September 18, 2018

FAIR VALUE: **19**

CURRENT PRICE: **14.60**

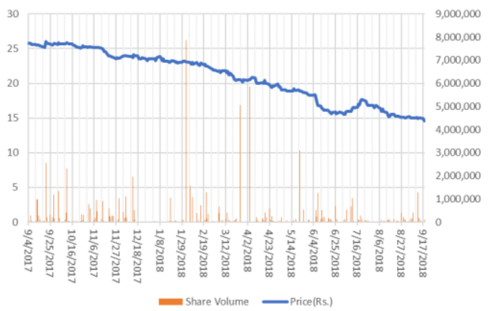
Access Engineering PLC (AEL)

Price target	LKR 19
Current Price	LKR 14.6
52-week range	LKR14.6-26.0
Market capitalization	LKR 14.6bn
Public float	25%
Average daily turnover	LKR 6.3m

YTD Performance	
ASPI	-6.2%
Sector	-40.5%
AEL	-37.8%

Year End 31-Mar	FY17	FY18	FY19e	FY20e
EPS (Rs)	2.7	3.1	3.9	4.1
DPS (Rs)	1.50	1.20	1.20	1.20
NAVPS (Rs)	18.84	20.78	23.44	26.34
P/E (x)	5.4	4.8	3.8	3.6
P/BV (x)	0.8	0.7	0.6	0.6
Div. Yield (%)	55.4	39.1	31.1	29.3
Div. Payout (%)	55.4	39.1	31.1	29.3
ROE (%)	12.7	13.1	15.0	14.3
EBITDA margin (%)	20.9	21.8	22.8	21.9

AEL: 52 week price/volume chart



Source: CSE, Taprobane Research

Infrastructure driven growth

Access Engineering (AEL) is a conglomerate with exposure to construction, real estate and automobile sales. Within a relatively short time span, AEL has established itself as a leading construction company in Sri Lanka. AEL has exposure to both public and private sector infrastructure projects. We estimate AEL's current order book to be c.40bn with revenue visibility extending into FY2020-21 period. With several large-scale infrastructure projects slated to takeoff over the next 2-3 years, we expect AEL to further increase its order book and extend its revenue visibility beyond our explicit forecast period. Nevertheless, we expect significant headwind from rising raw material prices, labour costs and LKR depreciation. Delays in payments from the Government due to procedural and/or fiscal bottlenecks pose significant downside risk to AEL. We expect AEL to maintain EBITDA margins at c.20%. AEL's joint ventures with foreign contractors should augur well for its bottom line, with positive contribution from high value property development projects. We also expect AEL's automobile sector subsidiary, Sathosa Motors (SMOT) to be earnings accreditive. We expect group net profit growth to average at c.15% over the forecast period. Our 12-month Sum of the parts (SOTP) based share price is Rs.19/share which is a c.30% upside. We recommend BUY

Construction sector to benefit from continuing infrastructure investments: We expect the construction sector to benefit from Sri Lankan Government's (GoSL) commitment to ongoing large-scale infrastructure investments as well as plans to initiate several key infrastructure projects over next 2-3 years. These include projects such as Express Highways, Urban regeneration, water and sanitation projects, the Colombo Trincomalee Economic Corridor etc. In addition to this, large scale private sector led projects such as the Colombo International Financial City, Waterfront Properties, Colombo City Centre etc. would also help boost the construction sector.

Strong order book and extended revenue visibility: We estimate AEL's order book at cLKR40bn with revenue visibility extending into FY2020-21. We are confident that with increase in construction activity, AEL should be able to expand its order book and extend revenue visibility further. We also feel that AEL's efforts to partner with foreign constructions firm will yield benefit as it facilitates technology transfer as well as access to overseas markets.

Attractive valuation: Based on a SOTP valuation, we estimate AEL's 12-month Target Price at Rs.19/share which is a c.30% upside. Our WACC estimates average at c.16-19%, with terminal growth rates in the 2-3% range. Increase in input costs, LKR depreciation. delays in cash disbursement for Government projects and political instability are significant down risk. We recommend BUY.

YE 31 March (Rs m)	FY16	FY17	FY18	FY19e	FY20e	FY21e
Revenue	17,625	20,448	26,056	30,819	34,353	35,820
+/- YoY%	6.7	16.0	27.4	18.3	11.5	4.3
EBITDA	3,736	4,272	5,677	7,029	7,509	7,018
PBT	2,995	3,231	4,231	5,367	5,692	6,449
PAT	2,465	2,708	3,071	3,864	4,098	4,643
+/- YoY%	5.1	9.8	13.4	25.8	6.1	13.3
EPS (Rs)	2.5	2.7	3.1	3.9	4.1	4.6
NAVPS (Rs)	17.5	18.8	20.8	23.4	26.3	29.8
EBITDA margin (%)	21.2	20.9	21.8	22.8	21.9	19.6

Source: Company Data, Taprobane Research

Company Outlook

Construction industry growth is key driver

Access Engineering (AEL) is a Conglomerate with interests mainly in construction, commercial real estate and automobile sales and servicing. It also has exposure to property development through its associate companies and joint venture investments. AEL has the highest accreditation awarded to contractors by the national construction sector oversight body, the Construction Industry Development Authority (CIDA). AEL has a very strong order book thanks to contract awards in several big ticket public sector driven infrastructure projects such as expressways, water and sanitation projects, large scale urban housing etc. AEL also has been awarded contracts in key private sector real estate projects such as Waterfront Properties, Havelock City etc.

The construction sector accounts for 7.1% of Sri Lanka's GDP in 2017 (cf. 7.1% in 2016) and contributed to c.7% of GDP growth in 2017 (cf. c.12% in 2016). We expect the Government to be the main promoter of large-scale infrastructure projects. Nevertheless, the private sector too is investing in infrastructure, especially in Commercial Real Estate, High end residential projects and also mixed development projects.

Strong order book and extended revenue visibility

We estimate AEL's order book to be c.Rs.40bn with revenue visibility extending over 3-4 years. Given AEL's track record and industry accreditations, we feel AEL should be a strong contender for contract awards in upcoming public sector infrastructure projects as well as high value private sector construction projects. In addition to local projects, AEL is also venturing into overseas construction projects through JVs with foreign firms. Nevertheless, AEL has faced headwind from factors affecting the construction industry such as rising raw material prices and lack of skilled labour as well loss of preferential corporate tax rate. AEL, also has intense competition from foreign, mainly Chinese and Indian construction firms vying for contracts in Sri Lanka. In an attempt to atleast partially off-set this, AEL has formed partnerships with overseas construction companies operating in Sri Lanka

Value from associates and Joint Ventures

AEL also has exposure to the real estate business, through its subsidiaries Access Realty and Harbour Village. The labter is a collaboration between AEL, China Harbour Engineering Company (CHEC) and Musthafa's Singapore for the launch of a mixed development project – Marina Square. It also has a joint venture (Blue Star Realties) for the construction of a 242 unit apartment complex. With the Sri Lankan Government looking at Public Private Partnerships (PPP) as a means to off-set increasing fiscal pressure, AEL also stands to benefit from PPP driven infrastructure projects.

SMOT to be value accretive

AEL owns a c.85% stake in SMOT, a well-established motor vehicle importer. SMOT owns the dealership for ISUZU in Sri Lanka. AEL also has a c.42% stake (SMOT holds a 50% stake) in SML Frontier Automotive (Pvt) Ltd, which is the distributor for Jaguar and Land Rover vehicles. ISUZU has a strong base in the light and heavy commercial vehicle segment. As such SMOT is cushioned to a considerable extent from changes to Government fiscal policy on vehicle imports which are mainly focused on passenger vehicles. However, SML Frontier Automotive which operates in the premium segment should be more vulnerable in this regard. SMOT's vehicle sales volumes have increased over the last 5 years, albeit from a low base when total motor vehicle registrations have remained largely stagnant. Nevertheless, SMOT faces FX pressure from LKR depreciation and JPY appreciation as well as competition from lower priced Indian light and heavy commercial vehicles.

Summary of group structure

Access Engineering PLC (AEL)

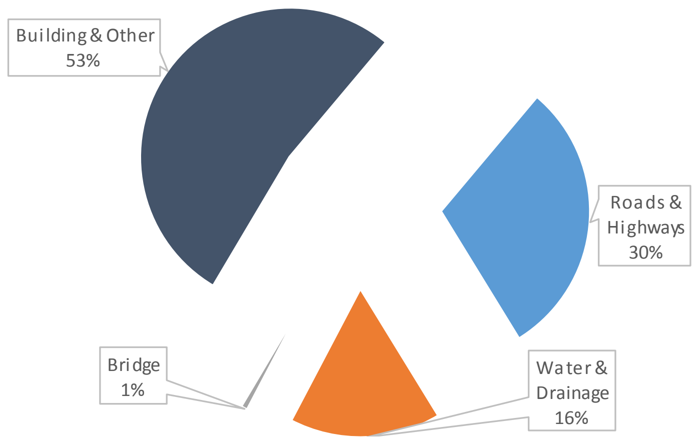
Access Realties (Pvt) Ltd - 100%	property development
Access Realties 2 (Pvt) Ltd - 100%	property development
ARL Elevate (Pvt) Ltd - 100%	MICE
Sathosa Motors PLC - 84.42%	Automobile sales - ISUZU
SML Frontier Automotive (Pvt) Ltd - 42.21%	Automobile sales - Jaguar & Land Rover
Access Projects (Pvt) Ltd - 80%	construction-related services and materials
Harbour Village (Pvt) Ltd 60.83%	property development

ZPMC Lanka Company (Pvt) Ltd - 30%	maintenance of container handling equipment
Blue Star Realties (Pvt) Ltd - 50%	property development

Source: Company Data. Taprobane Research

Contract awards in large infrastructure project should benefit order book

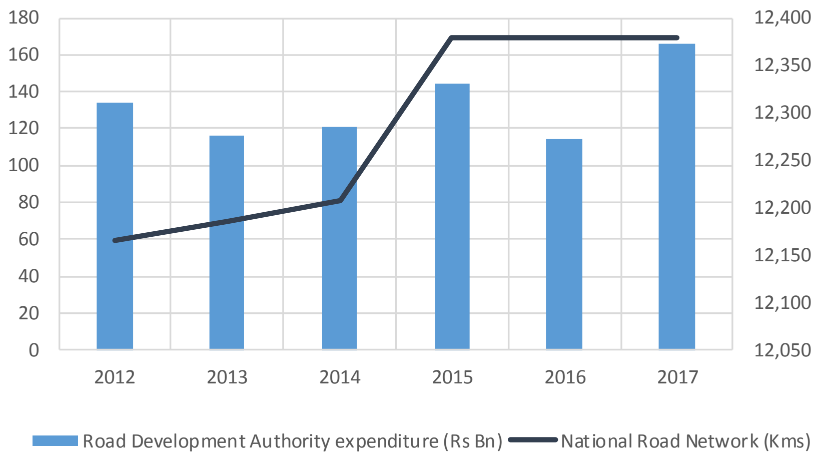
AEL's order book and revenue visibility should increase with large scale infrastructure projects: AEL's order book is estimated at c.LKR40bn with revenue visibility extending into FY2020-21. Nevertheless we feel that AEL will be able to expand its order book even further with potential contracts from key public and private sector infrastructure investments. Large scale government led projects such as the Colombo Trincomalee Economic Corridor, Colombo Metrorail project, Central Express Highway, Colombo Elevated Highways, Wind Power projects should assist in driving AEL's order book growth. Moreover, AEL also has potential to receive contracts from large scale private sector projects such as the Colombo International Financial City which is to be based in the Colombo Port City and estimated to cost c.USD1bn. The contractor for this project is CHEC. AEL has received sizeable contract awards from CHEC in the past. AEL is also collaborating with CHEC on a large scale mixed development project.



Source: Company Data, Taprobane Research

Investment in road projects have continued to grow

Ongoing and proposed road development projects should provide major boost to AEL: Road and bridge construction have contributed a significant portion to AEL's revenue and order book. AEL is currently involved in building sections of the Central Express Highway (CEH) 2. AEL's share of work on this project is c.Rs9.4bn. There are several high value road construction projects in the pipeline such as Outer Circular Highway (OCH – Section 3 with a project value of c.70-80bn), Ruwanpura Elevated Highway, Extension of Southern Expressway Project (Phases 1-4). In addition to large, high value projects, there are several medium to small scale road rehabilitation and development projects funded by foreign collaborations, e.g. iRoad project which is funded mainly by the Asian Development Bank (ADB) with a project value of Rs150-160bn.



Source: CBSL, Taprobane Research

WRMMP is be a key driver for the sector

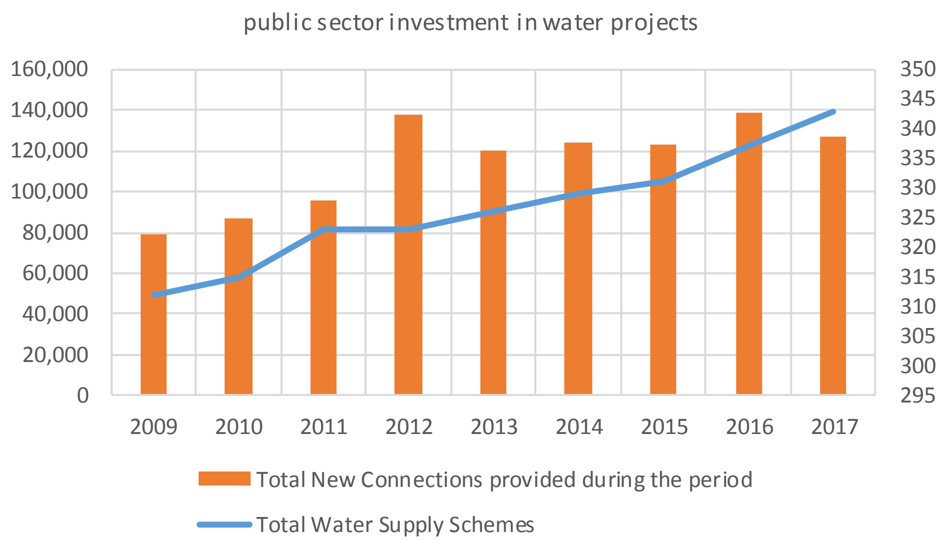
Western region megapolis development should be a major infrastructure investment project: The Western Region Megapolis Master Plan (WRMMP) is an ambitious infrastructure development project launched by the Government spanning several decades aimed at transforming Colombo and its suburbs along with the entire Western Province into a modern world class mega city. The WRMMP envisages the complete transformation of the existing Central Business District (CBD) area of Colombo into the Core area of the Megapolis. The WRMMP states that at least c.60 new high-rise buildings with c.40 or more floors will be located in this new CBD. The WRMMP also spells out several initiatives to enhance Colombo's appeal as a city for living and doing business. These include amongst others, Development of a Rapid Transit System (light rail, elevated highways etc.) for efficient commuting within the CBD and outlying areas, setting up a Modern Integrated Transport Hub in Pettah and development of a shopping and entertainment district along the Beira Lake area. While it's beyond the scope of our research to forecast the progress of the WRMMP, we believe AEL and the entire construction industry stands to benefit at least in the short to medium term from launch of individual projects identified within the WRMMP.

CRE is a growth sector

Commercial Real Estate (CRE) should undergo major development over the next decade: The demand for office space is directly linked to growth in the service sector. Currently over 50% of the Sri Lankan economy is service oriented. With development of the Banking and Financial Services, IT, BPO and Logistics industries, demand for CRE should only increase in the near future. Moreover, positioning Colombo as an attractive clean city should also attract MNCs to set up offices here. Key infrastructure Initiative such as the WRMMP, Colombo International Financial City, the Port city project should also serve to make Colombo an attractive regional business hub. This should augur well for AEL's commercial real estate business as well as AEL's construction segment which stands to benefit from current and future private sector led projects.

Heavy investment in water and sanitation

AEL should benefit from major water and irrigation related projects: Increasing urbanization, water scarcity from drastic weather patterns and pollution of water sources have placed increased pressure on the supply of clean water. In 2017, the government received over USD700m in overseas development loans earmarked for the water and sanitation sector while USD247 was earmarked for the irrigation sector. These funds are allocated to key projects such as the USD279m Kalu Ganga Water Supply Expansion Project, USD250m Kandy North Pathadumbara Integrated Water Supply Project and USD120m Jaffna Kilinochchi Water Supply. AEL currently has several water supply and irrigations contracts in its order book and we feel that it should be able to benefit from some the new projects planned to be undertaken by the Government.



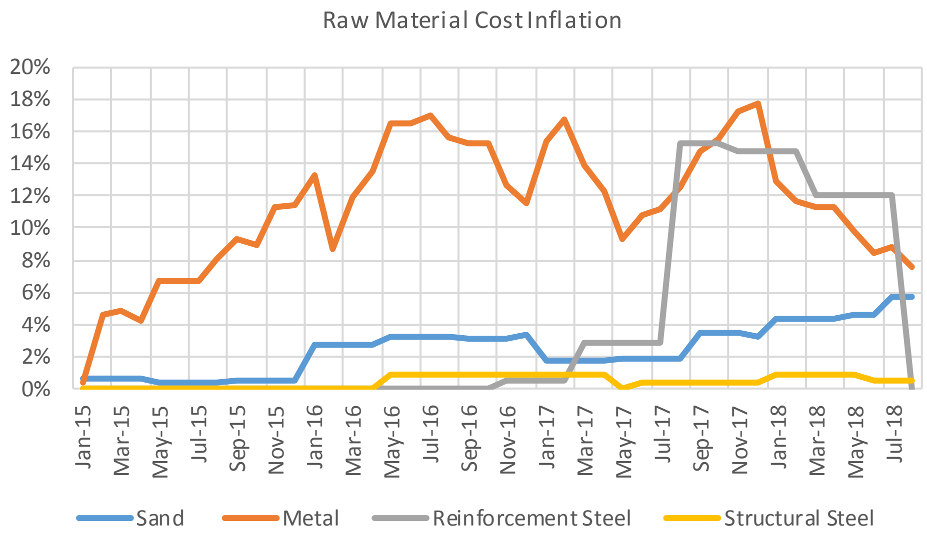
Source: CBSL, Taprobane Research

Public housing projects will continue

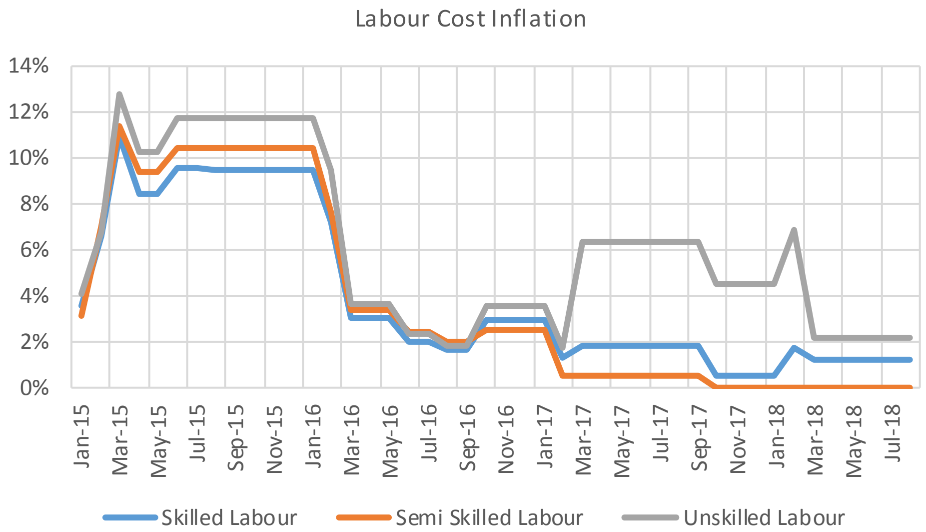
Tailwind from public housing projects: The provision of housing for low and middle income families located in Colombo has been a major priority for the Government. The Urban Development Authority (UDA) has launched housing projects aimed at the low and middle income segments. Under the urban regeneration program, the UDA has completed 9,971 housing units with 7,744 units under construction. The UDA plans to launch c.16,500 housing schemes in the 2018-2020 period. AEL should be well placed to be awarded contracts under this project given its previous track record in undertaking housing projects.

Inputs cost inflation is a headwind; but has ameliorated in recent months

Increase in input costs pose significant risk: Cost increase of key raw materials, services and labour have been a major concern for the industry. Of the major raw materials, price of cement is the only item that has remained largely flat due to price controls established by the Government. Nevertheless, price inflation of major raw materials such as sand and iron which had increased significantly have ameliorated in 2018. Labour cost inflation which had increased across all skill levels, have also ameliorated in the recent past, partially due to inflow of foreign (mainly Chinese and Indian) labour.



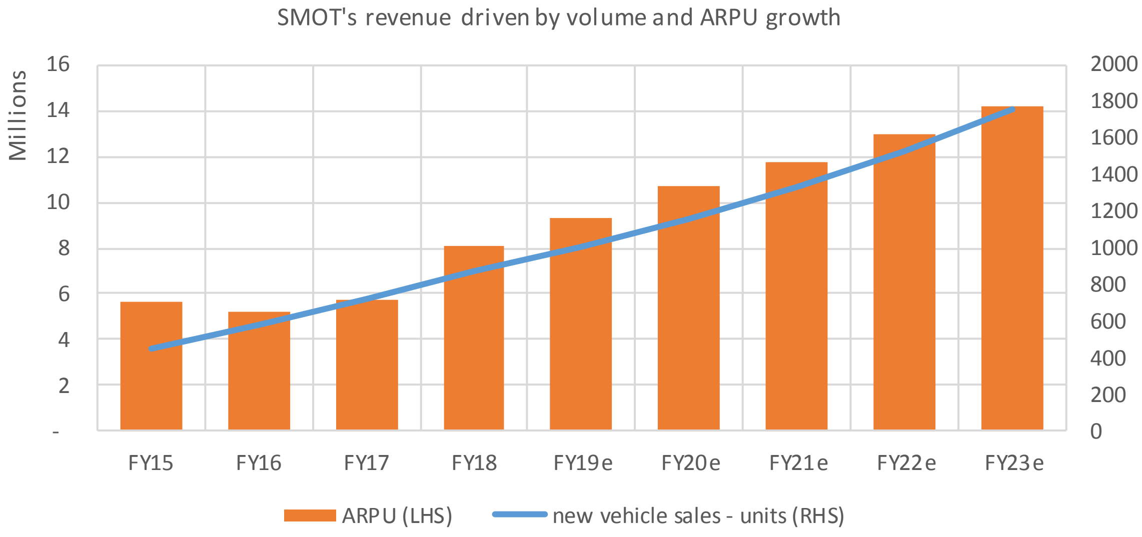
Source: CIDA, Taprobane Research



Source: CIDA, Taprobane Research

SMOT should be earnings accretive

Automobile segment should be earnings accretive: We expect AEL's automobile segment which is comprised of Sathosa Motors (SMOT). SMOT in turn owns SML Frontier Automotive (Pvt) Ltd. We expect SMOT to remain earnings accretive going forward. We expect new vehicles sales to increase by c.20% with ARPU increasing by c.15% over our forecast period. We also expect after sales and sale of vehicle spares to increase by c.10% in our forecast period. We expect SMOT's EBITDA margin to hover at c.10%. Key risks to SMOT are Government tax policy on vehicle imports and LKR depreciation against the JPY and GBP.



Source: Company Data, Taprobane Research

Attractive Valuation: Our SOTP model yields a 12 Month Target Price of Rs.19/share. Our WACC estimates for the various segment of the SOTP are in the 16-19% range. We have modelled terminal growth in the 2-3% range. The key assumption in our valuation is that AEL would be able to increase its order book and extend revenue visibility beyond our explicit forecast period. Nevertheless, significant downside risks remain from factors such as LKR depreciation, Government inaction on key infrastructure projects due to political instability, increase in input costs etc.

SOTP Valuation	**Rs m**
SMOT (Enterprise Value)	4,174
AEL - Ex SMOT (Enterprise Value)	14,028
Less: Debt, MI & adjustments	(7,438)
Add: Value of JVs/associates	5,305
Add: Cash & other investments	2,906
	18,977

Income statement

YE 31 March (Rs m)	FY16	FY17	FY18	FY19e	FY20e	FY21e
Revenue	17,625	20,448	26,056	30,819	34,353	35,820
Operating Profit	2,888	3,352	4,623	5,864	6,326	5,794
Net finance cost	96	-150	-383	-507	-644	645
Associate/JV income	11	29	-10	10	10	10
PBT	2,995	3,231	4,231	5,367	5,692	6,449
Net Profit	2,465	2,708	3,071	3,864	4,098	4,643
EPS (Rs)	2.5	2.7	3.1	3.9	4.1	4.6

Balance Sheet

YE 31 March (Rs m)	FY16	FY17	FY18	FY19e	FY20e	FY21e
Property, Plant & Equipmei	4,791	5,428	5,980	6,077	6,296	6,533
Investment properties	4,521	6,599	11,116	11,116	11,116	11,116
Intangible Assets	1,354	1,418	1,401	1,371	1,343	1,314
Other non current assets	1,691	2,628	2,674	2,684	2,694	2,704
Non Current Assets	12,357	16,074	21,171	21,249	21,450	21,668
Inventories	2,376	5,313	6,086	5,579	5,291	4,855
Receivables	6,576	8,821	11,249	12,752	13,714	13,567
Short-term deposits	6,792	2,922	2,041	2,041	2,041	2,041
Cash and cash equivalents	504	949	1,394	1,051	3,812	2,884
Other current assets	1,738	1,967	2,497	2,497	2,497	2,497
Current Assets	17,986	19,972	23,268	23,920	27,356	25,844
Government grant	6	6	6	6	5	5
Loans and borrowings	5,193	5,206	5,138	5,138	5,138	314
Other long term liabilities	404	467	1,396	1,396	1,396	1,396
Long term liabilities	5,603	5,680	6,540	6,540	6,540	1,715
Trade and other payables	5,368	7,852	10,117	8,183	8,921	9,009
Loans and borrowings	652	531	3,948	3,948	3,948	3,948
other current liabilities	725	432	753	753	753	753
Current Liabilities	6,745	8,815	14,818	12,884	13,623	13,710
Share Capital	9,000	9,000	9,000	9,000	9,000	9,000
Reserves	8,462	9,840	11,781	14,445	17,343	20,786
Minority Interest	532	2,712	2,300	2,300	2,300	2,300
Equity and Reserves	17,995	21,551	23,080	25,745	28,643	32,086
NAVPS	17.46	18.84	20.78	23.44	26.34	29.79

Cash Flow Statement

YE 31 March (Rs m)	FY16	FY17	FY18	FY19e	FY20e	FY21e
Operating Cash Flow	**3,168**	**1,995**	**630**	**1,532**	**4,915**	**5,004**
Capex	-1,431	-1,332	-1,590	-1,233	-1,374	-1,433
FCFF	**1,737**	**663**	**-960**	**299**	**3,541**	**3,572**
net debt issued/repaid	473	-108	3,348	0	0	-4,824
FCFE	**2,210**	**554**	**2,388**	**299**	**3,541**	**-1,253**
Dividends paid	-750	-1,500	-1,200	-1,200	-1,200	-1,200
other adjustments	3,072	-643	565	-299	-3,541	-3,572
Net Cash Flow	**4,532**	**-1,589**	**1,753**	**-1,200**	**-1,200**	**-6,024**

Key Financial Indicators

YE 31 March (Rs m)	FY16	FY17	FY18	FY19e	FY20e	FY21e
Revenue growth (%)	6.7	16.0	27.4	18.3	11.5	4.3
EBITDA margin (%)	21.2	20.9	21.8	22.8	21.9	19.6
EBIT margin (%)	16.4	16.4	17.7	19.0	18.4	16.2
ROE	14.2	12.7	13.1	15.0	14.3	14.5
ROA - pre tax)%)	9.9	9.0	9.5	11.9	11.7	13.6
Equity Multiplier (x)	1.7	1.7	1.9	1.8	1.7	1.5

Source: Company Data, Taprobane Research

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