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Strength in diversity of low-key company's business profile recognised

by *Leu Siew Ying*

Boustead Singapore, which calls itself an infrastructure-related engineering company, appears to be finally winning acceptance for its diverse business interests. And, its shares, which have risen 48% over the past year, might have much further to climb.

Last week, Kim Eng became the second major research house to initiate coverage on the company in three months. In a report on Jan 3, its analyst Yeak Chee Keong recommended a "buy" on the stock with a price target of $1.39, which implies a 26% upside. Boustead has interests in the energy, water and real-estate sectors, and its shares currently trade at 10.7 times forward earnings. That compares with 7.6 times for energy-related companies, 13.6 times for water players and 14.9 times for industrial real-estate companies.

"At first glance, Boustead's businesses appear difficult to understand and the stock tends to be overlooked by investors who often fail to appreciate the diversity," Yeak says. "Indeed, it is hard to draw associations and find synergies among diversified streams of businesses, which range from direct-fired boilers and water treatment to industrial real estate and mapping software," he says, referring to Boustead's key business divisions.

In Yeak's view, Boustead's businesses are "diversified but not unrelated". For instance, oil refineries that require heaters from its subsidiary Boustead International Heaters could also become customers for water and wastewater treatment plants supplied by Boustead Salcon. That gives the Boustead group an edge across its seemingly diverse range of businesses. At the same time, the diversity of its businesses could well be a key reason behind Boustead's "amazing" resilience and growth amid the 2008-09 global financial crisis.

Boustead has, in fact, been quietly delivering record profits from FY2003 to FY2009 with sustained double-digit growth rates. That, Yeak says, affirms its management's execution skills and focus on high-value processes while outsourcing the low-value ones. "We expect FY2011 to be another record-breaking year, driven by the strong order book momentum from previous years."

Mixing oil, water and real estate

Now, Yeak sees Boustead benefiting from a new round of capital investment in the oil and energy sector following the mothballing of expenditure in 2009 when oil prices fell. Oil prices have just breached US$90 a barrel, well above the US$40 to US$70 level said to be the breakeven level for most oil exploration and production investments. And, there is a need for further investment in infrastructure to support rising demand for energy, Yeak says. Meanwhile, Boustead is tilting its investments towards Asia, which could see it benefit from the shift in distillation projects to Asia-Pacific and the Middle East, he adds.

Boustead's chairman and CEO Wong Fong Fui had told *The Edge Singapore* that he is refocusing the company's global business and has since expanded Boustead International Heaters' operations in Malaysia. In fact, Wong announced last week that the energy-related engineering division secured contracts totalling $16 million at end-2010 from refineries in Iraq, Malaysia and Saudi Arabia. "We are delighted to have been awarded contracts from new clients, as well as a repeat client at major energy developments in the Middle East and Southeast Asia," he says. "This is a pleasing way to usher in 2011 and as long as global crude oil prices remain around current levels, we expect good progress with negotiations for small to mid-sized contracts to continue throughout the year."

Yeak also sees opportunities in the water sector. The group's Boustead Salcon unit was struggling with unprofitable projects, but it has since turned around. "We see continued profitability, with the advent of higher-quality projects and expect Boustead to take the business up one notch," Yeak says. Boustead Salcon is the only Asian water and waste water engineering specialist outside Japan that is pre-qualified by many of the world's largest engineering corporations. As such, it competes in a different league from its Singapore counterparts.

Boustead recently proposed to spend as much as $42 million to acquire a 20% stake in Bio-Treat Technology, a once troubled water company. But the deal fell through and Boustead ended up investing just $4 million in the company. Still, officials at Boustead say the investment is a reflection of the group's readiness to expand in the water sector in collaboration with Bio-Treat. "What we are putting in might be small but it is also a signal to have an informal cooperation with them," says Keith Chu, Boustead's vice-president for corporate marketing and investor relations. "We have expertise they could tap on if they want to expand into industrial waste water treatment. We are not building a big presence in China, but we are keeping the door open." Boustead is waiting for an impending consolidation in China's water sector to take care of smaller and uncompetitive players before entering in a bigger way. "If we pump in $42 million, with the uncertainty of the China market, that is too big an investment. This $4 million suits us," Chu says.

Things are more subdued at Boustead's Real Estate Solutions division, though. While Boustead says it is getting enquiries, the size of its projects are smaller at $15 million to $20 million compared with $50 million to $60 million before the financial crisis. Yeak is confident, however, that the sector will return to healthy growth, buoyed by the recovery in the manufacturing sector. "Order flow will catch up in the mid to long term. The change in strategy to secure more recurring income by leasing out its properties rather than selling them will help enhance earnings stability," he says.

Boustead recently proposed to invest some $150 million in TT International's warehouse complex in Jurong, but the deal was eventually aborted. Boustead's current portfolio consists of six properties, including two under construction, with a gross floor area of 63,352 sq m. Once the remaining two properties are completed, the portfolio could contribute a recurring income of $6 million to $7 million to its bottom line, according to Yeak.

Capacity for acquisitions

Boustead has an enviable cash pile of $183.9 million. With plans to invest in Bio-Treat and TT International's warehouse project having fallen through, the company can easily take on other investments to fuel its growth. But Boustead is likely to take its time to evaluate any prospects that come along, Yeak says. "They are conservative and won't be aggressive in buying things that they are not confident of."

That being the case, Boustead might face pressure to declare a special dividend to return some of the cash to shareholders if it cannot find a suitable investment. Whatever the case, it seems that investors have little to worry about, says Yeak. "Its balance sheet and cash flow are very strong. There is very little downside to the share price."

Not everyone is positive on Boustead, though. Tan Ai Teng, an analyst at DBS Vickers, who has covered the company since 2007, downgraded her recommendation to "hold" in a Dec 12 research note. She also revised her price target to $1 from $1.10. According to Tan, there could be further delays in Boustead's township joint venture in Libya. Boustead is currently renegotiating the terms of its Libyan projects. Tan also cut her FY2011 (the company has a March 30 year-end) earnings forecast by 14% to $200 million on lowered assumptions for contract wins. "We expect share price to be range-bound in view of muted growth and a lacklustre outlook," she says.

Boustead has recognised $40 million in revenue and no profits from Libya so far. Yeak is assuming that the group will recognise revenue of $200 million over the next three years from its Libyan projects but that is still only a breakeven figure. However, as long as it doesn't eventually lose any money, it is unlikely to affect Yeak's forward forecasts.

Yeak sees Boustead reporting a 49% rise in earnings to $64.3 million for FY2011, and a drop of 21.6% in FY2012 to $50.4 million. The decline in earnings does not mean a slowdown, he says. It reflects the lumpiness of revenue owing to the project-based nature of its business. The substantial difference in FY2010 and FY2011 revenue is also the result of a delayed recognition of a project that spilled over to 1QFY2011.

Besides Kim Eng, the other research house that has begun coverage of Boustead is Standard Chartered Bank. It is forecasting a 45% rise in earnings to $62.6 million in FY2011, and a further increase of 6% in FY2012 to $66.4 million. It is recommending an "outperform" on the stock, with a price target of $1.39.

If Boustead delivers or exceeds those forecasts, it might continue winning a broader following among analysts and investors.