John Keells Stock Brokers (Pvt) Ltd.
A JKSB Research Publication
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Access Engineering PLC (AEL)

Rs. 20.80

AEL FULL YEAR PROFIT ▲37%

AEL 4QFY13	
NBVPS (Rs.)	12.47
Issued Capital (Shares 'mn) Voting	1,000
Market Capitalisation Rs. 'mn	20,800
Forecast earnings to equity FY14E Rs. 'mn	3,000
FY 14E EPS Rs.	3.00
PER (x)	6.93

		Revenue (Rs. Mn)	Gross Profit (Rs. Mn)	Operating Profit (Rs. Mn)	PAT to equity (Rs. Mn)	EPS (Rs.)
This quarter	4Q FY2013	4,034	921	722	731	0.73
Previous	4Q FY2012	2,787	824	855	761	0.76
Change (%)		45	12	(16)	(4)	(4)
This 12 mths	Apr - Mar 13	13,900	3,061	2,435	2,382	2.38
Previous	Apr - Mar 12	7,320	2,121	1,931	1,733	1.73
Change (%)		90	44	26	37	37

Full year earnings in-line with our expectations; 4Q earnings drag due to temporary margin contraction

AEL reported full year earnings of Rs. 2.4bn for full year FY13 (+37% YoY), broadly in-line with our expectations, supported mainly by robust top line growth (+90% YoY) stemming from revenue recognition on completed projects, coupled with a greater than two-fold increase in net finance income (+134% YoY), which offset margin contraction at both the gross and operating level (-7ppt YoY and -8.9ppt YoY respectively). Margin contraction during the year is, in our view, reflective of an increase in order book contribution from the building sector during the period - AEL is currently working on a low margin building project for the Urban Development Authority (UDA) involving the relocation of underserved settlements at Henamulla. Construction on the project commenced in September 2011, and as such, full year margin impact took effect in FY13. We anticipate a sharp improvement in margins upon completion of the project in June 2014, as order book contribution should once again be dominated by high margin sectors (e.g. water supply, roads and highways). Further, given that the housing project is being constructed under a lump sum contract (in contrast to AEL's other projects which are based on percentage of completion), the company should post a sharp increase in top line in FY15E, on the back of an anticipated revenue recognition of Rs. 2.5bn. Fourth quarter earnings dipped slightly (-4% YoY) despite strong revenue growth (+45% YoY), due mainly to margin contraction relating to the above mentioned building project.

Strong order book of US$216mn & pipeline of ~US$200mn as at end March 2013

AEL has posted robust growth in its order book over the last 1-2 years, from US$170mn at the time of its IPO (in March 2012) to US$216mn as at end March 2013 (with a further pipeline of US$200mn), on the back of the post war infrastructure boom in the country. The company has converted several large projects which were in its pipeline at the time of our last published report (April 2013) to confirmed orders, including 1) a Rs. 2.3bn (US$18.1mn) water sector project - financed by the Hungarian Export-Import Bank - relating to development of the Labugama and Kalatuwawa water treatment plants; 2) a Rs. 550mn JV with Centunion S.A. of Spain relating to construction of the Veyangoda flyover - funded by the government of Spain; and 3) two bridge projects amounting to Rs. 1.6bn (US$12.6mn). The roads, bridges, & flyovers sector remains the dominant contributor to AEL's confirmed order book (>50%), followed by buildings (15%) and the water sector (14%). However, as previously stated, contribution from the building sector should decline from FY15E onwards on completion of the UDA housing project.

Significant potential for growth in order inflows over the medium term

The Sri Lankan government recently announced that China - a key source of donor funding in recent years - has pledged a further US$2.2bn in loans for local infrastructure development. Key areas of funding include 1) the construction of the Northern Expressway; 2) an extension of the Southern highway; and 3) water supply schemes in Attanagalla, Minuwangoda and Kurunegala. This should, in our view, translate to further growth in AEL's order book over the next five years given that the company is often a preferred contractor of many of the large Chinese principal contractors operating in SL (due mainly to long standing working relationships). Management also sees strong opportunities to expand overseas into the Asia Pacific and Middle East region by leveraging on its long standing relationships with foreign principal contractors, and would likely focus on provision of mechanized services such as piling, horizontal drilling, etc. We have not incorporated incremental revenue uplift stemming from overseas expansion into our top line forecasts, which suggests significant upside potential over the medium term should it prove to be successful.

Margin erosion to be reversed from FY15E onwards

We expect AEL's gross and operating margins to remain at FY13 levels in FY14E, but to pick up from FY15E onwards (post completion of the above mentioned housing project) on the back of increased contribution from higher margin sectors. As per management, AEL intends to increase focus on the water sector going forward, given greater opportunities for design engineering/value addition work which is typically higher margin (due to lower man power requirement). This, coupled with the company's long standing relationships with overseas principal contractors - which, in our view, give it a competitive edge over peers in terms of preferential pricing - should continue to drive above industry project margins of ~16%-18% from FY15E onwards.

Currently trades at a significant discount to the market

We project full year earnings of Rs. 3.0bn in full year FY14E, which translates to an EPS of Rs. 3.00 (+26% YoY). At its current price of Rs. 20.80, AEL trades at a FY14E P/E of 6.9x at a significant discount to the market.