RHB Research Institute Sdn Bhd
A member of the RHB Banking Group
Company No: 233327 -M

Corporate Highlights

Visit Note

07 February 2013

Ahmad Zaki Resources

Ahmad Zaki 2.0

Share Price	:	RM0.67
Fair Value	:	RM1.45
Recom	:	**Buy** (Maintained)

Table 1 : Investment Statistics (AZRB; Code: 7078) — **Bloomberg: AZR MK**

FYE Dec	Turn-over (RMm)	Net Profit# (RMm)	EPS# (sen)	Growth (%)	PER (x)	C.EPS* (sen)	P/CF (x)	P/NTA (x)	ROE (%)	Net Gearing (%)	GDY (%)
2011	534.9	11.9	4.3	nm	15.6	-	nm	1.0	6.2	0.2	2.8
2012f	720.0	22.8	8.3	92.6	8.1	-	(19.0)	0.9	11.1	0.3	3.7
2013f	850.9	25.9	9.3	13.2	7.2	-	5.3	0.8	11.6	0.1	4.2
2014f	855.1	27.5	9.9	6.2	6.7	-	(14.0)	0.7	11.3	0.2	4.4

Main Market Listing /Non-Trustee Stock /Syariah-Approved Stock By The SC *#Excluding EI* ** Consensus Based On IBES*

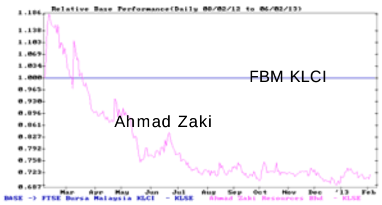
- **A defensive side that is under-appreciated.** Ahmad Zaki Resources (Ahmad Zaki) is beginning to see the fruit of its labour of having grown some defensive non-construction businesses, i.e. bunkering operation at Kemaman Supply Base, oil palm plantation in West Kalimantan, and the design, build, lease, maintain & transfer (DBLMT) of a teaching hospital for the International Islamic University Malaysia (IIUM) in Kuantan under the Private Finance Initiative (PFI). With their defensive, recurring and less cyclical incomes, these three businesses will materially boost the sustainability, visibility and resilience of Ahmad Zaki's earnings. Theoretically, a radically changed earnings profile (with enhanced stability) will appeal to a generally still risk-averse market. Also, theoretically, enhanced earnings stability means reduced equity risk premium, translating to higher stock valuation or a re-rating.
- **New orderbook target of RM500-600m in FY12/13.** Ahmad Zaki guided new contract wins of about RM500-600m in FY12/13 that are most likely to come from building jobs for universities and colleges, and "infrastructure works in Eastern Coast Economic Region (ECER), particularly, road jobs". At present, its outstanding construction orderbook stands at about RM2.3bn.
- **A slice of action in high-rise building segment.** Also, Ahmad Zaki in recent years managed to break into a new segment, i.e. high-rise buildings, putting it in a good position to bid for a slew of high-rise building jobs that are coming into the market.
- **Forecasts.** Maintained.
- **Risks.** These include: (1) New construction contracts secured in FY12/13-14 coming in below our target of RM500m p.a.; and (2) Escalation in input costs.
- **Maintain BUY.** We expect construction stocks to trend downwards during the early part of 2013 as the 13th General Election (GE) deadline draws closer. After the 13th GE and once the dust settles, we believe investors will refocus on fundamentals of construction stocks, that may appear to be reasonably attractive underpinned by a construction upcycle. We also like Ahmad Zaki for the non-construction businesses under its belt, i.e. bunkering operation at Kemaman Supply Base, oil palm plantation in West Kalimantan and DBLMT of a new IIUM teaching hospital in Kuantan under PFI, that generate defensive, recurring and less cyclical incomes. Fair value is raised by 56% from RM0.93 to RM1.45, having rationalised our valuation method to "sum of parts" from 10x FY12/13 EPS previously.

Issued Capital (m shares)	276.8
Market Cap (RMm)	185.4
Daily Trading Vol (m shs)	0.4
52wk Price Range (RM)	0.665-1.08
Major Shareholders:	**(%)**
Zaki Holdings	58.9

FYE Dec	FY12	FY13	FY14
EPS Revision (%)	-	-	-
Var to Cons (%)	nm	nm	nm

PE Band Chart

Relative Performance To FBM KLCI



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Ahmad Zaki 2.0

- **Highlights.** Key takeaways from our recent meeting with Ahmad Zaki Resources (Ahmad Zaki) are:
  1. Ahmad Zaki is beginning to see the fruit of its labour of having painstakingly (and quietly) grown some defensive non-construction businesses, i.e. bunkering operation at Kemaman Supply Base, oil palm plantation in West Kalimantan, and the design, build, lease, maintain & transfer (DBLMT) of a teaching hospital for the International Islamic University Malaysia (IIUM) in Kuantan under the Private Finance Initiative (PFI);
  2. For its bread-and-butter construction business, Ahmad Zaki guided new contract wins of about RM500-600m in FY12/13; and
  3. Also, for the construction business, Ahmad Zaki in recent years managed to break into a new segment, i.e. high-rise buildings, putting it in a good position to bid for a slew of high-rise building jobs that are coming into the market.

- **A defensive side that is under-appreciated.** Unknown to many (given the very limited research coverage on Ahmad Zaki in the market at present), Ahmad Zaki has during the recent years undergone a "quiet revolution", having substantially scaled up non-construction businesses under its belt, i.e. bunkering operation at Kemaman Supply Base, oil palm plantation in West Kalimantan and DBLMT of a new RM412.6m IIUM teaching hospital in Kuantan under PFI (see Table 2 for more details on these three businesses). With their defensive, recurring and less cyclical incomes, these three businesses will materially boost the sustainability, visibility and resilience of Ahmad Zaki's earnings (Already, for 9MFY12/12, the bunkering operation contributed about 30% of total profits). Theoretically, a radically changed earnings profile (with enhanced stability) will appeal to a generally still risk-averse market. Also, theoretically, enhanced earnings stability means reduced equity risk premium, translating to higher stock valuation or a re-rating.

Table 2: Non-Construction Business

Business	Business Model/Scale	Growth Prospects
Bunkering	The unit holds a concession (i.e. a "throughput and tenancy agreement" signed with Kemaman Supply Base) that grants it "the right to receive, store, distribute and sell marine fuels and carry out bunkering activities at Kemaman Supply Base". We understand that the concession will only be due for renewal in 2023. The unit is effectively "the sole bunkering operator of marine diesel oil to the Petronas production sharing contractors and oil companies developing and operating the petroleum industry off the shores of Peninsular Malaysia". The marine diesel oil is sourced from Petronas Dagangan by land transportation from refineries in Kerteh.	The company guided a CAGR of 8-10% in terms of volume in FY12/13-15 (vis-a-vis our more conservative assumption of 5%) on increased investment and therefore activities in the oil & gas fields in the east coast of Peninsular Malaysia, particularly, from the RM10bn Tapis Enhanced Oil Recovery project by Petronas and ExxonMobil.
Oil palm plantation	19,000 ha of plantation land in West Kalimantan (about 4-hr drive from both Kuching and Pontianak), out of which 5,000 ha are already planted with oil palms.	The company guided continued start-up losses in FY12/13 (for 9MFY12/12, the unit reported RM9.3m pretax loss), before breaking even in FY12/14 on increased production and improved economies of scale. It intends to plant another 5,000-10,000 ha over the next three years.
DBLMT of a new IIUM teaching hospital in Kuantan	Project IRR (including construction profits) of 8% on project cost of RM412.6m under PFI.	Construction profits during the first 3.5 years (from Sep 2011) and operation and maintenance (O&M) profits during the remaining 21.5 years.

Source: Company, RHBRI

- **New orderbook target of RM500-600m in FY12/13.** Ahmad Zaki guided new contract wins of about RM500-600m in FY12/13 (that is fairly consistent with our assumption of RM500m) that are most likely to come from building jobs for universities and colleges, and "infrastructure works in Eastern Coast Economic Region (ECER), particularly, road jobs". This is substantially lower than RM1.44bn it achieved in FY12/12 but it is nothing out of the ordinary given that 2012 was a bumper year for most construction companies in Malaysia thanks to the award of lumpy work packages from the Sg Buloh – Kajang (SBK) MRT Line project. At present, its outstanding construction orderbook stands at about RM2.3bn comprising predominantly Package V6 of the SBK MRT Line project (RM750m), redevelopment of the former MAS Building (RM673m) and IIUM teaching hospital (RM383m) (see Table 3 for the complete outstanding construction orderbook).

- **A slice of action in high-rise building segment.** Also, for the construction business, Ahmad Zaki in recent years managed to break into a new segment, i.e. high-rise buildings (currently dominated by IJM), having bagged the RM673m redevelopment of the former MAS Building along Jalan Sultan Ismail, Kuala Lumpur as well as the RM309.4m Komplex Kerja Raya 2 along Jalan Sultan Salahuddin, Kuala Lumpur. With these two high-rise building jobs under its belt, Ahmad Zaki is well positioned to bid for a slew of high-rise building jobs that are coming into the market such as Tun Razak Exchange (TRX), Warisan Merdeka Tower, Harrods Hotel integrated development, etc.

- **Forecasts.** Maintained.

- **Risks.** These include: (1) New construction contracts secured in FY12/13-14 coming in below our target of RM500m p.a.; and (2) Escalation in input costs.

- **Maintain BUY.** We expect construction stocks to trend downwards during the early part of 2013 as the 13th General Election (GE) deadline draws closer. Apart from a high risk premium due to the perceived uncertain outcome of the 13th GE, we believe the market also wants to see the gap between earnings of construction companies and their lofty stock valuations bridged (that we believe is more likely to happen in 2H2013 as key projects move up the "S-curve" in terms of profit recognition). After the 13th GE and once the dust settles, we believe investors will refocus on fundamentals of construction stocks, that may appear to be reasonably attractive underpinned by a construction upcycle backed by various large-scale infrastructure, property and oil & gas projects driven by the Government, government-linked companies/agencies, national oil company Petronas and the private sector.

- We also like Ahmad Zaki for the non-construction businesses under its belt, i.e. bunkering operation at Kemaman Supply Base, oil palm plantation in West Kalimantan and DBLMT of a new IIUM teaching hospital in Kuantan under PFI, that generate defensive, recurring and less cyclical incomes. Fair value is raised by 56% from RM0.93 to RM1.45, having rationalised our valuation method to "sum of parts" (see Table 4) from 10x FY12/13 EPS previously.

Table 3: Outstanding Construction Orderbook

Project	Value (RMm)
Package V6, SBK MRT Line	750
Redevelopment of former MAS Building	673
IIUM teaching hospital, Kuantan	383
Komplex Kerja Raya 2	132
East Coast Expressway (Phase 2)	125
Universiti Darul Imam, Terengganu	92
Public housing, Kuala Terengganu	60
Others	69
Total	**2,284**

Source: Company

Table 4: "Sum-Of-Parts" Valuation

Business	Valuation (RMm)	Valuation (RM/shr)	Basis And Remarks
Construction & bunkering	338.7	1.224	10x FY12/13 net profit, in line with our 1-year forward target PER of 8-13x for the construction sector, and at a discount to our 1-year forward target PER of 12-17x for the oil & gas sector.
Plantation	62.1	0.224	At 0.5x book value of RM124.1m as the venture is only expected to break even in FY12/14. We believe we are taking an extremely conservative stance here given that the plantation, on an "as is where is" basis, could be worth as much as RM250m or RM0.90 per Ahmad Zaki share based on the market valuations of US$12,000-15,000/ha for planted area and US$1,000-1,250/ha for unplanted area in West Kalimantan.
Total	**400.8**	**1.45**	

Source: RHBRI

Table 5: Earnings Forecasts				
FYE Dec (RMm)	**FY11A**	**FY12F**	**FY13F**	**FY14F**
Turnover	**534.9**	**720.0**	**850.9**	**855.1**
Turnover growth (%)	-38.6	34.6	18.2	0.5
EBITDA	**41.9**	**59.1**	**59.1**	**63.6**
EBITDA margin (%)	7.8	8.2	6.9	7.4
Depreciation	-9.1	-10.2	-11.1	-13.2
Net Interest	-8.4	-9.5	-10.0	-10.0
Associates	0.0	0.0	0.0	0.0
EI	0.0	0.0	0.0	0.0
Pretax Profit	**24.4**	**39.3**	**38.0**	**40.3**
Construction/bunkering	24.8	51.3	46.0	40.3
Plantation	-0.4	-12.0	-8.0	0.0
Tax	-11.8	-15.7	-11.4	-12.1
PAT	12.6	23.6	26.6	28.2
Minorities	-0.7	-0.7	-0.7	-0.7
Net Profit	**11.9**	**22.8**	**25.9**	**27.5**

Source: Company data, RHBRI estimates

Table 6: Forecast Assumptions			
FYE Dec	**FY12F**	**FY13F**	**FY14F**
Construction PBT margin (%)	4.6	3.4	2.6
New orderbook secured (RMm)	1,440^	500	500

^Actual
Source: RHBRI estimates

IMPORTANT DISCLOSURES

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The recommendation framework for stocks and sectors are as follows : -

Stock Ratings

Buy: Share price may exceed 10% over the next 12 months

Trading Buy: Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain

Neutral: Share price may fall within the range of +/- 10% over the next 12 months

Take Profit: Target price has been attained. Look to accumulate at lower levels

Sell: Share price may fall by more than 10% over the next 12 months

Not Rated: Stock is not within regular research coverage

Industry/Sector Ratings

Overweight = Industry expected to outperform the FBM KLCI benchmark, weighted by market capitalisation, over the next 6-12 months.

Neutral = Industry expected to perform in line with the FBM KLCI benchmark, weighted by market capitalisation, over the next 6-12 months.

Underweight = Industry expected to underperform the FBM KLCI benchmark, weighted by market capitalisation, over the next 6-12 months.