

Access Engineering PLC [AEL.N: LKR 31.50]
Full order book, rising demand for construction materials and anticipated boom in construction industry to drive AEL's topline

Recommendation: BUY

Target Price: LKR 43.90

Sector: Capital Goods

Access Engineering PLC- one of the leading construction firms in Sri Lanka is mainly engaged in the construction of highways, buildings, drainage, bridges (contributes to 55% of group's topline) and sale of construction related material (contributes to 27% of group's topline). Through AEL's fully owned subsidiary - Access Realties (Pvt) Limited, the group is also involved in leasing out office space in Access Tower I & II, whereas under the automobile sector AEL owns 84.4% stake in Sathosa Motors which is the authorized distributor of ISUZU, Jaguar and Land Rover in Sri Lanka. The group marked its presence in property segment through the investments in Marina Square Colombo and Capital Heights Rajagiriya condominium projects.

Topline to grow along with the increase in investments in construction industry amid full order book: We expect AEL's topline to grow by 45%YoY in FY22E driven by AEL's order book value exceeding LKR 80Bn which is estimated to be realized till FY25E. AEL's contribution to the group's topline from construction of buildings and highways were 33% and 12% respectively in FY21. Sri Lanka's construction sector has been growing at a notable CAGR of 8% during 2010- 2019 period whereas investment on road development projects (predominantly construction of expressways, bridges and flyovers) growing by a CAGR of 8% during 2014- 2020. Moreover, we could expect a further boost in this space as 20% of the total undisbursed foreign financing available (as at April'21) from already committed loans are allocated for roads and bridges development - a segment in which AEL is a dominant player commanding a higher margin. These funds are expected to be utilized within the next 3-5 years, thus benefiting AEL. We are bullish on major projects such as Central Expressway (stage 1- 37.1Km and stage 4- 60.3Km are yet to commence construction) and Ruwanpura Expressway too specially given that AEL having the highest CIDA grading of CS2 for the construction of highways, buildings, bridges, water supply and sewerage. Construction of Port City certainly will benefit the industry, providing more opportunities for local contractors including AEL.

When looking at major projects in pipeline, the ADB funded 'I Road' project is scheduled to be completed in FY25 where 20% of the work has been completed while construction of the Elliot place housing project is expected to be completed in FY24E where 10% of the construction is already completed. In Dec'21, the group was awarded the contract to construct the East Container Terminal (ECT) through the 51% owned joint venture with China Harbour Engineering (CHEC) which resulted in AEL becoming the first local construction company to undertake a LKR 43Bn worth project in ports segment. We project this venture to contribute an additional income of LKR 13Bn annually within FY22-FY25 and with the completion of the project AEL would get the exposure and opportunity to take part in similar large-scale projects both locally and internationally in our view.

Expected cash inflow for the next three years from ongoing projects

| Project | Total value (LKR Bn) | Amount to be recognized (LKR Bn) |
|---|----------------------|----------------------------------|
| 432 Affordable Housing at Orugodawatta- phase 02 | 5.3 | 4.3 |
| The Elliot Place Housing Project | 9.4 | 8.4 |
| The Stadiumgama Housing Project | 6.0 | 4.5 |
| 600,000sq.ft logistics park in Ekala | 10.0 | 10.0 |
| East container terminal | 39.0 | 39.0 |
| Widening & improvement of Nittambuwa pasyala on colombo- kandy Rd | 2.2 | 1.8 |
| Gatambe & Kohuwala flyover | 3.3 | 3.3 |
| Slave island fly over | 2.7 | 2.6 |
| Multi storied public car park at Union Place | 0.6 | 0.3 |
| I Road project | 7.5 | 6.0 |
| BIA - piling project | 2.8 | 0.8 |
| Total | 88.8 | 81.0 |

Key Statistics

| | |
|-----------------------|---------------|
| Market Cap (LKR Bn) | 31.50 |
| Market Cap (USD Mn) | 155.17 |
| Issued Quantity (Mn) | 1000.00 |
| Current Trading Range | 31.00-32.00 |
| 52 week High/Low | 21.40/31.70 |
| YTD High/Low | 21.40/31.70 |
| Valuation | |
| Market PE (x) | 13.2 |
| Market PBV (x) | 1.6 |
| AEL PE (x) | 11.5 |
| AEL PBV (x) | 1.3 |
| Bloomberg Ticker | AEL SL |
| GICS Industry Group | Capital Goods |

Main shareholders as at 30.09.2021

| | |
|-------------------------|--------|
| Mr. S J S Perera | 25.00% |
| Mr. J C Joshua | 10.10% |
| Mrs. R M N Joshua | 7.00% |
| Mr. Shamal J S Perera | 5.08% |
| Mrs. D R S Malalasekera | 4.50% |

Share Price Performance


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Construction material segment to double the revenue contribution in FY22: AEL being Sri Lanka's largest asphalt producer, fulfills the group's raw material requirement and cater to the external demand as well. The group has an extensive network of production plants which includes asphalt plants (capacity of 656 TPH), concrete batching plants (capacity of 340m³/hour), crusher plants (capacity of 690 TPH) and sand plant (50TPH). The revenue contribution from the segment increased to 41% in 1H'FY22 from 27% in FY21 mainly due to the '100,000 KM road project' of which only 30% is completed. Hence, this trend is expected to continue till FY25 thus increasing the contribution from construction material segment to LKR 12Bn in FY22E and LKR 17Bn in FY23E.

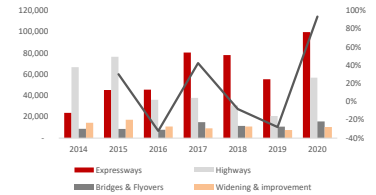
Recognition of sale of apartments to boost the topline further: We forecasted an additional revenue of LKR 5.4Bn in FY22E and LKR 7.6Bn in FY24E backed by the realization of revenue when handing over the pre-sold apartments at Capital Heights and Marina Square in FY22E and FY24E respectively. Through the 60% ownership in Blue Star Realities (Pvt) Ltd, the group engaged in the construction and sale of apartments of Capital heights in Rajagiriya which includes 242 apartments. Currently, 90% of the construction is completed and 64% of the apartments are already sold. Under the joint venture- Harbour Village (Pvt) Ltd with China Harbour Engineering Company and Mustafa Singapore, AEL is engaged in the development of The Marina Square mixed development project which includes 1088 units and 150,00sq.ft commercial space. 46% of the apartments have been sold and the project is expected to be completed in FY24E.

AEL's exposure to government treasury is near zero: AEL facing a risk of defaulted receivables is minimal as only 3% of AEL's customers are from the public sector and the projects are funded through local banks and funding agencies via bilateral and multilateral agreements, making the group less dependent on the GOSL treasury.

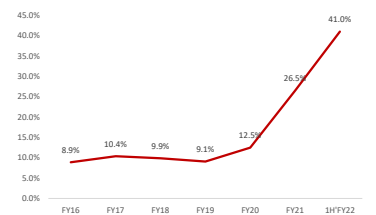
Margin pressure & foreign currency reserves are some concerns faced by AEL: Although there could be some pressure on the GP margins due to higher cost of raw materials and imposition of new taxes proposed by 2022 budget we expect AEL to maintain margins at 15%-16% levels specially with some of the project cost been able to passed down to end customer and focusing their energy on high margin projects (according to the management however, the impact from the 25% one off tax and the 2.5% tax on turnover is still uncertain due to the less clarity on the tax base and we believe it to have an adverse impact if imposed on the construction industry, as most companies are running at low margins). We believe higher profits would be stemming mainly from rapid increase in topline with AEL recognizing revenue from the already sealed projects and upcoming projects despite some possible squeeze in margins.

We also think the country's ongoing foreign currency crisis to have a short-term impact for AEL, however believe this to be mitigated with some stability through inflows outlined in the six-month roadmap. We also think despite some pressure, construction sector investments to be always prioritized given that it's one of the main engines of the economic recovery, invariably having a relatively lower risk on AEL.

AEL's SOTP valuation indicates an upside of 39% to the CMP: We estimate AEL's equity holder's profit to reach LKR 3.0Bn (30%YoY) in FY22E supported by higher demand for construction materials, additional income from the pre-sold apartments of Capital Heights and the revenue from major ongoing construction projects. Based on the SOTP, we value the counter at LKR 43.90 (recurrent core business earnings valued on DCF, Sathosa Motors on market based and property segment on NPV), derive an upside of 39% to the CMP of LKR 31.50. Thus, we recommend BUY.

Investment on major road development projects grew by a CAGR of 8% during 2014- 2020


Source: CBSL annual reports

Construction material segment's contribution to topline almost doubled in 1H'FY22


Source: Company reports

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Earnings Forecast

| YE 31 March | FY18 | FY19 | FY20 | FY21 | FY22E | FY23E | FY24E |
|---------------------------------|--------|--------|--------|--------|--------|--------|--------|
| Revenue (LKR Mn) | 26,056 | 32,277 | 24,027 | 23,837 | 34,645 | 48,282 | 56,077 |
| YoY growth (%) | 27% | 24% | -26% | -1% | 45% | 39% | 16% |
| Equity Holder's Profit (LKR Mn) | 2,507 | 2,150 | 979 | 2,386 | 3,093 | 4,440 | 5,048 |
| YoY growth (%) | -7% | -14% | -54% | 144% | 30% | 43% | 14% |
| Reported EPS (LKR) | 2.5 | 2.2 | 1.0 | 2.4 | 3.1 | 4.4 | 5.1 |
| DPS (LKR) | 0.5 | 0.5 | 0.5 | 0.5 | 0.6 | 0.9 | 1.0 |
| BVPS (LKR) | 22.1 | 23.6 | 24.4 | 26.5 | 29.6 | 34.0 | 39.1 |
| Ratios (%) | | | | | | | |
| Dividend Payout(%) | 20% | 23% | 51% | 21% | 20% | 20% | 20% |
| Dividend Yield (%) | 1.6% | 1.6% | 1.6% | 1.6% | 2.0% | 2.8% | 3.2% |
| ROE (%) | 11% | 9% | 4% | 9% | 10% | 13% | 13% |
| PE (x) | 12.5 | 14.6 | 32.0 | 13.1 | 10.1 | 7.1 | 6.2 |
| PBV (x) | 1.4 | 1.3 | 1.3 | 1.2 | 1.1 | 0.9 | 0.8 |

Source: CSE & Company reports

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