Leform Berhad

(0266) ACE | Industrial Products & Services

The forming of a stellar steel player

Non-Rated

Fair Value: RM0.315

KEY INVESTMENT HIGHLIGHTS

- **Leform Bhd to be listed on the ACE Market on Nov 22**
- **IPO price at 23 sen per share, targeting to raise RM71.5m**
- **Proceeds to be used for construction of new HQ, repayment of bank borrowings and working capital**
- **Top 5 in terms of market share of steel pipes in Malaysia**
- **Machineries all set to scale up once new warehouse is ready**
- **Estimated fair value of 31.5 sen per share**

RETURN STATISTICS	
IPO price	**0.23**
Expected share price return (%)	**+36.96**
Expected dividend yield (%)	**+1.83**
Expected total return (%)	**+38.79**

SHARE INFORMATION	
Listing	ACE Market
Enlarged share capital (m)	1,481.01
Market capitalisation (RM'm)	340.63
Issue price (RM)	0.23
Shariah compliant	Yes
IPO INDICATIVE TIMETABLE	**DATE**
Opening of application	26-Oct-2022
Closing of application	11-Nov-2022
Balloting of applications	24-Nov-2022
Allotment/transfer of shares	29-Nov-2022
Listing	30-Nov-2022
PROCEEDS	**RM'm/%**
Construction of new HQ	30.04/42
Repayment of bank borrowings	14.39/20.1
Working capital	21.91/30.6
Estimated listing expenses	5.2/7.3
TOTAL	**71.53/100**

EXECUTIVE SUMMARY

Company background. Steel products producer Leform Bhd ("Leform" or the Group" is going public on the ACE Market on the 22nd of November. Incorporated in 1995, Leform's principal activities are manufacturing and trading steel pipes and flat steel products. It specialises in electric resistance welding (ERW), a process where heat generated from electric current is applied to edges of steel sheets. The group's core products are steel pipes and flat steel products, catering mainly to the furniture, automotive and construction industries. It also produces guardrails, which is a complementary product.

IPO Statistics. The Group's listing on the ACE Market of Bursa Malaysia comprises a public issue of 311.0m new ordinary shares, representing about 21.0% of its enlarged share capital. There is also an offer for sale of 74.1m existing ordinary shares. With an issue price of 23 sen per share, Leform targets to raise RM71.5m, the bulk of which will be allocated for the construction of its new headquarters, followed by repayment of bank borrowings, working capital and estimated listing expenses. Upon listing, the enlarged share capital will be 1.48b shares. (page 29)

Well-equipped, ready to scale. Leform has 19 pipe mills machine (two installed but unutilised), three guardrail machines, three slitting machines and four shearing machines, all of which can run simultaneously. Assuming an eight-hour operating day for 312 days a year, the Group has an annual production capacity of 127,075 tonnes for steel pipes and guardrails and 163,738 tonnes for flat steel products but utilisation rates are currently way lower than these. What constrains Leform at the moment is its limited storage space. The Group's new headquarters will give it +93.2% of storage space which will allow the Group to scale up comfortably once the new premises is ready by 2025.

Dividend counter. Management endeavours to maintain a dividend payout ratio of at least 20% of its net earnings, subject to recommendation of the Board.

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A. BUSINESS OVERVIEW

Manufacturing of steel products. This is Leform's main business segment, where it manufactures steel pipes, guardrails and flat steel products. It currently has 17 pipe mills machines, three guardrail machines, three slitting machines and four shearing machines that are operational. Among the end-user industries are furniture manufacturing, construction and industrial product manufacturing, such as automotive parts and telecommunication tower pole parts. Clients are predominantly from Malaysia, with a small portion of exports mainly to New Zealand, Cambodia, Singapore, Australia and Brunei.

i) Steel pipes

Long, hollow-shaped steel products used in manufacturing and construction. These are manufactured using the ERW process where welding is done without requiring additional fillers and materials, ultimately improving cost efficiency of production while producing less emissions of harmful gas. The types of steel pipes produced are round steel pipes, steel hollow sections, oval steel pipes, ellipse steel pipes and rolled steel (in U or C shapes).

iii) Flat steel products

Leform produces two main types of flat steel products – slitted steel coils and steel sheets. Slitted steel coils are long pieces of finished steel sheets that have been rolled and wounded up. Steel sheets are small pieces of steel that are cut to size according to customers' requirements.

ii) Guardrails

Made from slitted steel coils that are used to create protective barriers on roads to prevent access from one side to another.

Trading of steel products. The trading business complements the manufacturing business where Leform purchases and resells steel products which are usually certain ranges of product specifications that it does not manufacture, in order to provide a broader range of products to its clients. End-customers comprise manufacturers of steel infrastructure pipes, scaffolding, vehicles and contractors that require steel products to construct steel-based structures.

B. IPO DETAILS

Issuer Name	Leform Berhad ("**Leform**" or the "**Company**")
Selling Shareholder	Law Kok Thye
Offering Size and structure	Public issue of 311,013,000 shares representing c.21.0% of the enlarged issued share capital ("**ESC**"): ▪ 37,025,500 issue shares (5% of the ESC) made available for application by the Malaysian public ▪ 29,620,000 issue shares reserved for application by Leform's "Eligible Persons" ▪ 22,215,000 issue shares by way of private placement to identified institutional and/or selected investors ▪ 185,127,000 issue shares by way of private placement to identified Bumiputera investors approved by the MITI
Enlarged Share Capital	1,481,013,000 shares
Shariah Status	Shariah Compliant

Source: Company

C. UTILISTION OF PROCEEDS

Details of use	Estimated time frame of utilisation	RM'm	%
Construction of new headquarters, warehouse storage facility and workers' accommodation	Within 18 months	30.04	42.0
Repayment of bank borrowings	Within 10 months	14.39	20.1
Working capital	Within 12 months	21.91	30.6
Estimated listing expenses	Within 3 months	5.2	7.3
	Total	**71.53**	**100**

Source: Company

D. PROMOTERS AND SUBSTANTIAL SHAREHOLDERS

Leform is currently wholly-owned by its managing director Law Kok Thye, who holds a personal stake of 66% and 34% through Tianwen Holdings Sdn Bhd, an investment holding vehicle which is 100% held by Mr. Law. The table below sets out the structure of the shareholdings of Leform, before and after the IPO.

Promoters and Substantial Shareholders	No. of shares pre-IPO ('000)	Stake pre-IPO (%)	No. of shares post-IPO, Bonus Issue and Share Split ('000)	Stake post-IPO (%)
Law Kok Thye	4,290	66	340,549	23
Tianwen Holdings Sdn Bhd	2,210	34	755,400	51
Total	**6,500**	**100**	**1,095,949**	**74**

Source: Company

E. STRENGTHS AND PROSPECTS

Industry outlook. The Malaysian Iron and Steel Industry Federation (MISIF) forecasted that the apparent steel consumption in the country will grow by +11% to 7.8m tonnes in 2022, followed by +9% to 8.5m tonnes in 2023. These are expected to be supported by the automotive sector and stronger construction activities with the acceleration and rollout of infrastructure works. All these bode

Top five player. We gathered from the industry that Leform stands at the fifth spot for the steel pipes and tubes business with its market share of 10.2% for the year 2020. The leader of the industry is Alpine Pipe Manufacturing Sdn Bhd (wholly-owned subsidiary of Hiap Teck Venture Bhd) with a market share of about 25%, followed by Melewar Steel Tube Sdn Bhd (wholly-owned subsidiary of Melewar Industrial Group Bhd), Southern Pipe Industry (M) Sdn Bhd (96.1% subsidiary of Southern Steel Bhd) and Choo Bee Metal Industries Bhd.

High quality products. Leform serves a wide range of customers with its steel products, which conform to the Japanese Industrial Standards (JIS) or equivalent standards. The standard denotes the steel grade, which is typically a requirement among local and international customers. Steel pipes, which is one of Leform's core products, is manufactured using the electric resistance welded (ERW) process, which it specialises in. Leform also holds the ISO 9001:2015 accreditation from TuV Nord Cert GmbH, which indicates that its products adhere to globally recognised quality compliance standards and procedures.

Integrated operations. Leform's steel pipes are produced using the slitted steel coils and sheets that it manufactures on its own, enabling it to procure larger quantities of supplies at better competitive prices. This also gives Leform the control over the supply of its steel pipes as they can easily slit and shear the slitted steel coils and sheets according to sizes required. On top of the consistent supply, this also reduces the lead time to fulfil customers' orders. Leform also handles its own deliveries with 25 trucks and a delivery team of 13 personnel to speed up turnaround time for its clients' orders.

Second-tier in the steel industry pyramid. The steel industry is basically structured like a pyramid, divided into the first, second and third tiers. The first tier comprises mainly integrated mills, those that produce long products such as steel bars, basically starting from iron ore to liquid steel and finally the semi-finished product. The second tier is where companies like Leform operates in, whereby it will purchase the semi-finished goods and manufacture products that will be sold to the third-tier constituents – the end users. We understand that the second tier is the most profitable level of the steel sector supply chain.

Well-equipped and ready to soar. Leform has 19 pipe mills machine (two installed but unutilised), three guardrail machines, three slitting machines and four shearing machines, all of which can run simultaneously. Assuming an eight-hour operating day for 312 days a year, the Group has an annual production capacity of 127,075 tonnes for steel pipes and guardrails and 163,738 tonnes for flat steel products but utilisation rates are currently way lower than these. While it may seem that Leform may have overinvested on the machines, management justified that this was to improve efficiency as they manufacture steel pipes of various specifications and any change in specifications or sizes would take about eight hours before the machines will be up and running again. All the machines are capable of running for 24 hours daily, save for maintenance downtime. To our understanding, what constricts Leform is the lack of storage space, which is stretched at the moment. Leform's proposed new headquarters, which will include a warehouse, will give Leform an additional warehouse size of +93.2% or 194,173 sq ft, enabling it to store an estimated 198,599 more tonnes of products. Coupled with the existing space for 161,372 tonnes, the Group will have about 359,971 tonnes of storage space, which will allow the Group to scale up comfortably once its new premises is ready by 2025. Management guided that demand is strong and there is a consistent take up of their products, all of which will be sold within 120 days.

Operational capacities and output

	Steel pipes and guardrails				Flat steel products			
	2019	2020	2021	6M22	2019	2020	2021	6M22
Max. capacity (tonnes)	98,283	127,075	127,075	63,537	152,506	163,738	163,738	81,869
Actual output (tonnes)	57,423	56,605	41,049	20,327	40,083	49,515	29,551	9,581
Utilisation rate	58.4%	44.5%	32.3%	32.0%	26.3%	30.2%	18.0%	11.7%

Source: Company

Storage capacities

	2019	2020	2021	6M22
Max. storage capacity (tonnes)	137,919	161,372	161,372	80,686
Highest storage utilisation (tonnes)	136,199	135,793	123,218	76,971
- Raw material	*53,891*	*45,642*	*39,601*	*42,734*
- Finished products	*82,308*	*90,151*	*83,617*	*34,237*
Utilisation rate	98.8%	84.1%	76.4%	95.4%

Source: Company

F. FUTURE PLANS

Headquarters relocation, warehouse expansion and workers accommodation. Leform intends to relocate its headquarters to a proposed new facility to be constructed on an existing plot of vacant land (Lot 859), measuring 397,484 sq ft located adjacent to one of its existing processing facilities in Serendah. This new facility will have a total built-up area of 285,547 sq ft, housing the new headquarters of a four-storey office building, a five-storey workers accommodation and two units of two-storey warehouse storage facility. Conditional approvals have been obtained from the Hulu Selangor District Council for the construction of the new facility. Management plans to make this new premises as its one-stop centre to consolidate its delivery operations and improve efficiency by reducing loading time on lorries while also being able to systematically store its material and finished goods, without having to stack or mix them. Leform's existing headquarters comprises its principal office, processing facilities and warehouse storage facility on three plots of land with a total built-up area of 316,459 sq ft. While its range of machineries are capable of producing 290,813 tonnes per year, we can see that Leform is constrained by its existing storage facility, which can only fit about 161,372 tonnes of steel products at any one

time. This also handicaps Leform in terms of production capacity. Additional warehouse space would be able to cater for further growth for Leform.

Expand range of steel pipes manufactured. With the additional storage facility, Leform has plans in store to manufacture thicker, 5mm gauge steel pipes. It currently manufactures steel pipes with thickness of 4mm or less, used for light industrial purpose such as in the manufacturing of automotive seats and furniture or as scaffolding or light construction structures. Thicker steel gauge pipes of 5mm or more can be used for applications such as infrastructure pipes or large structural poles in construction. This would open up new revenue streams for Leform while being able to expand its customer base. Management plans to start producing thicker gauge steel pipes once its proposed new facility is completed by 1QCY25. They would also need to hire 50 more workers to cater for the expansion.

G. RISK FACTORS

Global steel price fluctuations. Due to the nature of Leform's business, its top and bottom lines are influenced by the fluctuations in steel prices which has seen a spike since last year. About 90% of the group's cost of sales comprise steel materials, mainly cold-rolled steel coils, hot-rolled steel coils and galvanised steel coils. Being a manufacturer, Leform is able to quote its selling prices based on market prices of steel, therefore allowing it to transfer part of the price increase to the clients. The risk is when it is unable to do so and would have to take on the spike in prices on its own, which may compress its margins. Another factor is the requirement for Leform to maintain a certain level of inventory in order to provide timely deliveries to its customers. During times when it purchases materials at prices which are unfavourable, this would result in higher inventory holding cost. We however, note that steel prices have started to moderate from the high levels seen in March and April, in line with the slump in prices of hard commodities globally. But even as Leform has taken on an unfavourable position, the problem would only last for four months due to the stock turnover, as per its first in first out (FIFO) way of rotating its stock. The group practices the weighted average method on its pricing, which enables them to even out the prices over the longer term.

Absence of long-term contracts. Due to the volatility in steel prices, Leform only holds its inventory for approximately four months and does not enter into long-term contracts with its customers. This may lead to fluctuations in the group's revenue and overall business performance. Sales are mainly from purchase orders from customers on a project or as-needed basis. Despite the fluctuations, we view that this allows Leform to reduce its downside risks from locking in a long-term contract at high prices while allowing its clients to benefit from a reduction in average price.

Foreign exchange risk. Leform sources its cold-rolled steel coils, hot-rolled steel coils and galvanised steel coils locally and from suppliers based in Singapore, Taiwan and Indonesia. Materials sourced from foreign countries are denominated in USD therefore fluctuations in the exchange rates could affect the group's margins if higher costs could not be passed through to the clients in a timely manner.

External impact. The war between Russia and Ukraine led to an escalation of steel prices as it resulted in lower supplies of steel products from the two countries, who are major exporters. Risks of the war aggravating may lead to geopolitical instability and would further disrupt the global supply chains. In China, its ongoing Zero-Covid policy has caused a backlog in the global supply chain. While things are gradually returning to normalcy, the risk of renewed lockdowns in affected areas in China remains as the Zero-Covid policy is still in place.

H. FINANCIALS

Snapshot of 6MFY22 results. Leform recorded a net profit of RM12.17m for the six-month period ending June-22, which was a decline of -56%yoy, on the back of a slightly higher revenue by +5.1%yoy to RM213.67m. The increase in revenue came mainly from the increase in contribution from the manufacturing and trading segments, which saw an increase of +3.6%yoy to RM167.12m and an increase of +10.8%yoy to RM46.47m for manufacturing and trading segments respectively. The higher revenue from both manufacturing and trading segments was attributable to the increase in average selling prices, in line with the spike in global steel coil prices on top of supply disruptions of mother coils globally due to the impact of the Russia-Ukraine war, in spite of lower volume of products sold. Leform's average selling prices of steel pipes and guardrails rose 42.5% while that of flat steel products rose 22.3% during the period. The lower sales volume points towards clients holding back on purchases due to the elevated prices.

	Average selling price/tonne (RM)			Sales volume (tonne)			Revenue (RM'm)		
	6M21	6M22	YoY %	6M21	6M22	YoY %	6M21	6M22	YoY %
Steel pipes and guardrails	3,917.53	5,580.99	42.5	21,997	17,408	(20.9)	86.17	97.15	12.7
Flat steel products	3,838.16	4,694.05	22.3	19,594	14,914	(23.9)	75.21	70.01	(6.9)
Trading	3,881.38	5,157.38	32.9	10,808	9,010	(16.6)	41.95	46.47	10.8

Source: Company, MIDFR

FY21 results review. Leform recorded a six-fold increase in earnings in FY21 to RM45.5m, driven by higher average selling prices. Revenue came in higher at +5.4% to RM374m, boosted mainly from an +11.5% growth in manufacturing of steel pipes and guard rails, which made up 48.2% of the group's total revenue. This cushioned the slight decline of -4.2% for the manufacturing of flat steel products to RM114.6m, but still contributing a significant portion of 30.7% to the total revenue. Trading activities rose +7.6% to RM78.9m for the year, accounting for 21.1% of the total revenue. The increase in average selling prices is attributable to the rise in global steel coil prices, resulting from the spike in iron ore, coal and steel scrap due to a disruption in the global supply chain as economies recover from Covid-induced lockdowns, removal of export rebates in China and increase in energy prices. As a manufacturer, Leform is able to pass on part of the increase in material cost to its clients.

Forecast. We expect demand for Leform's steel products to be lower in FY22 compared to FY21, mainly due to the elevated prices. Steel prices peaked in June, before it started to see some softening in July. Nevertheless, we expect revenue to grow by about +3% to RM390.98m, with a net profit of RM34.5m. Revenue is expected to improve further in FY23F and FY24F to RM401.66m and RM402.41m respectively, on the back of rising demand from increased level of activities and also due to moderating prices. Earnings are also projected to improve to RM36.47m and RM42.64m respectively. We forecast that the strong growth would actually come in by year 2025 upon the completion of its new premises that gives Leform the additional warehouse capacity, allowing Leform to ramp up its production, assuming that demand remains on a strong growth trajectory

I. FAIR VALUE

FV RM0.315. We estimate Leform's fair value to be at 31.5 sen per share by pegging its FY23 EPS of 2.46 sen to a target PER of 12.8x. The valuation multiple is based on +1 SD above the historical three-year mean of its closest peers. We believe this is justified based on the demand for Leform's steel pipes, its strong market share and its readiness to scale up once its new premises is ready.

Profit and loss summary

RM'000 unless otherwise stated	FY19A	FY20A	FY21A	FY22F	FY23F	FY24F
Revenue	344,581	354,714	373,974	390,979	401,661	402,409
Cost of sales	(323,288)	(323,514)	(294,085)	(332,332)	(341,010)	(333,194)
Gross profit	21,293	31,200	79,889	58,647	60,651	69,214
Other income	5,333	3,422	7,990	9,588	5,753	5,465
Admin expenses	(12,566)	(11,588)	(13,509)	(14,857)	(12,050)	(12,072)
Other expenses	(3,341)	(3,213)	(6,434)	(4,692)	(4,017)	(4,829)
Net impairment loss on financial assets			(108)			
Operating profit	10,719	19,821	67,828	48,686	50,337	57,778
Finance cost	(9,506)	(9,160)	(5,955)	(7,500)	(5,250)	(4,988)
Profit before tax	1,213	10,661	61,873	41,186	45,087	52,790
Income tax expense	(2,844)	(3,524)	(16,463)	(6,673)	(8,616)	(10,156)
Profit /(loss) after tax from continuing operations	(1,631)	7,137	45,410	34,513	36,471	42,635
PAT from discontinued operation	157	223	78			
Profit/(Loss) after tax	(1,474)	7,360	45,488	34,513	36,471	42,635
EPS (sen)	(0.10)	0.50	3.07	2.33	2.46	2.88

Source: Company, MIDFR

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MIDF AMANAH INVESTMENT BANK: GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <-10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.
ESG RECOMMENDATIONS* - source Bursa Malaysia and FTSE Russell	
☆☆☆☆	Top 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆☆	Top 26-50% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆	Top 51%- 75% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆	Bottom 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell

* ESG Ratings of PLCs in FBM EMAS that have been assessed by FTSE Russell in accordance with FTSE Russell ESG Ratings Methodology