

## Regal International Group Ltd.

## Overweight

Current Price	S\$0.100
Fair Value	S\$0.382
Up / (downside)	282%

## Stock Statistics

Market cap	S\$20.2m
52-low	S\$0.085
52-high	S\$0.485
Avg daily vol	49,152
No of share	200.1m
Free float	32.2%

## Key Indicators

ROE 16F	12.6%
ROA 16F	3.7%
P/BK	0.75x
Net gearing	45%

## Major Shareholders

Su Chung Jye	65.5%
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## Historical Chart



Source: Bloomberg

## Research Team

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## Time to Relook at Regal

- Proposed disposals adds clarity to value.** Regal International Group Ltd. announced the proposed disposal of its Precision Business for S\$7m in cash and prospective cash proceeds from 63 Sungei Kadut Loop (63SKL) a leasehold property currently owned by the Precision Business. We estimate that the Regal may reap S\$11.28m to S\$12.5m of proceeds, depending on how the value of 63SKL is realised. More importantly, the equity base of Regal's Property Business will jump by 113.8% to 136.3% after the disposal, translating to a Property Business book value per share of S\$0.103 to S\$0.113. Regal closed at S\$0.100 on 7 June 2016. The disposal supports the view that Regal is potentially undervalued, with the development upside/gain from its Sarawak projects not factored into its share price.
- Financial transparency to also improve.** On a consolidated basis, Regal made net profit attributable to shareholders of RM51,000 in 1Q16. However, the Precision Business made a net loss of S\$0.20m or RM0.59m in 1Q16. Hence, we can infer that the Property Business actually made RM0.64m of net attributable profit in 1Q16. We expect the Precision Business to be disposed by the end of July or August. Hence, Regal's reported financial results will fully reflect contribution by the Property Business from 4Q16 onwards, thus improving overall financial and business transparency.
- The loss on disposal is not so relevant now.** We noted that the Precision Business actually has a book value of S\$17.45m as of 31 March 2016. Hence, the transaction may result in an accounting loss of S\$4.37m to S\$6.53m (S\$0.022 to S\$0.033 per share) on completion, depending on the accounting treatment applied to 63SKL if it is still unsold on completion. However, we are disregarding this loss – it is a non-cash sunk cost to dispose the loss making Precision Business, rather than an incurred loss on the Property Business. Post-completion, shareholders will end up with solely the Property Business whose book value will rise from S\$0.048 to S\$0.103 – S\$0.113 per share, or up to 11.3% from Regal's current share price.
- High return/high risk – Deserves to trade at premium to NTA.** We maintain our valuation at S\$0.382 per share for Regal, pending completion of our model review. On the whole, we see this transaction as an opportunity for new investors to buy into Regal at a relatively undervalued entry point, vis-à-vis the original public shareholders of the Precision Business. While upside may seem high, our valuation only implies a market value of S\$76.4m or RM230.7m, and is based mainly on the RNAV of the Property Business's properties. In fact, we argue that Regal deserves to trade at a higher P/B than other developers. This is because Regal does not practice land banking, but enters into development right agreements with landowners. This way, Regal's business is less capital intensive and can potentially generate higher ROE than other developers.

Key Financial Data (RM m, FYE Dec)	2014	2015	2016F	2017F	2018F
Sales	95.3	120.7	179.0	200.6	220.4
Gross Profit	32.2	20.8	53.7	62.2	68.3
Net Profit	(17.9)	(72.4)	11.4	18.2	23.7
EPS (sen)	(12.6)	(36.2)	5.7	9.1	11.8
EPS growth (%)	(152.0)	(305.3)	115.7	60.5	30.0
PER (x)	nm	nm	5.2	3.3	2.5
NTA/share (sen)	71.8	40.3	45.0	53.4	64.4
DPS (sen)	4.0	0.0	0.4	0.6	0.7
Div Yield (%)	13.3	0.0	1.5	2.0	2.5

Source: Company, NRA Capital forecasts

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**Overview of transaction.** Based on the announcement, the original controlling shareholders of the Precision Business (Precision Business Buyers) will purchase the loss-making Precision Business back from Regal for S\$7.0m in cash and the equivalent of net proceeds from the sale of 63SKL, if it is sold prior to the completion of the sale of the Precision Business (Completion).

If 63SKL is not sold prior to Completion, any proceeds from the subsequent sale or rent of 63SKL will be paid to Regal. Likewise, Regal will, subject to the approval of the Jurong Town Corporation if applicable, have the right to rent out, sell or furnish 63SKL as security for bank borrowings. If 63SKL is foreclosed, Regal do not need to compensate the Precision Business. In addition, Regal can procure the Precision Business to assign 63SKL to any party.

**63 Sungei Kadut Loop.** Based on a valuation commission by Regal, 63SKL has an “Open Market Value” (OMV) of S\$5.5m before selling costs as of 23 May 2016. According to prior disclosures, 63SKL has an approximate floor area of 51,989 sq. ft. The property’s lease will expire on 16 September 2024.

For 8.3 years’ remaining lease, the S\$5.5m valuation is equivalent to renting the property at a fixed monthly rate of S\$1.06 per sq. ft. per month for the rest of the lease, without taking into account the time value of money. Based on data from the JTC, median rentals ranged from S\$1.16 at Tuas South Street 11 to S\$2.96 per sq. ft. per month at Tannery Lane during 1Q16. Hence, the implied rental rate of the valuation is comparable to market rates.

**Figure 1: 63 Sungei Kadut Loop**

As of 31 December 2015	
Leasehold properties as per Annual Report Page 91	RM10.13m
SGD MYR exchange rate	3.0363
Leasehold properties as per Annual Report (Assume to be 63 Sungei Kadut Loop)	S\$3.34m
Open Market Value as of 23 May 2016, less costs to sell	S\$5.5m

Source: Company, NRA Capital

**Why not a “fixed all-cash” deal?** Rationally, we can only surmise that the management of Regal has decided that the fixed all-cash offer, if any, given by the Precision Business Buyers is lower than the effective value of a “fixed cash + variable sum from 63SKL” deal, and that it can extract higher value by linking the part of the consideration to 63SKL than by asking for an upfront fixed sum of cash out of the Precision Business Buyers.

It is worth noting that 63SKL is currently being used by the Precision Business. Upon completion of the disposal, Regal retains the right to evict the Precision Business by giving three months’ notice. Taking into consideration other rights that Regal will obtain over 63SKL, we can conclude that Regal shall have significant control of 63SKL and can reap future economic benefits out of it in the future.

**Proceeds of S\$11.28m to S\$12.5m.** The OMV of S\$5.5m excludes costs to sell such as marketing and commission expenses. We are also uncertain what would be the actual price fetched for 63SKL in negotiations with any buyer, given the remaining lease life. Hence, we decided to value the consideration at S\$11.28m to S\$12.5m, implying a value of S\$4.28m to S\$5.5m for 63SKL.

The lower base of S\$4.28m is based on the average of book value of S\$3.34m and S\$5.225m (S\$5.5m less assumed 5% selling costs). On the other hand, the full upper range may be recognized in Regal’s balance sheet as an investment. Hence, we anchor the range from S\$4.28m to S\$5.5m.

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**Deriving the book value of 10.3 cents to 11.3 cents per share.** If 63SKL is still not sold on Completion, an asset arising from Regal's rights over 63 SKL is effectively created in the balance sheet of Regal. We are uncertain if this asset shall be 63SKL itself or a receivable from the Precision Business, as the legal title of 63SKL will still belong to the Precision Business.

Based on the estimated book value and the OMV of 63SKL, the carrying value of such an asset will likely be between S\$3.34m to S\$5.5m. S\$3.34m is the estimated book value of 63SKL as of 31 December 2015. In this case, the book value of Regal post completion will amount to S\$20.53m or 10.3 Singapore cents per share.

On the other hand, if Regal decides to rent out 63SKL to extract the full S\$5.5m of value over time, 63SKL can be classified as an investment property especially when it does not operate the asset. In this case, the full fair value of 63SKL can be recognized on balance sheet at S\$5.5m. Under this scenario, the book value of Regal will amount to S\$22.69m or 11.3 Singapore cents per share.

These are pro-forma estimates based on historically reported book values and this transaction only. Actual reported figures post-completion will include ongoing contribution from business activities, and another transaction at the Precision Business level. The sale of the Precision Business includes the waiver of an inter-company debt of S\$0.58m owing by Regal to the Precision Business. At the same time, the Precision Business is also selling its overseas subsidiaries who owe Regal an inter-company debt of S\$0.58m, which will also be waived by Regal. Our calculations are presented in Figure 2.

**Deserves to trade at premium to book value.** While Regal will only trade around price to book following the completion of the disposal at today's share price, Regal's balance sheet does not reflect the land value of its development projects. This is because it typically enters into development rights agreements with landowners such that the landowners will be paid for the land via a mix of cash and an agreed-upon proportion of completed units, or even entirely in completed units. In such cases, the company does not need to tie up its capital in land under development, paying for mainly the construction cost. As a result, capital intensity is lower and a higher than average ROE, and hence higher P/B trading multiple, is possible.

Figure 2: Book value estimates

S\$ m, as of 31 March 2016	Scenario			
	Property sold prior to completion		Property unsold on completion	
	Sold at S\$4.28m	Sold at S\$5.5m	Receivable/ Asset	Investment Property
Book value of Regal Group*	27.05	27.05	27.05	27.05
Cash proceeds	7.00	7.00	7.00	7.00
Sale Price / Carrying value of 63SKL related asset	4.28	5.23**	3.34***	5.50
Waiver of inter-company debt owing to Precision Business	0.58	0.58	0.58	0.58
Book value of Precision Business	-17.45	-17.45	-17.45	-17.45
Accounting Loss	-5.59	-4.64	-6.53	-4.37
Book value of Property Business Prior to Completion	9.60	9.60	9.60	9.60
<b>Per Share (A)</b>	<b>\$0.0480</b>	<b>\$0.0480</b>	<b>\$0.0480</b>	<b>\$0.0480</b>
Book value of Regal Group and Property Business on Completion	21.47	22.41	20.53	22.69
<b>Per Share (B)</b>	<b>\$0.1073</b>	<b>\$0.1120</b>	<b>\$0.1026</b>	<b>\$0.1134</b>
Change (B against A)	123.6%	133.4%	113.8%	136.3%

\*Based on reported RM78.87m as of 31 March 2016 divided by exchange rate of 2.9155. \*\*Assume 5% selling cost. \*\*\*As of 31 December 2015.

Source: NRA Capital

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**Leaving Regal in a stronger position.** To conclude, the disposal provides the following benefits/disadvantages.

- 1) The Property Business now has more assets at its disposal to grow, with book value doubling to at least S\$0.103 per share.
- 2) Lower gearing. The S\$7.0m will be applied to repay a bank loan of S\$6.75m. Total liabilities to total assets of the Property Business will drop from 83.7% as of 31 December 2015 to an estimated 74.6% to 77.0% depending on the sale price of 63SKL or its carrying value, and without taking into consideration the changes in inter-company debt.
- 3) There will be an accounting loss of S\$4.37m to S\$6.53m. However, this loss is a sunk cost and can be considered as part of the premium paid by the early shareholders of Precision Business for acquiring the Property Business in October 2014.

From the existing shareholders and new shareholders' perspective, the accounting loss is also a form of sunk cost to dispose the loss-making Precision Business, with actual net cash inflow into the Property Business.

- 4) In reality, the future profitability of Regal will improve given that the loss-making Precision Business will no longer drag on reported profit and loss on consolidation.

On balance, this disposal actually represents an opportunity for investors to enter at a relatively worthwhile price point.

**Minimum Trading Price.** We continue to see Regal as a high return/high risk investment. For completeness, we have to mention that the minimum trading price criteria is a risk that the company will have to address. We maintain our forecasts (which have not been adjusted for the accounting loss) and valuation in this report, pending valuation model review. While some adjustment is likely to reflect changes in working capital and debt on completion of the disposals, the net impact is unlikely to materially change our view.

**Figure 2: Valuation (unchanged from previous reports, except for new projects)**

+ NRA's net unsold project valuation (RM m) - assumption 30% operating profit margins	330.49
+ Development properties held for sale in the process (RM m)	100.91
+ Net cash / (net debt) (RM m)	-35.69
+ Working capital (RM m)	56.28
<b>NRA's revaluation (RM m)</b>	<b>452.00</b>
Number of share outstanding	200.11
NRA's RNAV per share (RM m)	<b>2.259</b>
MYR:SGD exchange	2.960
NRA's RNAV per share (S\$)	0.763
<b>Fair value discount of</b>	<b>50%</b>
	<b>0.382</b>

Source: NRA Capital

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<b>Profit &amp; Loss (RM m, FYE Dec)</b>	<b>2014</b>	<b>2015</b>	<b>2016F</b>	<b>2017F</b>	<b>2018F</b>
Revenue	95.3	120.7	179.0	200.6	220.4
Operating expenses	(78.9)	(142.6)	(166.7)	(182.0)	(197.8)
EBITDA	16.4	(21.9)	12.3	18.6	22.6
Depreciation & amortisation	(1.6)	(4.7)	(5.0)	(5.2)	(5.5)
EBIT	14.8	(26.6)	7.3	13.3	17.1
Non-operating income/(expenses)	(6.6)	(44.2)	(2.9)	(2.6)	(1.5)
Associates' contribution	8.9	(1.5)	9.6	11.5	13.2
Exceptional items	(30.1)	0.0	0.0	0.0	0.0
<b>Pretax profit</b>	<b>(12.9)</b>	<b>(72.3)</b>	<b>13.9</b>	<b>22.2</b>	<b>28.7</b>
Tax	(5.0)	0.1	(2.2)	(3.5)	(4.6)
Minority interests	0.0	(0.2)	(0.3)	(0.4)	(0.4)
<b>Net profit</b>	<b>(17.9)</b>	<b>(72.4)</b>	<b>11.4</b>	<b>18.2</b>	<b>23.7</b>
Shares at year-end (m)	200.1	200.1	200.1	200.1	200.1
<b>Balance Sheet (RM m, as at Dec)</b>	<b>2014</b>	<b>2015</b>	<b>2016F</b>	<b>2017F</b>	<b>2018F</b>
Fixed assets	16.6	22.7	24.7	26.7	28.6
Goodwill and intangible assets	39.3	0.0	0.0	0.0	0.0
Other long-term assets	23.7	17.7	17.7	17.7	17.7
<b>Total non-current assets</b>	<b>79.6</b>	<b>40.4</b>	<b>42.4</b>	<b>44.4</b>	<b>46.3</b>
Cash and equivalents	27.7	22.5	16.0	24.3	30.2
Stocks	30.3	36.7	37.6	38.8	38.0
Trade and other debtors	78.9	73.6	79.1	78.3	82.6
Development properties and others	54.0	113.5	129.8	142.2	149.1
<b>Total current assets</b>	<b>190.9</b>	<b>246.3</b>	<b>262.5</b>	<b>283.6</b>	<b>299.9</b>
Trade and other creditors	55.5	61.1	75.2	83.0	91.2
Short-term borrowings	16.5	31.3	35.8	36.1	22.0
Other current liabilities	39.8	96.5	82.2	83.5	88.1
<b>Total current liabilities</b>	<b>111.8</b>	<b>188.9</b>	<b>193.2</b>	<b>202.7</b>	<b>201.4</b>
Long-term borrowings	13.7	15.7	19.7	16.0	13.2
Other long-term liabilities	1.4	1.3	1.3	1.3	1.3
<b>Total long-term liabilities</b>	<b>15.0</b>	<b>16.9</b>	<b>20.9</b>	<b>17.3</b>	<b>14.5</b>
<b>Shareholders' funds</b>	<b>143.6</b>	<b>80.5</b>	<b>90.1</b>	<b>106.9</b>	<b>128.8</b>
Minority interests	0.1	0.4	0.7	1.1	1.5
NTA/share (RM)	0.52	0.40	0.45	0.53	0.64
<b>Total Assets</b>	<b>270.6</b>	<b>286.7</b>	<b>305.0</b>	<b>328.0</b>	<b>346.2</b>
<b>Total Liabilities + S'holders' funds</b>	<b>270.6</b>	<b>286.7</b>	<b>305.0</b>	<b>328.0</b>	<b>346.2</b>
<b>Cash Flow (RM m, FYE Dec)</b>	<b>2014</b>	<b>2015</b>	<b>2016F</b>	<b>2017F</b>	<b>2018F</b>
Pretax profit	(12.9)	(72.3)	13.9	22.2	28.7
Depreciation & non-cash adjustments	19.2	49.6	(2.3)	(1.0)	2.6
Working capital changes	(20.3)	10.9	(5.4)	(1.9)	(0.3)
Cash tax paid	0.3	(0.7)	(16.5)	(2.2)	(3.5)
<b>Cash flow from operations</b>	<b>(13.7)</b>	<b>(12.4)</b>	<b>(10.2)</b>	<b>17.1</b>	<b>27.6</b>
Capex	(1.4)	(3.2)	(3.0)	(3.0)	(3.0)
Net investments & sale of FA	0.0	1.9	0.0	0.0	0.0
Others	24.0	1.7	0.0	0.0	0.0
<b>Cash flow from investing</b>	<b>22.7</b>	<b>0.3</b>	<b>(3.0)</b>	<b>(3.0)</b>	<b>(3.0)</b>
Debt raised/(repaid)	23.1	12.5	8.5	(3.3)	(16.9)
Equity raised/(repaid)	0.0	0.0	0.0	0.0	0.0
Dividends paid	0.0	0.0	0.0	(0.9)	(1.2)
Cash interest & others	(8.5)	(9.9)	(1.8)	(1.6)	(0.6)
<b>Cash flow from financing</b>	<b>14.6</b>	<b>2.5</b>	<b>6.8</b>	<b>(5.8)</b>	<b>(18.6)</b>
<b>Change in cash</b>	<b>23.6</b>	<b>(9.6)</b>	<b>(6.4)</b>	<b>8.3</b>	<b>5.9</b>
<b>Change in net cash/(debt)</b>	<b>0.5</b>	<b>(22.0)</b>	<b>(15.0)</b>	<b>11.6</b>	<b>22.8</b>
<b>Ending net cash/(debt)</b>	<b>(2.4)</b>	<b>(24.4)</b>	<b>(39.4)</b>	<b>(27.8)</b>	<b>(5.0)</b>
<b>KEY RATIOS (FYE Dec)</b>	<b>2014</b>	<b>2015</b>	<b>2016F</b>	<b>2017F</b>	<b>2018F</b>
Revenue growth (%)	(24.2)	26.7	48.2	12.1	9.9
EBITDA growth (%)	(48.2)	(233.2)	156.0	51.3	21.7
Pretax margins (%)	(13.5)	(59.9)	7.8	11.1	13.0
Net profit margins (%)	(18.7)	(60.0)	6.4	9.1	10.8
Effective tax rates (%)	(38.5)	0.1	16.0	16.0	16.0
Net dividend payout (%)	0.0	0.0	(15.7)	(19.6)	(18.8)
ROE (%)	12.7	(41.8)	12.6	17.1	18.4
Free cash flow yield (%)	(74.7)	(77.3)	(65.3)	69.6	121.5

Source: Company, NRA Capital forecasts

# Regal International Group Ltd.

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