



HUP SENG HUAT - RIDING HIGH ON ROBUST DEMAND

The Chinese believe in the theory that harmony breeds success and prosperity, and the name Hup Seng Huat is the epitome of this theory. Founded by three brothers, Mr Lim Boon Wan, Boon Kee and Boon Hong in the 1940s, the company is celebrating its 60th anniversary.

There are a number of reasons to celebrate: Firstly, there are not many successful companies that are still around after 60 years; it reported record profits in FY05; also, its share price movement is in a crescendo since early 2003.

BACKGROUND

Today, Hup Seng Huat has grown to become one of Asia's leading suppliers of steel products in the region, and the first industrial hardware company to be listed on the Mainboard of the Singapore Exchange (formerly Stock Exchange of Singapore) in 1994.

The Group supplies over 3,000 items of carbon

steel products. In addition to the wide range of pipes, fittings and flanges, it also expanded into the market for structured steel products with the acquisition of Hoe Seng Huat in January 2004. In 2005, it further widened its product range to include stainless steel products.

The principal activities of the group are the import and export, wholesaling and retailing of steel products to the oil and gas, petrochemical, marine engineering, construction and shipbuilding industries. The group's products are also used in the energy sector, such as power plants and fuel storage terminals.

Carrying on with the founding entrepreneurial spirits, the current management is transforming Hup Seng Huat from

its origin as a stockist, to be the preferred global total solutions provider for steel products and services. The group plays a critical bridging role between the manufacturers of steel products and end-users, providing a one-stop shop service to its customers.

SIZE AND NETWORK MATTER

Hup Seng Huat has successfully established itself as a major supplier to the region's oil majors and state-owned energy and leading shipyards. It has a long working relationship with customers like Shell, Unocal, Keppel Group, Sembawang Group, ASL Marine and Labroy Marine, and is recognized as a reliable supplier with competitive pricing and a comprehensive product range.

As one of the leading industry players with a substantial share of the carbon steel market, Hup Seng Huat's competitive strengths lie in its long history in the steel distribution business, the deep understanding and



knowledge of the steel industry, an extensive network of suppliers and customers, economies of scale and a broad product range. Given its size, it is able to secure bulk discounts from leading steel mills.

It also carries a wider range of products than the other market players. The ability to provide a one-stop shop for customers is a major advantage, as customers prefer to deal with a single supplier for procurement needs. Both are key factors that increase Hup Seng Huat's price competitiveness.

SOLID RESULTS ON BOOMING OFFSHORE & MARINE DEMAND

Hup Seng Huat reported a set of sterling results for FY05, underpinned by buoyant demand from the booming offshore and marine sectors. Organic growth from core business was up a strong 60% year-on-year. Overall FY05 performance was also lifted by the full-year contribution of Hoe Seng Huat.

For the 11 months that ended in Jun-05 (financial year end changed from July to June), the group reported a robust 85% increase in revenue to \$197.82m. Revenue for 4Q05 (\$42.82m), which consisted of only two

months of operations due to the change in financial year, was still 6% higher than the full three months in 4Q04 (\$40.56m).

Gross profit increased by 38% to S\$46.13m in FY05, underpinned largely by higher turnover of the enlarged group. Although revenue from structural steel products accounted about 50% of FY05 revenue, its profit margins are usually lower than those of Hup Seng Huat's traditional pipes & fitting business. As a result, FY05 gross profit margins for the enlarged group moderated to about 23.3%, from 31.3% in FY04 due to the change in revenue mix and higher inventory carrying costs.

Higher expenses for the enlarged group were offset by cost reduction from streamlining of operations in 2HFY05. As a result, FY05 net profit was up a strong 57% to S\$21.61m.

Hup Seng Huat's share price has risen in recent months, reflecting investors' endorsement of the group's good performance.

TO BENEFIT FROM RESURGENCE IN CONSTRUCTION/INFRASTRUCTURE DEMAND

The run-up in the share prices

of local-listed marine players can be attributable to the strong order book for new ships and rigs, which are expected to keep the yards busy till 2008. Busy yards mean more business for Hup Seng Huat. The yards' strong order book is also expected to increase demand and earnings visibility for Hup Seng Huat.

The acquisition of Hoe Seng Huat is also well-timed. Demand from the construction sector is expected to pick up. In addition to projects like the circle line and Terminal 3, the Singapore government has announced mega projects such as the Business Financial Centre, Marina Dam and the Integrated Resort. These could provide good growth opportunities for the group through Hoe Seng Huat, which has a strong network for the supply of structured steel products to the construction sector.

NEW GROWTH DRIVERS - OVERSEAS MARKETS AND NEW PRODUCTS

Underlying demand is very firm. The group is expanding beyond its traditional stronghold in the carbon steel market, and started offering stainless steel

S\$('000)	4Q05	4Q04	Change (%)	FY05	FY04	Change (%)
Revenue	42,819	40,563	6	197,819	106,984	85
Gross Profit	9,753	14,370	-32	46,133	33,539	38
Net Profit	4,505	5,696	-21	21,608	13,806	57
GPM (%)	22.3	35.4	-37	23.3	31.3	-34.3
NPM (%)	10.5	14	-25	10.9	12.9	-15.5
Financial highlights						



	Hup Seng Huat	Sin Soon Huat	HG Metal	Asia Enterprise
PE Ratio	6.2X	13.3X	4.4X	6.2X
Price/Book	1.16X	1.96X	1.35X	1.28X
NPM	10.9%	11.4%	9.5%	14.6%
ROE	18.7%	13.6%	35.2%	27.8%
Share Price	\$0.44	\$0.23	\$0.43	\$0.27

Peer comparison

products. It is also looking into supplying higher quality materials in response to changing market requirements.

The group is also extending its sales network to capitalize on the booming demand in regional countries like Indonesia and Malaysia. It also looks to supplying to new markets in Indochina and the Middle East, where demand is rising.

Furthermore, it is moving into value-added services like sand-blasting, an anti-rust measure, to the shipyard operators, who are looking to outsource this function to third party players due to their hectic schedule. Moving up the value chain will help Hup Seng Huat to stay ahead of the competition.

PRICES STABILIZED ON IMPROVED SUPPLIES

2004-2005 has seen sharp spike in steel prices due to short supplies. This has also led to customers stocking up in anticipation of price hikes. The supply situation has improved in recent months, prompting some customers to run down on their excess inventory. As a result, prices for commodity steel products such as steel rods and plates have softened in recent months.

However, prices for specialized parts such as pipes, fittings and flanges, have remained fairly stable.

A report by Morgan Stanley in the United States, if true, should help to raise steel prices even further.

In the report, it said that the steel market has bottomed-out and prices are primed for a rise. It added that industry discipline has helped to work off excessive inventory and production is likely to rise again in the fourth quarter of this calendar year.

PEER COMPARISON

The listed comparable of Hup Seng Huat are Asia Enterprise, HG Metal and Sin Soon Huat. Asia Enterprise and HG Metal deal mainly with structural steel such as steel sheets while Sin Soon Huat is mainly in the pipes and fittings business. On the other hand, Hup Seng Huat is able to offer both categories of products and to a wider customer base.

Priced at 6.2X FY05 earnings, Hup Seng Huat is cheaper than Sin Soon Huat, which trades at the same PE as Asia Enterprise, but more expensive than HG Metal. It is more diversified in the segmental mix and, thus, should

command a premium according to the market's valuation of a market leader.

It is the cheapest on the price-to-book basis but yields a lower margin due to a more diversified product mix across several industries.

Its share price has climbed from \$0.20 a year ago to around \$0.45 lately, reflecting the confidence in the group's strong financial results and business model. However, the group may find it hard to match the growth that it experienced in FY05. It is likely that 1H06 would be weaker due to a softening in demand from customers, who have already bought ahead of their requirements and are running down their excess inventories. However, as the yards continue to secure orders for new ships and/or rigs, they would soon need to start ordering as inventories get depleted.

Still, Hup Seng Huat is in a strong position to ride on the next upturn when steel prices turn up, and is poised to benefit from its effort to penetrate new markets and as well as to actively participate in the proposed infrastructure projects when they kick off.

— Gabriel Gan