

Stock Digest

Company Note – AWC Bhd

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Trackwork Acquisition to Boost Earnings Prospects

Highlights

- AWC Bhd is planning to acquire a 60.0% equity stake in Trackwork & Supplies Sdn Bhd for RM43.5 mln in a bid to diversify its existing engineering services business to include rail-related works.
- Trackwork, which was established in 1999, is mainly involved in supplying track materials and rolling stock, the maintenance of railway tracks, supplying and commissioning of track tools, equipment and machineries, as well as supplying of depot equipment, tools and track diagnostics and monitoring systems.
- The proposed acquisition also comes with a cumulative net profit guarantee of RM20.0 mln for FY18 and FY19. Consequently, the acquisition cost of RM43.5 mln will be paid in cash and the issuance of new AWC shares in tranches. (Refer Appendix 1)
- AWC is planning to finance the proposed acquisition via internal funds and/or bank borrowings, which is expected to be completed by the second quarter of 2Q2018.
- Further, the contract also include a Call/Put option which entails:
 - i.) The granting of a **Call option** for AWC to purchase the remaining 40.0% shareholding in Trackwork owned by Trakniaga (shareholder of Trakwork), effective from the expiry of the profit guarantee period (i.e.: 30th September 2019) up to the fifth anniversary year of the completion date for the acquisition,
 - ii.) The granting of a **Put option** for Trakniaga to require AWC to purchase its remaining 40.0% shareholding in Trakwork, effective up to six months from the expiry of the Call option.

Financial Highlights					
FYE June (MYR mln)	2015A	2016A	2017A	2018F	2019F
Revenue	128.0	248.5	296.5	324.6	282.7
EBITDA	14.2	31.6	41.6	44.8	38.1
Net Profit	8.1	17.1	22.0	23.8	19.7
Revenue Growth (%)	7.1	94.1	19.3	9.5	-12.9
EBITDA Growth (%)	-5.3	122.7	31.5	7.9	-14.9
Net Profit Growth (%)	16.3	111.9	28.6	8.0	-17.2
EPS (sen)	3.0	6.4	8.2	8.8	7.3
P/E(x)	26.8	12.6	9.8	9.1	11.0
DPS (sen)	0.0	2.5	0.0	2.0	2.0
Dividend Yield (%)	0.0	3.1	0.0	2.5	2.5
BVPS (RM)	0.4	0.6	0.6	N/A	N/A
P/BV (x)	1.9	1.5	1.3	N/A	N/A
ROE (%)	8.8	14.4	0.2	N/A	N/A

Source: Company Data, MSSB Research

BUY

Share Price: RM0.805

Target Price: RM0.95

Key Statistics

Stock Information: Engaged in the provision of integrated facilities management services, engineering services and automated pneumatic waste collection systems

Sector: Trading/Services

Industry: Professional & Technical
Specialty Services

Listing: Main Market

Stock Code: 7579

Share Issued (mln): 272.4

Market Capital (RM mln): 216.6

Par Value (RM): N/A

Major Shareholders:

K-Capital Bhd	29.8%
EVLI Fund Management Company Ltd	4.5%
Tan Keng Hee	4.1%

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- The group inked the conditional share sale agreement with Goh Poey Hong, Chong Kim Loong, Goh Tse Woei, Kong Keat Voon, Chong Chong Hong, Lim Huey Yih and Shaun Chan Thiam Eng for the proposed acquisition. About RM20.0 mln of the total cost will be paid in cash, while the remaining amount will be satisfied via the issuance of new AWC shares in tranches.
- We also note that Trackwork's key existing directors has agreed to stay on with the company for a minimum period of five years commencing from the completion date, which will ensure a smoother transition and business continuity.

Prospects

The proposed diversification will provide an additional revenue and income stream for the group and reduce its reliance on its IFM business as the group expects contributions from rail-related projects to make up more than 25.0% of its net profits in due course.

We think that the new business will allow the group an opportunity to leverage on the untapped railway maintenance industry, which will be further boosted by mega railway projects expected to be announced this year. As at 21st February, 2018 Trackwork has secured an orderbook of about RM120.0 mln for track-related projects and sales commission income up to RM6.8 mln, which will provide earnings visibility in the near term.

Meanwhile, AWC is planning to fund the acquisition via internally-generated funds and/or bank borrowings, although the exact proportion of the finance structure is yet to be announced.

In our assumptions, we assumed that the group will be funding the purchase by internal cash and borrowings on a 50:50 ratio (Refer Appendix 2). We still believe that AWC is fully capable of funding the acquisition as the group holds a sizable cash pile (net cash: RM79.1 mln as of 31st December 2017) and has been in a net cash position for the last few years.

Valuation and Recommendation

We view the proposed acquisition positively as it will strengthen AWC's earnings ability in the long run. Although we do not foresee an immediate bump to bottomline in FY18 as we expect the acquisition to be completed at end-FY18, we think that the significant benefits will be recognised from FY19 onwards, resulting in a potential increase in FY19 EPS to 8.9 sen (from 7.3 sen) post-acquisition (Refer Appendix 2). The higher EPS will add a potential upside of 21.5% to our existing target price of 95.0 sen to RM1.16, which is favorable in our view. However, we did not provide an estimate for the impact of the acquisition from FY20 onwards as it is beyond our current forecast horizon.

For now, we leave our earnings forecast unchanged pending the completion of the proposed

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acquisition and maintain our **BUY** recommendation on AWC with a target price of RM0.95 by ascribing a target PER of 13.0x on FY19's EPS of 7.3 sen. Our target PER is discounted to AWC's nearest competitor, **UEM Edgenta Bhd** due to the former's smaller market capitalisation.

Risk to our recommendation and target price include failure to replenish its targeted orderbook and project delays due to the cyclical risks inherent to the construction industry, which could lead to unforeseen cost increases and reputational damage. Escalating utility cost and increase in the prices of consumables could also compress the margins of the IFM contracts, while any fluctuation in the cost of raw materials could also impact AWC's margins in the already saturated HVAC market.

Income Statement					
FYE June (MYR mln)	2015A	2016A	2017A	2018F	2019F
Revenue	128.0	248.5	296.5	324.6	282.7
EBITDA	14.2	31.6	41.6	44.8	38.1
Depreciation & Amortisation	1.5	1.8	2.5	3.3	3.7
Net Interest Income/(Expense)	0.1	0.3	-0.4	-0.1	0.2
Pre-tax Profit	12.8	30.1	38.7	41.5	34.6
Effective Tax Rate	8.6%	21.4%	20.1%	21.0%	21.0%
Net Profit	8.1	17.1	22.0	23.8	19.7
EBITDA Margin	11.1%	12.7%	14.0%	13.8%	13.5%
Pre-tax Margin	10.0%	12.1%	13.0%	12.8%	12.2%
Net Margin	6.3%	6.9%	7.4%	7.3%	7.0%

Source: Company Data, MSSB Research

Appendix 1: Mode of payment

Payment Structure	Timeline	RM mln	No. of shares mln
1st Tranche Issuance of new shares @ issue price RM1.00/share Cash payment	Upon completion date	11.5 20.0	11.5 -
2nd Tranche Issuance of new shares @ 5-day VWAP of AWC shares*	Conditional on achieving Year 1 profit guarantee of RM8.0 mln**	6.0	6.0
3rd Tranche Issuance of new shares @ 5-day VWAP of AWC shares*	Conditional on achieving Year 2 profit guarantee of RM12.0 mln**	6.0	6.0
Total		43.5	23.5

*assume issue price of RM1.00 per share

**calculated after the date of signed audited FY18 and FY19 financial statements of Trackwork

Source: Company Data, MSSB Research

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Appendix 2: Changes to FY18-FY19 EPS

Changes to AWC's FY18-FY19 EPS:	FY18F	FY19F
	RM mln'	RM mln'
Forecast net profit	23.8	19.7
Profit guarantee apportionment*	-	6.6**
Finance income/(costs) net^		(0.8)
Estimated net profit	23.8	25.5
	mln'	mln'
Total shares issued	269.0	269.0
11.5 mln shares issued in 1st Tranche	-	11.5
6.0 mln shares issued in 2nd Tranche	-	6.0
Enlarged share issue	269.0	286.5
Revised EPS (sen) #	8.8	8.9
Current EPS (sen)	8.8	7.3
Net increase in EPS (sen)	-	21.5%
*assume acquisition is completed in June 2018		
**apportioned on pro-rata basis based on AWC Bhd's financial year end at 30th June, 2019		
^ interest rate at 1.5% and 12.1% respectively for interest income and interest expense		
#assume all other factors remain constant		

Source: Company Data, MSSB Research

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