ALLIANCE RESEARCH

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Initiating Coverage

Ahmad Zaki Resources — Buy

Construction — *Bloomberg Ticker: AZR MK | Bursa Code: 7078*

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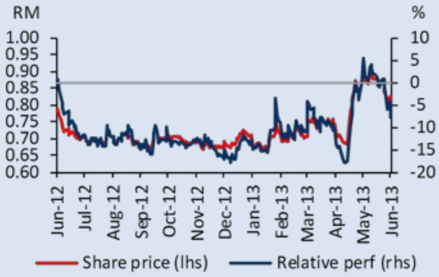
12-month upside potential	
Target price	1.22
Current price (as at 20 June)	0.79
Capital upside (%)	54.1
Net dividends (%)	0.8
Total return (%)	54.9

Key stock information	
Syariah-compliant?	Yes
Market Cap (RM m)	217.6
Shares outstanding (m)	275.5
Free float (%)	35.9
52-week high / low (RM)	0.92 / 0.67
3-mth avg volume ('000)	696.2
3-mth avg turnover (RM m)	0.6

Share price performance

	1M	3M	6M
Absolute (%)	-13.7	5.3	16.2
Relative (%)	-12.4	-1.7	9.4

Share price chart



Source: Bloomberg

Major shareholders	**%**
Zaki Holdings Sdn Bhd	59.2

Ready for blast off

We initiate coverage on AZRB with a BUY rating and RM1.22 TP (54% upside) based on 12x FY14 earnings. AZRB sits on a huge orderbook of RM3.6bn, implying 6x its construction revenue. It is also a prime beneficiary of government project rollouts given its past success in bagging such jobs. We project a 3-year earnings CAGR of 29.6%. With market cap at only 0.06x of its orderbook, valuations look like a steal.

Beneficiary of government projects

- AZRB's sits on a huge orderbook of RM3.6bn, implying 6x FY12 construction revenue. In comparison, its peers only command an average orderbook to revenue ratio of 2.2x.
- Its key projects include the EKVE (RM1.6bn), Bangunan MAS redevelopment (RM673m) and MRT V6 (RM765m). Orderbook profile is also relatively young.
- We view AZRB as a prime beneficiary from the rollout of government projects given past success rate in securing such jobs. Since 2005, AZRB managed to secure RM6.2bn worth of jobs, of which RM5.5bn (89%) were from the government, its related entities or GLCs.
- In recent years AZRB managed to tap into the construction of high rise buildings when it secured the JKR2 Complex (RM309m) and Bangunan MAS redevelopment. More high rise buildings are expected to emerge in KL from redevelopment plans.
- Other potential jobs include public hospitals. We gather that AZRB is very close to securing a building type job worth RM150-200m.

Building its recurring income base

- AZRB's concession assets provide a dual stream of profits: (i) construction profits during construction period and (ii) recurring income once the asset is operational.
- It secured its first concession when it bagged the UIA teaching hospital (RM413m) in Sept 2011. Upon completion in mid-2015, AZRB will receive deferred payments and maintenance charges for the facility. IRR is estimated at 9%.
- In Feb, AZRB sealed a 50-year concession for the East Klang Valley Expressway (EKVE). AZRB has procured the necessary approvals from both the state and federal governments. The next step is for financial closure, by Feb 2014. IRR is guided to be at "high single digit".

Bunkering and plantations

- AZRB holds a bunkering concession to supply marine diesel to production sharing contractors (PSC) at Kemaman Port. In May, the bunkering fee was revised upwards by 2.4%. Over the last 3 years, bunkering contributed 10-13% of revenue.
- In Kalimantan, AZRB has 21,701ha of plantation land, of which, 4,750ha were planted. As the trees are still at the early stage of its maturity cycle, this division is still loss making.

Earnings forecast

- We project FY13 earnings to dip slightly (-4.4%) as the EKVE has not begun while other major jobs are still at the early stage. Plantation losses will continue to drag earnings.
- However in FY14-15, we project a strong y-o-y surge in earnings at 56.5% and 41.6% when the EKVE commences and other major jobs hit full swing. Plantation losses will also narrow in FY14 before breaking even in FY15.
- Overall, we project a strong 3-year earnings CAGR of 28.4%.

Valuation and recommendation

- We initiate coverage on AZRB with a BUY rating and RM1.22 TP (+54.1% upside) based on 12x FY14 earnings, inline with its 3- and 5-year mean P/E.
- While AZRB trades at 12.2x FY13 P/E, this will be drastically cut to 7.8x and 5.5x in FY14-15 once earnings growth kicks in. Market cap to orderbook is a bargain at 0.06x, one of the lowest within the construction space.

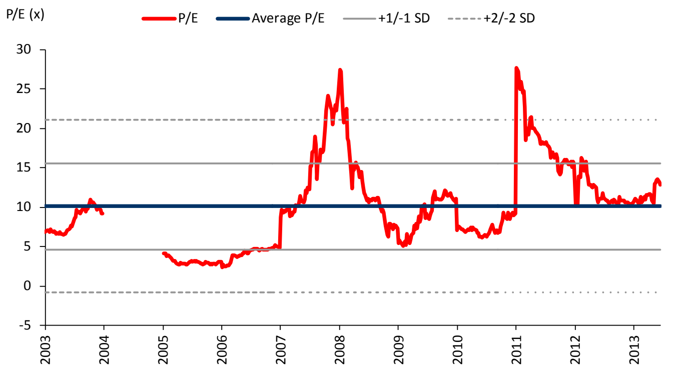
SNAPSHOT OF FINANCIAL AND VALUATION METRICS

Figure 1 : Key financial data

FYE 31 Dec	FY11	FY12	FY13F	FY14F	FY15F
Revenue (RM m)	534.9	674.7	730.7	874.9	1,071.3
EBITDA (RM m)	44.1	61.2	60.7	85.4	113.8
EBIT (RM m)	35.6	51.3	50.1	73.8	101.2
Pretax profit (RM m)	24.4	37.8	35.7	55.9	79.2
Reported net profit (RM m)	11.9	18.7	17.9	28.0	39.6
Core net profit (RM m)	11.9	18.7	17.9	28.0	39.6
EPS (sen)	4.3	6.8	6.5	10.1	14.4
Core EPS (sen)	4.3	6.8	6.5	10.1	14.4
Alliance / Consensus (%)			66.9	98.8	n.a
Core EPS growth (%)	(62.9)	57.5	(4.4)	56.5	41.6
P/E (x)	18.3	11.7	12.2	7.8	5.5
EV/EBITDA (x)	7.5	5.4	5.5	3.9	2.9
ROE (%)	1.8	2.6	2.2	2.9	3.4
Net gearing (%)	19.5	42.1	46.9	62.1	63.5
Net DPS (sen)	1.9	-	0.6	1.0	1.4
Net dividend yield (%)	2.4	-	0.8	1.3	1.8
BV/share (RM)	0.69	0.75	0.81	0.90	1.03
P/B (x)	1.1	1.0	1.0	0.9	0.8

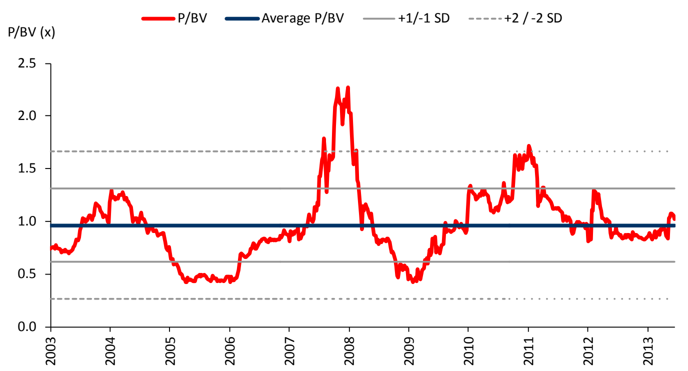
Source: Alliance Research, Bloomberg

Figure 2 : Forward P/E trend



Source: Alliance Research, Bloomberg

Figure 3 : Forward P/B trend



Source: Alliance Research, Bloomberg

Figure 4 : Peer comparison

Company	Call	Target price (RM)	Share price (RM)	Mkt Cap (RM m)	EPS Growth (%) CY13	EPS Growth (%) CY14	P/E (x) CY13	P/E (x) CY14	P/BV (x) CY13	P/BV (x) CY14	ROE (%) CY13	ROE (%) CY14	Net Dividend Yield (%) CY13	Net Dividend Yield (%) CY14
Gamuda	Buy	5.70	4.67	10,476.7	11.9	11.7	15.5	13.9	2.2	2.0	14.2	14.4	2.6	2.9
IJM Corporation	Neutral	6.14	5.69	7,929.0	14.8	9.5	15.4	14.1	1.3	1.3	8.9	9.0	2.6	2.8
WCT	Neutral	2.68	2.51	2,741.4	28.9	11.8	14.4	12.9	1.4	1.4	10.0	10.5	2.8	3.1
Mudajaya Group	Neutral	2.93	2.62	1,420.6	-17.0	16.0	7.3	6.3	1.1	1.0	15.6	15.9	3.4	4.0
Eversendai	Buy	1.66	1.45	1,122.3	2.8	9.5	9.5	8.6	1.2	1.1	13.2	12.9	1.6	1.7
Kimlun Corp	Buy	2.35	2.14	514.6	6.5	14.7	9.8	8.5	1.6	1.4	16.6	16.5	2.0	2.3
TRC Synergy	Trading buy	0.76	0.61	290.9	162.3	49.8	12.0	8.0	0.9	0.8	7.3	10.2	2.5	3.7
Ahmad Zaki Resources	Buy	1.22	0.79	217.6	-4.4	56.5	12.2	7.8	1.0	0.9	8.0	11.2	0.8	1.3
Average					9.8	12.5	14.0	12.5	1.7	1.6	12.0	12.2	2.6	2.9

Source: Alliance Research, Bloomberg *Share price date: 20 Jun 2013*

BACKGROUND

Established in 1982, Ahmad Zaki Resources Bhd ("AZRB") started off largely undertaking subcontracting and smallish sized jobs in the northern state of Terengganu. After years of building on its track record, it received the Class A contracting licence in 1993 which enables it to undertake government jobs of unlimited size. It was listed on the then Second Board of Bursa in 1999 and subsequently transferred to the Main Market in 2003. The Zaki family, which founded AZRB, remains very much involved in its day to day operations. Via Zaki Holdings (M) Sdn Bhd, the family holds a 59.2% stake in AZRB.

Construction remains the key earnings driver for AZRB, making up 86-89% of revenue over the last 3 years. Since founding, AZRB has completed over RM4bn worth of jobs comprising highways, elevated roads, earthworks, mosques, hospitals, stadiums and campuses. It continues to add on its track record and is currently undertaking new structures such as the MRT and high rise buildings. As a compliment to its construction activities and to establish a recurring income base, AZRB has also been actively seeking out concession assets. It is currently working on a hospital concession and tolled expressway.

Aside construction, AZRB is also involved in bunkering, property and plantations. Bunkering is it's 2nd largest revenue contributor after construction at 10-13%. This involves the supply of marine diesel at the Kemaman Port in Terengganu. The property division is rather small and remains centred on the Paka Industrial Park development in Terengganu. In 2011, AZRB saw contribution from its plantation venture in Kalimantan but this is loss making as most of the planted area is still at its infancy stage.

Figure 5 : Corporate structure of AZRB

ENGINEERING & CONSTRUCTION	• Ahmad Zaki Sdn Bhd • AZSB Machineries Sdn Bhd • Unggul Energy & Construction Sdn Bhd
EXPRESSWAY	• EKVE Sdn Bhd
HOSPITAL CONCESSION	• Peninsular Medical Sdn Bhd
PROPERTY DEVELOPMENT	• Kemaman Technology & Industrial Park Sdn Bhd • AZRB Properties Sdn Bhd • Trend Vista Development Sdn Bhd • Temala Development Sdn Bhd • Betanaz Properties Sdn Bhd
OIL & GAS	• Inter-Century Sdn Bhd • Astral Far East Sdn Bhd
PLANTATION	• PT Ichtiar Gusti Pudi
OVERSEAS INVESTMENT	• AZRB Construction (India) Pvt Ltd • AZRB International Ventures Sdn Bhd • Ahmad Zaki Saudi Arabia Co Ltd
PROJECT MANAGEMENT	• Peninsular Prokonsult Sdn Bhd

Source: AZRB

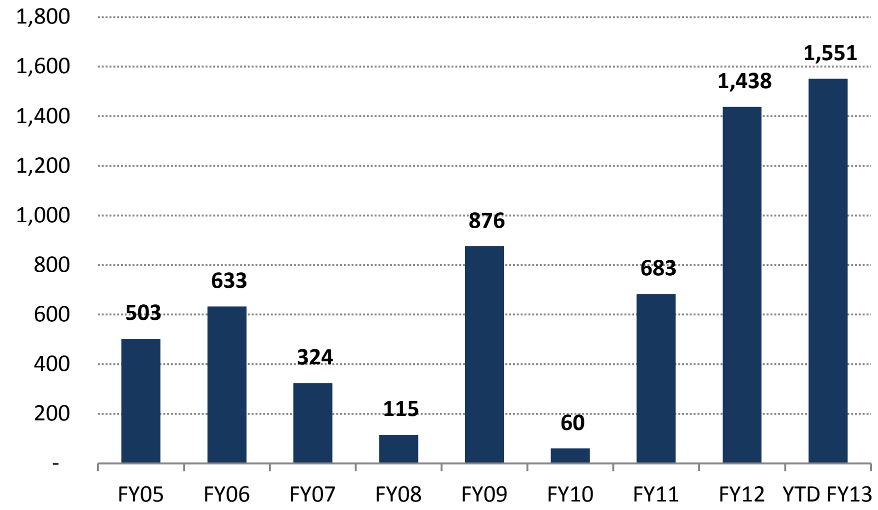
INVESTMENT CASE

Anchored by sizable orderbook

Strong orderbook replenishment over the last 2 years

Construction has always been AZRB's bread and butter, contributing an average 88.3% to its revenue over the past 5 years. Following a dismal year in FY10 for contract flows, AZRB has since witnessed a strong reversal in its fortunes. Job wins surged strongly at RM683m in FY11 and rocketed to a record RM1.44bn in FY12. Despite 2 strong consecutive years of contract awards, the momentum is not slowing for AZRB this year when it was awarded the East Klang Valley Expressway worth RM1.55bn.

Figure 6 : Annual orderbook replenishment (RM/m)

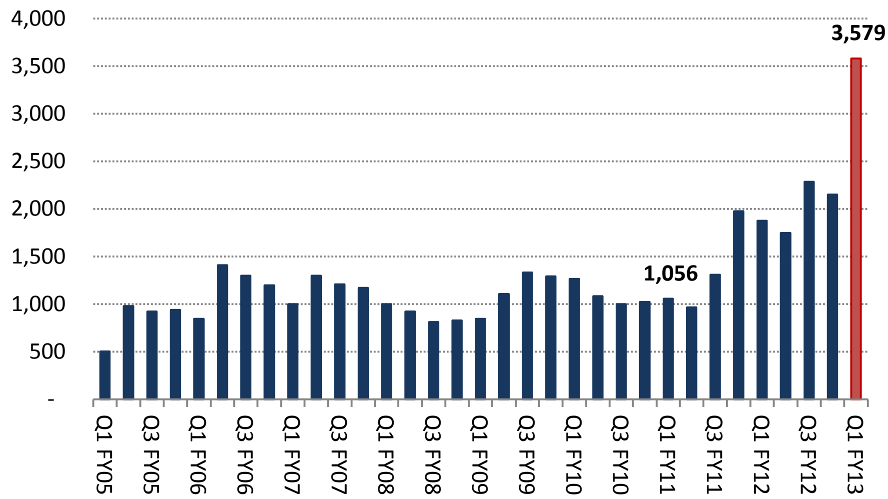


Source: Compilation from Bursa announcements

Attractive orderbook to revenue ratio of 6x

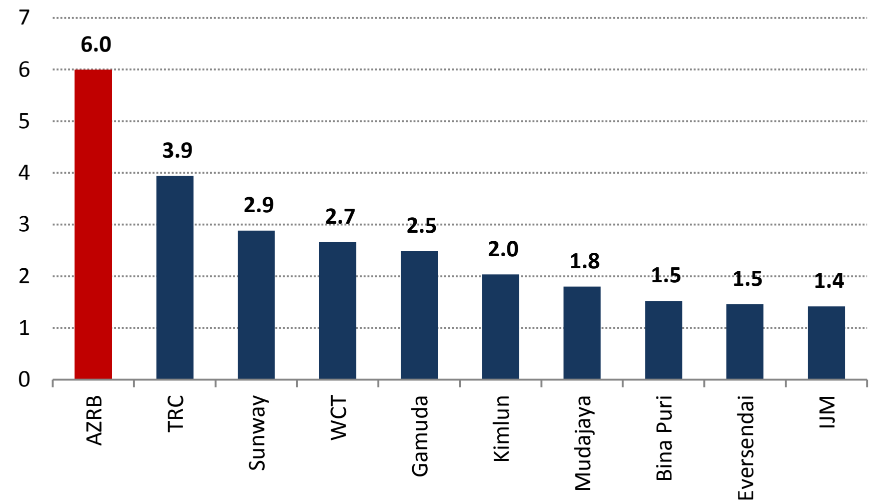
Following strong job wins since FY11, AZRB has managed to more than triple its orderbook balance over the last 2 years from RM1.06bn to RM3.58bn. When stacked against its FY12 construction revenue of RM597m, this boasts a very high multiple of 6x. This is indeed a tall standard when compared against its peers which only commands an average orderbook to revenue ratio of 2.2x (ex AZRB). In terms of orderbook replenishment, we assume an additional RM250m for the remainder of FY13 (full year: RM1.8bn) and RM400m p.a. for FY14-15. We believe this is conservative considering that it is below the long term average replenishment rate of RM579m p.a.

Figure 7 : Movement in AZRB's orderbook balance (RM/m)



Source: AZRB

Figure 8 : Comparison of orderbook to revenue ratio



Source: Alliance Research estimates

Relatively young orderbook profile

The key projects in AZRB's RM3.58bn orderbook is the East Coast Expressway, UIA teaching hospital, MRT Package V6, redevelopment of Bangunan MAS and East Klang Valley Expressway (EKVE). Collectively, these 5 projects make up 95.3% of AZRB's orderbook and all have outstanding balances of > 70%, indicating that overall, its orderbook profile is relatively young. This implies strong potential for revenue momentum to accelerate going forward once these projects are being executed.

Figure 9 : AZRB's orderbook balance as at 1QFY13 (RM/m)

Project	Value	Balance
Maternity specialist hospital, Kuala Terengganu	115	13
Infra works for Kerteh Polymer Park	78	10
JKR Complex 2, KL	309	67
University Darul Imam, Besut	225	54
Flats for Public Housing Program, Kuala Terengganu	125	23
East Coast Expressway (Phase 2), Terengganu	145	106
UIA teaching hospitsl via PFI	413	373
MRT V6 Plaza Phionex to Bdr Tun Hussein Onn	765	716
Redevelopment of Bangunan MAS, Jln Sultan Ismail	673	666
East Klang Valley Expressway (EKVE) via BOT	1,551	1,551
Total orderbook		**3,579**

Source: AZRB

Riding on government project rollouts

Strong track record in securing government projects

With the 13th General Elections (13GE) now over, we believe that the rollout of government projects is set to regain traction, likely in the 2H. In our view, AZRB is a prime beneficiary from this as it has established a strong track record in competing for government jobs, particularly infra based ones. Figure 10 (next page) lists down the contracts secured by AZRB since 2005 which amounts to RM6.18bn. Of this sum, 88.9% (RM5.49bn) was awarded either directly by the government (via its various ministries), its related entities (e.g. Putrajaya Holdings, MRT Corp, PNB) or government-linked companies (GLCs). As the bulk of AZRB's orderbook comes from the public sector and its related entities, credit risk is rarely an issue.

Figure 10 : Contracts secured by AZRB since 2005

Date	Contract	Client	RM/m
13-Feb-13	East Klang Valley Expressway (BOT)	Govt of M'sia	1,551
3-Oct-12	Redevelopment of Bangunan MAS, Jln Sultan Ismail	PNB	673
30-Jan-12	MRT SBK Line, Pacakge V6, Plaza Phoenix - Tun Hussien Onn	MRT Corp	765
21-Sep-11	International Islamic Teaching Hospital (PFI), Kuantan	Ministry of Education	413
10-Mar-11	East Coast Expressway (Phase 2), Terengganu	Ministry of Works	145
31-Jan-11	3 blocks of flats, Public Housing Program, Kuala Terengganu	Ministry of Housing	125
2-Apr-10	Waterfront shop offices, Precint 8, Putrajaya	Putrajaya Holdings	60
23-Dec-09	Preliminary works for Hulu Terengganu Hydroelectric Project	Tenaga Nasional	49
18-Nov-09	Jabatan Kerja Raya Complex 2, Kuala Lumpur	Ministry of Works	309
10-Aug-09	University Darul Iman, Besut Campus, Terengganu	Ministry of Works	225
5-Aug-09	Elevated interchange from palace to Jln Duta, Kuala Lumpur	Ministry of Works	106
18-May-09	Reinforced concrete structures, Jabal Omar Dev, Mecca	Saudi Oger Ltd	186
1-Dec-08	Maternity specialist hospital, Kuala Terengganu, Terengganu	Ministry of Works	115
5-Jun-07	East Coast Expressway (Package 5A, 6 and 9C), Terengganu	Ministry of Works	324
11-May-06	Road upgrade from Kuantan to Pekan, Pahang	Ministry of Works	384
25-Apr-06	Indoor stadium, Gong Badak, Terengganu	Terengganu Govt	116
3-Mar-06	Subang-Kelana Link (additional works), Subang Jaya	Govt of Malaysia	133
29-Jun-05	Alfaisal University (Phase 1&2), Riyadh, Saudi Arabia	Alfaisal University	397
15-Apr-05	Improvement and maintenance of IT Corridor, Chennai, India	IT Expressway Ltd	105
	Total contracts awarded since 2005		**6,183**

Source: Compilation from Bursa announcements

Ventured into the high rise building segment

AZRB's job scope has traditionally been focused on road related works and non-high rise building jobs such as stadiums, campuses and hospitals. However in late 2009, AZRB made its maiden foray into high-rise building jobs when it clinched the 37-storey JKR 2 complex building (RM309m) from the Ministry of Works on a design and build basis. Upon completion by year end (currently 80% completed), it will be one of the iconic buildings in KL with its slanting curvature structure. Following good execution with the JKR 2 complex, AZRB managed to clinch an even larger high rise building job in Oct last year involving the redevelopment of Bangunan MAS (RM673m) for PNB. The job involves the refurbishment of the existing office block and construction of a new 50-storey hotel at the same site.

Figure 11 : Artist impression of JKR2 complex and Bangunan MAS redevelopment

Source: AZRB

More high-rise buildings from redevelopment projects

With AZRB now having set foot on high-rise buildings within the KL city centre area, we believe it is in a good position to secure more of such jobs. Within KL, there exist quite a number of redevelopment plans involving high-rise buildings such as:

- **Equatorial Hotel**: Existing hotel has been demolished and a new one to be built.
- **Komplex Antarabangsa** and **Crowne Plaza**: Redeveloped into Tradewinds Centre involving retail podium, offices, service apartments and medical centre.
- **Lai Meng School**: 50-storey twin towers comprising offices, hotel and service residence. To begin once school relocated to Bukit Jalil in 2014.
- **Chulan Square**: First 7-star Harrods Hotel to be built on the former Restaurant Seri Melayu site.

Partnering foreign contractor to bid for Warisan Merdeka

Another high-rise structure that AZRB is hopeful to participate in is the Warisan Merdeka. If implemented, the 118-storey tower (>600m) will be the tallest in Malaysia. We understand that the job requires a minimum 30% participation involving a local contractor. Management guides that it will be partnering a foreign contractor to bid for the job. Construction cost of the tower alone is estimated at RM2.5-3bn.

Government buildings and hospitals are other job flow prospects

AZRB is also eyeing some government building jobs such as the Tabung Haji Haj Complex near KLIA, new headquarters for Prasarana and office buildings in Putrajaya. We understand that these jobs could be in the range of RM200-300m each. Aside that, there are also a few hospitals in which tenders could be called soon such as the Putrajaya Hospital extension, hospital for UPM in Serdang and another for University Darul Imam in Terengganu. In the near term, our sources indicate that AZRB is close to securing another building project worth RM150-200m.

Building on its recurring income base

UIA teaching hospital is AZRB's first concession project

Management acknowledges the cyclical nature of its construction business and is actively taking steps to build on its recurring income base via the ownership of concession assets. In Sept 2011, AZRB inked a concession agreement (CA) with the International Islamic University Malaysia (IIUM) and the government to implement the University Islam Antarabangsa (UIA) teaching hospital via Private Finance Incentive (PFI).

Recurring income for 21 years once facility is completed by mid-2015

The concession duration lasts for 25 years which includes a 3.5-year construction period. Under the structure, AZRB will fully undertake and finance the construction of the 300-bed facility costing RM412.6m. During the construction period, AZRB will be able to recognise revenue and profits from construction. As of 1QFY13, work has hit the 10% mark and management guides that this is on track for completion by mid-2015. Upon completion of the facility, AZRB will receive returns from IIUM via 3 forms of charges which are payable on a monthly basis for the remaining 21.5 years. The charges are:

- **Availability charges –** Payments that covers for the cost of construction and interest cost incurred to finance the construction.
- **Maintenance charges –** Payments for the maintenance of the teaching hospital. Management guides that the maintenance will largely be for the medical equipment. As AZRB does not have any experience in this field, it has subcontracted the maintenance task to Advance Pact in a deal totalling RM600m. Advance Pact is a biomed engineering contractor which maintains medical equipment for 23 government hospitals nationwide.
- **Asset replacement charges –** Payments for replacement of any of the facility's assets.

Projected IRR of 9%

To finance the construction of the project and any subsequent funding required during the maintenance period, AZRB has already secured a RM458.4m debt facility. Management remains tight lipped on the exact amount of the payments it will receive from IIUM over the concession period but guides for an IRR of 9%. Thus far, we have only accounted for the construction profits into our earnings model and not factored in any contribution from the maintenance contract.

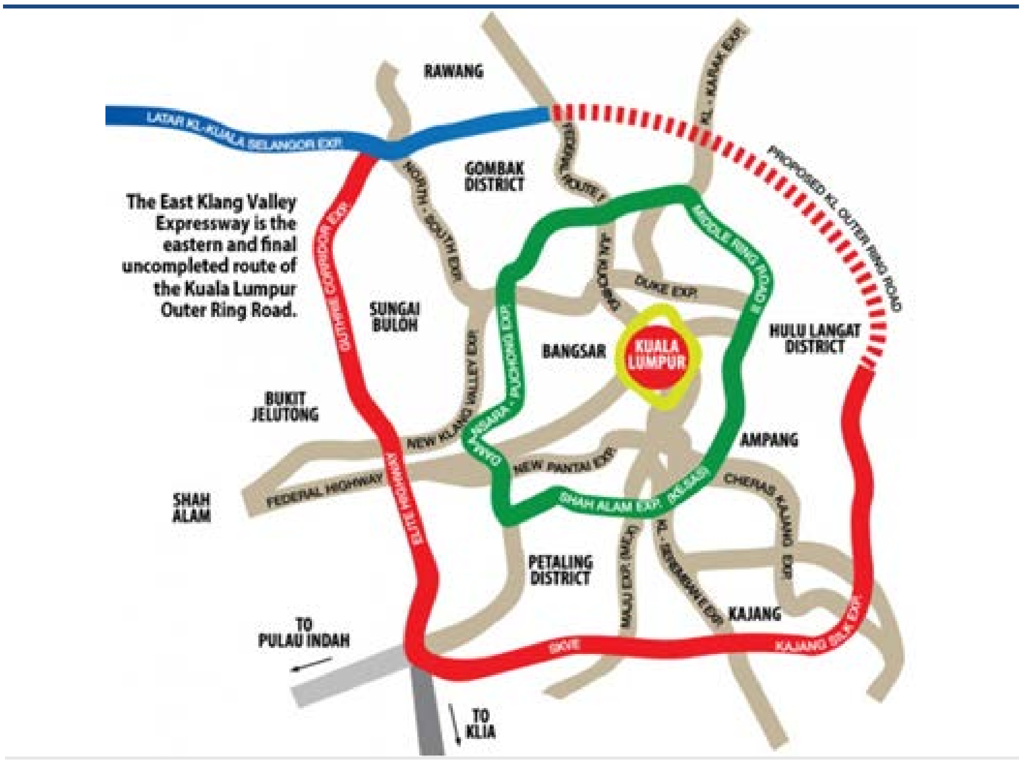
CA for EKVE inked in Feb 2013

In 2007, AZRB received a Letter of Intent (LOI) for the proposed East Klang Valley Expressway (EKVE) via the Build-Operate and Transfer (BOT) method. However, when the Selangor State Government (SSG) was taken over by Pakatan Rakyat in 2008 following the 12GE, the project hit a temporary snag. Despite the change in state government, AZRB continued to embark on further discussions with both the SSG and Federal Government to push for the project. After numerous rounds of negotiations with both governments, the CA for the EKVE was finally inked in Feb this year, 6 years after the LOI was received.

EKVE is the final part of the KL Outer Ring Road

The EKVE forms the final section of the KL Outer Ring Road (KLORR) which currently comprises of the LATAR Highway, Guthrie Corridor Expressway, ELITE Highway, South Klang Valley Expressway (to be opened soon) and SILK Expressway. The KLORR is part of the ring road networks in the Klang Valley which now consists of the Inner Ring Road, Middle Ring Road 1 (MRR1) and MRR2.

Figure 12 : Location of the EKVE as part of the KLORR



Source: Business Times

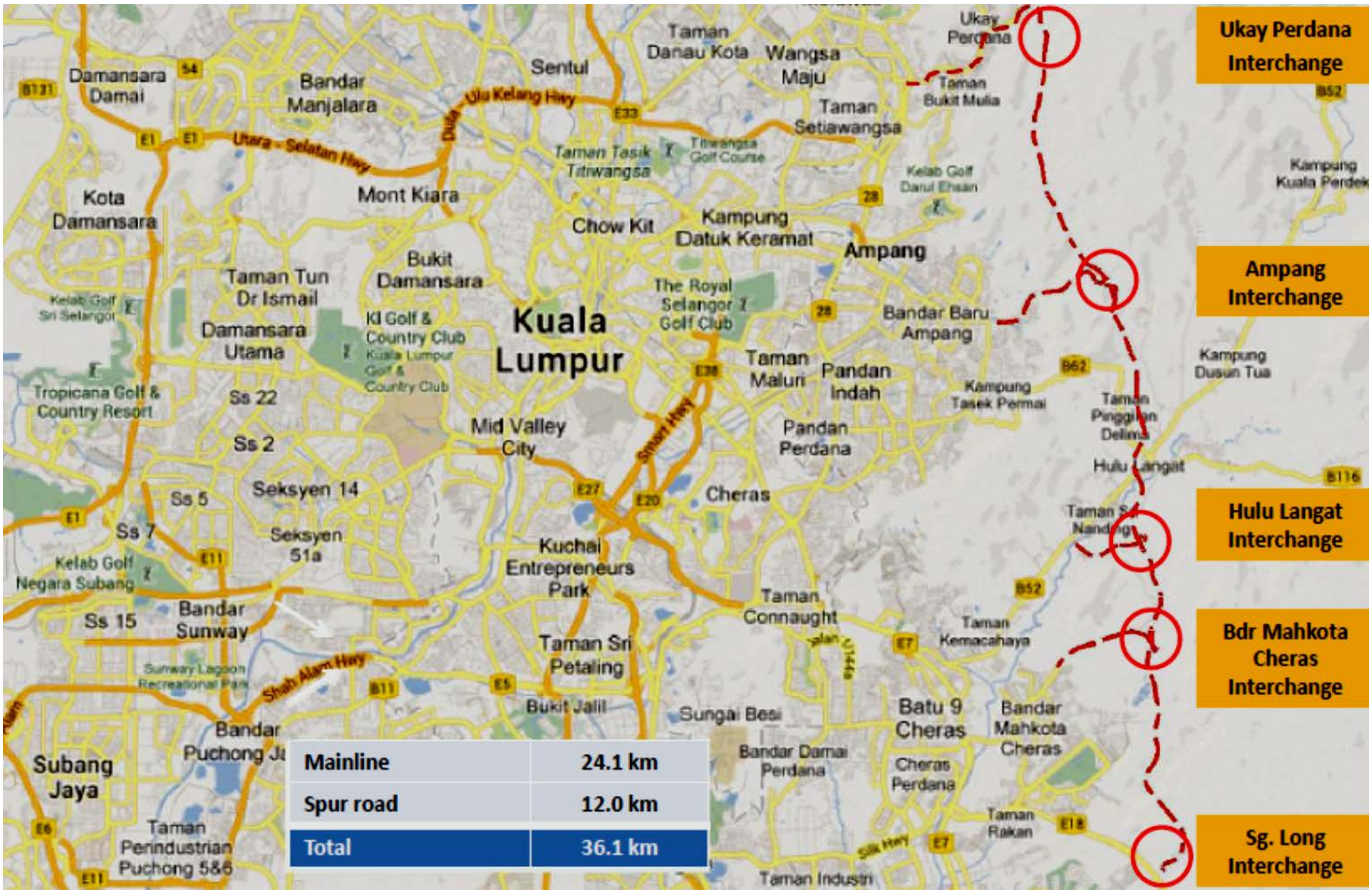
An alternate route without having to travel through KL city

The EKVE will have a length of 36.1km of which comprises 24.1km for the main road and 12km in spine roads. Its alignment begins at Sungai Long and ends at Ukay Perdana with 3 other interchanges in between at Bdr Mahkota Cheras, Hulu Langat and Ampang. In terms of connectivity, the EKVE links to the SLIK Highway at the south and the Karak Expressway in the north. The EKVE will enable motorists from south Klang Valley, such as Cheras, Bangi and Subang, to travel to Selayang and Gombak without having to go through the city centre. Management indicates that the MRR2 is currently running at 250% of its design capacity in terms of vehicle usage. Completion of the EKVE is expected to see some traffic, possibility 10-20%, being diverted from the MRR2.

Closed toll system

The EKVE will operate as a closed toll system. Under a closed toll system, the toll amount is based on the distance travelled. Vehicles enter and exit the highway via plazas and the toll amount is calculated based on the distance between the plazas. The North South Expressway is an example of a closed toll system. By contrast, in an open toll system, motorists are charged a fixed toll sum regardless of distance travelled (i.e. toll is paid once the vehicle passes a toll plaza). Examples of an open toll are the New Pantai Expressway (NPE) and Damansara Puchong Expressway (LDP).

Figure 13 : Proposed alignment of the EKVE



Source: AZRB

Construction to begin in 2Q14, 3.5 years to complete

Construction of the EKVE is expected to take 3.5 years which we expect to commence sometime in 2Q14 once financial closure is achieved. Following the inking of the CA in Feb, AZRB has a timeframe of 1 year to achieve financial closure, i.e. by Feb 2014. Management guides that the bulk of the highway will be elevated. This should not be an issue as AZRB does have experience, having completed elevated roads such as the Subang-Kelana Link (RM315m) and Istana interchange to Jln Duta (RM106m). The elevated structure is required as almost 50% of the EKVE's alignment runs through forest reserve land. For the same reason, management guides that the project will be executed under highly strict conditions, of which 62 have been imposed by the SSG.

Approvals from state and federal governments procured

Management said that it has procured all the necessary approvals from both the SSG and Federal Government for the project. About 50% of the required land is located on private land while the balance is state owned. While AZRB will be spearheading the land acquisition process, it will be paid by the Federal Govt. We foresee no major hiccups on the project's execution with the exception of some protests from environmentalist groups.

May need to raise some equity capital

Management guides that it intends to finance the EKVE with a combination of debt (80%) and equity (20%). The government has agreed to provide AZRB with a RM635m soft loan at 4% interest, which means that another RM606m will have to be raised to achieve the 80% debt requirement of RM1.24bn. Management indicates that it is working with 2 financial institutions to raise the additional RM606m debt which will be a combination of Sukuk and bank borrowings. As for the equity portion (20%) of RM310m, AZRB currently only has RM99m in its cash pile. We think it is very likely that AZRB will have to raise equity capital to finance the EKVE's equity requirements, possibly via share placement.

Figure 14 : Financing structure for EKVE

Financing structure for EKVE	RM/m
Government soft loan at 4% interest	635
Additionl debt raised via Sukuk	606
Debt requirement at 80% of project value	1,241
Equity requirement at 20% of project value	310
Project cost of EKVE	**1,551**

Source: Alliance Research estimates

IRR at "high single digit"

Upon completion of the EKVE in mid-2017, AZRB can then commence tolling which will last 46.5 years (i.e. 50 year concession less 3.5 years for construction). Management guides that the IRR for the EKVE to stand at "high single digit". Thus far, we have only imputed the EKVE's construction profits into our forecast and not the NPV of the concession.

"Petrol station" at Kemaman Port

Bunkering services at Kemaman Port

After construction, AZRB's 2nd largest revenue contributor is bunkering which made up an average 10.6% of revenue in the past 5 years. AZRB holds the sole right to conduct bunkering services for marine diesel at the Kemaman Supply Base (KSB) which is part of the Kemaman Port in Terengganu. The concession was awarded by Petronas Dagangan back in 1993 and will last until 2022. To put it simplistically, one can think of AZRB as operating a large petrol station at Kemaman Port that supplies marine diesel to Petronas' production sharing contractors (PSC) and O&G companies.

Recent upward revision in bunkering fee

AZRB earns a flat fee per litre of diesel sold, regardless of the current market price. Given such, earnings of this division are driven by (i) volume of diesel bunkered and (ii) revision in the fee per litre bunkered. Volume of diesel bunkered is dependent on the level of offshore activities by PSCs, which typically is the strongest in 3Q and 4Q. As for the bunkering fee, this is revised every 5 years. The most recent revision in May saw rates increase from 8.25 sen/ litre to 8.45 (+2.4%).

Figure 15 : Location of the KSB

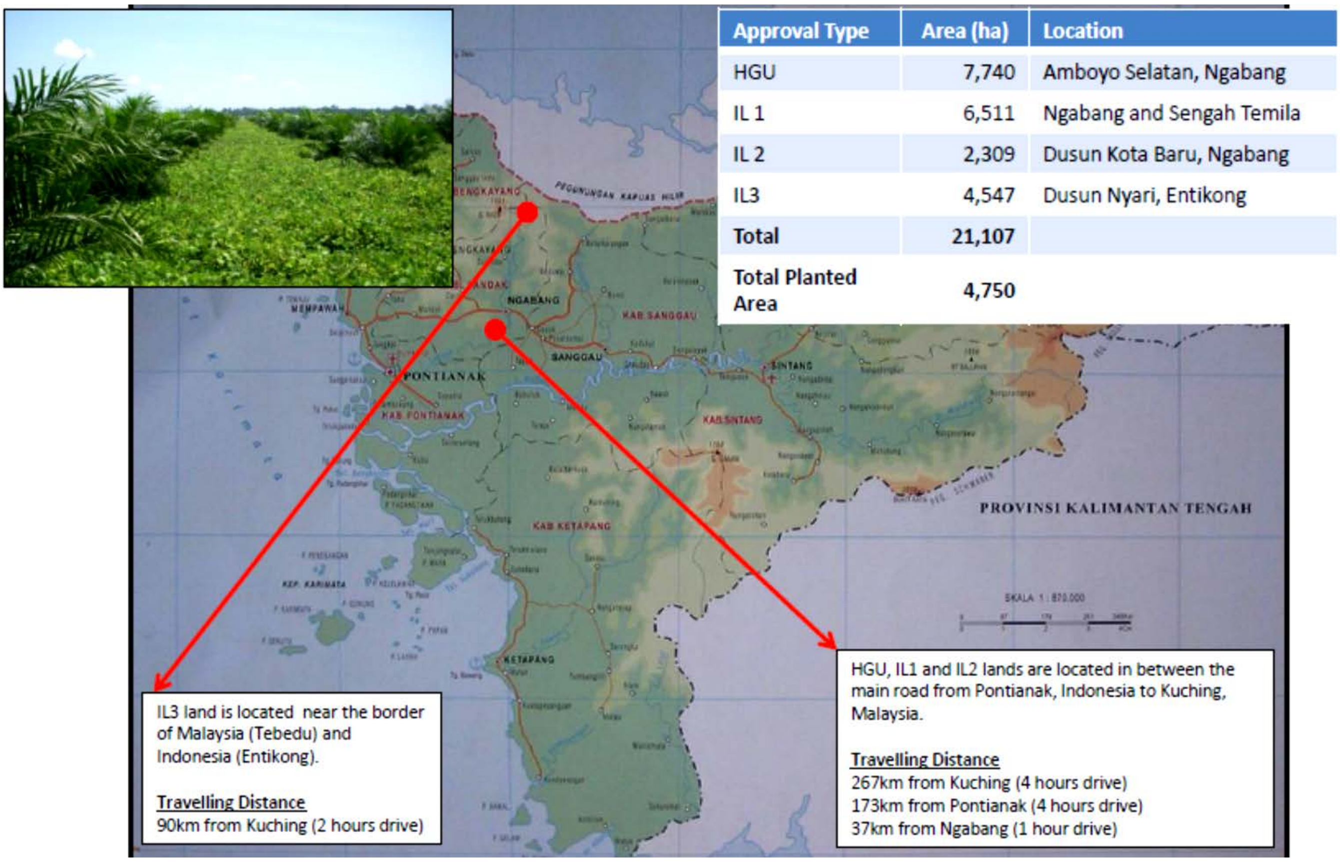
Source: Compilation from Bursa announcements

The bearing of fruits

Harvesting from plantation venture has begun

In late 2004, AZRB ventured into the plantation business when it acquired Indonesia-based PT Ichtiar Gusti Pudi, which has been granted the right to cultivate oil palm trees on 27,107 hectares (ha) of land in Ngabang, West Kalimantan. Management guides that the land contains high quality soil that is suitable for palm oil with sufficient rainfall recorded. A total of 4,750ha (17.5%) has been planted since it commenced in early 2006. Of the planted area, management guides that 1/3rd is currently bearing fruit. Since harvesting began in late 2011, the division has been loss making as the planted area is still at the early stage of its maturity cycle. Management expects the planted area to be fully fruit bearing by end-2013/ early-2014 and should breakeven in 2015.

Figure 16 : Location of AZRB's plantation land in Kalimantan



Approval Type	Area (ha)	Location
HGU	7,740	Amboyo Selatan, Ngabang
IL 1	6,511	Ngabang and Sengah Temila
IL 2	2,309	Dusun Kota Baru, Ngabang
IL3	4,547	Dusun Nyari, Entikong
Total	**21,107**	
Total Planted Area	**4,750**	

Source: AZRB

Targets to construct own mill, further planting ahead

At the moment, AZRB is only selling the fresh fruit bunches (FFB). Management said that it intends to construct its own mill which will enable it to extract and sell palm oil from the FFB. Construction of the mill is targeted to commence by year end and this should be operational in mid-2015. As for the remaining planting schedule, AZRB intends to commence planting on another 10,000ha. Seed cultivation has recently commenced in the nursery and planting for this 10,000ha is scheduled to begin in April 2014. Assuming an average planting expenditure of RM15k/ha, the next 10,000ha is expected to cost RM150m. Management indicates that it has gotten a US$93m (RM279m) financing in place for the upcoming mill and its next planting phase.

FINANCIAL HIGHLIGHTS

Flattish earnings outlook this year, but…

FY13 earnings to dip slightly…

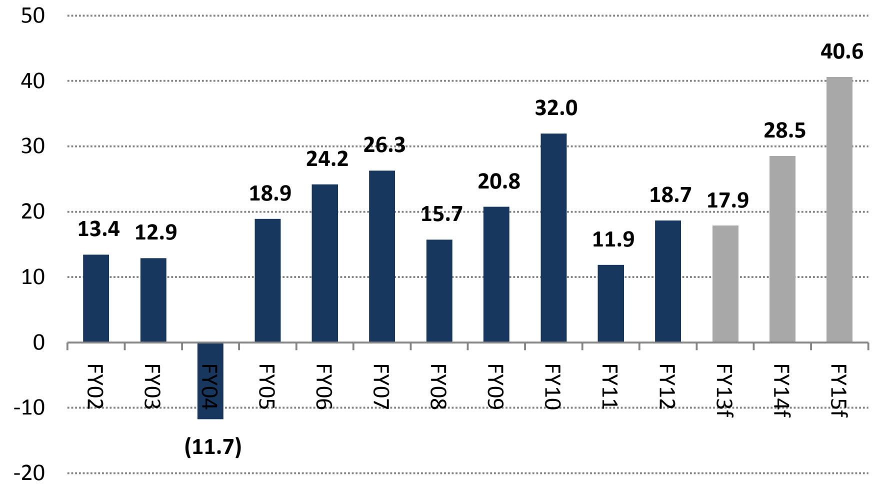
AZRB's key earnings appeal lies in its sizable orderbook of RM3.6bn, which represents 6x its FY12 construction revenue. Despite this huge orderbook sum, we only project FY13 revenue to grow at 8.3%. This rather muted revenue growth is because (i) the EKVE which makes up 43.3% of its orderbook is only expected to commence in FY14 and (ii) the MRT and Bangunan MAS redevelopment, which collectively make up 38.6% of orderbook, are still at early stages of completion and have yet to move into "high gear". With pedestal revenue construction revenue growth coupled with continued drag from losses in the plantation division, we project FY13 earnings to dip slightly by 4.4%.

…acceleration expected from FY14 onwards

…but strong FY13-15 CAGR of 28.4%

We project FY14-15 earnings to display robust growth of 56.5% and 41.6% respectively. This is driven by stronger revenue recognition on its orderbook once the EKVE commences and when jobs such as the MRT and Bangunan MAS redevelopment move into full swing. Aside a stronger construction division, lower plantation losses in FY14 and breaking even in FY15 is expected to provide an earnings boost. All in, we project 3-year earnings CAGR of 28.4%.

Figure 17 : Earnings track record and projection for AZRB (RM/m)



Note: FY10 earnings exclude RM94m write off for a job in Saudi Arabia. Loss of RM62m if included.

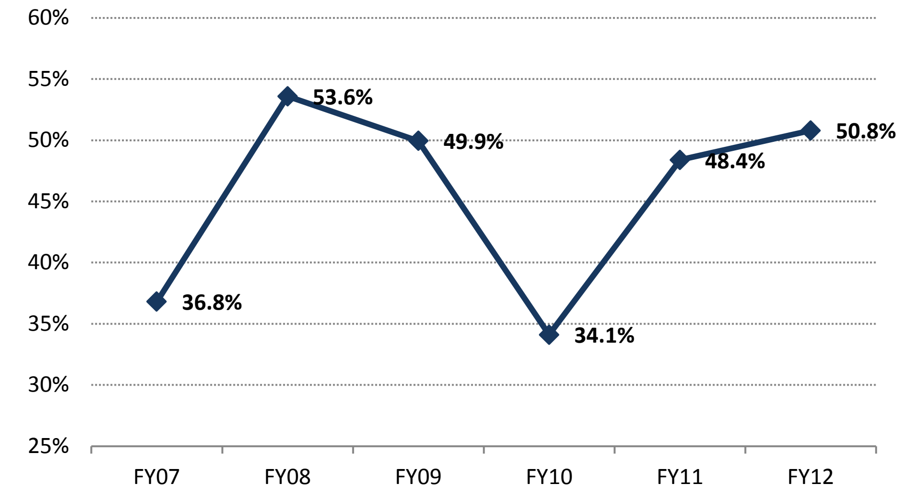
Source: Annual reports, Alliance Research estimates

Tax restructuring to provide upside?

Earnings upside if effective tax rate can be reduced

AZRB's effective tax rate has been unusually high with FY12 at 50.8%, FY11 at 48.4% and its 5 year historical average at 47.4% (Figure 18). Its financial statements reveal that the main reason for the high effective tax rate is due to a large proportion of "non-deductible expenses". We were told that these non-deductible expenses largely comprise interest cost owing to debts that are parked at the holding company level rather than its operating subsidiaries. Management acknowledges its high effective tax rate and said that it is undertaking efforts to restructure and reduce it. Our earnings forecast assume a continued high effective tax rate at 50%. Should AZRB manages to reduce its effective tax rate, there would be upside to our estimates.

Figure 18 : Effective tax rate for AZRB



Source: Annual reports

Figure 19 : Explanatory notes for AZRB's taxation in 2012 annual report

	Note	2012 RM	2011 RM
Profit for the year		18,587,079	12,607,701
Total income tax expense		19,187,690	11,821,103
Profit excluding tax		37,774,769	24,428,804
Income tax calculated using Malaysian tax rate of 25% (2011: 25%)		9,443,692	6,107,201
Non-taxable income		–	
Non-deductible expenses		6,093,457	6,011,682
Deferred tax assets not recognised		2,887,022	407,859
Under/(Over) provision of current tax in prior year		516,990	(263,859)
Under/(Over) provision of deferred tax in prior year		246,529	(441,780)
Tax income tax expense		19,187,690	11,821,103

Source: Annual report 2012

Margins

Despite thinner margin for MRT project, overall margins lifted by plantation earnings

We have assumed gross construction margins of 14-14.5% for FY13-15 which is lower than the 16-17% witnessed over the last 3 years. This reflects the nature of the MRT job which generally commands lower margins. Despite our assumption of lower construction margins, overall margins still shows an expansion from FY14 onwards given lower losses from the plantation division and eventually breaking even in FY15.

Gearing

Borrowings to rise from FY14 when EKVE works commence

AZRB's net gearing currently stands at 51.8%. We expect this to moderate downwards slightly in FY13 to 48% given higher progress payments on its construction jobs. However, in FY14-15, we project this to increase to 61-62% once the drawdown for the EKVE debts begin.

Dividend

Dividend to resume from FY13

No dividends were declared last year as management guided that it was conserving cash to fund its concession assets. Management did mention that it is looking to resume dividend payments this year. To be conservative, we have only imputed a 10% payout ratio compared to 22-44% witnessed in FY09-11. This translates to a yield of 0.8-1.2% for FY13-15.

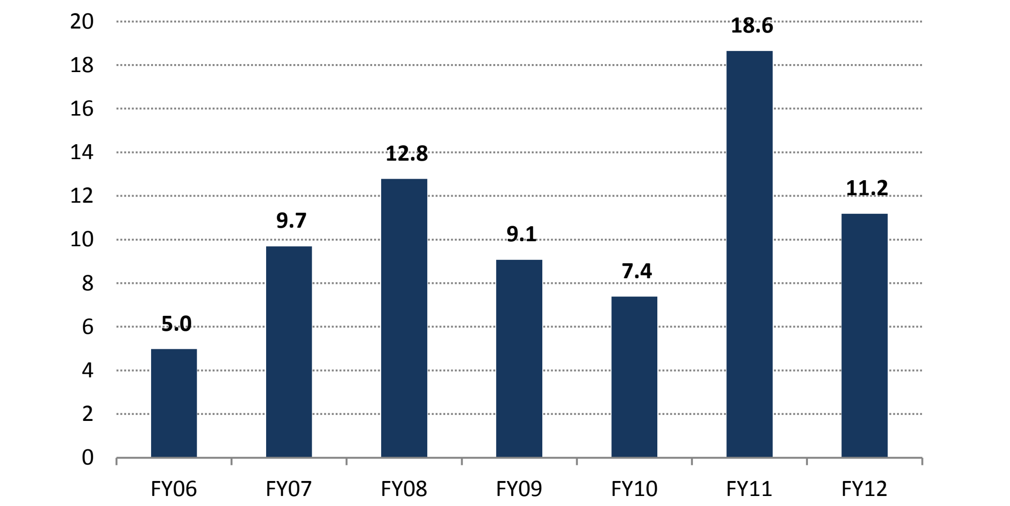
VALUATION AND RECOMMENDATION

Initiate with BUY, RM1.22 TP offers 54% upside

Mean P/E of around 12x

As indicated below, AZRB's average P/E trend (based on 1-year forward earnings) in the past has been rather volatile. In our valuation for AZRB, we have ascribed a 12x P/E multiple to FY14 earnings. Our applied P/E multiple of 12x is in between its 3-year mean of 12.4x and 5-year mean of 11.8x. We feel it is more relevant to value AZRB on its FY14 earnings (rather than FY13) as this is when its earnings up cycle kicks in.

Figure 20 : Average P/E based on 1-year forward earnings

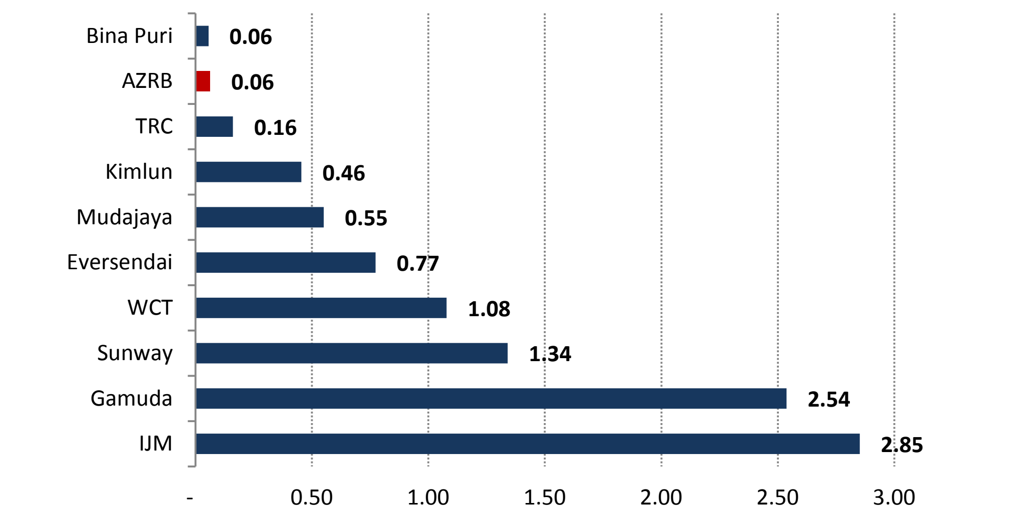


Source: Bloomberg, Alliance Research estimates

Initiate with BUY, RM1.22 TP (+54% upside)

We initiate coverage on AZRB with a BUY rating and TP of RM1.22 which offers an upside potential of 54.1%. AZRB currently trades at 12.2x FY13 P/E but this will be cut substantially to 7.8x and 5.5x once earnings flow in FY14-15. With the 13GE now over, risk appetite for cyclical construction plays has returned. We view AZRB an excellent proxy to ride on the rollout of government projects given its past success rate in bagging such jobs. Further, valuations appear to be a steal from a market cap to orderbook perspective at only 0.06x. This is perhaps one of the lowest in the industry.

Figure 21 : Market cap to orderbook ratio



Source: Bloomberg, Alliance Research estimates

INVESTMENT RISKS

Concentrated orderbook

As previously mentioned, 82% of AZRB's RM3.6bn orderbook balance comprises of 3 jobs, namely the EKVE, Bangunan MAS redevelopment and MRT. Delays in any particular job would have a significant impact on our revenue forecast and earnings.

Setbacks for EKVE

Although AZRB has procured all the necessary approvals from both the SSG and Federal Government, there are 2 issues that remain to be settled. Firstly, is the land acquisition, of which 50% is on state land while the balance is on private land. Land acquisition will be spearheaded by AZRB but cost will be borne by the Federal Government. Delays in the land acquisition involving private land owners could delay the project, although management said that works can always start on state-held land first. Secondly, there have been numerous protests from environmentalist NGOs on the EKVE. If this amplifies, there is a possibility that construction commencement could be delayed.

Execution risk

AZRB's orderbook is running at an all-time high, more than 3x its balance 2 years ago. There are concerns that the company may face execution issues as it has never handled such a huge orderbook sum before. While this may be a valid concern, we argue that it is more relevant to look at the nature of the projects in its orderbook rather than absolute size. Firstly, the EKVE and MRT are predominantly elevated structures and AZRB has completed such works before involving the Subang-Kelana Link and palace interchange at Jln Duta. Secondly, while AZRB has never executed building jobs as tall as the Bangunan MAS redevelopment at 50 storeys, progress on its maiden high rise building, JKR2 Complex (37 storeys) is on track and set for completion this year.

Ahmad Zaki Resources — Financial Summary — Price Date: 20 June 2013

Balance Sheet

FYE Dec	FY11	FY12	FY13F	FY14F	FY15F
PPE	64.7	86.1	85.5	93.9	101.4
Intangibles	3.7	8.8	8.8	8.8	8.8
Inventories	10.0	14.7	13.8	16.4	20.1
Receivables	309.1	330.1	380.4	479.4	587.0
Other assets	161.3	186.8	213.7	243.3	277.9
Deposit, bank and cash	116.2	98.1	120.6	131.0	164.6
Assets	**664.9**	**724.5**	**822.8**	**972.8**	**1,159.7**
LT borrowings	107.1	146.0	169.1	214.1	259.1
ST borrowings	46.3	39.5	56.4	71.4	86.4
Payables	301.1	304.1	345.9	410.8	502.1
Other liabilities	13.1	22.0	22.5	22.5	22.5
Liabilities	**467.7**	**511.5**	**593.8**	**718.7**	**870.0**
Share capital	138.4	138.5	138.5	138.5	138.5
Reserves	53.0	69.2	85.3	110.4	146.1
Shareholder's equity	**191.4**	**207.7**	**223.8**	**248.9**	**284.6**
MI	5.9	5.3	5.2	5.2	5.2
Equity	**197.3**	**213.1**	**228.9**	**254.1**	**289.7**
Equity and Liabilities	**664.9**	**724.5**	**822.8**	**972.8**	**1,159.7**

Cash Flow Statement

FYE Dec	FY11	FY12	FY13F	FY14F	FY15F
Profit before taxation	24.4	37.8	35.7	55.9	79.2
Depreciation & amortisation	8.6	9.9	10.6	11.6	12.5
Changes in working capital	9.7	(22.7)	(7.6)	(36.8)	(19.9)
Net interest received/ (paid)	(11.1)	(13.5)	(14.4)	(17.9)	(22.1)
Tax paid	(11.8)	(19.2)	(17.9)	(28.0)	(39.6)
Others	(43.1)	9.3	-	-	-
Operating Cash Flow	**(23.4)**	**1.5**	**6.5**	**(15.1)**	**10.2**
	-	-	-	-	-
Capex	(19.9)	(31.4)	(10.0)	(20.0)	(20.0)
Plantation development	(15.3)	(4.8)	(25.0)	(30.0)	(35.0)
Others	58.2	(8.2)	-	-	-
Investing Cash Flow	**22.9**	**(44.4)**	**(35.0)**	**(50.0)**	**(55.0)**
	-	-	-	-	-
Issuance of shares	0.0	0.1	-	-	-
Changes in borrowings	8.2	32.0	40.0	60.0	60.0
Dividends paid	(5.2)	-	(1.8)	(2.8)	(4.0)
Others	(23.4)	(7.0)	12.8	18.3	22.5
Financing Cash Flow	**(20.3)**	**25.1**	**51.0**	**75.5**	**78.5**
	-	-	-	-	-
Net cash flow	(20.7)	(17.8)	22.5	10.4	33.7
Forex	2.9	(1.6)	-	-	-
Others	18.1	1.2	-	-	-
Beginning cash	115.9	116.2	98.1	120.6	131.0
Ending cash	**116.2**	**98.1**	**120.6**	**131.0**	**164.6**

Income Statement

FYE Dec	FY11	FY12	FY13F	FY14F	FY15F
Revenue	534.9	674.7	730.7	874.9	1,071.3
EBITDA	44.1	61.2	60.7	85.4	113.8
Depn & amort	(8.6)	(9.9)	(10.6)	(11.6)	(12.5)
Net interest expense	(11.1)	(13.5)	(14.4)	(17.9)	(22.1)
Associates & JV	(0.0)	(0.0)	-	-	-
EI	-	-	-	-	-
Pretax profit	**24.4**	**37.8**	**35.7**	**55.9**	**79.2**
Taxation	(11.8)	(19.2)	(17.9)	(28.0)	(39.6)
MI	(0.7)	0.1	-	-	-
Net profit	**11.9**	**18.7**	**17.9**	**28.0**	**39.6**
Core net profit	**11.9**	**18.7**	**17.9**	**28.0**	**39.6**

Key Statistics & Ratios

FYE Dec	FY11	FY12	FY13F	FY14F	FY15F
Growth					
Revenue	24.2%	26.1%	8.3%	19.7%	22.4%
EBITDA	-19.7%	38.7%	-0.9%	40.7%	33.2%
Pretax profit	-44.1%	54.6%	-5.4%	56.5%	41.6%
Net profit	-119.2%	57.5%	-4.4%	56.5%	41.6%
Core EPS	-62.9%	57.5%	-4.4%	56.5%	41.6%
Profitability					
EBITDA margin	8.3%	9.1%	8.3%	9.8%	10.6%
Net profit margin	2.2%	2.8%	2.4%	3.2%	3.7%
Effective tax rate	48.4%	50.8%	50.0%	50.0%	50.0%
ROA	1.8%	2.6%	2.2%	2.9%	3.4%
ROE	6.2%	9.0%	8.0%	11.2%	13.9%
Leverage					
Debt/ Assets (x)	0.23	0.26	0.27	0.29	0.30
Debt/ Equity (x)	0.80	0.89	1.01	1.15	1.21
(Net debt)/ equity (x)	0.19	0.42	0.47	0.62	0.64

Key Drivers

FYE Dec	FY11	FY12	FY13F	FY14F	FY15F
New job wins (RM/m)	683	1,438	1,800	400	400

Valuation

FYE Dec	FY11	FY12	FY13F	FY14F	FY15F
EPS (sen)	4.3	6.8	6.5	10.1	14.4
Adj EPS (sen)	4.3	6.8	6.5	10.1	14.4
P/E (x)	18.3	11.7	12.2	7.8	5.5
EV/ EBITDA (x)	7.5	5.4	5.5	3.9	2.9
Net DPS (sen)	1.9	-	0.6	1.0	1.4
Yield	2.4%	0.0%	0.8%	1.3%	1.8%
BV per share (RM)	0.69	0.75	0.81	0.90	1.03
P/BV (x)	1.1	1.0	1.0	0.9	0.8

DISCLOSURE

Stock rating definitions

Strong buy	- High conviction buy with expected 12-month total return (including dividends) of 30% or more
Buy	- Expected 12-month total return of 15% or more
Neutral	- Expected 12-month total return between -15% and 15%
Sell	- Expected 12-month total return of -15% or less
Trading buy	- Expected 3-month total return of 15% or more arising from positive newsflow. However, upside may not be sustainable

Sector rating definitions

Overweight	- Industry expected to outperform the market over the next 12 months
Neutral	- Industry expected to perform in-line with the market over the next 12 months
Underweight	- Industry expected to underperform the market over the next 12 months

Commonly used abbreviations

Adex = advertising expenditure
bn = billion
BV = book value
CF = cash flow
CAGR = compounded annual growth rate
Capex = capital expenditure
CY = calendar year
Div yld = dividend yield
DCF = discounted cash flow
DDM = dividend discount model
DPS = dividend per share
EBIT = earnings before interest & tax
EBITDA = EBIT before depreciation and amortisation

EPS = earnings per share
EV = enterprise value
FCF = free cash flow
FV = fair value
FY = financial year
m = million
M-o-m = month-on-month
NAV = net assets value
NM = not meaningful
NTA = net tangible assets
NR = not rated
p.a. = per annum
PAT = profit after tax

PBT = profit before tax
P/B = price / book ratio
P/E = price / earnings ratio
PEG = P/E ratio to growth ratio
q-o-q = quarter-on-quarter
RM = Ringgit
ROA = return on assets
ROE = return on equity
TP = target price
trn = trillion
WACC = weighted average cost of capital
y-o-y = year-on-year
YTD = year-to-date

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