0	50.0	33.3	25.0

Cash Flow (NZ\$m)	2019A	2020A	2021E	2022E	2023E
EBITDA	23.6	15.0	31.0	31.0	30.6
Working capital change	(0.2)	31.5	10.8	1.4	(1.5)
Interest & tax paid	(4.9)	(7.9)	(13.3)	(11.8)	(11.0)
Other	(4.4)	(5.2)	0	0	0
Operating cash flow	14.1	33.3	28.5	20.7	18.2
Capital expenditure	(7.0)	(7.1)	(6.8)	(6.9)	(7.1)
(Acquisitions)/divestments	2.3	5.9	8.8	0	0
Other	0	(13.0)	(11.7)	(10.3)	(9.1)
Funding available/(required)	9.4	19.1	18.9	3.4	2.0
Dividends paid	(5.9)	(2.5)	(2.0)	(6.2)	(6.5)
Equity raised/(returned)	78.8	0	0	0	0
(Increase)/decrease in net debt	82.3	16.6	16.9	(2.7)	(4.6)

Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Working capital	163.6	135.8	125.1	123.6	125.1
Fixed assets	52.0	41.0	35.9	39.1	42.0
Intangibles	56.9	11.9	10.5	9.3	8.3
Right of use asset	0	87.1	76.5	68.9	62.0
Other assets	3.5	14.0	13.6	13.6	13.6
Total funds employed	276.1	289.7	261.6	254.4	251.1
Net debt/(cash)	15.0	(7.4)	(29.5)	(31.4)	(30.9)
Lease liability	0	95.1	79.0	71.1	64.0
Other liabilities	7.2	20.8	20.5	20.4	20.5
Shareholder's funds	253.9	181.3	191.6	194.4	197.5
Minority interests	0	0	0	0	0
Total funding sources	276.1	289.7	261.6	254.4	251.1

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

Valuation Ratios	2019A	2020A	2021E	2022E	2023E
EV/EBITDA (x)	9.4	14.2	7.4	6.8	6.9
EV/EBIT (x)	13.5	n/a	15.7	13.1	12.8
PE (x)	15.2	n/a	24.8	18.1	16.8
Price/NTA (x)	0.8	1.0	0.9	0.9	0.9
Free cash flow yield (%)	4.4	16.2	13.5	8.5	6.9
Net dividend yield (%)	5.1	2.0	3.0	4.0	5.1
Gross dividend yield (%)	7.0	2.8	4.2	5.6	7.0

Capital Structure	2019A	2020A	2021E	2022E	2023E
Interest cover EBIT (x)	5.8	n/a	3.1	4.3	5.2
Interest cover EBITDA (x)	8.4	2.2	6.7	8.4	9.7
Net debt/ND+E (%)	5.6	-4.3	-18.2	-19.3	-18.6
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	4.4	4.9	5.1
Return on equity (%)	3.9	-4.3	3.4	4.6	4.9
Return on funds employed (%)	4.1	-2.7	4.7	6.5	6.7
EBITDA margin (%)	4.7	3.5	7.1	7.2	7.0
EBIT margin (%)	3.3	-1.3	3.4	3.7	3.8
Capex to sales (%)	1.4	1.7	1.6	1.6	1.6
Capex to depreciation (%)	150	40	45	50	54
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	77	-42	75	73	85

Operating Performance	2019A	2020A	2021E	2022E	2023E
Operating revenue	498.1	417.9	434.3	428.8	434.5
Cost of sales	387.1	338.8	341.3	338.7	343.3
Gross margin	111.0	79.1	92.9	90.0	91.3
Gross margin %	22.3%	18.9%	21.4%	21.0%	21.0%

Other revenue	1.0	7.4	1.8	1.8	1.9
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Expenses	2019A	2020A	2021E	2022E	2023E
Operating expenses	88.3	71.6	63.7	60.9	62.5
Depreciation and amortisation	7.3	20.5	16.4	14.9	14.1
Total expenses	95.6	92.1	80.1	75.8	76.6

EBIT	16.3	(5.5)	14.6	16.1	16.5
EBIT margin %	3.3%	-1.3%	3.4%	3.7%	3.8%

Expenses % of sales	19.2%	22.0%	18.4%	17.7%	17.6%
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Result analysis and earnings changes

Figure 1. 1H21 result analysis

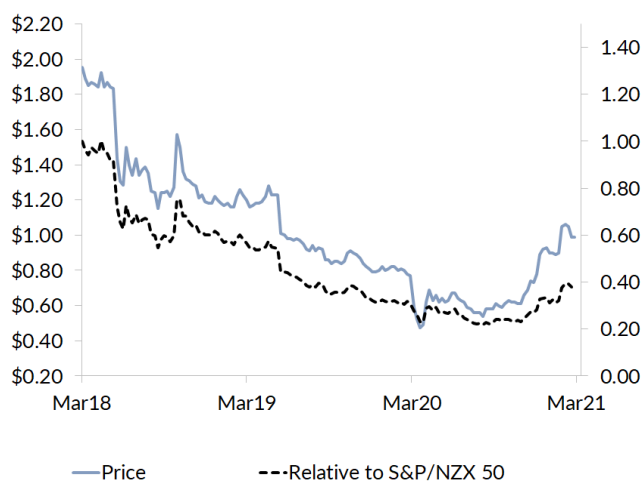
NZ\$m	1H20	1H21	% chg	Forbar	% diff
Revenue	232.2	226.5	-2.5%	220.0	3.0%
Cost of sales	(182.6)	(180.5)	-1.2%	(174.3)	3.5%
Gross margin	49.6	46.0	-7.2%	45.7	0.7%
Gross margin %	21.4%	20.3%	-4.9%	20.8%	-2.2%
Operating expenses	(33.7)	(29.2)	-13.3%	(32.5)	-10.1%
EBITDA	15.9	16.8	5.7%	15.9	5.7%
Depreciation & amortisation	(10.2)	(9.2)	-9.2%	(8.6)	nm
EBIT	5.7	7.6	32.1%	7.3	3.9%
Abnormal items	-39.1	1.3	nm	1.5	-14.1%
EBIT	(33.4)	8.9	-126.5%	8.8	0.9%
Interest	(3.5)	(3.0)	-14.2%	(2.5)	20.6%
Net profit before tax	(36.9)	5.8	-115.8%	6.3	-7.0%
Tax	(0.1)	(1.5)	1787.7%	(1.8)	-13.0%
Net profit after tax	(37.0)	4.3	-111.7%	4.5	-4.6%
Underlying NPAT	3.6	2.5	-31.1%	2.5	0.1%
Underlying EPS (cps)	2.2	1.5	-31.1%	1.5	0.1%
Dividend (cps)	2.0	1.2	-39.5%	2.0	-39.5%

Source: Forsyth Barr analysis

Figure 2. Earnings changes

NZ\$m	FY21E			FY22E			FY23E		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
Revenue	433.2	436.0	0.7%	420.5	430.6	2.4%	425.2	436.4	2.6%
EBIT	14.4	14.6	1.8%	14.8	16.1	8.7%	15.0	16.5	10.2%
Adjusted NPAT	6.5	6.5	0.9%	7.7	8.9	15.4%	8.2	9.6	17.6%
Adjusted EPS (cps)	4.0	4.0	0.9%	4.7	5.5	15.4%	5.0	5.9	17.6%
Dividend (cps)	3.0	3.0	0.0%	4.0	4.0	0.0%	4.0	5.0	25.0%

Source: Forsyth Barr analysis

Figure 3. Price performance


Source: Forsyth Barr analysis

Figure 4. Substantial shareholders

Shareholder	Latest Holding
New Zealand Steel Limited	15.8%

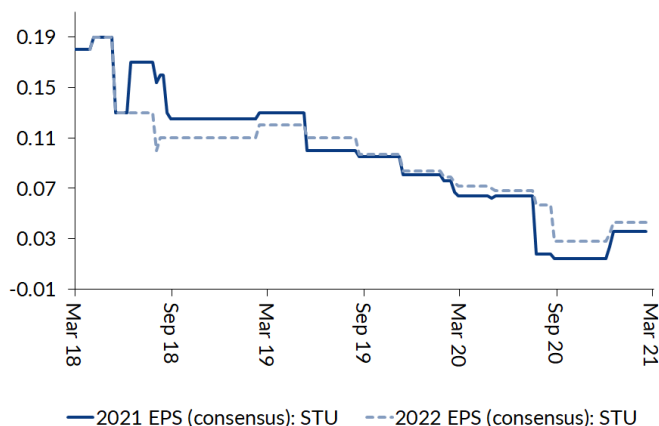
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 5. International valuation comparisons

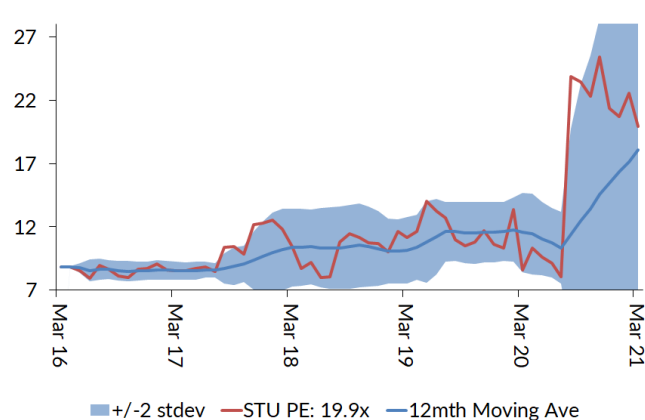
Company	Code	Price	Mkt Cap	PE	EV/EBITDA	EV/EBIT	Cash Yld
(metrics re-weighted to reflect STU's balance date - June)							
Steel & Tube Holdings	STU NZ	NZ\$0.99	NZ\$161	24.8x	18.1x	5.0x	4.0%
FLETCHER BUILDING *	FBU NZ	NZ\$6.51	NZ\$5,366	13.5x	13.8x	6.1x	5.2%
METRO PERFORMANCE GLASS	MPG NZ	NZ\$0.40	NZ\$74	7.4x	8.5x	4.7x	1.2%
ADBRI	ABC AT	A\$3.34	A\$2,179	21.4x	19.5x	10.5x	3.5%
BORAL	BLD AT	A\$5.24	A\$6,422	24.4x	19.9x	9.3x	2.9%
BLUESCOPE STEEL	BSL AT	A\$17.43	A\$8,781	9.8x	10.9x	6.4x	0.9%
CSR	CSR AT	A\$5.63	A\$2,733	17.9x	18.6x	8.7x	3.7%
WAGNERS HOLDING CO	WGN AT	A\$1.95	A\$365	n/a	25.7x	12.4x	1.7%
GWA GROUP	GWA AT	A\$3.12	A\$824	20.3x	17.0x	12.0x	4.3%
JAMES HARDIE INDUSTRIES-CDI	JHX AT	US\$29.68	US\$13,184	27.8x	23.7x	17.9x	2.5%
REECE	REH AT	A\$16.51	A\$10,665	41.2x	36.9x	18.7x	1.1%
SIMS	SGM AT	A\$13.77	A\$2,772	27.6x	19.3x	8.4x	2.3%
Compco Average:				21.1x	19.5x	10.3x	2.7%
STU Relative:				17%	-7%	-52%	52%

EV = Current Market Cap + Actual Net Debt

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

Figure 6. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 7. One year forward PE (x)


Source: Forsyth Barr analysis

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