John Keells Stock Brokers (Pvt) Ltd.
A JKSB Research Publication

Lourdeena Kudaliyanage *lourdeena@jkstock.keells.com*

Access Engineering PLC (AEL)

Rs. 21.30

AEL 1Q PROFIT ▲68%

AEL 1QFY14	
NBVPS (Rs.)	13.04
Issued Capital (Shares 'mn) Voting	1,000
Market Capitalisation Rs. 'mn	21,300
Forecast earnings to equity FY14E Rs. 'mn	2,901
FY 14E EPS Rs.	2.90
PER (x)	7.34

		Revenue (Rs. Mn)	Gross Profit (Rs. Mn)	Operating Profit (Rs. Mn)	Earnings to equity (Rs. Mn)	EPS (Rs.)
This quarter	1Q FY2014	3,152	717	584	554	0.55
Previous	1Q FY2013	2,793	462	327	329	0.33
Change (%)		13	55	79	68	68

Core business profits +88% YoY supported by strong topline growth and margin expansion

AEL reported robust growth in first quarter earnings, +68% YoY to Rs. 554mn, driven by higher revenues +13% YoY coupled with healthy margin expansion at both the gross and operating level, +6ppt YoY and +7ppt YoY respectively. The core construction & engineering business posted 88% YoY growth in profits during the quarter, on the back of 1) revenue recognition on ongoing projects; 2) margin expansion stemming from increased order book contribution from high margin sectors (e.g. the water sector); and 3) increased production income. At a subsidiary level, Access Realties reported a modest 9% YoY increase in 1QFY14 profit, off a 16% YoY increase in revenues, while Sathosa Motors registered a 15% YoY increase in profits despite a 10% YoY decline in revenue during the quarter.

Doubling of DPS in FY13; total shareholder return of 21% in YTD Aug 2013

AEL declared a final dividend of Rs. 0.25 per share for FY13 - payable on 26th August 2013 - taking full year DPS for FY13 to Rs. 0.50 per share (vs. a DPS of Rs. 0.25 per share in FY12), translating to a 2% dividend yield. The stock has outperformed the ASPI in YTD Aug 2013, appreciating by 18% vs. a 9% increase in the ASPI, generating a total shareholder return of 21% (inclusive of the upcoming DPS of Rs. 0.25). Given a healthy balance sheet, with 1) short term deposits of Rs. 1.4bn; 2) cash and cash equivalents of Rs. 940mn; and 3) negligible debt levels as at end June 2013, with no forseeable need for a significant increase in capex over the medium term (following a significant post IPO capacity increase), we believe the company should continue to steadily increase its dividend payout going forward. AEL is, in our view, unlikely to incur additional debt to fund construction of Access Towers 2, and would likely utilise existing cash reserves and an 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).

Order book of US$216mn/pipeline of >US$200mn; margin boost stemming from increased contribution from water sector

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%), followed by buildings (15%) and the water sector (14%). However, as previously stated, the company is now seeing increased contribution from the water sector with the commencement of the Rs. 2.3bn (US$18.1mn) Labugama-Kalatuwawa water treatment plant project, as well as the Rs. 691mn Kandana water treatment plant (commenced in end March 2013; scheduled for completion in March 2015). 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 stated in our previous earnings review, we expect contribution from the building sector to decline from FY15E onwards on completion of the ongoing low margin UDA housing project involving the relocation of underserved settlements at Henamulla.

Core business expands overseas with commencement of Papua New Guinea project

AEL has successfully leveraged on its long standing relationship with China Harbour Engineering Company Ltd (China Harbour) 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. 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 choice of subcontractor for many of the large Chinese principal contractors operating in SL (due mainly to long standing working relationships with these companies, some of whom were introduced to Sri Lanka by AEL).

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 equity in the newly formed company, while AEL will hold a minority 30% share. At this stage, AEL has not provided further disclosure on the size of its investment represented by the 30% equity stake, or the expected incremental earnings impact from the venture.

Currently trades at a significant discount to the market

We maintain our full year earnings forecast of Rs. 2.9bn for FY14E, which translates to an EPS of Rs. 2.90 (+22% YoY). At its current price of Rs. 21.30, AEL trades at a FY14E P/E of 7.3x at a significant 38% discount to the market.

John Keells Stock Brokers (Pvt) Ltd.
186 Vauxhall Street Colombo 2 Sri Lanka T. 9411 230 6250 F. 9411 2326 863, www.jksb.com
Company No. PV 89