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Boustead proposes a BREAK-UP

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Demerging its real-estate business could unlock value at the conglomerate. But it would leave it more exposed to the volatile energy sector. Should investors support the proposal?

Boustead Singapore's chairman and CEO Wong Fong Fui likes to say that his company's seemingly diverse and far-flung businesses have one important thing in common: They are all engineering-related. Yet, he struggled for years to get analysts and investors to understand the group. Now, just as the market is beginning to appreciate the 186-year-old conglomerate's earnings stability and rising dividend payouts, Wong has let it be known that he intends to break it up.

On Dec 2, Boustead announced that it was considering demerging its real-estate business and listing it separately. The real-estate business, known as Boustead Projects, is essentially a niche industrial property developer. Over the years, it has accumulated a portfolio of properties leased to clients for whom they were designed and built. This business was incorporated in 1996 soon after Wong took control of the group.

Boustead has two other major business divisions. Its energy engineering division builds process heaters and waste heat recovery units for oil refineries and petrochemical and power plants. The division also includes Boustead Salcon Water Solutions, which is involved in wastewater treatment and is now focusing on projects in the energy sector.

The other key division is the geospatial technology unit, which distributes geographic information mapping software. This unit serves a diverse range of clients, including government agencies involved in disaster response planning, natural resource companies that want to efficiently organise their operations and minimise their environment impact and even retailers trying to figure out where to locate their outlets and warehouses.

Boustead was originally a British trading *hong*, founded by Edward Boustead in 1828. It traded commodities, and went on to planting rubber and smelting tin. It later represented many consumer brands such as Cadbury, Nestle, Nissan and Thomas Cook on both sides of the Causeway. After Singapore and Malaysia split in 1965, Boustead itself broke into two entities operating independently in each country. By virtue of their geographic location, most of the company's assets and properties went to the Malaysian arm, which is now known as Boustead Holdings. The Singapore company was left with a smattering of distribution agencies, an upstream engineering business serving the oil and gas sector, and the geospatial technology business.

In 1996, Wong and some partners acquired a 65.4% stake in the Singapore company, at a price that valued the whole company at $80 million. Wong had been CEO of food group QAF, which he helped turn around and sell to Indonesia's Salim group. He initially wanted to use Boustead to build another food empire, but later abandoned the idea to avoid a confrontation with his business associates in that field. Instead, he went into industrial properties, water treatment and paging services. The paging services provider, EasyCall International, which owns a college in China, has since been sold. Today, Wong holds a 33.7% stake in Boustead. The company has a market value of $886 million.

While it isn't a particularly large company, Boustead is arguably among the most global of Singapore's companies, with businesses and projects in more than 80 countries all over the world. Yet, that's one reason it has flown under the radar of analysts and investors. "It takes a lot of time and effort to understand the company and start coverage, [given that it's] a company with a market cap of only $1 billion," says Brandon Ng, an analyst at UOB Kay Hian.

Still, the company's steady revenue and earnings, robust balance sheet and gradually rising dividends have won it some fans. Besides UOB Kay Hian, the company is now also covered by Phillip Securities and CIMB. Shares in Boustead soared to an all-time high of $1.934 on March 24, but have since retraced to $1.70. The stock is trading at 13 times forward earnings and offers a dividend yield of about 5%.

Pros and cons of a break-up

Wong walks into the boardroom at his office in Edward Boustead Centre, raising his hand in a salute of sorts to the 40 people who have gathered for Boustead's annual meeting with retail investors. The crowd has already spent two hours listening to updates on the company's business operations. As Wong sits down at the corner of a white marble table, one long-time shareholder immediately takes the opportunity to voice her opposition to the idea of breaking up the company.

"I thought you would be jumping for joy," Wong says. The idea of breaking up Boustead has been around for at least three years. In a 2012 interview with *The Edge Singapore*, Wong disclosed that he had received an offer for subsidiary Boustead International Heaters and was also considering spinning it off and listing it. At the time, BIH was generating an annual revenue of $122 million.

Wong said then most of Boustead's other major business divisions were also sizeable enough and had sufficient track records to be listed on their own. As separately listed units, they might well be easier for analysts and investors to understand and value, putting them in a strong position to raise capital and expand, he noted. Nothing came of those ideas, though. Subsequently, Wong mooted the idea of unlocking value at Boustead Projects, packaging its expanding portfolio of properties into a real estate investment trust (REIT).

Yet, it is clear that some investors prefer Boustead to be left pretty much intact. The shareholder who voiced her opposition to the break-up pointed out that spinning off Boustead Projects would leave the rest of the group heavily exposed to the oil and gas sector, which is now convulsing on sharply weaker oil prices. Maintaining its diversity would shield Boustead from the cycles of individual industries such as energy, the shareholder pointed out.

To be sure, from the perspective of investors, there are pros and cons to breaking up the group. However, from the point of view of the company's management and controlling shareholder, a break-up of the group might be inevitable. Wong, 71, clearly cannot continue running the group forever. And, he is indicating a desire to put in place a succession plan.

He says it could now be time for Boustead Projects to be spun off as it is doing well, and its management team has a proven track record in decision-making and execution. "So, we are allowing them to go on independently, and encouraging them to feel they are responsible for themselves," Wong says. Boustead Projects is run by Thomas Chu, who holds the position of managing director. The younger of Wong's two sons, Yu Wei, 37, is senior deputy managing director of Boustead Projects and reports to Chu.

"Thomas has done exceedingly well and Yu Wei doesn't mind playing second fiddle," Wong says of the team he has put in place at Boustead Projects. Wong's older son, Yu Loon, 39, is Boustead's group investment director and heads the energy engineering division. Wong tells *The Edge Singapore* that he is trying to put in place a new and younger team of managers who will be able to take over eventually. In the past year, both of Wong's sons have taken a more public profile in the affairs of Boustead.

Much like Wong's sons, Boustead Projects is also coming of age. In the early days, it grew fast by designing and building industrial properties for its clients. It also adopted the model of holding the properties on its books and leasing them to clients, earning steady revenue from the assets. However, after 18 years in business, things are getting much more competitive, not least because of the emergence of REITs. "We need to be more focused," Wong says. "As a separate entity, [Boustead Projects] can make decisions faster. As a parent, you want your child to grow up, so I think this is the right thing to do."

The demerger plan is at a preliminary stage and it is not yet clear how it will be done. It could involve a restructuring of the real-estate business under Boustead Projects, followed by a distribution in specie to shareholders of the company, according to company officials. This means that shareholders will get shares in the divested company on the basis of their holdings in Boustead. Boustead Projects could then be listed. The REIT plan is a separate matter from the demerger exercise and will be pursued, company officials say.

Will shareholders of Boustead be better off if Boustead Projects is demerged? Is that a reason to buy shares in Boustead now? How high could this stock go?

'Beautiful conglomerate'

Joshua Tan, an analyst at Phillip Securities, says he is not convinced the demerger of Boustead Projects is the best way to unlock value for the group. "Boustead is one of the most beautiful conglomerates we have in Singapore. It's not humongous but very profitable and well run. It gives a hedge against the various business cycles. If you demerge, you will lose one leg."

The way Tan sees it, a demerger would only benefit investors with a short-term view. For investors who want to hold Boustead for the long term and sleep easy while doing it, maintaining the current diversified conglomerate structure makes more sense.

On the other hand, Ng of UOB Kay Hian is all for a demerger. "With the split, it could have some institutional investor following," he says. "Some fund managers give a conglomerate discount to companies like this." Others cannot even invest in conglomerates such as Boustead because their mandates allow them to invest only in mid-cap companies that are also pure plays in specific fields.

Phillip's Tan says while it is true that companies with market caps of more than $1 billion tend to have broader followings, those with market values of more than $500 million with compelling track records have little trouble attracting institutional investor interest too. In the case of Boustead, the tightly held shares rather than the market capitalisation is the main problem in attracting institutions. "The real issue is that the shareholding is tightly held by people who don't want to sell, and for very good reason," he says. "Boustead is a very good company."

Even with a largely retail shareholder base, Boustead's market performance hasn't been too bad in recent years, according to Tan. He concedes that a demerger could result in a 50% pop in value for Boustead's shareholders, though the risk profile of the separated units would be higher. In his view, the board has to explore all options to maximise the value of the group, but he notes that the demerger proposal has created a fresh buzz about Boustead.

Viable pure plays

That's not to say that Boustead Projects and the rest of the Boustead group couldn't attract a broader following on their own. In fact, Boustead Projects could be an interesting company if it adopts the model of other major real-estate groups such as CapitaLand that have developed a stable of REITs and funds to support their growth.

Tan says if Boustead Projects is to be a viable stand-alone entity, it has to move away from doing just engineering work. It also needs to develop a fund management platform to manage an expanding portfolio of assets and raise the necessary capital. "Then, you can be a strong entity with double-digit PE [price-to-earnings]," says Tan. "Valuation does not depend just on earnings but on earnings resilience and the business model must be complete. With all these elements, it will be complete."

In fact, Boustead Projects formed a partnership with Abu Dhabi Investment Corp in August to develop and redevelop logistics and industrial projects. The group has also invested in projects led by Perennial Real Estate Holdings, the property group run by Pua Seck Guan, a former CapitaLand executive. Over the past year, Boustead has also looked to Malaysia for opportunities in real estate. Under a joint venture with Mainboard-listed Tat Hong Holdings and privately held Malaysian developer AME Construction, it recently launched an industrial project for small and medium-sized enterprises in Iskandar Malaysia. Of the 52 units offered in the first phase of the project, 27 have been sold.

Meanwhile, a unit of Boustead Projects is also undertaking a RM90 million ($33.4 million) contract to build a medical device manufacturing facility for a US company in Kulim, in the Malaysian state of Kedah. The contract is a milestone in that it gives Boustead Projects critical mass to build a separate team in Malaysia to develop business there, according to officials at the company.

As for the rest of Boustead, analysts say there is enough to keep investors interested even if it loses the real-estate business, which contributed 39% of group revenue in 2QFY2015 ended September. Boustead's geospatial business is a cash cow, generating $26.4 million in revenue in 2QFY2015, of which half is recurring income. The energy division is also a valuable niche business, contributing $52.4 million, or 40.4% of group revenue.

What about the impact of falling oil prices? "I don't think we need to worry. We are a service provider. We are not a manufacturer of equipment, so our overhead and capital expenditure is low. Look at the Gold Rush. The investors went bust. The only people who survived were the service providers. So, we will survive," Wong says.