INTER-PACIFIC RESEARCH SDN BHD
(449005-X)
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KDN PP8927/07/2013(032977)

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Trading/Services

15 Nov 2016

AWC Bhd

Initiating Coverage

BUY

Current Price	**RM 0.80**
Target Price	**RM 1.00**
Consensus Price	**RM 1.29**

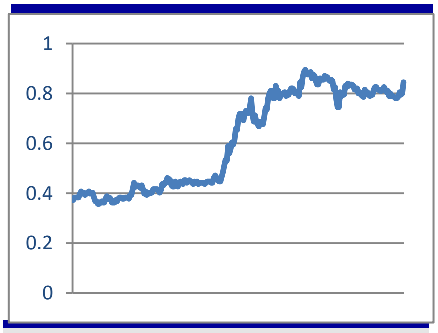
Key Statistics

Bloomberg Ticker	AWC MK
Masa Ticker / Stock Code	AWC/7579
Shares Issued (m)	259
Market Capitalisation (RM'm)	219
52 Week Hi/Lo Price (RM)	0.91/0.35
3 Mths Avg Vol (Shares)	3,790,650
Est Free Float (m)	138
YTD Returns (%)	120.6
Beta (x)	0.51

Major Shareholders (%)

Dato Ahmad Kabeer	33.7

1-Year Share Price Performance



Analyst: Research Team
Email: research@interpac.com.my

AWC - A Well-rounded Company

Valuation: We initiate coverage on AWC Bhd assigning a target price of RM1.00 based on our sum of parts valuation. We like AWC for its 1) Earnings visibility 2) an attractive PER valuation of 9.4x FY18 earnings 3) Well diversified earnings base. We are of the view that the company deserves richer valuation due to its earnings visibility and sustainability. This stands out sharp against the current backdrop of a poor economic environment with dwindling earnings.

- **Nice combination of growth and business segments with stable cash flows:** AWC struckout on agrowth path with the addition of plumbing and rainwater harvesting systems to its businesses, thus also adding synergy to its waste collection system. Qudotech secured high profile projects such as KL118, PNB1194 and the TRX Signature Tower worth a total of RM99m. This adds a new revenue stream to a stable revenue stream that became assured when its concessions for maintaining government buildings and the critical asset refurbishment program concession (CARP) concession were renewed recently, worth RM695m for 10 years.

- **Earnings visibility:** AWC's current order book of RM1.2b, where RM900m are facilities division, RM190m from engineering division and RM120m from environmental division, of which RM500m will sustain the company FY17 and FY18 earnings.

Table 1 :Investment Highlights & Earnings Forecasts

FYE 30th Jun	FY14	FY15	FY16	FY17(F)	FY18(F)
Revenue (m)	119.5	128.0	249.3	263.4	288.4
PBT (m)	12.6	13.8	30.4	33.0	36.0
PAT (m)	8.8	12.6	30.1	25.3	27.7
PATAMI (m)	6.7	8.1	20.7	20.2	22.2
CORE EPS (sen)	2.5	3.1	7.9	7.7	8.5
EBITDA (m)	14.85	14.18	33.16	35.77	38.85
Earnings Growth (%)	46.1%	21.5%	156.7%	-2.5%	9.6%
EBITDA Margin (%)	12.4%	11.1%	13.3%	13.6%	13.5%
PER (x)	31.5	25.9	10.1	10.4	9.4
DPS (sen)	0	0	2.5	2.5	2.5
Dividend Yield (%)	NA	NA	3.1%	3.1%	3.1%
ROE (%)	8.4%	8.8%	17%	15%	15%
ROA (%)	5.9%	8.3%	12.9%	10.0%	9.8%
Net Gearing Ratio (%)	NET CASH	NET CASH	NET CASH	NET CASH	NET CASH
Price/Book Ratio (x)	2.65	2.29	1.76	1.58	1.41

Source: Company, Interpac

Business Divisions

AWC operates three divisions :-

1. **Facilities Management**- provision of an integrated range of maintenance services (integrated facilities management or IFM) for office, commercial, industrial, residential and administrative buildings. These services include electrical, mechanical, civil, structural, energy and utility management and maintenance, vertical transport management, security and safety management and central monitoring systems, landscaping and ground care.

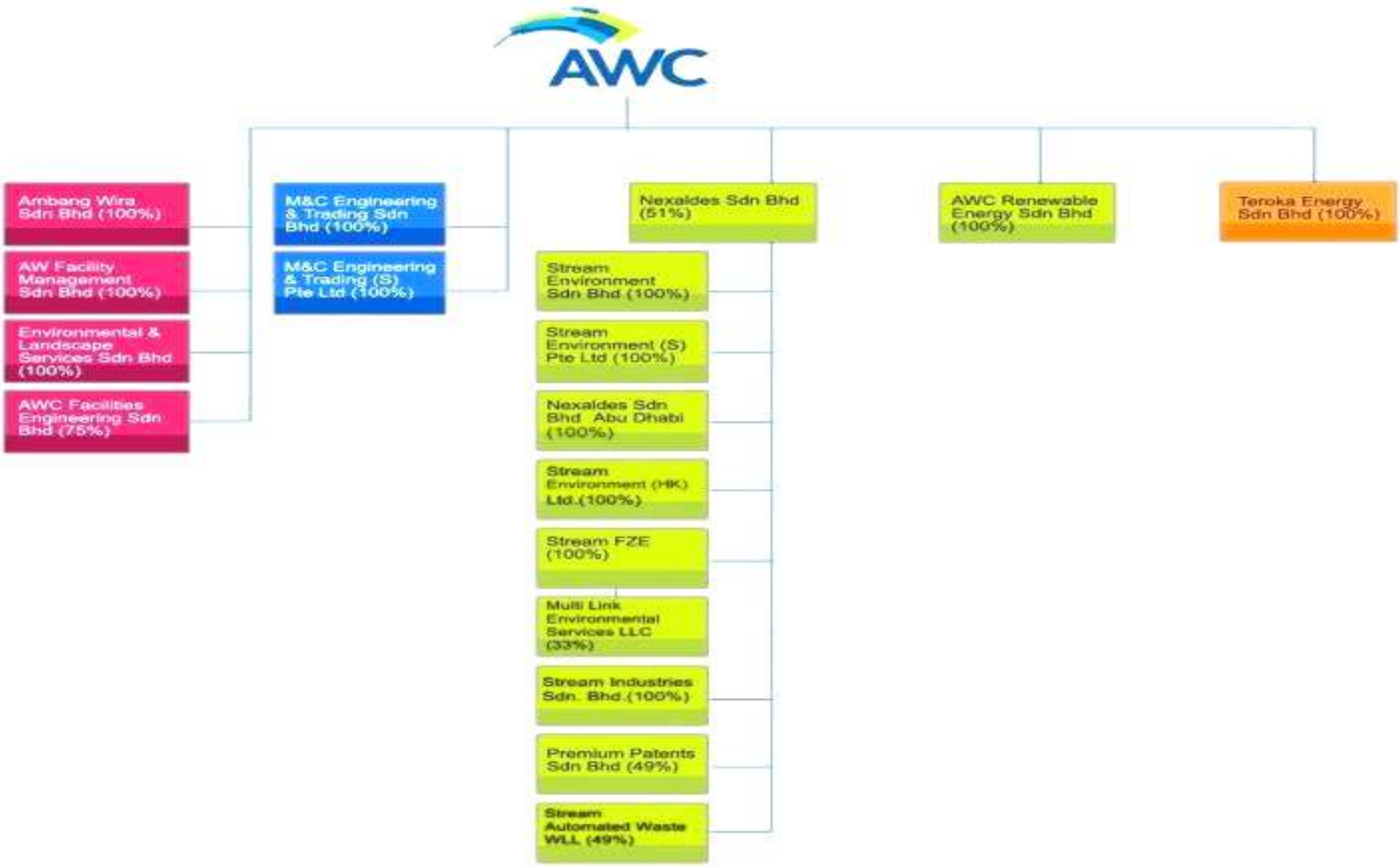
2. **Environment** - provision of environmentally-friendly solutions for waste collection system management. These include general trading, design, development, installation and commissioning of cleaning equipment, central vacuum systems and STREAM Automated Pneumatic Waste Collection System.

3. **Engineering** - provision of various mechanical and electrical engineering services for the building industry. These include plumbing, rain water harvesting system,Building Automation Systems, Heating, Ventilation and Air-Conditioning Systems (HVAC), integrated installation of electrical systems, energy saving and lift systems.

Illustration 1: Business Divisions

Source: Company

Illustration 2: Corporate Structure



Source: Company

Facilities Management Division

AWC provides IFM services on a concession basis for 37 federal government buildings in four states in the Southern region (Johor, Melaka, Negeri Sembilan and in Sarawak since 1998. Its concession is valued at RM555m (USD139m). The concession was renewed on Mar 2016for 10 years from 1 Jan 2016 to 31 Dec 2025 at RM52m annually for the first five years and RM59m annually for the subsequent five years. AWC was also awarded a Critical Asset Refurbishment Programme (CARP) concession value at RM140m for 10years, which involves the replacement of old mechanical and electrical(M&E) equipment in government buildings. Recently AWC awarded RM130m contract from the Government for the maintenance of Terminal Bersepadu Selatan (TBS) in Bandar Tasik Selatan for 5 years. The contract is currently deferred due to pending resolution of certain operational and technical matters between the government and the existing contractor for TBS.

AWC also provides IFM services for commercial clients ranging from commercial buildings, shopping malls to hospitals. In Feb 2016, the company secured a five-yearRM90mil sub-contract for the maintenance of the Shah Alam Hospital. The company also maintains Hospital Rehabilitasi Cheras and all the government clinics in the State of Johor. Non-concession clients are Cheras Plaza, Leisure Mall, OCBC Tower, Menara Celcom and others.

Illustration 3:Facilities division

Source: Company

Environmental Division

The AWC environmental division provides design, engineering, supply of automated pneumatic waste collection systems under its proprietary brand of "STREAM" with on-going projects in Middle East, Singapore, Hong Kong, Taiwan, India and Malaysia. The underground waste collection system is based on a vacuum technology. The management claims it has 90% and 35-45% market share in Malaysia and Singapore respectively. The division also undertakes operations and maintenance services for its clientele.

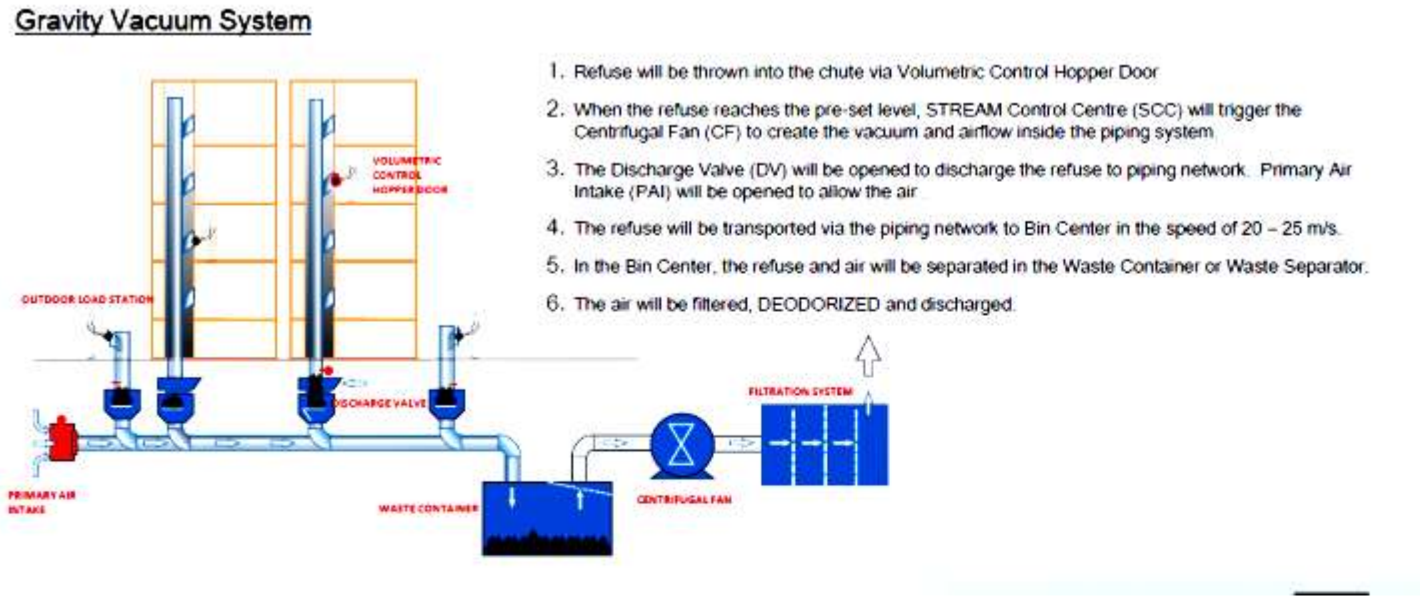
The STREAM system allows for optimisation in both cost and functionality in urban settings. The system is suitable for high rise residential, offices, mix developments, transport terminals, hotels, hospital, convention centres, recreational and tourist park and city developments. STREAM is well recognized internationally, having landed a high profile clientele in the Middle East, Singapore and Hong Kong with providing solutions for buildings such as Changi Airport terminal 3, Tampines North HDB, Changi General Hospital, Cathay Pacific Catering Serving Centre and Abu Dhabi's Al Raha Developmental project.

AWC's special milestone was in 2007, when STREAM expanded to the Middle East and opened a regional office in the UAE. Within 3 years, STREAM elevated itself as the market leader for Automated Waste Collection Systems (AWCS) in the UAE securing contracts valued more than AED400 mil (RM440mil) and expects to pull in RM150m-RM200m worth of contracts over the next 10 years. The environmental division is still in the process of carrying out work in the Al Raha Beach project for Aldar as it works towards completing the new In Plot projects. A total of 20km of underground pipelines has been installed for the Eastern Precinct. AWC was recently awarded the Phase 2 works for the Infrastructure Design as well as for the installation of 4 AWC S-modules to bring to 7 the total number of modules serving this high prestige development. In this respect, Abu Dhabi's government is considering developing the western Precinct with an estimated development cost of RM400m. Given AWC strong likelihood of securing the western Precint developmental works come from its established relationship with the government, AWC could hand out special dividends.

Illustration4 : Benefits of automated pneumatic waste collection system

Source: Company

Illustration5 : Waste collection system



Source: Company

Illustration6 : STREAM's clientele

Malaysian clientele

Source: Company

Singapore Clientele

Source: Company

Changi AirportTerminal 4

Changi General Hospital

The Integrated Transport Terminal (ITT), Bandar Tasik Selatan

KL118 Tower

Source: Company

Engineering Division

This AWC division operates in two subsectors namely 1) Plumbing and Rainwater harvesting 2) M&E/Building Management System (BMS)/HVAC - Building Automation System.

1. AWC acquired Qudotech Sdn Bhd (QDT) and DD Techniche Sdn Bhd (DDT)for RM26.5 m through a combination of cash and issuance and allotment of new ordinary shares of par value 30 sen each in AWC in 4QCY15. The payment is segregated into 3 tranches where the 1st tranche of RM18.7m is paid upon acquisition while the 2nd and 3rd tranche to be settled 30 days after issuance of the audited accounts for the FY16 and FY17 subjected to the provision of cumulated profit guarantee of RM7.8m. The acquisition of QDT and DDT provided working capital surplus, resulting successful bids for KL118 Tower, PNB1194 and TRX Signature Tower.

   QDT is a renowned player in the plumbing industry specializing in cold/hot water and sanitary plumbing catering for high-end and high-rise residential and commercial buildings. It has completed more than RM220m worth of projects since 1995. Its acquisition allowed AWC to expand its existing suite of engineering and facility management services. DDT is principally involved in contracting for mechanical engineering works, the design of piping and systems for rainwater harvesting products and trading of specialised water tanks and rainwater harvesting products. Additionally, DDT distributes both proprietary and non proprietary rain water harvesting products, such as filters, valves, high-density polyethylene tanks, pumps and treatment equipment in Malaysia. DDT is the sole distributor for Germany's 3P Technik rainwater harvesting products and JOBE part filed valves of New Zealand for the territory of Malaysia. DDT imports as well as sources locally for rainwater harvesting products. DDT's order book will grow due to the regulatory push since 2011 to make rainwater harvesting system as a mandatory part of building plans for commercial and industrial buildings, semi -detached houses and bungalows with built-up area equal to or exceeding 100 sq m in Perak, Selangor, Johor, Melaka , Kelantan and Perlis.

Illustration 7 :DDT System'sBusiness Partners

Source: Company

2. The company also distributes several international brands of building controls and engineering components for heating, ventilation & air conditioning (commonly known by the acronym "HVAC") systems and is a provider of building management systems in Malaysia and Singapore. AWC also undertakes larger projects in the HVAC field as a contractor for the implementation of full air conditioning systems for buildings and facilities. Ongoing projects include Xiamen University, Dengkil and Education Hub in Cyberjaya (RM12.7m).

Key drivers of Value

Niche market player poised to tap potential synergies

AWC's environmental arm (STREAM) operates in a niche market for high-end commercial buildings. STREAM overseas clients include Changi Airport Terminal 4, Tampines North HDB, Changi General Hospital, Cathay Pacific Catering Centre and Abu Dhabi's Al Raha Developmental project. In Malaysia, notable clients are The Loft @ Southbay City, Lakeville Residence, KL ECO City, KLIA 2 Integrated Complex,Integrated Transport Terminal and KL Sentral towers. STREAM has 90% and 40% market share in Malaysia and Singapore respectively. This environmental operations unit recorded EBIT margins of 21-23% for the past three years. Recently, the environmental arm won 3 contracts worth RM28mil (USD7mil). These contracts are 1) a RM9.5mil (USD2.4mil) contract for an industrial township in the Delhi Mumbai Industrial Corridor, 2) a RM7.8mil (USD2mil) contract for a new in flight catering facility in Taoyuan International Airport, Taiwan, which is a unit of SATS Singapore, and 3) a RM10.2mil (USD2.6mil) contract for the solid waste management for KL118 Tower. AWC's work for KL118 Tower showcases synergistic cross-selling within the group**. Going forward, the group should see more opportunities to exploit the synergistic potential from its portfolio of waste management, plumbing and rainwater harvesting operations.**

High-profile projects pave way for margin expansion

The engineering arm secured projects worth RM112m following its Qudotech (Plumbing) and DDT (rainwater collection system) acquisitions. Projects recently won include the KL118 Tower, PNB1194 Building, Pejabat Annex (TRX Signature Tower at the Tun Razak Exchange). Other notable projects are The Astaka - Johor Bahru, Puteri Cove Residence- Puteri Harbour, Bayan Tree Signatures- Kuala Lumpur and Ilham Baru Tower- Kuala Lumpur. The expected steadily increasing complexity of the jobs will be in tandem with a steady rise in margins. Management's guidance is that the plumbing division is operating at almost full capacity and it will be prioritizing the execution of its current projects over securing new ones.

Earnings visibility

AWC's earnings visibility is anchored by the renewal of its public sector concessions and its diversification into plumbing systems. Its current order book stands at a impressive RM1.2b vs revenues recognized in FY16 and FY15 of RM249m and RM128m respectively. The replenishment of order books came from the extension of a building maintenance concession contract covering government buildings in the Southern Region (comprising the states of Johor, Malacca, Negeri Sembilan) and Sarawak State (value at RM555m). Secondly, the company was awarded aRM140m deal under the government's critical asset refurbishment program concession (CARP). Under CARP, the company will undertake the refurbishment of critical assets currently deployed in buildings which do not form part of the original concession nor the extended concession. In the event the Government builds any new buildings in the zones, AWSB would then be responsible also for the building maintenance and support services for these future buildings at a contract price to be agreed later. Both concessions periods started from 1 Jan 2016 and provides earnings visibility up to 2025. **The stable concession cash flow leaves room for steady dividends** as the facility division contributed 34% of group EBIT in FY16. **This stands out sharp against the current backdrop of a poor economic environment with dwindling earnings and earnings visibility becoming increasingly widespread. We reckon the company's earnings visibility is a pivotal strength and this offers value for investors.**

Risk

1. **Project execution and slow pick up in green technology**

   Project delays and execution are prominent challenges in the construction industry. A good example was the LRT extension project which was subject to frequent delays leading to a risk of margin compression. Many construction industry peers suffered margin compression in this manner. Secondly, escalating construction cost, resistance to change, a lack of national guidelines for projects implementation and execution are factors impeding green technology. However, government efforts at increasing the adoption of green building codes/guidelines and tax incentives combined with mandatory implementation (rain water harvesting) are positive developments that encourage green technology usage.

2. **Dependence on key personnel**

   AWC is dependent on the directors of its acquired divisional units for their business insight. The continued success of these units could affect the financial performance of AWC should there be loss of key technicians or management team members. The company believes that attractive remuneration, promotion, successful planning and benefits will allow it to retain, attract talent and key technicians to drive growth. STREAM operations are run by its founder Sri Skanda Rajah, his partner Jason Gan Geok Soon and CEO Chea Thein Teik (10> years with STREAM). The company's outline succession plan aims to ensure continued operational capabilities. DDT's and QDT's management teams and senior staff have agreed to remain with their respective operating units for a further 3 and 5 years respectively.

Financials

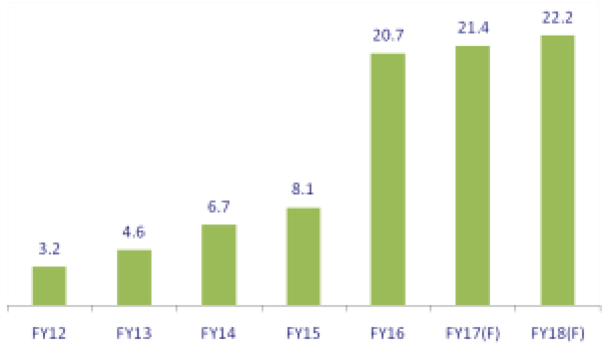
Table2 : Historic and forward EBIT margins

Division	FY12	FY13	FY14	FY15	FY16	FY17(F)	FY18(F)
Facilities Management	6.6%	6.4%	12.1%	9.5%	11.4%	9.5%	9.5%
Engineering	7.8%	-3.4%	4.7%	11.6%	5.0%	10.5%	10.6%
Environmental	33.2%	8.2%	21.1%	23.2%	21.9%	21.0%	21.0%

Source: Company, Interpac

To err on the conservative side, we conservatively project lower margins for the Facilities and Environmental division despite facilities management units having recorded improving EBIT margins generally rising, from 6.6% in FY12 to 11.4% in FY16, and the environmental division's margin at a little above 20%. The Environmental Division reported a sharply lower 8.2% EBIT margin for a year in FY12 due to a revision in the project margin for the Al Raha Beach Development during the financial year. Our forecast excludes of Terminal Bersepadu Selatan (TBS) contract maintenance for 5 years worth RM130m due to pending resolution.

Illustration 8 : AWC PATAMI trending up (RM m)

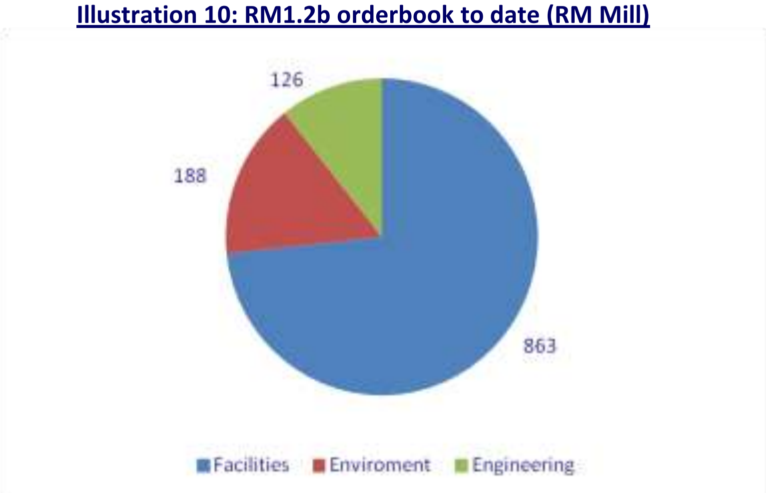


Source: Company, Interpac

We forecast AWC to clinch cumulated RM20m new jobs annually from its environmental and engineering conditioning division. Our forecast excludes possible margin expansion from its facilities and plumbing division. AWC has no formal dividend policy. The group did not declare dividends in FY14 and FY15 due to the concession with the federal government having expired in 2012 and AWC was awaiting confirmation of concession renewal. We believe the AWC is likely to pay dividends again as concession has since been renewed for another 10 years. **We assume the company will pay 25% of its earnings as dividend (2.5sen) for FY17 and FY18.** In our forecasts, the Facilities Management Division will generate 3.0-3.5/share annually, more than our dividend payout assumption.

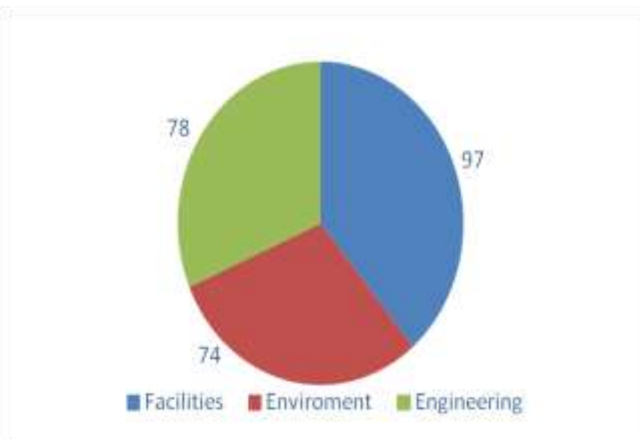
Furthermore, the group is in a net cash position of 19sen/share and business CAPEX requirements are low. We reckon AWC is well-positioned for special dividend payouts or otherwise accumulate cash for acquisitions aimed at vertical integration.

Illustration 10: RM1.2b orderbook to date (RM Mill)



Source: Company

Illustration 11: FY16 Revenue (RM Mill)



Source: Company

Valuation

We are initiating coverage with an assigned valuation of RM1.00 for AWC shares using a sum-of-parts approach. We pegged PER at 11.4x to the facilities division earnings based on the level of valuation ascribed to the KFM Holdings Sdn Bhd(Facility Management Service Provider)acquisition by UEM Edgenta, a conservative PER of 10x for its engineering division and a PER of 10x for the Environmental Division due to its stronger margins. We like AWC for its 1) Earnings visibility 2) its current pricing at an attractive composite valuation of 10x 3) niche player in the burgeoning waste collection systems business 4) a well-diversified earnings base.

With observed valuations compared against UEM Edgenta, AWC is current trading at a discount against UEM Edgenta features a somewhat similar nature of operations (11xforward PER versus UEM Edgenta's 17x,) dividend yield of 3.2% vs UEM Edgenta's 4.4%. On a positive note, AWC order book to rolling 4 quarters revenue ratio stands 4.8x vs UEM Edgenta's 2.2x, easing worries of earnings visibility. We believe AWC's valuation will appreciate when the company's order book rises further and the bottom line grows in tandem, combined with increasing investor awareness as it steps up its nascent investor relations efforts.

Table 3 :Sum Of Parts Valuation

Sum of parts		RM mill	RM(sen)
Concession	FY17 PER 11.2x	96.54	0.37
Engineering	FY17 PER 10x	65.16	0.25
Environmental (51% owned subsidiary)	FY17 PER 10x	51.93	0.20
Net Cash		49.3	0.19
SOP per AWC share			1.00

Source: Interpac

Ratings System

Ratings:	Description:
BUY	Total return is expected to exceed 15% in the next 12 months
NEUTRAL	Total return is expected to be between above –15% to 15% in the next 12 months
SELL	Total return is expected to be below -15% in the next 12 months

Abbreviation

Abbreviation	Definition
PER	Price Earnings Ratio
PEG	PER to Growth
EPS	Earnings per Share
FYE	Financial Year End
FY	Financial Year
CY	Calendar Year
MoM	Month-on-Month
QoQ	Quarter-on-Quarter
YoY	Year-on-Year
YTD	Year-to-Date
p.a.	Per Annum
DCF	Discounted Cash Flow
FCF	Free Cash Flow
NAV	Net Asset Value

Abbreviation	Definition
CAGR	Compounded Annual Growth Rate
CAPEX	Capital Expenditure
DPS	Dividend per Share
ROA	Return on Asset
ROE	Return on Equity
PBT	Profit Before Tax
PAT	Profit After Tax
EV	Enterprise Value
EBIT	Earnings Before Interest And Tax
EBITDA	EBIT Depreciation &Amortisation
WACC	Weighted Average Cost of Capital
NTA	Net Tangible Asset
BV	Book Value

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