Protasco (BUY; NEW)

INDUSTRY: OVERWEIGHT
INITIATION

9 June 2017
Price Target: RM1.20
Share price: RM1.05

Sowing the seeds for the next upcycle

Highlights

- **Backed by concessions and LTCs.** Protasco holds 2 concessions to maintain Federal roads in the states of (i) Selangor, Pahang, Kelantan and Terengganu which was renewed in Feb 2016 and (ii) Sarawak covering Sibu, Bintulu and Mukah. It also has 4 long term contracts (LTCs) to maintain State roads in Perak, Kelantan and Terengganu. Maintenance orderbook of RM4.4bn (9x cover ratio) provides a stable earnings base for the next 10 years.
- **Sarawak concession renewal likely.** Negotiations for the Sarawak concession renewal (expiring Feb 2018) are in at advanced stage with an outcome expected this year. While Protasco's stake will likely be reduced from 100% to 30%, road length maintained may double.
- **Potential election beneficiary.** We view Protasco as an election beneficiary as spending on road maintenance increases running up to the polls, which must be held by Aug 2018. To expand its recurring income base, Protasco is targeting the maintenance of government buildings.
- **Gunning for more job wins.** Protasco's construction division has orderbook of RM601m (2x cover ratio). It holds a Letter of Intent (LOI) for Phase 3 of the PPA1M housing (RM120m) in Putrajaya. Apart from that, Protasco is eyeing on new jobs in excess of RM4bn. These include highways (RM1bn), infra for a hydro plant (RM800m), affordable housing and buildings (RM600m) and a government job via the BLT model (>RM2bn).
- **New launches to resume.** Property sales have been on a downtrend since FY14 with no significant launches in the past 2 years. This is set to reverse in FY17 with RM830m in new launches coupled with RM115m worth of inventories.

Risks

- Non-renewal of the Sarawak concession and slow property take up rate.

Forecasts

- We expect FY17 earnings to decline -20% YoY. While maintenance should recover, we expect weaker construction (timing gap) and property (no unbilled sales).
- However, earnings should recover YoY in FY18-19 by 37% and 15% respectively driven by new job wins, more maintenance works and new property launches.

Rating

Initiate with BUY, RM1.20 TP (+19.9% total return)

- We like Protasco for the defensive qualities of its maintenance business which places a floor to downside risk via decent dividend payments.

Valuation

- Our TP of RM1.20 is based on a 12x P/E multiple pegged to mid-FY18 earnings.
- Dividend yield is also decent at 5.6% and 7.7% for FY17-18 assuming a 70% payout ratio (average: 73%).

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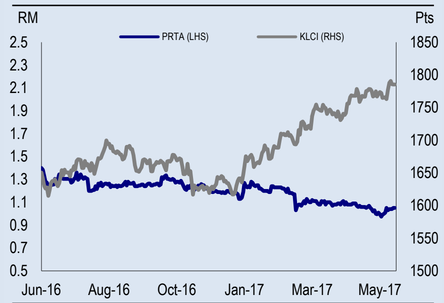
KLCI	1785.6
Expected share price return	14.3%
Expected dividend return	5.6%
Expected total return	19.9%

Share price



Information

Bloomberg Ticker	PRTA MK
Bursa Code	5070
Issued Shares (m)	424
Market cap (RM m)	445
3-mth avg. volume ('000)	1,945
Shariah- compliant	Yes

Price Performance	1M	3M	12M
Absolute	-0.9	-3.7	-25.0
Relative	-2.0	-7.3	-30.7

Major shareholders

Ket Pen Chong	14.8%
Penmacorp Sdn Bhd	9.2%
EPF	6.0%

Summary Earnings Table

FYE Dec (RM m)	FY16	FY17F	FY18F	FY19F
Revenue	1,089	1,060	1,157	1,167
EBITDA	99	93	119	132
EBIT	84	78	103	116
Profit Before Tax	80	74	100	114
Core PATAMI	44	36	49	56
vs Consensus (%)		-	-	-
Core EPS (sen)	10.5	8.4	11.5	13.2
P/E (x)	10.0	12.5	9.1	7.9
Net DPS (sen)	6.0	5.9	8.1	9.3
Net DY (%)	5.7	5.6	7.7	8.8
BV per share	0.93	0.96	0.99	1.03
P/B (x)	1.1	1.1	1.1	1.0
ROE (%)	11.5	8.9	11.8	13.1
Net Gearing (%)	87.9	22.6	23.9	21.2

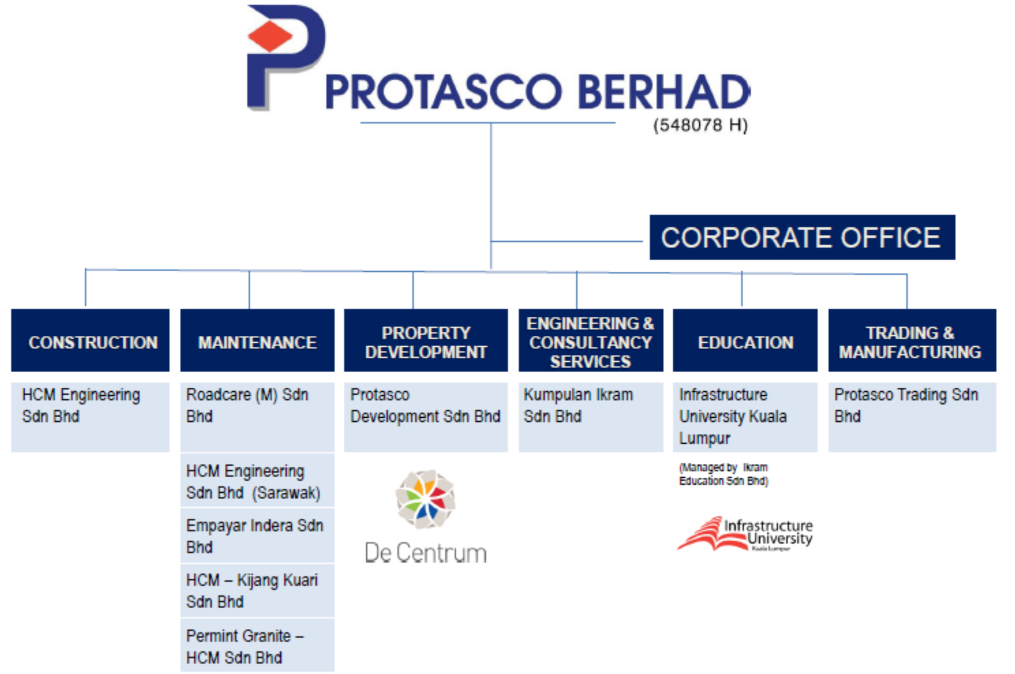
HLIB

Background

Involved in road maintenance, construction, trading, engineering services and education.

Diversified engineering player. Protasco's various subsidiaries were established over 2 decades ago and the company was subsequently listed on the Main Board of the Kuala Lumpur Stock Exchange in 2003. As a diversified engineering provider, Protasco is involved in road maintenance (45% of FY16 revenue), construction (27%), trading & manufacturing (13%), property development (6%), education (6%) and engineering consultancy (3%). Protasco is the largest private road maintenance provider in Malaysia which maintains over 18,000km of Federal and State roads. Its construction division has completed over RM8bn worth of works comprising both infra and buildings. For property development, its main project is the De Centrum City, spanning 100-acres in Kajang with GDV of RM10bn. Via Kumpulan Ikram, Protasco provides engineering & consultancy services such as on site investigation, lab testing, slope studies, pavement evaluation, geotechnical & structural and forensic engineering. Protasco also owns Infrastructure University KL (IUKL) with over 4,000 students which specialises in engineering programs from foundation to post graduate.

Figure #1 Corporate structure of Protasco



Company

Driven by founding member, Dato Sri Chong

Driven by its founding member. Protasco was set up in 1991 by its founding members Dato Sri Chong Ket Peng and Dato Hasnur Rabiain Ismail, both of whom have engineering roots from the Ministry of Works. In 2012, the former assumed full control over the business direction of Protasco as the latter sold off his stake. Currently, Dato Sri Chong is Protasco's Managing Director and holds a 25% stake in the company. Institutional shareholding in Protasco stands at 26% for locals and 6% foreign.

Investment Thesis

Maintenance: The crown jewel

Concession to maintain Federal roads in 4 Peninsular states was renewed

Backed by concession in Peninsular… Via 51% owned Roadcare (M) SB, Protasco holds a concession to maintain Federal roads totalling 7,263km in the states of Selangor, Pahang, Kelantan and Terengganu. Roadcare's remaining shareholders are Lembaga Tabung Haji (28%) and Muhibbah Engineering (not-rated) (21%). The concession was renewed in Feb 2016 for a 10 year period (expiring Feb 2026) and encompasses routine maintenance (RM130m p.a.) and periodic and emergency works (RM100-120m p.a.).

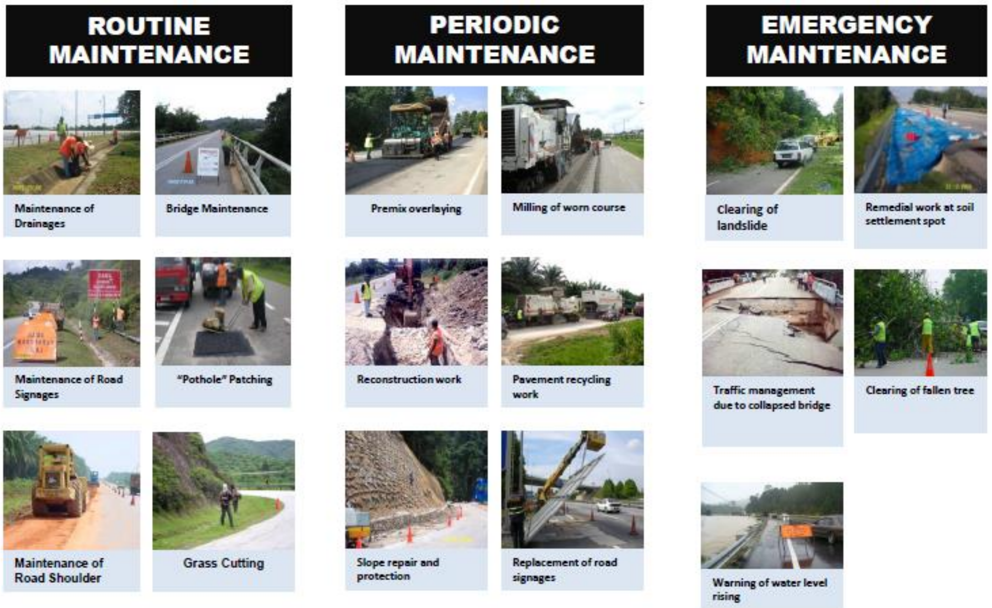
Potential renewal for Federal roads concession in Sarawak

…with likely renewal in Sarawak. In Sarawak, Protasco has a wholly owned concession to maintain Federal roads in Sibu, Bintulu and Mukah. This consists of RM10m p.a. for routine maintenance and RM30m p.a. for periodic and emergency works which began in Sept 2003 and expires next year in Feb. Management indicated they are in advanced negotiations to have the concession extended with an outcome expected this year. We understand that Protasco's stake in the renewed concession will be reduced from 100% to 30% (i.e. an associate) with the majority held by a "local Sarawakian" entity. However, the length of roads to be maintained will likely double from the current 420km, providing an upside to maintenance fees. This potential concession extension has not been factored into our earnings forecast.

Holds 3 LTCs to maintain State roads in Perak and Kelantan

Long term contacts for State roads. Protasco also has 4 long term contracts (LTCs) to maintain State roads. These consist (i) RM120m for State roads in Perak, (ii) RM90m for agriculture roads in Perak, (iii) RM129m for State roads in Kelantan and (iv) RM50m for minor roads in Terengganu. Going forward, Protasco is targeting to secure more LTCs involving State roads (RM150m) and rural & municipal roads (RM150m).

Figure #2 Road maintenance works undertaken by Protasco



Company

Election beneficiary as road maintenance increases prior to the polls

Potential election beneficiary. In the past, Protasco has undertaken more maintenance works than what was indicated in its concession agreements (CA). For example, in FY14-16, maintenance revenue was RM487-676m, higher than the stipulated sum in its 2 CAs of RM240-290m. Figure #3 depicts Protasco's "true" maintenance orderbook balance based on its 3-year average historical work done. We view Protasco as a potential election beneficiary as spending on road maintenance and repairs tends to increase prior to the polls (which must be held before 24 Aug 2018) to create a feel good factor amongst voters.

Figure #3 Protasco's road maintenance concessions and LTCs

Concession / LTC	Stake	KM	Start	End	Orderbook (RM m)		
					Routine	Periodic	Total
Federal Roads - Selangor, Pahang, Kelantan, Terengganu	51%	7,263	Feb-16	Feb-26	1,706	2,088	3,794
Federal Roads - Sarawak (Sibu, Bintulu, Mukah)	100%	420	Sep-03	Feb-18	28	116	144
State Roads - Perak	51%	1,959	Jan-13	Dec-19	108	90	198
Agriculture Roads - Perak	51%	13,084	Feb-17	Feb-19	58	32	90
State Roads - Kelantan	60%	n.a.	Aug-16	Aug-26	-	129	129
Minor Roads - Terengganu	70%	n.a.	Apr-17	Mar-22	-	50	50
Total					**1,900**	**2,505**	**4,405**

Company

Eyeing to maintain government related buildings

Eyeing on building maintenance. To expand its recurring income base, Protasco is looking to expand into building maintenance. We gather that Protasco is working on a potential concession to maintain several government related buildings. While details are scarce at this juncture, we reckon this will be somewhat akin to UEM Edgenta's (BUY, TP: RM3.64) concession to maintain government hospitals.

Construction: Riding on affordable housing

Timing gap for construction in FY17

Temporarily tapering off. Protasco's construction orderbook currently stands at RM601m, implying a 2x cover on FY16 construction revenue. We expect revenue from this division to decline -37% YoY in FY17 due to the timing gap between its jobs. Projects such as the Old Klang Road to NPE connector, AFC building and PPA1M (Phase 1) are all nearing completion while PPA1M (Phase 2) and SUKE will only start in 2-3Q17 and are unlikely to gain sufficient traction in time to make up for the completed ones.

Figure #4 Protasco's construction orderbook (RM m)

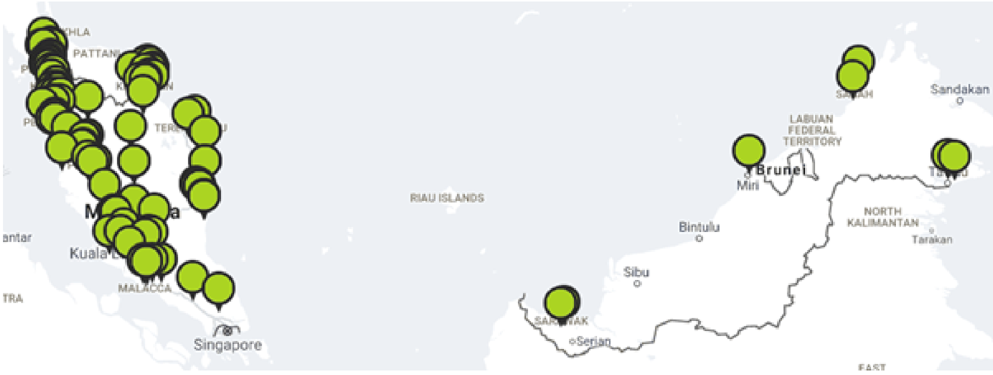
Contract	Value	Balance	Completion
Overtaking lanes in Sibu and Bintulu	77	56	1Q18
Connecting road from Old Klang Road to NPE	58	32	3Q17
Office builing for AFC and car parks	44	29	2Q17
PP1AM (Phase 1), Putrajaya	600	25	1Q17
PP1AM (Phase 2), Putrajaya	301	301	4Q19
Sg Besi - Ulu Klang Elevated Expressway (SUKE)	158	158	4Q19
Total		**601**	

Company

Affordable housing play via PPA1M

Affordable housing play. Protasco managed to secure 2 projects under Perumahan Penjawat Awam 1Malaysia (PPA1M), an affordable housing scheme for civil servants. The government targets to build 100k units of PPA1M homes by 2018 with units priced between RM90-300k. In Oct 2013, Protasco secured Phase 1 of the job in Putrajaya worth RM600m which was completed and handed over last month. Subsequently in Dec 2015, Protasco was awarded Phase 2 of the project (RM301m) which is scheduled to commence in 3Q17. Looking forward, Protasco has received a Letter of Intent (LOI) for Phase 3 of the same project (RM120m) and is also eyeing on Phase 4. Payment for the PPA1M projects undertaken by Protasco will be based on (i) 25% from the government facility fund in 2 payments at the 50% and 100% completion milestone and (ii) 75% from the purchasers of the property. For the latter, payment should not be an issue given strong take up (>90% for Phase 1) due to its pricing below market value and loans provided by the government for eligible purchasers.

Figure #5 Location of PPA1M affordable housing projects



PPA1M

Targeting RM4bn worth of domestic jobs

Gunning for more domestically. In terms of potential job wins, Protasco is eyeing on several domestic jobs worth in excess of RM4bn. This comprises (i) highways and infra jobs (RM1bn), (ii) infra works for a hydropower project (RM800m), (iii) several buildings (RM600m) and (iv) a building/infra project via the Build-Lease-Transfer (BLT) model (>RM2bn). On the overseas front, Protasco is targeting rural road upgrades in Sri Lanka (RM100m) and pavement recycling works in Bangladesh (RM150m). However, for its overseas jobs, Protasco's role is solely on project management with on-ground work execution undertaken by its local JV partners. Generally, Protasco receives a 5% project management fee on these overseas jobs. Overall, we have priced in new job wins of RM250m for FY17 and RM300m for FY18.

Property: Revival of launches

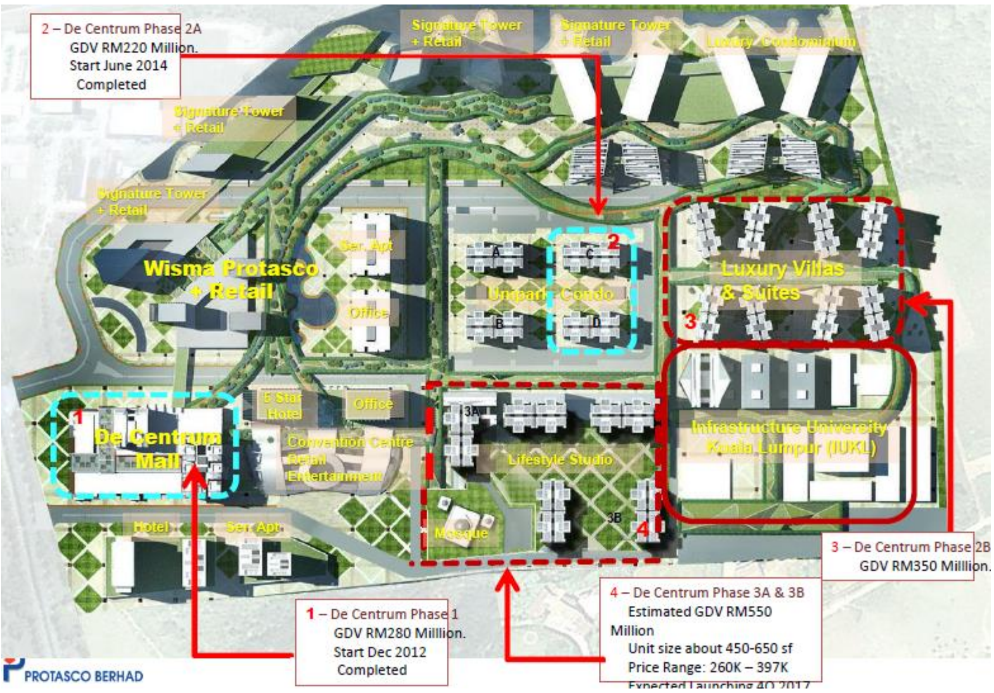
RM10bn De Centrum City is its flagship development

Kajang's latest landmark. Protasco's flagship property project is the De Centrum City, a 100-acre mixed development located in Kajang. With GDV of RM10bn over a development horizon of 20-25 years, De Centrum will comprise apartments, condos, shop offices, SOHO, convention centre, hotel, office suites and mall. Phase 1 (GDV: RM280m) consisting apartments (320 units), SOHO (192 units) and shop lots (54 units) was completed in Dec 2015 and full sold while the retail mall (160k sq ft) was retained as an investment property. Phase 2A (GDV: RM220m) which comprises 2 blocks of apartments (240 units) was recently completed and is 90% sold.

Figure #6 Location of De Centrum City

Company

Figure #7 Masterplan of De Centrum City

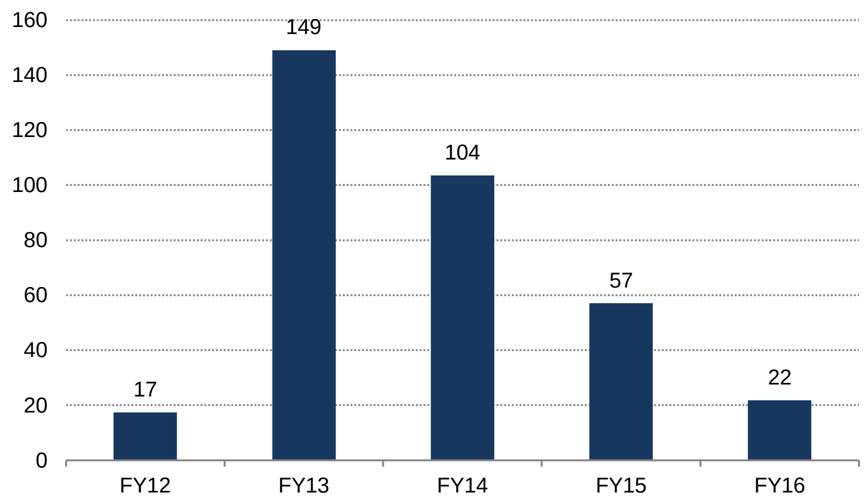


Company

Launches to resume this year. Protasco's property sales have been on a downtrend since FY14 owing to the absence of any significant new launches in the past 2 years. However, this should be revived with several launches slated for the year. At De Centrum, Protasco intends to launch Phase 3 (GDV: RM550m) in 3Q17. This comprises 4 blocks (1600 units) of lifestyle suites priced at RM580-610psf. In Kota Bahru, Kelantan, Protasco will be launching the Telipot Apartment (GDV: RM160m) in 3Q17. The development will have 584 apartment units with sizes ranging 460-850sqft selling at RM433-520psf. We understand that the state government and another government backed agency indicated interest to take up a sizable portion of the units. Lastly, in Pasir Gudang, Johor, Protasco is planning to launch 141 units of 2-storey shop lots (GDV: RM120m) with unit size of 3000sqft selling for RM284psf. Apart from the abovementioned 3 new launches, Protasco also has property inventory worth RM115m from its completed developments at De Centrum. Backed by these launches and inventory, we assume RM50m and RM100m worth of sales for FY17-18.

Launches to resume this year after a 2 year hiatus

Figure #8 Property sales by Protasco (RM m)



Company

Financial Highlights

Hitting a temporary snag

Earnings fell in FY16 due to hiccups in maintenance and weak property sales

Protasco's earnings have grown rather well since Dato Sri Chong assumed full control of its business direction in FY12 from RM37.5m to RM66.8m in FY15 (CAGR: 21.2%). However, in FY16, earnings fell -33.5% YoY due to a 27.9% decline in maintenance revenue attributed to (i) Federal road concession only renewed in Feb 2016, impacting 1Q performance, (ii) losses due to overhead costs associated with non-renewal of State road concession in Selangor and (iii) CSR costs incurred during the major floods in the East Coast. Apart from that, the property division also suffered losses due to (i) absence of launches in the year and (ii) weak sales for FY15-16 resulting to low unbilled sales balance.

Another decline this year but…

Maintenance to recover but offset by weaker construction and property

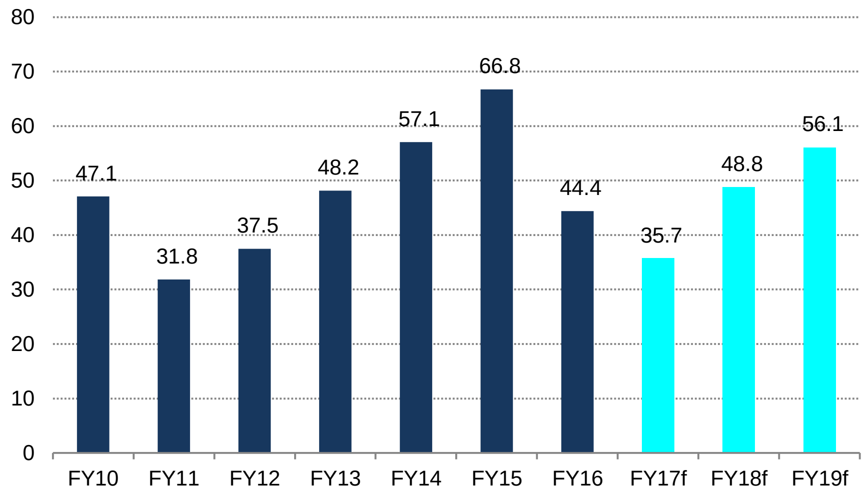
For FY17, we expect a recovery in the maintenance division driven by (i) full year recognition of the renewed Federal road concession and (ii) contribution from the LTCs in Perak, Kelantan and Terengganu. However, we expect this recovery to be offset by weaker performance for construction and property. As earlier explained, the construction division is expected to experience a timing gap as the completion of older jobs will not be filled up by the commencement of newer ones in 1HFY17. For property, the weak sales over the past 2 years will continue place a drag earnings. Overall, we expect earnings for FY17 to display a decline of -19.5% YoY to RM35.7m.

…recovery from FY18 onwards

Expect a recovery in FY18-19, 3-year CAGR of 8%

From a low base, we expect earnings to stage a 36.7% YoY recovery in FY18 to RM48.8m. This will be driven by (i) recovery in construction earnings as work gathers pace and (ii) potentially higher maintenance contribution fuelled by higher works running up to the 14th General Elections (assuming this is held in 2018 instead of 2017) and (iii) property segment recovering from the new launches in FY17. Looking at FY19, we project earnings to increase another 14.9% to RM56.1m, riding on further growth in construction from new job wins and property segment from higher progress recognition on the new launches. All in all, our earnings forecast imply a 3-year CAGR of 8.1%.

Figure #9 Core earnings trend and forecast (RM m)



HLIB estimates

Gearing to reduce once PPA1M payment received

Gearing to reduce. Protasco's net gearing rose significantly in FY16 from 21.6% to 87.9% due to increased borrowings to fund the PPA1M Phase 1 job. With the bulk of payment (88% or RM525m) to be received upon completion, we expect net gearing to reduce significantly in FY17 to 21.4% as the project was recently handed over in 1Q17.

Valuation & Recommendation

Initiate with BUY rating, TP: RM1.20

BUY, TP: RM1.20 (14% upside)

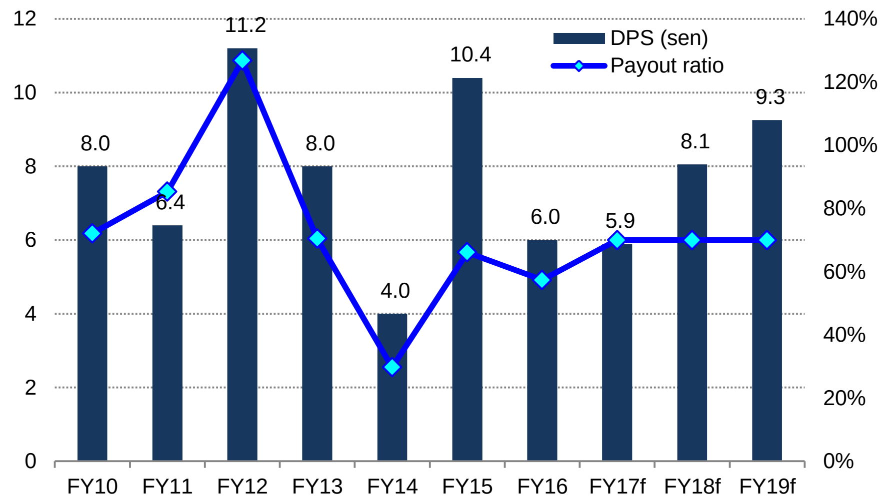
Protasco's average P/E (based on 1 year forward earnings) ranged between 7.4x and 12.3x for FY12-16. Given that the bulk of its earnings are derived from maintenance via concessions and LTCs (FY16: 45%), we reckon that Protasco should be accorded valuations at the higher end of its P/E range. To justify this, UEM Edgenta which derives 30-40% of its earnings from concessions in maintenance of roads (PROPEL) and buildings (government hospitals), currently trades at 13.7x and 12.6x on FY17-18 earnings. As such, we apply a P/E multiple of 12x on mid-FY18 earnings to derive our TP of RM1.20, implying an upside of 14% from current levels. We like Protasco for the defensive qualities of its maintenance business which provides a floor to downside risk via decent dividends.

Backed by decent yield

Dividend yield of 5.6-7.7%

Supported by its cash generating maintenance business, Protasco has managed to pay relatively decent dividends with payout ratio averaging 72.5% for FY10-16. Based on an assumed payout ratio of 70%, this would translate to yield of 5.6% and 7.7% for FY17-18.

Figure #10 DPS and payout ratio trend and forecast



HLIB estimates

Financial Projections for Protasco

Balance Sheet

FYE Dec (RM m)	FY15	FY16	FY17F	FY18F	FY19F
Cash and equivalents	256	209	265	206	164
Receivables	630	800	523	570	576
Inventories	5	29	12	13	13
PPE	206	204	201	200	199
Others	129	165	168	172	176
Assets	**1,225**	**1,406**	**1,169**	**1,162**	**1,128**
Debts	337	557	357	307	257
Payables	450	410	355	383	381
Others	29	29	29	29	29
Liabilities	**815**	**996**	**741**	**719**	**667**
Shareholder's equity	376	396	406	421	438
Minority interest	34	14	21	22	23
Equity	**409**	**410**	**428**	**443**	**461**

Cash Flow Statement

FYE Dec (RM m)	FY15	FY16	FY17F	FY18F	FY19F
Profit before taxation	129	80	74	100	114
Depreciation & amortisation	16	16	15	16	16
Changes in working capital	(123)	(234)	239	(21)	(6)
Taxation	(37)	(25)	(23)	(32)	(36)
Others	(14)	(20)	(11)	(32)	(30)
Cash flow from operations	**(29)**	**(183)**	**294**	**31**	**57**
Net capex	(49)	(14)	(13)	(15)	(15)
Others	(74)	47	-	-	-
Cash flow from investing	**(123)**	**33**	**(13)**	**(15)**	**(15)**
Changes in borrowings	150	220	(200)	(50)	(50)
Issuance of shares	2	6	-	-	-
Dividends paid	(17)	(44)	(25)	(25)	(34)
Others	(67)	(48)	-	-	-
Cash flow from financing	**67**	**135**	**(225)**	**(75)**	**(84)**
Net cash flow	**(85)**	**(16)**	**56**	**(59)**	**(42)**
Forex	(0)	0	-	-	-
Others	(6)	49	-	-	-
Beginning cash	253	162	195	251	192
Ending cash	162	195	251	192	150

Income Statement

FYE Dec (RM m)	FY15	FY16	FY17F	FY18F	FY19F
Revenue	**1,305**	**1,089**	**1,060**	**1,157**	**1,167**
EBITDA	149	99	93	119	132
EBIT	133	84	78	103	116
Finance cost	(4)	(4)	(3)	(2)	(2)
Associates	(0)	0	-	-	-
Profit before tax	**129**	**80**	**74**	**100**	**114**
Tax	(37)	(25)	(23)	(32)	(36)
PATMI (core)	**67**	**44**	**36**	**49**	**56**
Exceptionals	-	-	-	-	-
PATMI (reported)	67	44	36	49	56

Valuation & Ratios

FYE Dec (RM m)	FY15	FY16	FY17F	FY18F	FY19F
Core EPS (sen)	15.7	10.5	8.4	11.5	13.2
P/E (x)	6.7	10.0	12.5	9.1	7.9
EV/EBITDA (x)	5.4	8.1	8.7	6.8	6.1
DPS (sen)	10.4	6.0	5.9	8.1	9.3
Dividend yield	9.9%	5.7%	5.6%	7.7%	8.8%
BVPS (RM)	0.89	0.93	0.96	0.99	1.03
P/B (x)	1.2	1.1	1.1	1.1	1.0
EBITDA margin	11.4%	9.1%	8.8%	10.3%	11.3%
EBIT margin	10.2%	7.7%	7.3%	8.9%	9.9%
PBT margin	9.9%	7.3%	7.0%	8.7%	9.7%
Net margin	5.1%	4.1%	3.4%	4.2%	4.8%
ROE	18.8%	11.5%	8.9%	11.8%	13.1%
ROA	6.2%	3.4%	2.8%	4.2%	4.9%
Net gearing	21.6%	87.9%	22.6%	23.9%	21.2%

Assumptions

FYE Dec (RM m)	FY15	FY16	FY17F	FY18F	FY19F
Contracts secured	555	142	250	300	300
Property sales	57	22	50	100	120

Disclaimer

1. As of 9 June 2017, Hong Leong Investment Bank Berhad has proprietary interest in the following securities covered in this report:
(a) -.

2. As of 9 June 2017, the analyst, Jeremy Goh who prepared this report, has interest in the following securities covered in this report:
(a) -.

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Equity rating definitions

BUY	Positive recommendation of stock under coverage. Expected absolute return of more than +10% over 12-months, with low risk of sustained downside.
TRADING BUY	Positive recommendation of stock not under coverage. Expected absolute return of more than +10% over 6-months. Situational or arbitrage trading opportunity.
HOLD	Neutral recommendation of stock under coverage. Expected absolute return between -10% and +10% over 12-months, with low risk of sustained downside.
TRADING SELL	Negative recommendation of stock not under coverage. Expected absolute return of less than -10% over 6-months. Situational or arbitrage trading opportunity.
SELL	Negative recommendation of stock under coverage. High risk of negative absolute return of more than -10% over 12-months.
NOT RATED	No research coverage, and report is intended purely for informational purposes.

Industry rating definitions

OVERWEIGHT	The sector, based on weighted market capitalization, is expected to have absolute return of more than +5% over 12-months.
NEUTRAL	The sector, based on weighted market capitalization, is expected to have absolute return between –5% and +5% over 12-months.
UNDERWEIGHT	The sector, based on weighted market capitalization, is expected to have absolute return of less than –5% over 12-months.