Stock Digest

Initiating Coverage - AWC Bhd

Monday, 26 Sep, 2016

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Diversified Business Paves Way To Growth

Investment Highlights

- We initiate coverage on AWC with a **BUY** recommendation and a target price of RM1.05. Our recommendation is premised on the group's balanced business portfolio, which is a mix of stable and recurring-concession income, as well as high margin cash flows from its niche position in the plumbing and pneumatic waste management industry. With the renewal of the ten-year government facilities management concession and Critical Asset Refurbishment Programme (CARP) contract, on top of the acquisition of plumbing specialist, Qudotech and rainwater harvesting system provider DD Techniche (DDT), we think that AWC will achieve decent earnings growth in the foreseeable future.
- With the increasing awareness for corporate and environmental sustainability, we believe there is potential growth in AWC's green initiatives as it capitalises on its extensive skills and track record in the environmental business. AWC can also leverage on the synergy between its facilities management, engineering and environment divisions, which could further boost its earnings growth.
- Moving forward, the group plans to reduce its reliance on government-related projects, while expanding its waste management and engineering operations. The focus will be on private sector projects in the healthcare and commercial sectors, which commands higher margins due to the greater amount of experience and skills needed.
- We forecast AWC to register double-digit five-year net profit and revenue CAGRs of 37.6% and 16.7% to RM22.5 mln and RM314.3 mln respectively by FY18. We value the group by ascribing a target PER of 13x to its FY17 EPS of 8.0 sen, which we think is justified due to its strong earnings growth potential – as reflected in its low PEG of 0.4x for FY17.

Financial Highlights					
FYE June (MYR mln)	**2014A**	**2015A**	**2016A**	**2017F**	**2018F**
Revenue	**119.5**	**128.0**	**249.3**	**283.1**	**314.3**
EBITDA	**15.0**	**14.2**	**31.9**	**39.8**	**43.9**
Net Profit	**7.0**	**8.1**	**17.2**	**21.2**	**22.5**
Revenue Growth (%)	*-17.6*	*7.1*	*94.8*	*13.6*	*11.0*
EBITDA Growth (%)	*30.9*	*-5.0*	*123.9*	*25.0*	*10.3*
Net Profit Growth (%)	*52.6*	*16.3*	*113.4*	*23.1*	*5.9*
EPS (sen)	2.7	3.1	6.6	8.1	8.6
P/E(x)	30.9	26.6	12.5	10.1	9.6
Dividend Yield (%)	0.0	0.0	3.0	3.0	3.0
P/BV (x)	2.01	1.84	1.45	N/A	N/A
ROE (%)	8.8	8.8	14.5	N/A	N/A

Source: Company Data & MSSB Research

Recommendation: BUY

Share Price: RM0.82
Target Price: RM1.05

Key Statistics

Stock Code: 7579

Stock Information: Engaged in the provision of integrated facilities management services, engineering services and automated pneumatic waste collection systems.

Sector: Trading/Services

Industry: Professional & Technical Specialty Services

Listing: Main Market

Share Issued (mln): 262.3

Market Capital (RM mln): 215.1

Par Value (RM): 0.30

Major Shareholders:
K-Capital Bhd 30.3%
Dato' Ahmad Kabeer bin Mohamed Nagoor 3.4%
Md. Shah Bin Abu Hasan 2.5%

Recommendation

We like AWC for its diverse and resilient earnings, underpinned by a balanced portfolio mix of stable and recurring revenue from the facilities division, as well as decent returns from its environmental and engineering division. Steady cash flows from concession-based facilities management contracts will ensure that AWC is well-positioned to withstand the downtrend of the cyclical engineering industry, while the group's niche position in the plumbing and automated waste management industry will enable AWC to secure superior margins compared to its peers during the industry upcycle.

Due to AWC's asset-light and cash rich business model, the group has a strong balance sheet with RM49.3 mln worth of unencumbered cash as of 30th June 2016. The management has also guided that about RM30.0 mln to RM40.0 mln worth of borrowings will be procured to fund the CARP project in FY17 and FY18. Still, its balance sheet strength will permit the group to expand its businesses when opportunities arise.

We also see potential in AWC's waste management and rainwater harvesting systems which command lucrative margins despite still in their infancy stage. The increasing popularity for sustainable developments will fuel the need for green technologies and we believe that AWC has the capability to cater to the sprouting demand.

Lastly, we like the synergistic advantages of its engineering division - which presents cross selling opportunities to the other divisions such as the CARP and Integrated Facilities Management (IFM) contracts from the Facilities division.

Investment Risk

Risks to our recommendation and target price include delays in project execution due to cyclical risks inherent to the construction industry, which could adversely impact the group's margin and profitability. Failure to complete the contract works within the stipulated time frame could also result in arbitration and legal proceedings against the group, as well as tarnishing its reputation, making it difficult to secure future contracts.

The group's engineering division faces margin compression risks due to intense competition from cheaper substitutes and the saturated local heating, ventilation & air-conditioning (HVAC) market. However, the risk is substantially reduced by AWC's diversification into the plumbing and rainwater harvesting segment in 2015, which commands better margins.

Escalating energy and utility cost, on top of higher prices of consumables, could squeeze margins of government-linked concession projects. However, this is mitigated by higher rates following the renewal of the IFM government contract, which increased to RM52.0 mln in 2016 (from RM46.0 mln) for a period of five years and to RM59.0 mln from year six onwards. Further, the facilities management fees are also subject to renegotiation in the event of sudden cost escalations.

Higher costs (i.e: energy costs) from employing the group's automatic waste collection system (AWCS) vs. its traditional methods could potentially deter clients. However, the management has guided that a new patented system could reduce electricity usage by approximately 80.0%.

Company Background

AWC Bhd (formerly known as AWC Facility Solutions Bhd) is an investment holding company, while its subsidiaries and associates specialises in the provision of facilities management services, engineering services and environmentally-friendly automated pneumatic waste management solutions.

AWC was listed on the Second Board of the Bursa Malaysia in 2003, then mainly as an integrated facilities management provider, replacing Trans Capital Holding Bhd after acquiring the latter in a reverse takeover exercise.

In 2015, the group acquired Qudotech Sdn Bhd and DD Techniche (rainwater harvesting system provider) as an addition to AWC's engineering segment to counter the stiff competition and thinning margins in its building management system (BMS) and HVAC-related division.

AWC's Chairman is Dato' Nik Mod Amin Bin Nik Abd Majid, while the Managing Director-cum-Group Chief Executive Officer is Dato' Ahmad Kabeer Bin Mohamed Nagoor. Dato' Ahmad, a founding member of the AWC Group, is educated in the University of St. Louis, Missouri, USA with a Master's Degree in Finance. Presently, Dato' Ahmad holds a substantial stake in AWC with an estimated effective stake of 34.1% (direct: 3.4%, indirect via K-Capital: 30.7%).

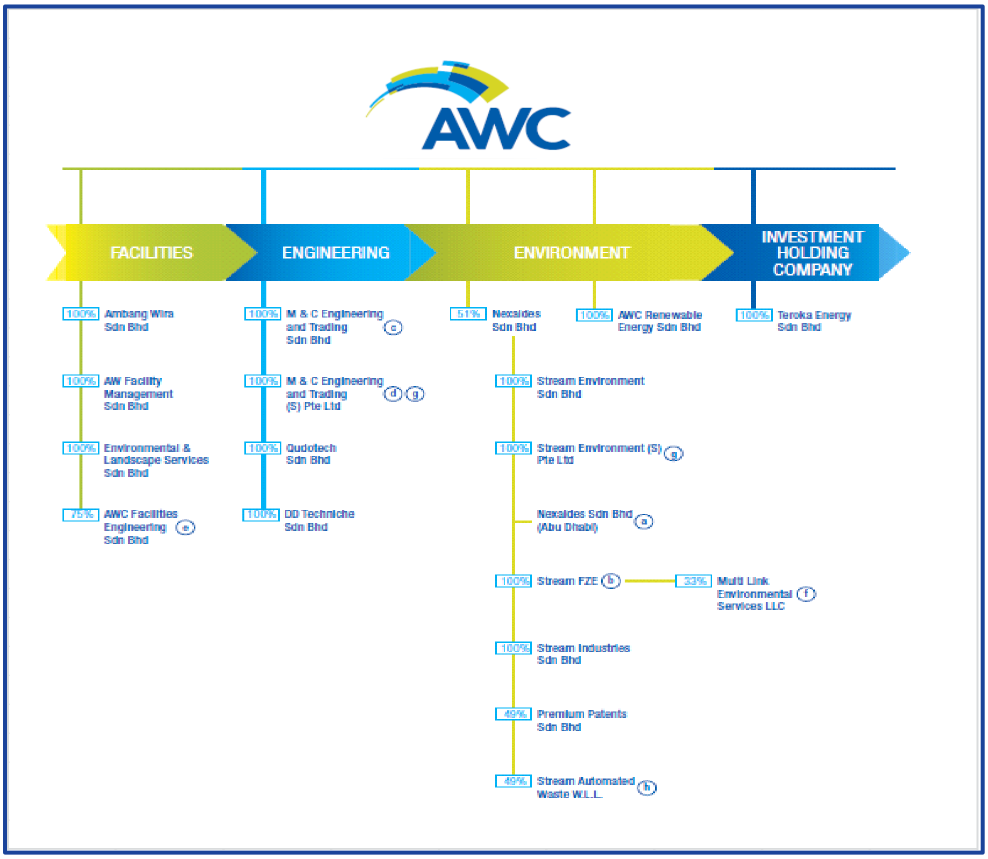
Although the majority of its business is domiciled in Malaysia, AWC has established a regional presence in United Arab Emirates, Singapore and Hong Kong. Key projects completed included:

1. Integrated Facility Management and Mechanical & Engineering works for the Prime Minister's office in Putrajaya (RM10.0 mln)

2. Integrated Facilities Management Services Concession on Federal Government buildings in Johor, Malacca, Negri Sembilan and Sarawak (about RM480.0mln)

3. Design, supply and installation of STREAM AWCS at Al-Raha Beach Development (RM177.4 mln)

Corporate Structure



Source: Company Data

Business Segments and Outlook

AWC's subsidiaries are mainly divided into three main business segments which consist of:

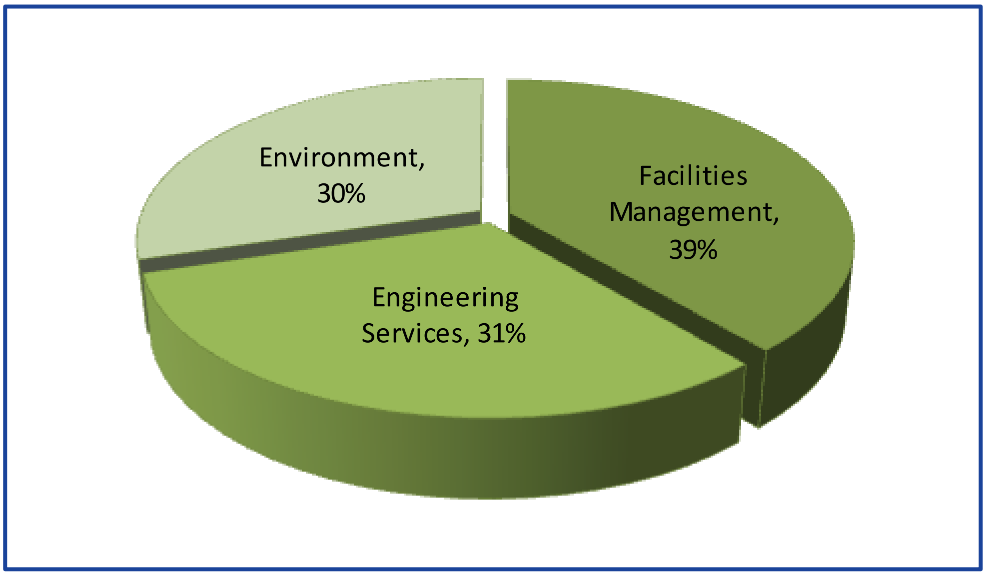
- Facilities Management
- Engineering Services
- Environment

These subsidiaries carry out activities such as: i.) providing IFM services to building owners, ii.) designing, supplying, installing, testing and commissioning of automated pneumatic waste collection system, iii.) providing heating, ventilation, air-conditioning system (HVAC), as well building management system (BMS), iv.) trading of BMS and HVAC components, and v.) providing plumbing and rainwater harvesting systems.

AWC's FY16 revenue is quite evenly distributed among its facilities division (RM96.7 mln or 39.0%) - which is relatively fixed and recurring, engineering division (RM78.3 mln or 31.0%) and environment division (RM74.3 mln or 30.0%), which boast of more lucrative margins due to its niche position.

Historically, about 70.0% of its revenue was from local operations, while Singapore accounted to around a quarter of its total revenue, followed Qatar and the United Arab Emirates with the rest.

Revenue Breakdown – FY16



Source: Company Data

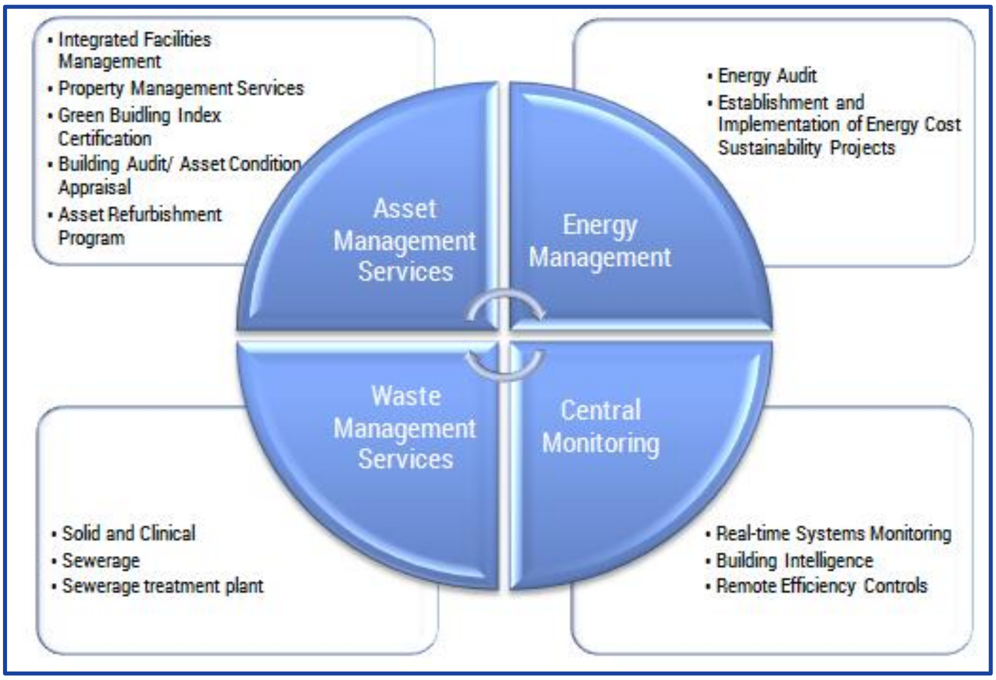
AWC's total outstanding orderbook of about RM1.2 bln, as at 30th June 2016, will provide earnings visibility for the next nine years. The facilities division's outstanding orderbook is about RM700.0 mln, while RM500.0 mln is shared between the engineering and the environment divisions. Going forward, we estimate the EBITDA margins to average 10.0%/12.0%/24.0% for the facilities, engineering and environment divisions respectively.

Facilities Management

AWC provides IFM services such as biomedical, facilities engineering maintenance services, security and cleaning services to buildings and facilities owners.

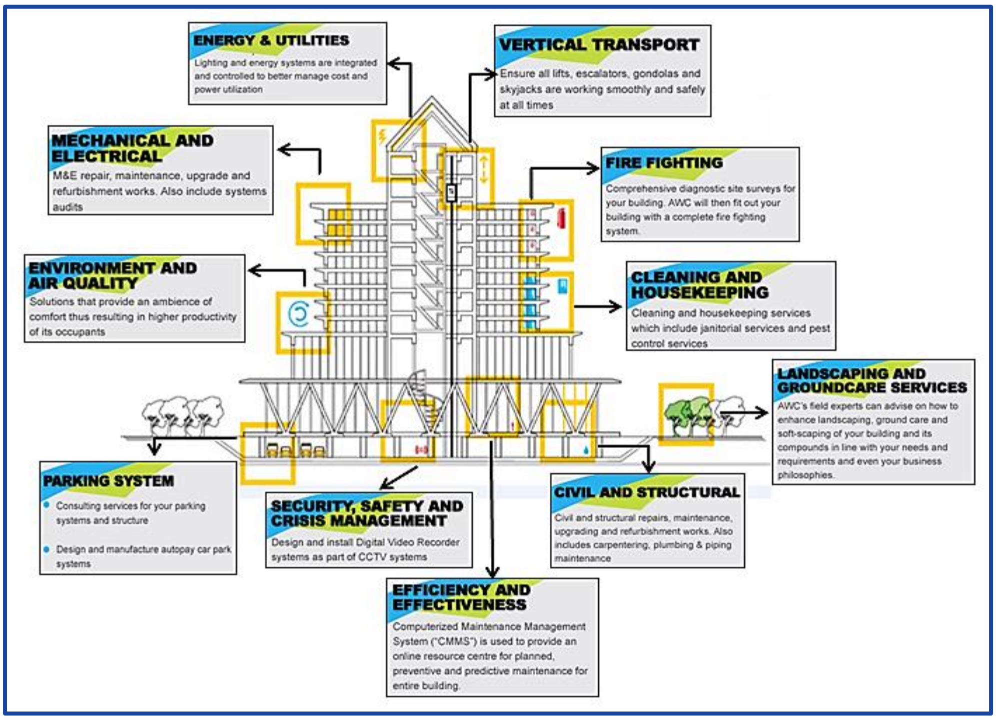
The facilities management division can be further divided into three sub-segments – namely, concession, commercial and healthcare segments. Projects secured in the concession segment are typically ten-year contracts from the Government or government-related bodies, while commercial and healthcare-related projects have shorter contract periods ranging from one-to-three years.

Core Services provided by the Facilities Management Division



Source: Company Data

Scope of Work



Source: Company Data

Newly introduced in 2016, CARP undertakings include the refurbishment of critical facilities infrastructures according to a pre-determined timeline. The CARP contract is a subset of the ten-year renewal of AWC's concession to maintain government buildings in Melaka, Negeri Sembilan, Johor and Sarawak that was awarded by the Federal Government, worth a cumulative RM695.0 mln.

The group has also clinched a RM90.0 mln contract to provide maintenance services to the newly completed Shah Alam Hospital, marking its second project in the local healthcare segment since its foray into the business segment in 2013. Significant other ongoing projects include Cheras Leisure Mall, Hospital Rehabilitasi Cheras and Menara Celcom.

As at 30th June 2016, concession contracts amounts to the lion's share of the FY16's revenue, accounting to about 50.0% of the revenue attributed to the facilities management division, while commercial and healthcare-related contracts made up the remaining 32.0% and 18.0% respectively.

Going forward, AWC plans to pursue organic growth and create additional revenue streams by targeting major contracts from the private sector (i.e.: healthcare or commercial industries), while reducing its dependence on government-linked concession contracts. That being said, the facilities division will still be the major contributor to group revenue in the foreseeable future, on the back of ongoing big ticket maintenance projects such as government-linked CARP and the Shah Alam hospital contracts.

Engineering Services

Through AWC's wholly-owned subsidiaries, M&C Engineering & Trading Sdn Bhd and M&C Engineering & Trading (S) Pte Ltd, the group distributes building controls and engineering components for HVAC system, as well as provides BMS in Malaysia and Singapore.

In 2015, the group began undertaking larger projects as an air-conditioning contractor in the HVAC industry, implementing full-scale air conditioning systems for buildings and facilities in a bid to mitigate the competitive environment in its traditional (trading) industry.

AWC also provides Building Automation System (BAS), which links together individual building systems (i.e.: security, lighting and water flow system) to form an automatic centralised control, regulating building functions, increased energy efficiency and allowing insights into a building's critical systems.

Ongoing Projects undertaken by the Mechanical & Engineering/BMS/HVAC segment

Source: Various

On 9th October 2015, the group acquired 100.0% equity stake in Qudotech and DDT, which is primarily involved in the design, installation and supply of Rainwater Harvesting Components and Products (RHCP) and has two exclusive dealerships for the distribution of RHCP in Malaysia. Under the acquisition terms, the vendors of Qudotech and DDT have agreed to a profit guarantee of RM3.9 mln per year for two financial years until FY17.

With more than 21 years of experience in the plumbing industry under its belt, Qudotech has completed approximately RM220.0 mln worth of projects todate. Key accomplishments include the KLIA2 Satellite Building, Platinum Park and IB Tower, while ongoing projects include PNB1194 and Signature Tower, Tun Razak Exchange.

Meanwhile, DDT is one out-of-only four players in the sale and distribution of RHCP products and it has exclusive distribution right from Germany's 3P Technick rainwater harvesting projects and New Zealand's JOBE part filled valves - giving the company a competitive edge and better control of its profit margins, where the net profit margin amounts to 16.1%, 13.0% and 19.3% from FY13 to FY15 respectively - above the average player's margins in the engineering field.

In FY16, the Engineering division's revenue skyrocketed to RM78.3 mln, from a mere RM19.9 mln (a 294.2% Y.o.Y growth) from the previous corresponding year, due to the inclusion of revenue from the new plumbing subsidiaries as well as the replenishment of air-conditioning contracts.

Moving forward, we remain sanguine on the prospects of the engineering division with the addition of the iconic skyscraper Signature Tower into the group's project portfolio. The aforementioned project will fortify AWC's reputation as an exclusive plumbing contractor, presenting opportunities for more premium high-end plumbing contracts in the future.

We also foresee the potential of growth in AWC's rainwater harvesting segment, mainly due to the limited RHCP players in the market and the increasing scarcity of fresh water supply, resulting in the need for rainwater harvesting (RWH) and utilisation systems. In 2011, the government mandated the incorporation of rainwater harvesting systems in new buildings within a certain roof size. The six states affected include Perak, Selangor, Malacca, Johor, Kelantan and Perlis, as well as the Federal Territory of Kuala Lumpur.

We noted that the aforementioned regulation applies mostly to industrial buildings, as opposed to residential projects.

Environment

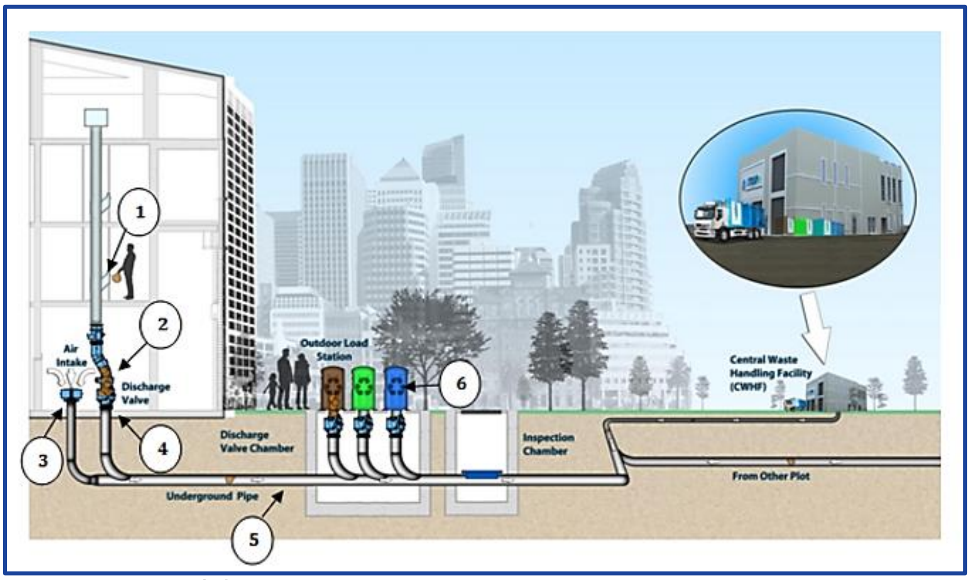
As the leading provider of automated waste management system in Malaysia, AWC provides eco-innovative solutions to conventional waste management systems. Under its internationally recognised brand name, STREAM AWCS, the group is engaged in the design, supply, installation, testing and commissioning of automated pneumatic waste collection system, as well as operations and maintenance (O&M) services of STREAM AWCS.

STREAM is currently owned by Nexaldes Sdn Bhd, a 51.0%-owned subsidiary of AWC, while the remaining 49.0% is held by Premium NXL Sdn Bhd. With significant experience in both the local and overseas markets, STREAM has been steadfast in securing new projects, including the ALDAR Headquarters and Al Bandar located within the Al Raha Beach Development in Abu Dhabi, as well as the Kuala Lumpur Eco City Strata Office suites and Changi Airport Terminal 4 in Singapore. Other notable clients include Sime Darby Bhd, Malaysia Airports Holdings Bhd, Changi Airport Group and Wing Tai Asia.

Regional Clients of STREAM

Source: STREAM website

STREAM Automatic Waste Collection System (AWCS)



Source: STREAM website

The automatic waste collection system or automated pneumatic waste collection system is an underground pipe network system that transports municipal or domestic solid waste from selected waste chutes and outdoor load stations into a sealed container which is about 2.5km away. The illustration above depicts how a standard AWCS works:

1. The refuse is deposited into the waste chutes via a Volumetric Control Hopper Door.

2. The refuse will be temporarily stored above the Discharge Valve (DV) until it reaches a certain level.

3. Once the refuse in the DV exceeds a pre-set level, the STREAM Control Centre (SCC) will activate the Centrifugal Fan (CF), creating a vacuum and active high speed air path inside the piping system.

4. Then, the DV will be opened to empty the refuse into the piping network, transporting the refuse at the speed of 20 to 25 m/s to the Control Waste Handling Facility (CWHF) where refuse will be segregated in a sealed waste container, while the air will be filtered, deodorized and discharged.

5. Transportation pipelines that form the network between the inspection chambers and the CWHF.

6. Load stations located outside of the buildings also allow users to dispose smaller quantities of waste material into the system.

Benefits of AWCS

i.) Eliminates garbage spillages, odours and pests
ii.) Reduces labour cost due to automation
iii.) Facilitate automatic waste separation systems
iv.) Low carbon emissions due to a centralised refuse collection point

Source: STREAM website

In FY16, the environment division saw its sales doubled to RM74.4 mln, compared to RM34.2 mln in FY15 – buoyed by the commencement and delivery of several key projects. Meanwhile, in terms of market share, AWC is the main player in Malaysia, while the group shares an equal market share with global vacuum waste collection provider, Envac AB in Singapore.

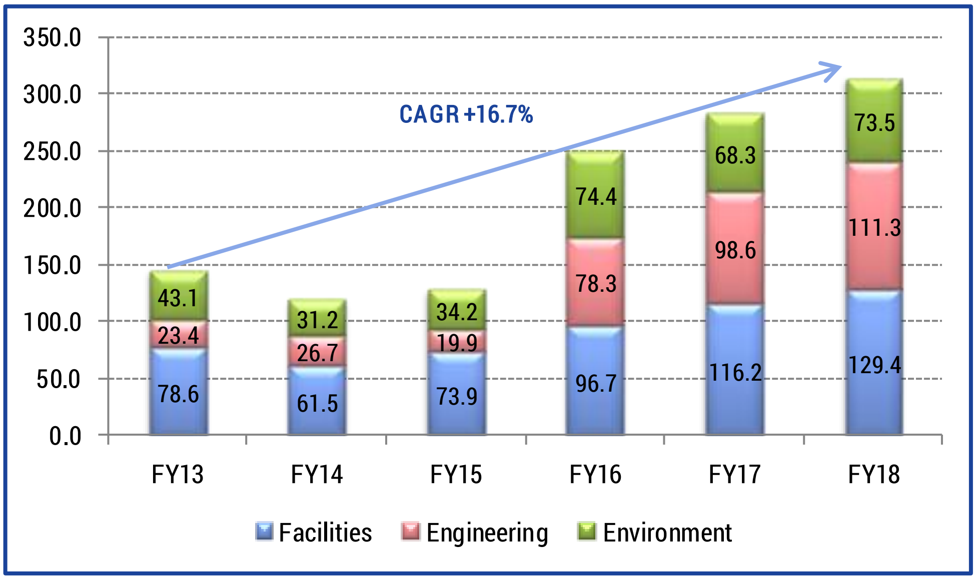
Looking ahead, we expect AWC to expand steadily in both the local and global markets, in tandem with a wider recognition for sustainable developments. Despite the slight slowdown in the property sector, due to sluggish global growth, we think that STREAM AWCS has ample potential to grow into a cash cow in the future on the basis of the group's recent success in penetrating into the Indian and Taiwanese markets (via the ICF Taiwan and IIT India projects) and the unsaturated AWC market.

Earnings Outlook

We estimate AWC's blended EBITDA margin to rise to 14.0% over the next two years – above its historical three-year average EBITDA of 12.1%, fueled by revenue growth in all three divisions as new projects take-off. We expect the facilities division (FY17: 41.0% of revenue) to remain the key driver of the group's revenue, followed by the engineering (FY17: 34.8% of revenue) and environment (FY17: 24.1% of revenue) divisions.

As of 31st May 2016, AWC's tenderbook stood at RM12.0 mln, RM165.0 mln and RM82.0 mln respectively for the facilities management, engineering and environment divisions.

Revenue Breakdown



Source: Company Data and MSSB Research

Based on our estimates, we expect AWC's five-year CAGR (FY13-FY18) revenue, EBITDA and net profit to experience double-digit growth at 16.7%, 30.9%, and 37.6% respectively, underpinned by the renewal of the 10-year IFM concession contract, higher margin projects secured and contributions from Qudotech and DDT.

For FY17, we project AWC's revenue and EBITDA to register a record high of RM283.1 mln (+13.6% Y.o.Y) and RM39.8 mln (+25.0% Y.o.Y) respectively, on the back of the full year recognition from CARP, which could contribute approximately RM14.1 mln in revenue and new contracts secured in FY16. The management expects revenue from engineering projects previously delayed (i.e.: the Xiamen University and Capital 21) to be realised in FY17 – further boosting AWC's top line. Meanwhile, net profit is forecast to increase 23.1% Y.o.Y to RM21.2mln.

In FY18, we expect AWC's revenue and EBITDA to grow at a slower pace to RM314.3 mln (+11.0% Y.o.Y) and RM43.9 mln (+10.3%) respectively. The bottom line is forecast to gain 5.9% Y.o.Y to RM22.5 mln – the softer growth is attributed to higher finance charges incurred on the CARP project and higher operating expenses from its expanded business operations.

Further, the management has guided that about RM30.0mln – RM40.0 mln worth of borrowings will be procured between FY17 and FY18 to finance the initial stage of the CARP project.

We note that the group does not have any dividend policy in place currently, as existing funds are required to finance its working capital and future expansion opportunities. However, AWC has declared a total payout dividend of 2.5 sen a share in FY16.

Valuation

We arrived at AWC's target price of RM1.05 by ascribing a PER of 13.0x to its FY17 EPS of 8.0 sen. The ascribed target PER is at a discount to its bigger competitor, UEM Edgenta due to AWC's smaller business scale and market capitalisation. The discount is also within the 10%-25% discount accorded to smaller companies within our coverage. We opine that the target PER of 13.0x is justified given the group's strong earnings growth potential, which is trading at PEG of 0.4x for FY17.

At the target price of RM1.05, AWC will trade at implied PER of 10.1x in FY17, which is still attractive compared to its nearest competitor UEM Edgenta's forward PER of 13.0x-17.0x. Moreover, the target price also implies a potential upside of 28.3%.

Peer Comparison

	UEM EDGENTA	AWC	AVERAGE
FYE	**Dec**	**June**	
Share Price @ 22, September 2016	3.40	0.82	
Market Capitalisation (mln)	2827.5	213.8	
P/E 2014 (x)	14.8	26.5	20.6
P/E 2015 (x)	17.6	12.5	15.0
P/B 2015 (x)	1.85	1.84	1.8
ROE (%)	15.3	8.8	12.1
DPS (Sen)	15.0	0.0	N/A
Dividend Yield (%)	4.5	0.0	N/A

Source: Company Data & MSSB Research

Income Statement					
FYE June (MYR mln)	**2014A**	**2015A**	**2016A**	**2017F**	**2018F**
Revenue	119.5	128.0	249.3	283.1	314.3
EBITDA	15.0	14.2	31.9	39.8	43.9
Depreciation & Amortisation	1.8	1.5	1.8	2.6	3.4
Net Interest Income/(Expense)	0.5	0.1	0.3	0.0	-1.1
Pre-tax Profit	13.8	12.8	30.4	37.3	39.5
Effective Tax Rate	*27.6%*	*8.7%*	*21.4%*	*22.0%*	*22.0%*
Net Profit	7.0	8.1	17.2	21.2	22.5
EBITDA Margin	*12.5%*	*11.1%*	*12.8%*	*14.1%*	*14.0%*
Pre-tax Margin	*11.5%*	*10.0%*	*12.2%*	*13.2%*	*12.6%*
Net Margin	*5.8%*	*6.3%*	*6.9%*	*7.5%*	*7.2%*

Source: Company Data & MSSB Research

Balance Sheet			
FYE June (MYR mln)	**2014A**	**2015A**	**2016A**
Total Assets	148.3	153.0	233.8
Fixed Assets	6.8	8.2	10.0
Current Assets	131.6	133.1	191.4
Other LT Assets	9.9	11.8	32.5
Current Liabilities	36.9	32.8	82.3
LT Liabilities	4.7	3.2	3.6
Share Capital	68.6	68.6	78.4
Total Equity	106.8	117.0	148.0

Source: Company Data & MSSB Research

Per Share Data					
FYE June	**2014A**	**2015A**	**2016A**	**2017F**	**2018F**
Book Value (sen)	40.7	44.6	56.4	N/A	N/A
Cash Flow (sen)	-8.0	5.7	0.9	N/A	N/A
Net Earnings (sen)	2.7	3.1	6.6	8.1	8.6
Dividend (sen)	0.0	0.0	2.5	2.5	2.5
Payout Ratio (%)	0.0	0.0	38.0	30.9	29.2
Dividend Yield (%)	0.0	0.0	3.0	3.0	3.0
PER (x)	30.9	26.6	12.5	10.1	9.6
P/Cash Flow (x)	-10.3	14.3	95.5	N/A	N/A
P/Book Value (x)	2.0	1.8	1.5	N/A	N/A
ROE (%)	8.8	8.8	14.5	N/A	N/A
Net Gearing (%)	Net Cash	Net Cash	Net Cash	N/A	N/A

Source: Company Data & MSSB Research