Company Update

Jaks Resources

JAK MK
Sector: Utilities

RM1.52 @ 13 March 2018

BUY (maintain)

Upside: 48%

Price Target: RM2.25

Previous Target: RM2.25

Price Performance

	1M	3M	12M
Absolute	-15.1%	2.0%	16.9%
Rel to KLCI	-16.5%	-4.9%	8.0%

Stock Data

Issued shares (m)	496
Mkt cap (RMm)/(US$m)	769.3/193.6
Avg daily vol - 6mth (m)	2.4
52-wk range (RM)	1.25-1.84
Est free float	51.0%
BV per share (RM)	1.43
P/BV (x)	1.07
Net cash/ (debt) (RMm)	(399)
ROE (2018E)	10.4%
Derivatives	No
Shariah Compliant	No

Key Shareholders

Yew Yin Khoon	20.5%
Lam Poah Ang	9.4%
Kit Pheng Tan	8.2%
Original Invention Sdn Bhd	5.8%

Source: Affin Hwang, Bloomberg

Ng Chi Hoong
(603) 2146 7470
chihoong.ng@affinhwang.com

Litigation impact (one-off) is manageable

We maintain our BUY call and 12-month TP of RM2.25 on Jaks Resources (Jaks) after meeting with management regarding the recent litigation, as we believe that the impact on both earnings and cash flow is manageable, even in a worst-case scenario. The current litigation has no impact on Jaks' day-to-day operations, and current earnings growth will likely continue to be supported by its Vietnam EPCC contract.

LAD on Tower A (Star Tower) is unlikely to be more than RM50m

We believe that in the worst-case scenario, where Jaks is liable for the liquidated ascertained damages (LAD) on Tower A (The Star Tower), the amount is only likely to be RM30m, based on the sale and purchase agreement (SPA) and assuming that Jaks can complete the building before the end of June. This is significantly lower than the corporate guarantee of RM50m that Star had called on. While it is up to the court to decide whether to grant the injunction on holding the RM50m payment, Jaks has also initiated an arbitration process to determine the final LAD cost and the party responsible for it.

Earnings impact a one-off; cash flow is not a problem

As Jaks has not made any provisions related to Tower A, it will have to absorb the cost in its P&L, should the court rule against its favour. However, as Jaks only owns a 51% stake in the company, the one-off impact to its P&L is still bearable at RM15.3m–RM25.5m or 18%-30% of its FY18E earnings. We believe that Jaks' day-to-day operation will not be impacted by this, as Jaks is poised to receive around RM154m from a recent land disposal, which would be sufficient to cover the cost, as it is only obligated to repay RM54m of debt associated with the disposed land.

Share price correction overdone; maintain BUY with RM2.25 TP

We believe that the share price correction of 17% (since the Star claim) is overdone, as most investors have already factored in the worst-case scenario. We maintain our BUY call with an unchanged RNAV-based TP of RM2.25, as the valuation is undemanding at a 8.6x 2018E PER. Key downside risks would arise from: 1) the progress of its Vietnam project, 2) construction order book wins, and 3) delays in the Pacific Star project.

Earnings & Valuation Summary

FYE 31 Dec	2016	2017	2018E	2019E	2020E
Revenue (RMm)	632.2	676.9	1,376.3	952.5	639.6
EBITDA (RMm)	57.9	63.0	92.7	127.2	71.3
Pretax profit (RMm)	(6.9)	112.2	68.1	103.1	119.7
Net profit (RMm)	0.8	126.7	85.4	93.1	106.4
EPS (sen)	0.2	26.7	17.7	19.3	22.1
PER (x)	837.2	5.7	8.6	7.9	6.9
Core net profit (RMm)	27.0	37.1	85.4	93.1	106.4
Core EPS (sen)	6.2	7.8	17.7	19.3	22.1
Core EPS growth (%)	>100	26.8	126.8	9.0	14.3
Core PER (x)	24.7	19.5	8.6	7.9	6.9
Net DPS (sen)	0.0	0.0	0.0	0.0	0.0
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0
EV/EBITDA (x)	46.8	10.0	16.6	12.1	21.6
Chg in EPS (%)			-	-	-
Affin/Consensus (x)			-	-	-

Source: Company, Affin Hwang forecasts, Bloomberg

Delay cost still controllable

Delays on Pacific Star are already well known

The property segment has been in the red since 2016 (excluding the gains from land disposal), driven by both the losses of the Evolve Concept Mall and the Pacific Star development project. However, we reckon that the recent share price correction was largely due to the claim by Star on Jaks' RM50m performance guarantee as it has yet to deliver Tower A (The Star Tower).

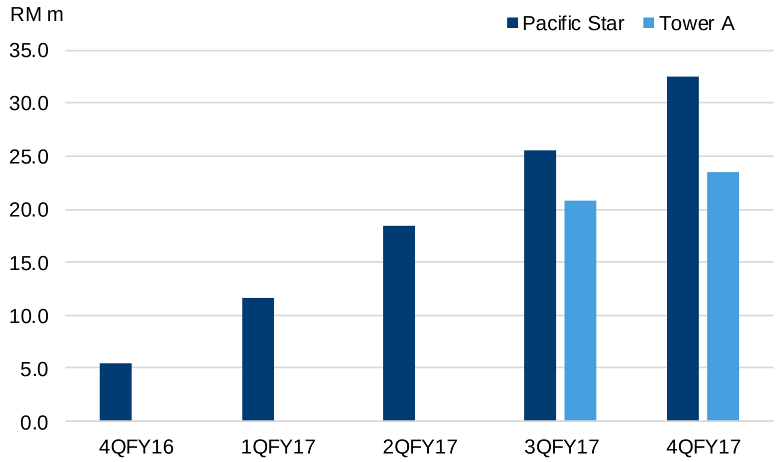
Fig 1: Overview of the Pacific Star development project

Source: Company

Started recognising the LAD (Tower B, C, D and E) in P&L

We believe that management understands that it is liable for the delays on Towers B, C, D and E, but not Tower A (The Star Tower), and had made LAD provision charges in its P&L amounting to around RM33m for those towers since 4Q2016. However, management has claimed that the delays on Tower A were due to design changes made by Star and that Jaks would be entitled to recoup the cost on those variation orders ("VO") instead.

Fig 2: The total LAD (cumulative) related to Tower A and Pacific Star



Source: Company, Affin Hwang estimates

The court case on 20th March will determine the injunction

However, Star has claimed that under the SPA signed on 19 August 2011, it is entitled to the RM50m security fee (in the form of a bank guarantee) in the event that Jaks fails to deliver Tower A on the stipulated date. Jaks has filed an injunction with the court to block the payment, and the next court hearing will be on 20 March 2018.

RM30m hit on Tower A; RM50m is likely the worst-case scenario

Apart from the court case, Jaks has also served a notice of arbitration to Star to help determine the party responsible for the delay and the cost for it. Assuming that the decision is not favourable to Jaks, we believe that Jaks could be liable for around RM30m of LAD under the original SPA terms. The amount is based on the current run-rate of around RM1m/month, assuming that Jaks is able to deliver the project by the end of June, which is significantly lower than the RM50m security performance.

Pacific Star should be fully completed by end of 2018

We believe that management should be able to meet the June'18 target as Tower A has achieved 95.6% completion at end-February. The other components of the Pacific Star project will also be completed in phases over 2018. The overall take-up rate for the Pacific Star development currently stands at 93-96%; however not all units are subjected to the LAD, as Jaks only started marketing Tower C aggressively in late 2016.

One-off financial impact

Jaks only own 51% of the property development company

Assuming a worst-case scenario, where Jaks is liable for the RM50m, the impact on its PATAMI should only be RM25.5m, as it owns just 51% of Jaks Island Circle Sdn Bhd, the JV company involved in the Pacific Star development. The maximum negative impact is thus around 30% of our 2018E forecast. The impact should be viewed as a one-off, as Jaks will be delivering Pacific Star by the end of 2018, and will also end its chapter in the property development business, in our view.

Healthy cash inflow should support the payment if needed

Jaks' day-to-day operations would not be impacted by the RM50m payment, as it would soon receive the payment for its land disposal amounting to around RM154m. Apart from the RM54m earmarked for the borrowings related to the land, there is no other immediate debt repayment. The opportunity cost for not being able to pare down its debt position would be a finance cost of around RM3.3m/year, based on an effective interest rate of 6.6% p.a.

Maintain BUY with an unchanged TP of RM2.25

More than RM150m of market cap evaporated

The stock price has corrected by around 17% (or RM150m in market cap) since news of the claim by Star was announced. We believe the correction is overdone. Given that this would be a one-off cash payment, and assuming that Jaks is able to deliver Tower A by June, our fair value estimate of Jaks would be reduced only marginally.

Vietnam is still the key catalyst

The current problems in the property segment will no doubt consume more management time, but we believe that the distraction will not impact the progress of its Vietnam power plant project. The key catalyst for the stock price remains the timely completion of the power plant project, as the future earnings growth is highly dependent on this, in our view. Of our RNAV valuation, 87% is accounted for by the Vietnam IPP. We believe that management would be able to close the chapter on property development when it completes the Pacific Star project by end-2018.

Fig 3: RNAV valuation for JAKS

	Equity Value (RM m)	Per share	Comments
Construction (domestic)	116	0.24	PER at 8x
Disposable assets (non-core)			
Evolve City Mall	202	0.42	51% stake at book value
Pacific Star Business Hub	51	0.11	51% stake at book value
Other lands for disposal	193	0.40	Book Value
Total domestic asset value	563	1.17	
-) Gross Debt	-439	-0.91	Excluding minority interest share
+) Cash	40	0.08	
RNAV (without Vietnam)	**164**	**0.34**	
Vietnam IPP	407	0.84	DCF (Only JAKS's 30% stake)
Vietnam EPC contract	790	1.64	PER at 10x
RNAV (Vietnam only)	**1,197**	**2.48**	
Group RNAV	1,361	2.82	
Discount to RNAV	20%	20%	
Target Price (RM)	**1,089**	**2.25**	
# of shares	482.2		

Source: Affin Hwang estimates and forecasts

Out think. Out perform.

Jaks Resources – FINANCIAL SUMMARY

Profit & Loss Statement

FYE 31 Dec (RMm)	2016	2017	2018E	2019E	2020E
Revenue	632.2	676.9	1,376.3	952.5	639.6
Operating expenses	(574.3)	(613.9)	(1,283.6)	(825.3)	(496.4)
EBITDA	**57.9**	**63.0**	**92.7**	**127.2**	**143.3**
Depreciation	(14.6)	(14.3)	(10.8)	(10.7)	(10.7)
EBIT	**43.4**	**48.7**	**81.9**	**116.5**	**132.5**
Net int inc/(exp)	(24.1)	(26.1)	(13.8)	(13.3)	(12.9)
Exceptional items	(26.2)	89.6	-	-	-
Pretax profit	**(6.9)**	**112.2**	**68.1**	**103.1**	**119.7**
Tax	(9.5)	(2.1)	(17.0)	(25.8)	(28.7)
Minority interest	17.2	16.6	34.3	15.8	15.5
Net profit	**0.8**	**126.7**	**85.4**	**93.1**	**106.4**

Balance Sheet Statement

FYE 31 Dec (RMm)	2016	2017	2018E	2019E	
Fixed assets	17.9	7.0	6.8	6.6	7.5
Other long term assets	767.0	938.1	968.1	998.1	1,028.1
Total non-curr assets	**784.9**	**945.1**	**974.9**	**1,004.7**	**1,035.6**
Cash and equivalents	39.6	130.0	77.3	20.1	1.2
Stocks	4.2	1.8	8.5	5.9	3.9
Debtors	263.6	366.5	573.9	397.1	266.7
Other current assets	465.6	418.2	418.2	418.2	418.2
Total current assets	**773.0**	**916.6**	**1,077.9**	**841.3**	**690.1**
Creditors	438.5	559.9	859.9	585.9	383.6
Short term borrowings	283.5	153.2	3.2	3.2	3.2
Other current liabilities	5.3	66.0	66.0	66.0	66.0
Total current liab	**727.2**	**779.1**	**929.2**	**655.1**	**452.8**
Long term borrowings	247.5	310.6	300.6	290.6	280.6
Other long term liabilities	0.2	0.2	0.2	0.2	0.2
Total long term liab	**247.6**	**310.8**	**300.8**	**290.8**	**280.8**
Shareholders' Funds + MI	**583.0**	**771.8**	**822.9**	**900.2**	**992.1**

Cash Flow Statement

FYE 31 Dec (RMm)	2016	2017	2018E	2019E	2020E
Pretax profit	(6.9)	112.2	68.1	103.1	119.7
Depreciation & amortisation	14.6	14.3	10.8	10.7	10.7
Working capital changes	91.4	304.4	86.1	(94.7)	(69.9)
Cash tax paid	(9.5)	(2.1)	(17.0)	(25.8)	(28.7)
Others	29.4	(190.6)	(10.0)	(10.0)	(12.0)
Cashflow from operations	**118.9**	**238.2**	**137.9**	**(16.7)**	**19.7**
Capex	(0.6)	(0.1)	(0.6)	(0.6)	(0.6)
Others	(69.2)	(180.5)	(30.0)	(30.0)	(30.0)
Cash flow from investing	**(69.8)**	**(180.5)**	**(30.6)**	**(30.6)**	**(30.6)**
Debt raised/(repaid)	(27.4)	(8.2)	(160.0)	(10.0)	(10.0)
Equity raised/(repaid)	0.0	76.4	0.0	0.0	0.0
Net int inc/(exp)	(12.1)	(12.6)	0.0	0.0	1.0
Dividends paid	0.0	0.0	0.0	0.0	1.0
Others	(20.8)	(3.3)	0.0	0.0	0.0
Cash flow from financing	**(60.3)**	**52.3**	**(160.0)**	**(10.0)**	**(8.0)**
Free Cash Flow	**118.3**	**238.1**	**137.4**	**(17.2)**	**19.1**

Source: Company, Affin Hwang forecasts

Key Financial Ratios and Margins

FYE 31 Dec (RMm)	2016	2017	2018E	2019E	2020E
Growth					
Revenue (%)	37.1	7.1	103.3	(30.8)	(32.8)
EBITDA (%)	45.9	8.7	47.2	37.2	12.6
Net profit (%)	(98.1)	15,816.9	(32.6)	9.0	14.3
Profitability					
EBITDA margin (%)	9.2	9.3	6.7	13.4	22.4
PBT margin (%)	- 1.1	16.6	5.0	10.8	18.7
Net profit margin (%)	0.1	18.7	6.2	9.8	16.6
Effective tax rate (%)	- 137.1	1.9	25.0	25.0	24.0
ROA (%)	1.7	2.0	4.2	5.0	6.2
Core ROE (%)	4.6	4.8	10.4	10.3	10.7
ROCE (%)	3.2	3.4	7.6	7.8	8.4
Dividend payout ratio (%)	-	-	-	-	-
Liquidity					
Current ratio (x)	1.1	1.2	1.2	1.3	1.5
Op. cash flow (RMm)	57.9	63.0	92.7	127.2	143.3
Free cashflow (RMm)	118.3	238.1	137.4	(17.2)	19.1
FCF/share (sen)	27.0	50.2	28.5	(3.6)	4.0
Asset management					
Debtors turnover (days)	152.2	152.2	152.2	152.2	152.2
Stock turnover (days)	2.8	2.8	2.8	2.8	2.8
Creditors turnover (days)	295.6	295.6	295.6	295.6	295.6
Capital structure					
Net gearing (%)	97.3	47.3	28.6	31.0	28.5
Interest cover (x)	2.4	2.4	6.7	9.5	11.1

Quarterly Profit & Loss

FYE 31 Dec (RMm)	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17
Revenue	149.3	154.8	170.9	140.4	210.7
Operating expenses	(141.4)	(142.2)	(157.7)	(136.4)	(186.4)
EBITDA	8.0	12.6	13.2	4.0	24.3
Depreciation	(4.5)	(3.5)	(3.0)	(4.0)	(3.7)
EBIT	3.4	9.0	10.2	(0.0)	20.6
Int expense	(4.6)	(6.1)	(7.2)	(6.9)	(5.9)
Exceptional items	(26.2)	-	(7.6)	18.1	88.0
Pretax profit	(27.3)	3.0	(4.6)	11.2	102.6
Tax	(4.2)	(0.3)	(0.3)	(1.3)	(0.3)
Minority interest	7.5	4.9	6.8	(0.3)	5.1
Net profit	(24.0)	7.5	2.0	9.7	107.5
Margins (%)					
EBITDA	5.3	8.1	7.7	2.8	11.5
PBT	(18.3)	1.9	(2.7)	8.0	48.7
Net profit	(16.1)	4.9	1.2	6.9	51.0

Important Disclosures and Disclaimer

Equity Rating Structure and Definitions

BUY	Total return is expected to exceed +10% over a 12-month period
HOLD	Total return is expected to be between -5% and +10% over a 12-month period
SELL	Total return is expected to be below -5% over a 12-month period
NOT RATED	Affin Hwang Investment Bank Berhad does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation

The total expected return is defined as the percentage upside/downside to our target price plus the net dividend yield over the next 12 months.

OVERWEIGHT	Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months
NEUTRAL	Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months
UNDERWEIGHT	Industry, as defined by the analyst's coverage universe is expected to under-perform the KLCI benchmark over the next 12 months

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A Participating Organization of Bursa Malaysia Securities Berhad

22nd Floor, Menara Boustead,
69, Jalan Raja Chulan,
50200 Kuala Lumpur, Malaysia.

T : + 603 2142 3700
F : + 603 2146 7630
research@affinhwang.com

www.affinhwang.com