John Keells Stock Brokers (Pvt) Ltd.
A JKSB Research Publication
Lourdeena Kudaliyanage *lourdeena@jkstock.keells.com*

Access Engineering PLC (AEL)

Rs 22.00 — BUY

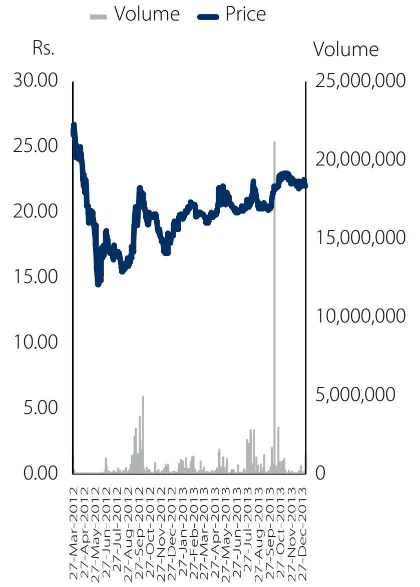
AEL	
Reuters Code	ACCE.CM
Bloomberg Code	AEL SL
Share Price LKR	22.00
Issued Share Capital (Shares)	
Voting	1,000,000,000
12 mth High/Low (Rs.)	23.00 / 18.60
Market Capitalisation (Rs.mn)	22,000
Average Daily Volume (Shares)	387,138

Price Performance (%)	1 mth	6 mth	12 mth
ASPI	6.4	2.7	6.1
AEL	(1.8)	9.5	15.2

Valuation Metrics	Mar 10A	Mar 11A	Mar 12A	Mar 13A	Mar 14E	Mar 15E	Mar 16E
Revenue (Rs.'mn)	3,175	3,651	7,320	13,900	16,409	20,595	25,693
EBITDA (Rs.'mn)	1,065	1,207	1,988	2,882	3,619	4,385	5,467
EBIT (Rs.'mn)	956	1,068	1,760	2,433	3,118	3,832	4,863
Earnings to Equity (Rs.'mn)	808	962	1,733	2,378	2,873	3,592	4,319
EPS (Rs.)	0.81	0.96	1.73	2.38	2.87	3.59	4.31
EPS Growth (%)	(5.9)	19.1	80.2	37.2	20.8	25.1	20.1
P/E (x)	27.2	22.9	12.7	9.3	7.7	6.1	5.1
EV/EBITDA (x)	21.0	18.6	10.3	7.4	5.5	4.4	3.3
P/B (x)	7.4	5.1	2.1	1.8	1.5	1.3	1.1
ROE %	27.3	22.1	16.2	19.0	19.7	20.9	21.0

Actuals for FY12/FY13 are based on SLFRS reporting standards, Previous years are based on SLAS

AEL Adjusted Price/Volume Graph



Executive Summary

Planned public infrastructure spend of Rs.1.4 trillion (US$10.8bn) over 2013-15

Sri Lanka's post war infrastructure boom is set to continue over the medium term, with public spending on infrastructure development expected to amount to Rs.1.4 trillion (US$10.8bn) over 2013-15, as per SL Ministry of Finance projections. Key areas of focus would continue to be 1) the road sector (US$4bn); 2) water & irrigation (US$1.0bn & US$1.1bn respectively); 3) power & energy (US$1.1bn); and 4) regional development (US$1.8bn). With China being the primary source of foreign funding for large scale infrastructure projects, Chinese principal contractors should continue to command a dominant share of work, with local construction companies being chosen as subcontractors/ JV partners on the basis of prior working relationships and pricing.

AEL offers investors a proxy to Sri Lanka's infrastructure boom

Amongst the construction and engineering companies listed on the CSE (Colombo Stock Exchange), we believe Access Engineering PLC (AEL) offers investors the best exposure to capitalize on the projected post war infrastructure boom in Sri Lanka, given both its liquidity and fundamental growth potential. The company's core construction & engineering business (accounting for >80% of AEL's earnings) enjoys the benefits of 1) a confirmed order book amounting to ~Rs.27.0bn (US$216mn) and a further pipeline of >US$200mn as at end May 2013, stemming from robust infrastructure spend in the country; 2) superior margins vs. peers, due to control over the value chain and well established relationships with overseas principal contractors operating in SL; 3) a healthy balance sheet, with virtually zero debt; and 4) a diverse project funding mix, with minimal risk of payment default. At the subsidiary level, we expect steady medium term earnings growth from fully owned subsidiary Access Realties - which operates Access Towers - and 84.39% owned subsidiary Sathosa Motors PLC (franchise holder of the Isuzu and Land Rover/Range vehicle brands in SL). Access Realties commenced construction on Access Towers 2 - a new 28 storey office complex – in 4QFY14, at an estimated cost of >US$20mn. AEL's existing office complex (Access Towers) currently enjoys ~100% occupancy.

Likely increase in medium term dividend payout

Given AEL's 1) strong cash position; 2) negligible debt levels; and 3) minimal medium term capex requirements (following a significant post IPO capacity increase), we anticipate a gradual expansion in annual dividend payout going forward, with an expected medium term payout amounting to around 4% of AEL's IPO price which translates to a DPS of Rs.1.00 and a healthy 5% dividend yield. The company doubled its DPS payout for FY13 to Rs.0.50 per share (vs. Rs.0.25 per share in FY12), and has thus far paid an interim dividend of Rs.0.25 per share for FY14.

Earnings to grow at a 22% CAGR over FY13-16E; currently trades at a substantial discount

We project earnings to grow at a 22% CAGR over FY13-16E to reach Rs.4.3bn by end FY16E. At its current price of Rs.22.00, AEL trades at a FY14E P/E multiple of 7.7x - at a substantial 37% discount to the FY14E market P/E - and at a FY15E P/E multiple of 6.1x. The stock outperformed the ASPI in 2012, appreciating by 22.8% vs. a 4.8% increase in the ASPI. Reiterate **BUY**.

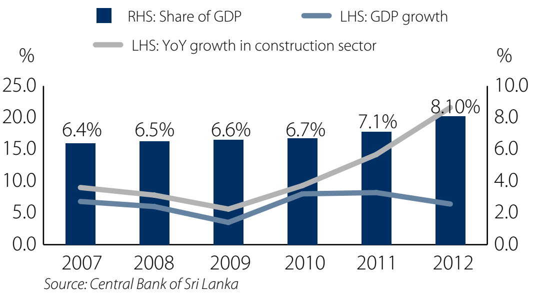
Sector Overview

Sharp increase in construction activity driven by post war infrastructure spend

Growth in Sri Lanka's construction sector has sharply outperformed GDP growth over the last six years (Figure 1) supported by a post war infrastructure boom in the country since mid-2009, which has resulted in significant investment in reconstruction activity in the North and East of the country, coupled with capacity building in other areas. The construction sector grew by 21.6% YoY in 2012 (vs. GDP growth of 6.4%), accounting for a 8.1% share of GDP during the year.

The construction sector grew by 21.6% YoY in 2012

Figure 1: Sri Lanka construction sector indicators 2006-12



Source: Central Bank of Sri Lanka

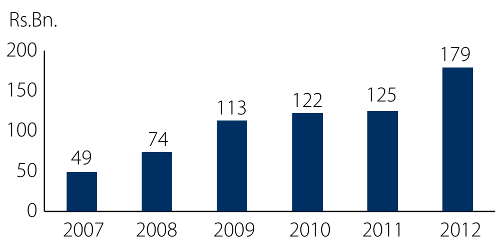
Key areas of focus in terms of public infrastructure spending in recent years have been 1) road development; 2) the development of port & airport facilities; 3) water supply & sanitation; and 4) investments in power and energy. Infrastructure spend in the private sector has been geared towards the construction of high end residential and commercial buildings (e.g. tourism related infrastructure). Major telco operators in the country have also invested heavily in establishing and expanding a fibre optic transmission network in major cities in recent years. We highlight below key areas of infrastructure development in which AEL has been involved/is entering:

Foreign financing of road development amounted to Rs.90.4bn in 2012

- **Roads and highways construction:**

Investment on road development has dominated infrastructure spending over the last 3-4 years, growing from an annual investment of Rs.49bn in 2007 to Rs.179bn in 2012 (Figure's 2 & 3), accounting for 41% of total capital expenditure in 2012 and ~2.4% of 2012 GDP. The share of foreign financing of total road investment has grown in tandem (from Rs.19.2bn in 2007 to Rs.90.4bn in 2012), a majority of which has been spent on rehabilitation (62%) and construction of expressways (36%).

Figure 2: Expenditure on roads (2007-12)



Source: Ministry of finance

Figure 3: Investment on roads by major categories (2007-12)

Category	Investment (Rs.Bn)					
	2007	2008	2009	2010	2011	2012
Expressways	7.7	14.9	22.1	23.3	25.6	34.7
National Roads	29.9	44.9	57.9	58.7	72.4	97.5
Provincial Roads	6.1	6.2	16.9	24.6	18.4	32.2
Rural Roads	5.5	8.1	15.7	15.4	9.0	14.8
Total	**49.2**	**74.1**	**112.6**	**122.0**	**125.4**	**179.2**

Source: Ministry of finance

The road sector accounts for >50% of AEL's confirmed order book

Major road development projects which are soon to be completed include Phase 2 of the Southern Expressway and the Colombo Outer Circular Highway Project, with longer term plans to undertake a Colombo– North/ East highway project. AEL is engaged in a number of the ongoing road rehabilitation/ construction projects in SL (Figure 4), with the road sector accounting for >50% of its current order book.

Figure 4: Ongoing road sector projects undertaken by AEL in Sri Lanka				
Customer/client	Project	Project Value (Rs.Mn)	Start Date	End Date
Road Development Authority	The Kandy road section from Kadawatha to Nittambuwa	7,132	11-Sep-13	11-Mar-15
Road Development Authority	Mannar Putalam Road Project	1,537	31-Aug-12	30-Apr-14
Xi'an Dagang Road Machinery Co. Ltd/Road Development Authority	Galagedara – Rambukkana Road	1,250	18-Jun-12	17-Jun-14
Road Development Authority	Bangadeniya – Andigama Anamaduwa Road Project	2,571	29-Nov-12	29-Oct-14
Road Development Authority	Ibbagamuwa Kubukgate Madagalle Road	2,862	8-Mar-12	14-Mar-14

Source: Company data

AEL worked as a subcontractor for China Harbour Engineering on the Mattala International Airport Project

• Ports & aviation:

The development of port and aviation services within the country has also contributed significantly to construction sector growth in recent years. Out of four port development projects, three have been completed, namely 1) the Colombo Port Expansion project (increasing container handling capacity to 7.2mn from 4.2mn); 2) the Oluvil Port Development Project; and 3) the Hambantota Port Development Project. Within the civil aviation sector, a second international airport was opened in Mattala in March 2013 supported by Chinese donor funding. China Harbour Engineering was the principal contractor on the project, while AEL as a subcontractor 1) constructed the cargo handling and fire rescue building; 2) designed and constructed the airport access road; 3) carried out laying of pipes; 4) constructed a water tower; and 5) constructed a fuel hydrant system. The 2nd phase of expansion of Bandaranaike International Airport (BIA) is expected to be completed in 2017.

AEL is now seeing increased order book contribution from the water sector

• Water supply & sanitation:

Annual investment in the water supply & sanitation sector has gradually increased over 2007-12 (Figure 5), accounting for an accumulated investment of ~Rs.143bn during the period. While the road sector remains the dominant contributor to AEL's order book, the company is now seeing increased contribution from the water sector with the commencement of the Euro 13.9mn Labugama-Kalatuwawa water treatment plant project, as well as the Rs.703.6mn Kandana water treatment plant (commenced in end March 2013; scheduled for completion in March 2015). We highlight some completed and ongoing water sector projects by AEL in Figure 6 below:

Figure 5: Investments in the water supply & sanitation sector (2007-12)						
Category	Investment (Rs.Mn)					
	2007	2008	2009	2010	2011	2012
Large scale water supply schemes	10,916	17,227	15,981	18,310	21,484	25,105
Emerging small townships water supply scheme	1,294	1,541	900	1,300	1,804	2,256
Water sector community facilitation	791	3,459	5,531	1,187	273	199
Tsunami water supply projects	1,705	3,162	3,466	2,290	1,038	1,561
Sewerage schemes	4,146	2,081	2,439	3,191	2,457	1,977

Source: Ministry of finance

Figure 6: Selected water sector projects undertaken by AEL					
Customer/client	Project	Project Value (Rs.Mn)	Start Date	End Date	
Salcon Engineering Berhad	Kandana Water Treatment Plant Extension – Civil, Mechanical / Electrical and ICM Works	703.6	25-Mar-13	23-Mar-15	Ongoing
Fovarosi Vizmuvek ZRT (Budapest Water Works)	Development of Labugama - Kalatuwawa water treatment plants	Euro 13.9 mn	21-Oct-13	21-Oct-16	Ongoing
China Harbour Engineering	Hambantota Port–Harbour Water Tower Project	26.2	14-Mar-12	31-Mar-13	Completed
National Water Supply & Drainage Board	Batticaloa Water Supply Project	4,141	1-Sep-07	30-Oct-11	Completed
National Water Supply & Drainage Board	Aluthgama Water supply Scheme	217	25-Jul-06	31-Mar-08	Completed

Source: Company data

• Private sector spending on telco related infrastructure:
AEL - in partnership with the main contractor Huawei Technologies of China - has designed and constructed most of the fibre optic networks for its long term client Dialog Axiata PLC (DIAL), the largest mobile telco provider in the country. DIAL is currently engaged in an aggressive broadband expansion strategy, with plans to extend its fibre network from ~1,370 km in 2012 to 2,500km by 2015, which should, in turn, drive telco related business volumes for AEL over the medium term.

China is now Sri Lanka's main source of foreign funding for infrastructure development

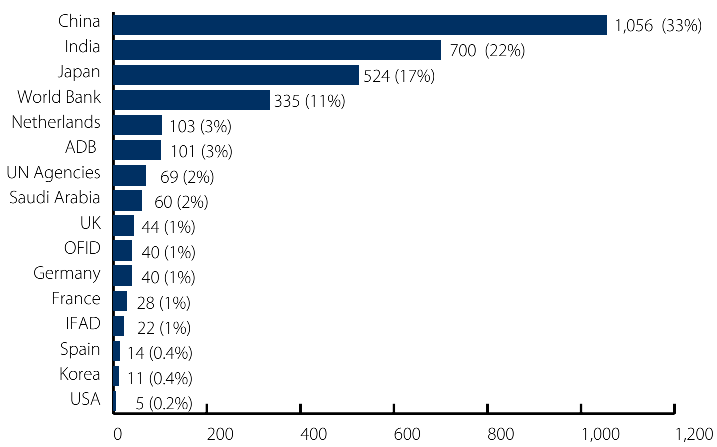
With Sri Lanka's progression to middle income status, concessional funding has begun to diminish

Foreign financing allocated for infrastructure development in recent years has taken the form of both multilateral funding (World Bank, Asian Development Bank, etc.) and bilateral funding (from Western nations, regional neighbours, and the Middle East). However, with Sri Lanka's progression to middle income status, concessional funding - in the form of outright grants and low interest credit - has begun to diminish, dropping from US$2.6bn in 2006 to US$1.5bn in 2012, while non-concessional financing has increased from US$260mn to US$1.7bn during the same period. Western bilateral partners such as the Netherlands, the UK, the USA, Sweden, etc. have now increasingly begun to provide financing in the form of export credits, and as such, the SL government has had to increasingly move towards raising longer term debt (with maturities exceeding 15 years).

China Exim bank has been the primary source of loan assistance

China is now Sri Lanka's main source of foreign funding in terms of infrastructure development, accounting for a 33% share of total foreign financing commitments in 2012 (Figure 7) - with the Export-Import (Exim) Bank of China being the primary source of loan assistance (Figure 8). A majority of the funds received from China have been directed towards investments in the roads & bridges sector (40%) and the power & energy (31%) sector - Figure 9, including major projects such as 1) a section of the Southern Expressway; 2) the Mattala International Airport; 3) the Colombo- Katunayake Expressway; 4) the Hambantota Port Development Project; and 5) the Norochcholai Coal Power Project; as well as several other national roads currently under rehabilitation.

Figure 7: Foreign finance commitments in 2012 in US$ Mn (% contribution)



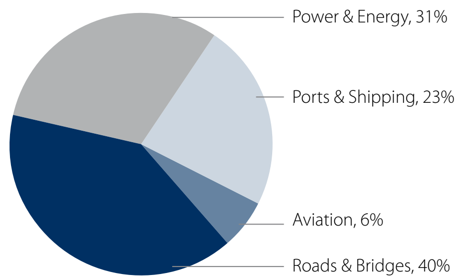
Source : Ministry of finance and planning Sri Lanka

Figure 8: Loan assistance from China (1971-2012)

Funding Source	No. of Projects	Amount (US$ Mn)
Exim bank	25	3,989
China Development Bank (CDB)	3	866
Industrial and Commercial Bank of China (ICBC)	1	70
	29	**4,925**

Source: Ministry of finance

Figure 9: Sectoral distribution of Chinese assistance (2008-12)



Source: Ministry of finance

With the increase in Chinese funding, Chinese principal contractors have been involved in a dominant share of recent projects

SL companies are chosen as subcontractors on the basis of prior working relationships and pricing

Another 39% of the national road network is yet to be developed

China has pledged a further US$2.2bn in loans for infrastructure development

Source of donor funding typically determines the choice of principal contractor

The choice of principal contractor on construction projects is typically determined by the source of donor funding (e.g. Chinese principals on China funded construction projects, Japan provides tied loans, etc.). Consequently, with the above mentioned increase in funding assistance from China, Chinese principal contractors - such as China Harbour Engineering Company (CHEC), China Railway No 5 Engineering Group Co. Ltd, and Xi'an Dagang Road Machinery - have been actively involved in a dominant share of recent public sector construction sector projects, while Sri Lankan construction companies are typically hired as subcontractors on these projects. Local subcontractors are typically chosen on the basis of prior working relationships and pricing.

Amongst the local construction companies, there are currently about 7-8 large operators, including 1) Access Engineering (AEL); 2) Maga Engineering; 3) International Construction Consortium (Pvt) Ltd (ICC); 4) Sanken Construction (Pvt) Ltd; 5) Sierra Construction Ltd; and 6) Tudawe Brothers (Pvt) Ltd; as well as >2,000 smaller companies. In terms of work distributed among the top 7-8 players, we estimate that AEL and MAGA both have around 15% market share, while the others each have about 8%-10% share.

Planned public investment of Rs.1.4 trillion (US$10.8bn) on infrastructure development over 2013-15

As per the Ministry of Finance, planned government investment on infrastructure development over 2013-15 is expected to amount to Rs.1.4 trillion (US$10.8bn) - Figure 10, accounting for nearly 60% of total planned public investments during the period.

As per the government, roughly 61% of the national road network has now been developed. With another 39% of the national road network yet to be developed - as well as the required construction/upgrading of rural and provincial roads under the 'Maga Neguma' project - investment in the roads/ highways sector is expected to continue to dominate public spending on infrastructure development over the next 4-5 years, with a planned investment of Rs.532.4bn (US$4bn) over 2013-15E. Over the longer term, spending should gradually taper off as the government's focus would eventually shift from new construction to maintenance mode.

With a government target of 60% piped drinking water supply and 7% piped sewerage coverage by 2020 (vs. 43% pipe-borne water coverage in 2012), public spending on water & waste water management is also expected to increase substantially over the next three years, with planned investments of Rs.135.4bn on the water sector and >Rs.140bn on irrigation over 2013-15(Figure 10).

Other key areas of focus in terms of public infrastructure spend would be the power & energy sector and regional development under the Gama Neguma and Pura Neguma schemes.

China is likely to continue to be a dominant source of foreign funding for infrastructure development over the medium term, with a recent pledge to provide a further US$2.2bn in loans to be directed towards 1) the construction of the Northern Expressway; 2) an extension of the Southern highway; and 3) water supply schemes in Attanagalla, Minuwangoda and Kurunegala.

Figure 10: Planned public investment on infrastructure development						
	Area of Investment	Investment (Rs.Mn)				
		2010-12 Annual Average	2013	2014	2015	2013-15 Total
Roads	Construction of 600 km of expressways	27,897	30,210	35,000	35,850	101,060
	Improvement and rehabilitation of national roads, provincial roads and reconstruction of major bridges	72,108	101,894	120,478	107,742	330,114
	Increase road durability by routine and periodic maintenance	6,718	7,500	8,450	9,100	25,050
	Upgrading rural roads	13,170	17,054	18,592	19,140	54,786
	Institutional strengthening, research and development	3,800	5,815	7,332	8,235	21,382
		123,693	**162,473**	**189,852**	**180,067**	**532,392**
Irrigation	Completion of the construction of 34 major and medium irrigation schemes	11,671	26,390	35,234	42,142	103,766
	Rehabilitation of irrigation schemes including Minor Tanks Rehabilitation	4,680	6,900	8,274	9,511	24,685
	Operations and maintenance, water management, research and feasibility studies	1,803	3,900	4,312	4,636	12,848
		18,154	**37,190**	**47,820**	**56,289**	**141,299**
Water	Increase the pipe borne water coverage by 10 percent	29,100	30,037	33,800	34,100	97,937
	Reduction of Non Revenue Water share to 20 percent of total water production	1,800	2,038	3,780	6,000	11,818
	Increase the access of piped wastewater discharging facilities from 2.3 percent to 3 percent	4,500	4,620	8,500	12,500	25,620
		35,400	**36,695**	**46,080**	**52,600**	**135,375**
Seaports & Airports	Enhance the passenger and cargo handling capacity by improving and expanding infrastructure facilities in ports and air ports	23,525	15,900	22,200	16,500	54,600
		23,525	**15,900**	**22,200**	**16,500**	**54,600**
Power & Energy	Achieve 100 percent electrification island wide and reduction in transmission losses	10,268	57,512	35,561	17,610	110,683
	Increase installed capacity to 4,000 MW by 2016	11,839	12,369	9,862	8,943	31,174
		22,107	**69,881**	**45,423**	**26,553**	**141,857**
Transport	Enhance the efficiency of the public transportation by reconstruction of 250km/construction of 100 Km of rail lines and maintain the bus fleet at 6,000 to provide 40 percent of bus transportation by CTB	26,756	64,692	46,150	29,650	140,492
	Increase safety and reliability	2,840	3,822	3,740	4,050	11,612
		29,596	**68,514**	**49,890**	**33,700**	**152,104**
Urban township development	Enhancing greener and cleaner urban environment to the people in Sri Lanka by developing network of urban townships	4,320	7,285	14,602	17,658	39,545
		4,320	**7,285**	**14,602**	**17,658**	**39,545**
Regional development	Empowering households to engage in gainful economic activities- (Creating self-reliance household backyard economy)- DiviNeguma	3,010	2,075	2,850	2,900	7,825
	Empowering villages providing, supporting infrastructure facilities- GamaNeguma	28,095	29,086	31,921	32,043	93,050
	Development of emerging regions - PuraNeguma	25,583	30,122	40,550	44,084	114,756
	Provincial Specific Development grants to address provincial disparities	8,972	7,063	10,817	9,784	27,664
		65,660	**68,346**	**86,138**	**88,811**	**243,295**
	Planned total investment on infrastructure development	**322,455**	**466,284**	**502,005**	**472,178**	**1,440,467**

Source: Ministry of finance

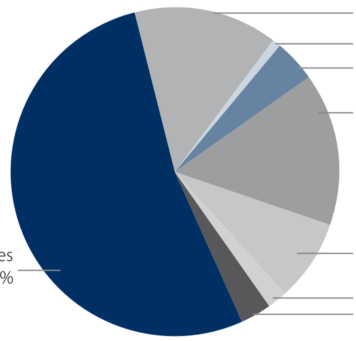
Investment themes

Prime beneficiary of post war infrastructure boom

Combined order book & pipeline of >US$400mn; increasing contribution from high margin sectors

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 May 2013 (with a further pipeline of >US$200mn), on the back of the post war infrastructure boom in the country. The roads, bridges, & flyovers sector remains the dominant contributor to AEL's confirmed order book (>50% - Figure 11), followed by buildings (15%) and the water sector (14%).

Figure 11: Confirmed order book by sector as at May 2013



Source: Company data

The road & water sectors offer higher margins due to more opportunities for value addition/ design engineering

As per management, the road and water sectors offer more opportunities for value addition/design engineering than the buildings sector, and therefore offer higher margins. As previously stated, contribution from the higher margin water sector has begun to gradually increase with the commencement of the Labugama Kalatuwawa water treatment plant project and the Kandana water treatment plant.

Completion of lump sum contract building project to bring in cash inflow of Rs.2.5bn in FY15E

A majority of the contracts in AEL's current order book are based on a percentage of completion basis, with a monthly billing cycle. However, AEL is also presently working on a low cost housing project for the Urban Development Authority (UDA) involving the relocation of underserved settlements at Henamulla. Construction on the project commenced in September 2011 and is scheduled to be completed in March 2014, bringing in a cash inflow of Rs.2.5bn.

Premium pricing power supports superior margins vs. peers

AEL has a sizeable competitive edge over many of its local peers, in the form of both pricing power and the ability to secure new business

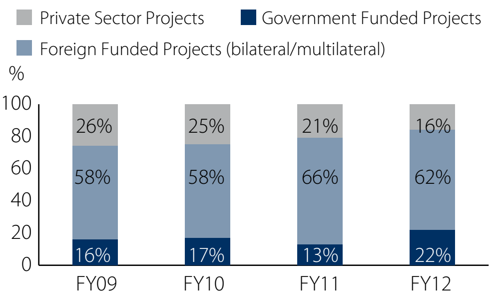
Our discussions with key stakeholders in the local construction space suggest that AEL's superior margin differential vs. peers stems primarily from its long standing relationships with many of the international principal contractors operating in Sri Lanka. Some of these players - including China Harbour Engineering - were either introduced to Sri Lanka by AEL, or have worked closely with AEL since entering the SL market in order to capitalise on its local market knowledge. This provides the company with a sizeable competitive edge over many of its local peers, in the form of both pricing power and the ability to secure new business. AEL is also able to control production costs by sourcing raw materials from its own resource base, thereby eliminating its dependency on external suppliers. The company's asphalt plants - located in Jaffna, Thalawa, Kanthale, and Kotadeniyawa - have a combined production capacity of 456 tonnes per hour (TPH), while the capacity of its crusher and concrete plants amount to 280 TPH and 175m3/hr respectively (excess production from its plants is sold to external customers, which contributed to 6% of top line in FY13). Consequently, the company typically enjoys a >20% margin on projects vs. an estimated 12% margin for peers.

Leveraging on relationships with international contractors to expand core business overseas

AEL typically works as either a JV or a subcontractor with foreign principals

AEL has successfully leveraged on its long standing relationship with China Harbour Engineering to expand its core construction and engineering business overseas, with the commencement of work on the Port Lae Tidal Basin Phase I development project in Papua New Guinea. China Harbour serves as the principal contractor on the ADB funded US$275mn project, while project value accruing to AEL amounts to roughly US$2mn-US$3mn. While the company sees further opportunities to expand overseas in Africa, its focus would remain on the local market given the current infrastructure boom in Sri Lanka, which management believes should be sustained for the next 5-7 years.

Figure 12: AEL's Project Funding Mix: FY09-FY12



Diverse project funding mix; minimal risk of payment default

Foreign funded projects (multilaterally and bilaterally funded) accounted for a majority 62% share of AEL's project mix in FY12 (Figure 12), followed by government funded projects (22%). The risk of default on payment is negligible, given that 1) all projects are backed by a bank guarantee; and 2) the company typically works as either a JV or a subcontractor with foreign principals, which provides a measure of security regarding its future cash flows.

New JV with ZPMC to carry out maintenance & repair of port handling equipment

AEL recently announced the formation of a JV company - ZPMC Lanka Company (Pvt) Ltd. - with Shanghai Zhenhua Heavy Industries Company Limited of China (ZPMC), which would carry out maintenance and repair of port handling equipment for Colombo International Container Terminals. ZPMC will hold 70% of the equity in the newly formed company, while AEL will hold a minority 30% share.

Healthy balance sheet supports a likely medium term increase in dividend payout

Significant infusion of funds from private placement & IPO

AEL raised Rs.4.5bn from its private placement and Rs.0.5bn from its IPO

AEL maintains a strong balance sheet with 1) short term deposits of Rs.1.3bn; 2) cash and cash equivalents of Rs.709.3mn; and 3) negligible debt levels as at end September 2013. The company raised Rs.5bn during FY12 - 1) Rs.4.5bn from a private placement in June 2011; and 2) Rs.0.5bn from its IPO in March 2012. The funds raised from both its IPO and private placement have been utilized for 1) settlement of an outstanding loan amount of Rs.596m; 2) capital expenditure on machinery and equipment; 3) working capital infusion; 4) the acquisition of a controlling stake in Sathosa Motors PLC in February 2012; and 5) to part-finance construction of the abovementioned Henamulla housing project. As per management, the remainder of the funds is currently held in short term investments, and would be used to finance future working capital requirements and the construction of Access Towers 2.

Minimal capex requirements over the medium term given post IPO capacity increase

Management guidance suggests an annual capex spend of around Rs.300mn-Rs.400mn per annum over the next three years

We see no forseeable need for a substantial increase in capex over the medium term, following a significant post IPO capacity increase. The company's capex spend in FY12 and FY13 amounted to Rs.1.5bn and Rs.1.2bn respectively, mainly aimed at increasing plant/machinery capacity and its staff head count in order to pursue growth opportunities over FY13-15E. AEL is, in our view, unlikely to incur significant debt to fund construction of Access Towers 2, and would likely utilise existing cash reserves and the expected lump sum payment of Rs.2.5bn from the UDA on completion of the ongoing Henamulla building project in March 2014. Management guidance suggests an annual capex spend of around Rs.300mn-Rs.400mn per annum over the next three years (vs. capex of Rs.1.2bn in FY13 and Rs.1.5bn in FY12 as previously stated).

Doubling of DPS in FY13; medium term payout expected to be ~4% of IPO price

AEL paid a full year DPS (dividend per share) of Rs.0.50 for FY13 (vs. a DPS of Rs.0.25 per share in FY12), translating to a 2% dividend yield. Given the company's 1) strong cash position; 2) negligible debt levels; and 3) minimal medium term capex requirements, we anticipate a further expansion in annual dividend payout going forward, with an expected medium term payout amounting to around 4% of AEL's IPO price which translates to a DPS of Rs.1.00 and a healthy 5% dividend yield. The company has thus far paid an interim dividend of Rs.0.25 per share for FY14.

Steady earnings growth expected at a subsidiary level

Sathosa Motors has reduced sole brand dependency with acquisition of Land Rover franchise

AEL purchased a 59.67% controlling stake in Sathosa Motors PLC (SMOT) from ITOCHU Corporation Japan in February 2012, for a total consideration of Rs.851.3m using a portion of its private placement funds. The company subsequently increased its stake to 77.1% in March 2012, and now holds roughly 84.39% of the company. SMOT is the franchise holder of the "Isuzu" brand of vehicles and spare parts in both Sri Lanka and the Maldives, and holds a substantial share of the market for Japanese light commercial vehicles in Sri Lanka.

In February 2013, SMOT also announced that its 50% owned subsidiary SML Frontier Automotive (Pvt) Ltd had been granted the exclusive rights to sell, distribute, and service Land Rover/Range Rover vehicles in Sri Lanka. As per management, Land Rover/Range Rover has been among the top three selling European luxury automobile brands in the country over the last five years. AEL further intends to make use of SMOT's workshop operations to repair and maintain its own construction equipment and vehicle fleet.

We expect SMOT to post 15%-20% YoY earnings growth over FY14E-16E, maintaining a steady contribution to Group bottom line over the medium term.

The company reported full year earnings of Rs.205.8mn in FY13, +19% YoY, and has reported earnings to equity of Rs.107.6mn in 1HFY14 (+38% YoY). It is on track to achieve our full year earnings forecast of Rs.233mn for FY14E.

Construction of Access Towers 2 commenced in 4QFY14
Access Realties - a fully owned subsidiary of AEL - operates Access Towers, a 12 storey office complex, and commenced construction on a new 28 storey office complex - Access Towers 2 – on its own land bank (adjacent to Access Towers 1) in 4QFY14. As per management, the project should take 24-30 months for completion. On completion, the property would have an approximate rentable area of 150,000 sq feet, with total floor area of roughly 280,000 sq feet.

Businesses based in the central business district area of Colombo are currently faced with a dearth of high end, purpose built office space. Consequently, operators such as Access Towers have maintained >95% occupancy rates during the last 2-3 years, and have seen a sharp appreciation in rental rates during the period. We believe AEL is better positioned by focusing on the construction of office space (vs. leisure sector or residential property development) given 1) a shorter payback period; 2) better margins (due to a lower cost base); and 3) access to its own resource base (e.g. piling machines, design capabilities, etc).

Financial Outlook

FY13 full year earnings in-line with our expectations
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 was, in our view, reflective of an increase in order book contribution from the building sector during the period.

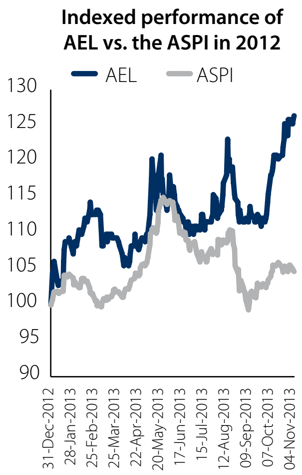
Core business profits +53% YoY in 1HFY14; on-track to achieve our full year earnings forecast
AEL has continued to post robust earnings growth in YTD FY14, with first half earnings, +49% YoY to Rs.1.2bn, driven by higher revenues (+20% YoY) coupled with healthy margin expansion at both the gross and operating level, +3.6ppt YoY and +4.3ppt YoY respectively. The core construction & engineering business posted 53% YoY growth in profits during 1HFY14, while at a subsidiary level, Access Realties and Sathosa Motors reported bottom line growth of 14% YoY and 40% YoY respectively. We believe AEL should comfortably achieve our earnings forecast of Rs.2.9bn for full year FY13E, which translates to an EPS of Rs.2.87 (+20.8% YoY), given that 3Q and 4Q are typically the strongest quarters for the company in terms of revenue recognition.

Earnings to grow at a 22% CAGR over FY13-16E
Over the longer term - given AEL's strong order book and a further pipeline of >US$200mn - we project earnings to equity to grow at a 22% CAGR over FY13-16E to reach Rs.4.3bn by end FY16E. In contrast to its competitors who are likely to continue to focus on growing turnover – sometimes at the expense of margins/ profitability – AEL is likely to cap civil engineering turnover at US$200mn. As per management, the company is likely to increase its exposure to BOI projects going forward, given the tax benefits.

Top Ten Shareholders as at 30th September 2013		
	Shareholder	%
1	Mr. S.J.S. Perera	25.0
2	Mr. R.J.S. Gomez	12.0
3	Mr. J.C. Joshua	10.0
4	Mrs. R.M.N. Joshua	7.0
5	Mr. S.J.S. Perera	4.6
6	Mrs. D.R.S. Malalasekera	4.5
7	John Keells Holdings PLC	4.0
8	Mr. S.A.A. Gomez	2.5
9	Mr. R.J. Gomez	2.5
10	Mr. S.D. Munasinghe	2.4
	Others %	*25.5*

Valuation

At its current price of Rs.22.00, AEL trades at a FY14E P/E multiple of 7.7x - at a substantial 37% discount to the FY14E market P/E - and at a FY15E P/E multiple of 6.1x. The stock outperformed the ASPI in 2012, appreciating by 22.8% vs. a 4.8% increase in the ASPI. **BUY**.



Profit & Loss Statement	2010	2011	2012	2013	2014E	2015E	2016E
Year Ended 31 March	Rs 'mn	Rs 'mn	Rs 'mn	Rs 'mn	Rs 'mn	Rs 'mn	Rs 'mn
Revenue	**3,175**	**3,651**	**7,320**	**13,900**	**16,409**	**20,595**	**25,693**
Cost of Sales	(2,275)	(2,355)	(5,200)	(10,839)	(12,594)	(15,807)	(19,725)
Gross Profit	**900**	**1,296**	**2,121**	**3,061**	**3,815**	**4,788**	**5,969**
Administrative expenses	(219)	(250)	(385)	(643)	(721)	(901)	(1,036)
Other expenses	(12)	(17)	(52)	(44)	(45)	(56)	(70)
Others	319	352	350	298	172	211	5
Profit before tax	**988**	**1,381**	**2,033**	**2,672**	**3,222**	**4,042**	**4,868**
Income tax expenses	(138)	(213)	(297)	(259)	(312)	(406)	(489)
Net profit	**850**	**1,167**	**1,737**	**2,413**	**2,910**	**3,636**	**4,379**
Minority Interest	(43)	(206)	(4)	(35)	(37)	(44)	(60)
Earnings attributable to equity	**808**	**962**	**1,733**	**2,378**	**2,873**	**3,592**	**4,319**

Actuals for FY12/FY13 are based on SLFRS reporting standards, Previous years are based on SLAS

Balance Sheet As at 31 March	2010 Rs 'mn	2011 Rs 'mn	2012 Rs 'mn	2013 Rs 'mn	2014E Rs 'mn	2015E Rs 'mn	2016E Rs 'mn
ASSETS							
Non Current Assets							
Property, Plant and Equipment	355	1,229	2,672	3,741	3,740	3,687	3,582
Investment properties	2,314	2,800	3,000	2,717	3,597	4,477	5,357
Intangible assets	216	-	553	551	551	551	551
Others	-	-	416	570	570	570	570
	2,884	**4,029**	**6,641**	**7,579**	**8,458**	**9,285**	**10,060**
Current Assets							
Inventories	112	312	1,817	1,860	2,337	2,802	3,576
Trade and other receivables	561	1,013	2,844	4,295	4,268	5,323	6,662
Cash and cash equivalents	491	225	1,641	703	2,115	3,212	4,677
Others	338	187	1,340	2,204	1,704	1,204	1,204
	1,502	**1,738**	**7,643**	**9,063**	**10,424**	**12,541**	**16,119**
TOTAL ASSETS	**4,386**	**5,767**	**14,284**	**16,642**	**18,882**	**21,826**	**26,180**
EQUITY AND LIABILITIES							
Equity							
Stated Capital	1,000	3,000	9,000	9,000	9,000	9,000	9,000
Revaluation reserve	-	228	-	-	-	-	-
Retained earnings	1,954	1,116	1,670	3,486	5,609	8,201	11,519
	2,954	**4,344**	**10,670**	**12,486**	**14,609**	**17,201**	**20,519**
Minority Interest	812	-	162	138	175	219	279
	3,767	**4,344**	**10,833**	**12,624**	**14,784**	**17,420**	**20,799**
Non Current Liabilities							
Interest bearing borrowings	19	453	6	2	2	252	477
Employee benefits	18	28	62	93	93	93	93
Others	1	44	106	165	165	165	165
	39	**525**	**174**	**259**	**259**	**509**	**734**
Current Liabilities							
Interest bearing borrowings	17	172	7	6	6	6	6
Trade and other payables	471	595	1,446	1,887	1,967	2,024	2,775
Others	94	132	1,825	1,866	1,866	1,866	1,866
	581	**898**	**3,277**	**3,759**	**3,839**	**3,896**	**4,647**
TOTAL EQUITY AND LIABILITIES	**4,386**	**5,767**	**14,284**	**16,642**	**18,882**	**21,826**	**26,180**

Actuals for FY12/FY13 are based on SLFRS reporting standards, Previous years are based on SLAS

Cash Flow Statement	2010	2011	2012	2013	2014E	2015E	2016E
Year Ended 31 March	Rs 'mn	Rs 'mn	Rs 'mn	Rs 'mn	Rs 'mn	Rs 'mn	Rs 'mn
Net profit (loss) before tax	**988**	**1,381**	**2,033**	**2,672**	**3,222**	**4,042**	**4,868**
Net cash from/(used in) operating activities	**949**	**745**	**638**	**1,301**	**2,056**	**1,635**	**2,716**
Cashflows from Investing activities							
Acquisition of PPE	(84)	(402)	(1,530)	(1,212)	(500)	(500)	(500)
Investments in short term deposit	(7)	(2)	(787)	(387)	500	500	-
Others	(114)	(924)	(599)	32	105	212	25
Net cash flows used in investing activities	**(205)**	**(1,329)**	**(2,916)**	**(1,567)**	**105**	**212**	**(475)**
Cashflows from Financing Activities							
Loan obtained during the year	0	610	0	0	0	250	275
Loan repayments	(5)	(10)	(611)	(7)	-	-	(50)
Others	(446)	(290)	4,728	(506)	(750)	(1,000)	(1,001)
Net cashflows from financing activities	**(451)**	**309**	**4,117**	**(512)**	**(750)**	**(750)**	**(776)**
Net increase/(decrease) in cash and cash equivalent	**294**	**(275)**	**1,839**	**(778)**	**1,412**	**1,097**	**1,465**
Cash and cash equivalents at the beginning of the year	183	477	202	1,624	691	2,103	3,200
Cash and cash equivalents at the end of the year *	**477**	**202**	**1,624**	**691**	**2,103**	**3,200**	**4,665**

Actuals for FY12/FY13 are based on SLFRS reporting standards, Previous years are based on SLAS

Ratios and Valuation	Mar 10A	Mar 11A	Mar 12A	Mar 13A	Mar 14E	Mar 15E	Mar 16E
Growth (%)							
Sales	(7.6)	15.0	100.5	89.9	18.0	25.5	24.8
EBIT	(3.9)	11.7	64.9	38.2	28.1	22.9	26.9
PAT	(2.1)	37.3	48.8	39.0	20.6	25.0	20.4
EPS	(5.9)	19.1	80.2	37.2	20.8	25.1	20.1
Margins (%)							
EBITDA	33.5	33.1	27.2	20.7	22.1	21.3	21.3
EBIT	30.1	29.2	24.0	17.5	19.0	18.6	18.9
Pre-Tax margin	31.1	37.8	27.8	19.2	19.6	19.6	18.9
Net Margin	25.4	26.3	23.7	17.1	17.5	17.4	16.8
Valuation Metrics (x)							
P/E	27.2	22.9	12.7	9.3	7.7	6.1	5.1
P/B	7.4	5.1	2.1	1.8	1.5	1.3	1.1
EV/EBITDA	21.0	18.6	10.3	7.4	5.5	4.4	3.3
EV/EBIT	21.5	19.2	11.7	8.4	6.6	5.4	4.2

Actuals for FY12/FY13 are based on SLFRS reporting standards, Previous years are based on SLAS

John Keells Stock Brokers (Pvt) Ltd.
186, Vauxhall Street Colombo 2 Sri Lanka T. 9411 2306 250, 9411 2342 066-7 F. 9411 2342 068 www.jksb.com
Company No. PV 89