



## Southern Cable Group Bhd Proxy to Solar and 5G adoption

Trading Buy

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|---|
| • Proxy to energy and solar adoption                                |
| • Capitalising on 5G rollout with new data and power cable products |
| • Expansion plans to increase production capacity                   |
| • Potential Fair Value of RM0.59/share                              |

### What is the view?

**Proxy to energy and solar adoption.** With the award of LSS 4, we expect Southern Cable to be a key beneficiary of higher demand for power cables. We anticipate the company to be uniquely poised to continue supplying such power cables that form the bulk of its FY17-20 revenue, at 70-82%. Southern Cable has existing contracts with many of the companies involved in LSS4 such as Tenaga (TNB) and Solarvest.

**Capitalising on 5G rollout.** The Malaysian government is fast tracking 5G deployments in the country through a "special purpose vehicle" (SPV) that will receive 5G spectra, as well as build, operate and lease 5G infrastructure to new and existing telcos by the end of 2021. Besides its existing 3-year contract with Telekom that has an unbilled amount of RM42m, it is in the midst of upgrading its existing facility to convert telephone cables production to data cables, which will allow it to secure contracts for 5G infrastructure in the near future. It is also set to apply for UL certification in 1H22.

**Expansion plans to increase production capacity.** The group has plans to expand its business in 2H21, with the target to increase its annual production capacity by 20% to approximately 37,400km. Construction is segmented into two phases, with phase 1 (Lot 38) targeted to end in 1H22 and phase 2 (Lot 29) to end in 2H22.

### What is the fair value?

**We value Southern Cable at RM0.59/share.** This is based on a PE-to-Growth of 1x FY20-22 CAGR of 18%. We are projecting FY21F PAT of RM28m and FY22F PAT of RM30m. This is on the back of revenue of FY21F revenue of RM640m and FY22F revenue of RM660m. Our assumptions are current outstanding orders of c.RM400m and incremental new orders of RM400m and RM550m for FY21F and FY22F, respectively, with an order recognition of 80-90% per year. We assume net margins to be stable at 4-5% but could trend higher on the back of the cost-saving measures, i.e. rooftop solar PV system lowering utility bills, and venturing into higher-margin products.

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### Beneficiary of increased solar and 5G adoption

**Power cable specialist.** Founded in 1993, Southern Cable Sdn Bhd principally manufactures power cables and wires that are used for power distribution and transmission, communications and control and instrumentation applications. The group's key supporting activities for cable and wire manufacturing are the production of copper and aluminium based wires, plastic compounds and casting operations.

**Expanding production capacity.** The group has factories in Kuala Ketil and Sungai Petani, Kedah that have an annual production capacity of 26,400 tons of aluminium and copper rods, 31,080km of cables and wires, 7,800 tons of polyvinyl chloride (PVC) compounds and 60,000 pieces of wooden cable drums. The group is in the midst of expanding its existing production capacity, with plans for a 20% increase to approximately 37,400 tons per annum.

**The Group is constructing a new plastic compounding factory** to increase its production capacity by 54% to approx. 12,000 tons. This will focus on the group's new range of plastic compounds and is slated for completion in 2H22. New product developments and certifications will allow it to penetrate into new market segments in Malaysia and overseas, as early as 1H22. These include automotive wires, elevator cables and aluminium conductors. New certifications such as PVC Copper LV Power Cable and XLPE Insulated Sheathed cables are targeted for overseas markets such as Singapore, Myanmar and Cambodia.

**Established customer base.** The group's cables and wires are used in numerous industry sectors including power distribution and transmission, telecommunications, building and construction, infrastructure, manufacturing and processing industries, including oil and gas processing and petrochemical plants. As such, it is a registered supplier of cables and wires with Tenaga Nasional Berhad, Sabah Electricity Sdn Bhd, Telekom Malaysia Bhd Berhad and PETRONAS. Its notable projects include RAPID in Pengerang, Johor and MRT Sungai Buloh – Kajang (MRT1).

**To benefit from new product certifications.** We expect Southern Cable to benefit from new product certifications, such as the Solar Photovoltaic DC Cable, which it can add to its existing supply of AC low voltage and medium voltage power cables used by EPCC contractors for solar PV projects. Southern Cable has established relationships with existing solar players such as Solarvest, Cypark and Samaiden, having recently secured a contract with Solarvest for a rooftop solar PV system last December. It currently has a total unbilled contract with TNB of RM290m. Notably, profit margins for power cables for the group are above average at 10% for FY20.

**Lower revenue due to MCO disruptions.** For FY20, group revenue decreased 14.3% y-o-y, due to dampened delivery fulfilment in 1H20. Local revenue decreased 18.7% y-o-y, as operations were halted for 11 days in March 2020, resulting in distribution channel disruption. After the MCO was lifted, its 2H20 operations normalised and this paved the way for a recovery that contributed to its resilient FY20 performance, coupled with sustainable demand from utilities customers. On the overseas front, revenue increased 207.8% y-o-y from higher sales of power cables, and wires to Myanmar, Cambodia and the Philippines. In terms of segmental revenue, power cables and wires contributed 70-82% for FY17-20, telecommunications cables 4-12% and control and instrumentation 5-12% and related product and services 5-10%.

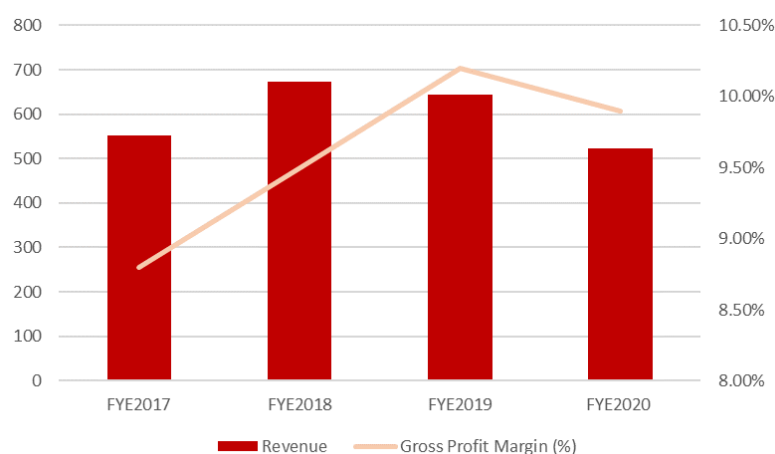
**Lower PBT and PAT margins in FY20.** The group registered lower PBT and PAT margins in FY20 due to payment of one-off listing expenses. For FY20 (unaudited), Group PBT and PAT declined 23.7% and 25.5%, respectively, in line with its lower revenue and one-off listing expenses of RM2.3m. Without the RM2.1m listing expense, FYE20 PBT and PAT would hypothetically have been RM32.1m and RM23.4m respectively.

**Gross margins remain stable.** For FY20 (unaudited), power cables made up 81.5% of group revenue, consistent with the 76.1% for FY19. Power Cables and Wires gross profit (GP) declined 7.4% y-o-y due to a marginal decline in topline, but this was offset by higher sales for LV & MV power cables. The GP for Communication Cables and Wires declined 30.2% on the back of lower topline, but this was offset by higher export sales and a favourable product mix. However, the GP for Control & Instrumental cables dipped 64.1% y-o-y due to a weaker topline.

**Healthy financial position** Its net gearing ratio has been on a downward trend, falling from 0.98x in FY17 to 0.56x in FY19, and it was in a marginal net cash position in FY20. This downward trend has emerged even before its IPO, thus putting it in a healthy financial position to execute growth plans. Southern Cable has also proposed a final single-tier DPS of 0.4 sen which translates into a dividend payout of 15.1%, in line with its dividend policy. Its balance sheet as at 31 December 2020 was in a slight net cash position.

**Relatively higher margins.** Southern Cables' closest competitor is Sarawak Cable. There is no active coverage on Sarawak Cable but it has a market capitalisation of RM140m (vs. Southern Cable's RM380m). In terms of FY20 revenue, Sarawak Cable generated RM609m but made a net loss of RM54m. GP margins appear to be low at 6%. For FY20, Southern Cable raked in revenue of RM560m and net profit of RM23m. Its GP margin as also superior at c.10%. Compared to FY19, revenue and net profit declined by 14% and 23% respectively. This was due to the imposition of the Movement Control Order (MCO) that led to a temporary halt in operations for 11 days in March 2020, coupled with disrupted distribution channels. Thereafter, its operations normalised in 2H20 on the resumption of the deliveries of cables and wires, and sustainable demand from key utilities customers.

#### Group Revenue (RMm) & Gross Profit Margin (%)



Sources: Company

**Contracts secured from Jan 2020 to Jan 2021**

	Customer	Contract Details	Contract Duration	Contract Amount
1	Distributor	Aluminum Rod	1 year (1/1/20-31/12/20)	RM27.0m
2	Cable Manufacturer	Aluminum Rod	1 year (1/1/20-31/12/20)	RM29.4m
3	Telecommunication Company	Supply, Delivery, Installation, Testing and Commissioning of Rectifier System and Accessories	3 year (1/1/20-31/12/22)	RM5.5m
4	Distributor	Aluminum Rod	11 months (1/2/20-31/12/20)	RM10.0m
5	Power Utility Company	PVC CU Multicore Cables	1 year (2/3/20-1/3/21)	RM228.0
6	Power Utility Company	11 kV 33 kV Cables	1 year (16/4/20-15/4/21)	RM2.3m
7	Rail Company	LV Power Control Cables	8 months (20/7/20-1/4/21)	RM11.9m
8	Processing Plant Project	High Voltage and Low Voltage Variable Frequency Cables	3 months (26/11/20-28/2/21)	RM9.8m
9	Power Utility Company	3 Core 185 mm <sup>3</sup> 11 kV XLPE Aluminum Cables	3 months (7/12/20-31/3/21)	RM7.8m
				FYE2020: RM331.7m
10	Cable Manufacturer	Aluminum Rod	1 year (1/1/21-31/12/21)	RM30.7m
11	Distributor	Aluminum Rod	1 year (1/1/21-31/12/21)	RM30.8m
12	Distributor	Aluminum Rod	1 year (1/1/21-31/12/21)	RM2.5m
13	Power Utility Company	Supply & Delivery of LV & MV Cables and Conductors	4 months (28/1/21-18/4/21)	RM4.7m
				JAN2021: RM68.7m

Sources: Company

**Key risks**

**Slowdown in capex for SOLAR, ENERGY, 5G rollout.** While there are initiatives in place from the government to expedite the adoption of 5G, solar and energy rollout, any potential slowdown in implantation and funding requirements may slow down the potential contract wins for Southern Cable.

**Higher raw material prices.** Fluctuations in the prices of raw materials, primarily copper and aluminium, may affect its profitability should the group be unable to pass the cost increment onto its customers. The group's main raw materials used for the manufacturing of conductors for cables and wires are copper cathodes, aluminium ingots, copper and aluminium rods and copper wires. From FY16 to FY20, copper-based materials accounted for 59.8% to 62.4% of the total costs of purchased materials. Given that copper and aluminium are globally traded commodity metals, the group's manufacturing line is subjected to global price fluctuations, bearing the risk of unfavourable price changes that can directly affect its profit margins. To offset this, the group has established contractual agreements with customers that allow them to adjust the selling price of price of cables and wires, which take into consideration the fluctuations in prices of copper and aluminium within a specified time stipulated for the contractual period. However, from FY18 to FPY20, revenue from these types of customers account for <30% of total revenue, meaning these specific clauses may not be enough to offset falling profit margins across total production.

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