

## Third time lucky?

The key catalyst for JAKS Resources Bhd (Jaks) hinges on achieving financial closure for the Vietnam IPP project by 31 Oct 2015. While this project has been delayed for long, the entry of CPECC suggests that it may finally take off. We initiate coverage with a BUY rating and target price of RM1.20 for Jaks, contingent upon Jaks successfully unlocking value in the Vietnam IPP project and monetising its mall.

### Vietnam IPP project regains traction

We gather that China Power Engineering Consulting Group (CPECC) was roped in quickly to enable Jaks to meet the financial closure deadline. CPECC has a strong track record and wide industry experience, which suggests that Jaks may have found a credible new JV partner, subject to fulfilling the conditions precedent under the JV agreement.

### Landscape in Vietnam

Vietnam is a fast growing economy in which the industrial sector has been one of the key drivers of growing energy consumption and has opened up opportunities for foreign investors to invest in power plants. Jaks is among only 3 players to have obtained the investment certificate for building an IPP, for which management expects an IRR in the mid-teens range.

### Construction business is key revenue growth driver

With the award of the non-technical EPC portion of the Vietnam project worth US\$454.5m (RM1.72bn), the group's outstanding construction work order book will expand significantly from c.RM700m to RM2.44bn. Over the years, Jaks has actively expanded its construction business to win road infrastructure and water-related infrastructure projects.

### RNAV valuation suggests that Vietnam IPP is the crucial driver

We derive a target price of RM1.20 for Jaks, based on a 40% discount to our RNAV (realisable net asset value) valuation of RM2.00. We believe the discount is appropriate to account for any uncertainty leading up to the financial closure on the Vietnam project on 31 Oct 2015. However, should there be any hiccups to the Vietnam project (given the long history of this project) if CPECC does not move ahead with the JV, we estimate that the RNAV for Jaks would be RM0.70.

### Downside risks

The key downside risk lies in a potential delay or inability to secure financial closure for the Vietnam project, as it is a significant component of Jaks' valuation. Other risks include delay in monetising the shopping mall and slower-than-expected property sales.

### Earnings & Valuation Summary

FYE 31 Dec	2013	2014	2015E	2016E	2017E
Revenue (RMm)	586.4	491.1	552.6	924.7	939.7
EBITDA (RMm)	42.7	73.8	76.1	189.0	191.8
Pretax profit (RMm)	19.8	53.9	56.2	169.3	172.3
Net profit (RMm)	7.5	14.0	22.5	67.7	68.9
EPS (sen)	1.7	3.2	5.1	15.4	15.7
PER (x)	46.2	24.8	15.4	5.1	5.0
Core net profit (RMm)	7.5	14.0	22.5	67.7	68.9
Core EPS (sen)	1.7	3.2	5.1	15.4	15.7
Core EPS growth (%)	172.8	86.1	60.9	201.3	1.8
Core PER (x)	46.2	24.8	15.4	5.1	5.0
Net DPS (sen)	-	-	-	-	-
Dividend Yield (%)	-	-	-	-	-
EV/EBITDA (x)	24.5	16.4	15.9	6.4	6.3
Chg in EPS (%)	-	-	-	-	-
Affin/Consensus (x)	-	-	-	-	-

Source: Company, Affin Hwang estimates

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## Initiate Coverage

# JAKS Resources

JAK MK  
Sector: Utilities

**RM0.79 @ 14 Aug 2015**

**BUY**

Upside 52%

**Price Target: RM1.20**



### Price Performance

	1M	3M	12M
Absolute	-1.3%	+11.3%	+11.3%
Rel to KLCI	+6.3%	+25.8%	+29.5%

### Stock Data

Issued shares (m)	438.4
Mkt cap (RMm)/(US\$m)	346.3/84.9
Avg daily vol - 6mth (m)	6.3
52-wk range (RM)	0.38-1.02
Est free float	75%
BV per share (RM)	1.06
P/BV (x)	0.76
Net cash/(debt) (RMm) (1Q15)	(560.0)
ROE (2015E)	12.3%
Derivatives	Nil
Shariah Compliant	No

### Key Shareholders

Ang Lam Poah	7.4%
Original Invention	5.0%
Dimensional Fund	4.1%

Source: Affin Hwang, Bloomberg

Lim Tee Yang, CFA  
(603) 2145 9616  
teeyang.lim@affinhwang.com

## Vietnam IPP project regains traction

### Third time lucky for Jaks?

The key share price catalyst for JAKS Resources Bhd (Jaks) hinges on successful financial closure of its Vietnam independent power plant (IPP) project by 31 Oct 2015. We gather that China Power Engineering Consulting Group Co Ltd (CPECC) has been roped in as the new JV partner to meet the Vietnam project's financial closure deadline.

Management expects the Vietnam IPP project to yield an internal rate of return (IRR) in mid-teens, partly because the Vietnam project will enjoy tax incentives with a preferential tax rate of 10% (vs. the standard corporate tax rate of 25%) throughout the 25-year tenure. In addition, the Vietnam project will be exempted from tax for the first 4 years and is entitled to a 50% reduction on tax payable for the subsequent 5 years.

Jaks has signed several agreements with CPECC as its new JV equity partner on 6 July 2015 in the US\$1.87bn (RM7.05bn) 25-year Build-Operate-Transfer (BOT) 2x600MW coal-fired power plant project in Hai Duong, northern Vietnam. The project will be funded by 75% debt and 25% equity.

While the Engineering, Procurement and Construction (EPC) work will be mainly undertaken by CPECC, Jaks has secured a US\$454.5m (RM1.72bn) or 24% of the US\$1.87bn Vietnam project for non-technical civil works, which will significantly boost its construction order book from c.RM700m to RM2.44bn. Construction of the Vietnam project is scheduled to begin by end-2015 and will commence commercial operations in 2020.

Jaks has invested US\$49.2m (RM186.9m) as at May15 in the Vietnam project, and is exposed to impairment risk if it is unable to secure further extension to complete the preconditions. However, we understand once the JV becomes unconditional, CPECC will reimburse Jaks 70% of its total investment. Historically, this risk has been mitigated by securing further extension to the financial closure deadline, which Jaks has been able to obtain from the Ministry of Industry and Trade of Vietnam (MOIT).

### Other hurdles to cross under the new JV

The main hurdle that Jaks needs to cross together with the new JV partner is to achieve financial closure by 31 Oct 2015. Other than that, we briefly highlight below the main conditions that needs to be fulfilled before the subscription agreement between Jaks and CPECC takes effect:

**Fig 1: Status of key conditions precedent**

Event	Status
CPECC to deposit a sum of USD100m within 2 weeks from the date of the subscription agreement to be utilized by CPECC for subscribing to shares in JAKS Pacific Power Ltd (JPP)	Done
CPECC or its parent company to provide a corporate guarantee if required by the financiers	Done
CPECC to immediately upon execution of the subscription agreement provide proof of funds that CPECC has unencumbered cash of at least USD500m (about RM1.89bn)	Done
CPECC upon execution of the subscription agreement to deposit a sum of USD7m (about RM26.4m) as security deposit	1 <sup>st</sup> tranche of USD3m completed
Execution of the EPC contract to undertake certain scope of work for the Project to be entered into between Jaks and the entities to be nominated by CPECC	Executed on 3 Aug 2015
if required, the approvals, consents, authorizations, permits or waivers of the relevant Vietnamese authorities or other authorities in respect of CPECC's investment in the Project	In final stages

Source: Company, Affin Hwang

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### Subscription agreement between Jaks and CPECC

We note that the subscription agreement largely stipulates the amount of funding required from Jaks and CPECC for the Vietnam IPP, and we understand from management that no cash call will be required from shareholders. Under the share subscription agreement, CPECC will eventually emerge with a 70% stake in JAKS Pacific Power Ltd (JPP) upon injecting a total of US\$327m (RM1.23bn), while JAKS will hold the remaining 30% via a US\$140.1m (RM528.8m) staggered capital injection.

While the total sum required from Jaks is significant, we believe Jaks should have sufficient internally equity generated financial resources (as we explain later) to undertake this massive capital intensive project. First, the revenue generated from its 24% participation in the EPC job assuming 12% margin, and second, monetisation of Evolve Concept Mall. However, we believe Jaks would need to gear up if it does not monetise the mall.

We note that Jaks has a call option under the option agreement to raise its stake in JPP to 40%. JPP wholly owns JAKS Hai Duong Power Company Ltd (JHDP), which is the vehicle awarded the Vietnam power plant project.

## How credible is the new JV partner?

### Background of its third JV partner

Based on CPECC's and its parent track record, we believe Jaks may have found itself a strong JV partner both financially and technically, after seeing its previous 2 JVs lapse with China-based energy firms, Wuhan Kaidi Electric Power Engineering Co and Meiya Power Ltd. According to management, Wuhan Kaidi lacked financial resources while there were some differences in strategic direction with Meiya Power.

CPECC is a state-owned enterprise in China, whose parent company is China Energy Engineering Group Co Ltd (CEEC). CPECC together with its subsidiaries are integrated power engineering service providers and among other things involved in EPC projects, survey and design, and investment and operation for power projects. Besides that, CPECC has participated in the construction and services of more than 300 overseas projects across countries.

CPECC's parent, CEEC was founded in 2011 and is state-owned with a registered capital of RMB26bn (RM16bn) with more than 160,000 employees and had registered RMB158bn (RM97bn) in operating revenue and RMB4.2bn (RM2.6bn) in profit, according to CEEC's website.

The CEEC website also states that CEEC was formed after a restructuring exercise that saw the integration of several enterprises which include China Gezhouba Group Corporation (CGGC), China Power Engineering Consulting Group Corporation (CPECC), State Grid Corporation of China (SG) and China Southern Power Grid Co (CSG). These companies were engaged in prospecting and design, power engineering, building and maintenance businesses in 15 provinces (municipalities and autonomous regions).

### CEEC's track record

CEEC is responsible for 90% of China's electricity and energy projects (plan, research and design, testing) as well as over 200 large electricity engineering projects in 60 countries.

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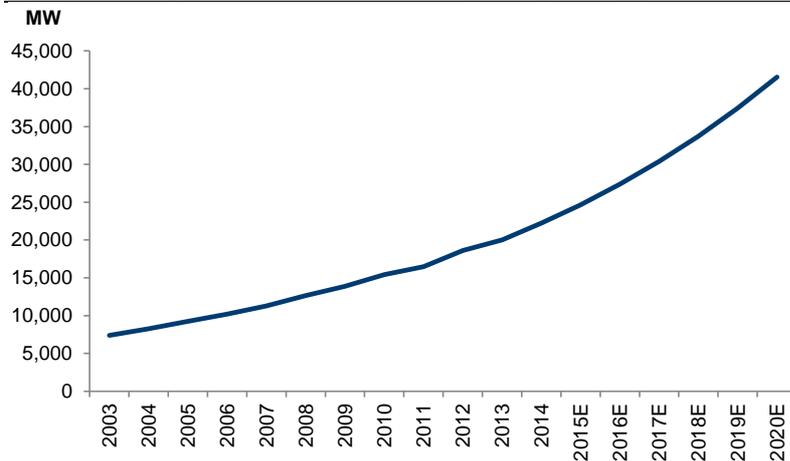
## An energy hungry situation in Vietnam

### A growing economy facing an energy deficit situation

Vietnam is a fast growing economy in which the industrial sector has been one of the key drivers of growing energy consumption and this has opened up opportunities for foreign investors to invest in the country's power industry. In 2014, Vietnam's GDP expanded by 6.0% (2013: +5.4%). According to Vietnam's MOIT, energy demand grew by 11% in 2014, and is projected to sustain at a robust annual growth of 11% from 2016 to 2020.

To address this growing energy demand, Vietnam is counting on new coal-fired power plants to supply the bulk of the country's needs. The pressing need for energy has even led to Vietnam contemplating a nuclear power development program, but deferred due to safety and legal issues.

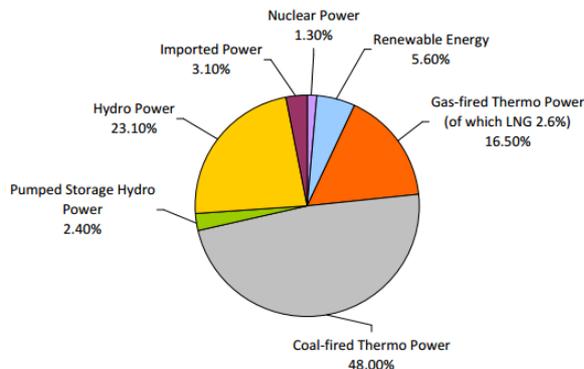
**Fig 2: Electricity peak demand in Vietnam growing strongly**



Source: Asian Power, Affin Hwang

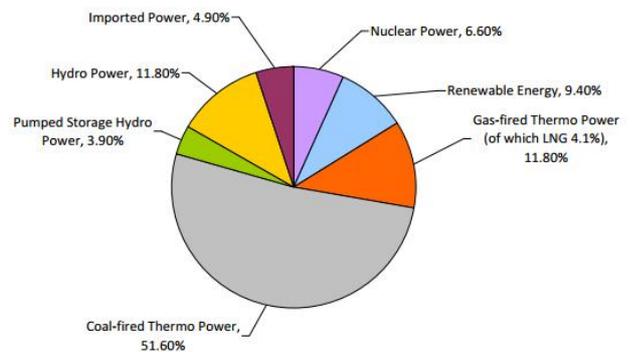
Under Vietnam's Power Master Plan VII, coal-fired power plants will account for about half of the country's total power generation capacity. The aggregate power generation capacity of all the power plants in Vietnam is expected to increase to about 75,000MW by 2020 (with produced and imported electricity reaching 330bn kWh).

**Fig 3: 75,000MW power capacity in Vietnam by 2020**



Source: Mondaq  
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**Fig 4: 146,800MW power capacity in Vietnam by 2030**



Source: Mondaq

### Status of power plant projects in Vietnam

While a surprising number of Build-Operate-Transfer (BOT) power plant projects in Vietnam remain in planning stages, we understand that only 3 coal-fired power plant projects (highlighted in bold in Fig 5) including Jaks' Hai Duong plant have received the investment certificate from the MOIT.

An investment certificate is required for any foreign investment project in Vietnam and is usually issued upon the successful negotiation and signing of project contract and related agreements.

As far as precedents are concerned, the Mong Duong-2 plant led by AES Corporation was delivered 6 months ahead of schedule, while the Vinh Tan 1 plant (95% funded by China Southern Power Grid and China Power International Holding) has only recently started construction in July 2015.

**Fig 5: List of BOT power plant projects in Vietnam**

Project	Capacity (MW)	Cost (US\$bn)	Company	Country	Plant Type	Status	Invest. Cert.	COD	Financial close	Expected COD
1 Phu My 2.2	715	0.5	EdF International Sumitomo Tokyo Electric Power	France Japan Japan	Gas	Operational	1999	2005	Yes	NA
2 Phu My 3	720	0.4	BP SempCorp Utilities Kyushu Electric Power Sojitz Corp	UK Singapore Japan Japan	Gas	Operational	1999	2004	Yes	NA
<b>3 Mong Duong-2</b>	<b>1240</b>	<b>2.1</b>	<b>AES Corporation</b> Posco Energy China Investment Corp	<b>US</b> Korea China	Coal	Operational	2010	2015	Yes	NA
<b>4 Hai Duong</b>	<b>1200</b>	<b>1.87</b>	<b>Jaks Resources</b> CPECC	<b>Malaysia</b> China	Coal	Seeking financial closure	2011	NA	No	2020
<b>5 Vinh Tan 1</b>	<b>1200</b>	<b>1.75</b>	<b>Southern Power Grid</b> China Power Int Vietnam National Coal	<b>China</b> China Vietnam	Coal	Started construction	2014	NA	Yes	2019
6 Vung Ang 2	1200	2.5	Mitsubishi CLP Holdings	Japan HK	Coal	Planning stage	NA	NA	No	2018
7 Quang Tri	1200	2.3	Egati	Thailand	Coal	Planning stage	NA	NA	No	2019
8 Song Hau	2000	3.5	Toyo-Ink	Malaysia	Coal	Planning stage	NA	NA	No	2021
9 Nghi Son	1200	2.3	KEPCO Murabeni	Korea Japan	Coal	Planning stage	NA	NA	No	2018
10 Van Phong	1320	2.0	Sumitomo	Japan	Coal	Planning stage	NA	NA	No	2017
11 Dung Quat	1200	2.0	SempCorp Utilities	Singapore	Coal	Planning stage	NA	NA	No	2020
12 Duyen Hai	1200	2.2	Teknik Janakuasa	Malaysia	Coal	Planning stage	NA	NA	No	NA
13 Vung Ang 3	1200	2.0	Samsung	Korea	Coal	Planning stage	NA	NA	No	2022
14 Long Phu Plant	1200	1.8	Tata Power	India	Coal	Planning stage	NA	NA	No	2019
15 Nam Dinh	2400	4.5	ACWA Power Taekwang	Saudi Korea	Coal	Planning stage	NA	NA	No	2018
16 Quang Trach	1300	2.4	Inter RAO	Russia	Coal	Planning stage	NA	NA	No	2024

Source: Affin Hwang, Various news reports

### Possible reasons for delays in power plant projects in Vietnam

Among the reasons that many of the BOT projects have yet to materialise are claims by foreign investors that Vietnam suffers from gaps in its regulatory framework that affect the negotiation process, potential concerns over enforceability of an arbitration award and difficulties in getting a PPA that will ensure commercial viability, according to Mondaq (an independent company offering online resources on legal, financial and regulatory information over 70 countries).

Power tariffs are still low at VND1,622 (US\$0.07) per kWh, but the Vietnam government intends to develop a competitive market in the power industry. This would require higher tariffs which will increase the viability of future power plants. The Vietnam government has been raising power tariffs with the most recent hike of 7.5% in March 2015.

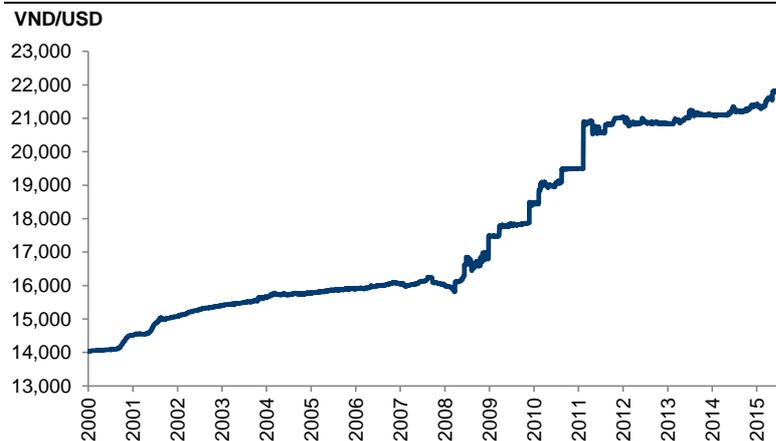
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### Risk mitigation measures taken by Jaks

As far as currency risk is concerned, we understand from management that Jaks will not be exposed to currency risk, as Jaks would have the option to convert all revenues generated in Vietnam Dong into US\$ as guaranteed by the Vietnam government in an undertaking. This is important as we gather that for projects subsequent to Mong Duong, the Vietnam government has tried to limit the amount of foreign exchange that it will guarantee for the conversion of project revenues.

Mitigating currency risk is important, as not being able to do so may have potential negative implications to returns on the project, given that the Vietnamese Dong has been depreciating against the US\$. The recent dong weakness is partly driven by the State Bank of Vietnam's policies, which has devalued the dong twice in 2015, in a bid to maintain export competitiveness and accelerate economic growth.

**Fig 6: Sustained weakness in Vietnamese Dong vs. the US\$**



Source: Affin Hwang, Bloomberg

### Agreements in place to run the power plant in Vietnam

We note that Jaks has the necessary major agreements in place with regard to the Hai Duong plant, which suggest that Jaks should not face any negative surprises in terms of operating costs and hence there is a high degree of certainty in recouping the project's capital outlay.

- a power purchase agreement with offtaker Vietnam Electricity for the purpose of generation and supply of electricity to Vietnam Electricity for 25 years
- a coal supply agreement with Vietnam National Coal-Mineral Industries Group for the purpose of securing a 25-year supply of domestic coal for the project
- a land lease agreement with Department of Natural Resources and Environment of Hai Duong People's Committee in respect of the leasing of a parcel of land for the project

We also understand from management that construction at the Vietnam site should proceed smoothly as: i) land at the site has been cleared; ii) backfilling works has been completed; and iii) protective walls have been built around the perimeter. In addition, the nearby power transmission grid has been realigned to be positioned within 500m of the site.

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## Better political ties between China and Vietnam

### China important for trade and foreign investment

The entry of CPECC into Vietnam should be seen in a positive light against a backdrop of improving political ties between China and Vietnam. Since the anti-China riots in May14 following a protest to China's deployment of an oil rig in waters claimed by both Beijing and Hanoi, both countries have sought to improve ties through increased high level official interactions between both countries.

Foreign investors including those from China have resumed operations in Vietnam since the riots as government efforts to maintain peace and the fast growing economy have managed to retain capital in the country.

More recently in Jun15, Chinese State Councillor Yang Jiechi and Vietnamese Deputy Prime Minister and Foreign Minister Pham Binh Minh co-chaired the 8th meeting of the China-Vietnam steering committee on cooperation in Beijing to discuss ways to further enhance bilateral relations and also agreed on specific measures to boost economic, trade, and investment relations.

China is important to Vietnam for trade, given that China is one of Vietnam's main export markets. Besides that, China had ranked as Vietnam's seventh largest investor before the riots. China had invested US\$2.3bn in 2014, more than six times what was invested in 2012.

A study by fDi Intelligence (a specialist in foreign direct investment and investment promotion) shows that Vietnam topped in greenfield foreign direct investment (FDI), leading all other emerging markets by a wide margin. Vietnam, with a score of 8.14, is attracting more than eight times the amount of greenfield FDI that was expected given the size of its economy.

**Fig 7: Greenfield FDI performance index 2014 for emerging markets**

Country	Score
<b>Vietnam</b>	<b>8.14</b>
Romania	3.91
Hungary	3.80
Malaysia	3.55
Thailand	2.47
Poland	2.04
India	1.95
Mexico	1.78
Egypt	1.13
Indonesia	1.08
Brazil	0.85
Saudi Arabia	0.62
China	0.56
Russia	0.45

Source: fDi Intelligence

## Construction business to drive growth

### The key near term revenue growth driver

With the award of the non-technical EPC portion of the Vietnam project worth US\$454.5m (RM1.72bn), the group's outstanding construction order book will expand significantly from c.RM700m to RM2.44bn. The non-technical EPC work will mainly cover both civil engineering works (such as construction of infrastructure and buildings) as well as M&E engineering works, which we understand from management, will be spread over 42 months or less.

Nonetheless, we note that Jaks' enlarged construction order book of RM2.44bn is dependent upon Jaks, together with CPECC, achieving financial closure by 31 Oct 2015, thereby paving the way for construction of the Vietnam project to kick off by end-2015, according to management. This is built into our earnings model.

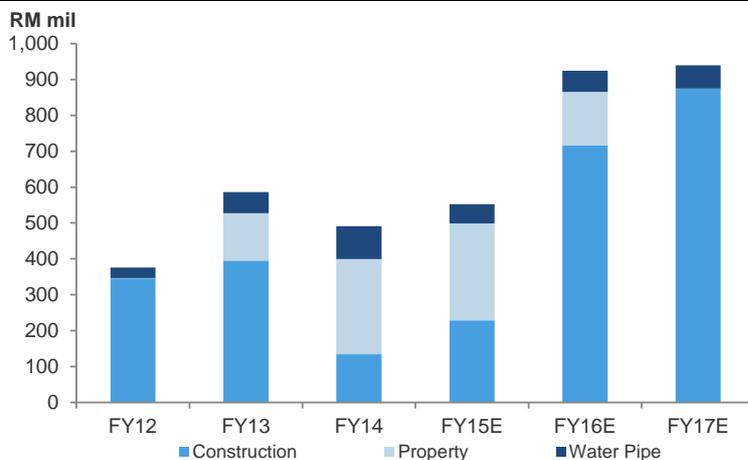
Without the non-technical EPC portion of the Vietnam project, we expect revenue growth from the construction segment to be relatively flattish going forward.

We also expect ongoing efforts by management to replenish its domestic construction work order book to provide a steady revenue source of construction income. We understand from management that Jaks has a tender book of roughly at least RM2bn, with a historical conversion rate of 50%.

Over the years, Jaks has actively expanded its construction business to win road infrastructure and water-related infrastructure projects. Two major road infrastructure projects currently undertaken by the group are the Sadong bridge in Sarawak worth RM211m and road upgrading works near Penang International Airport worth RM208m. Both these projects are due for completion in 2016.

Jaks is confident of securing more sewage-related infrastructure projects. The group is currently busy with the sewage pipe laying work for Puchong and Jinjang worth a combined value of RM636m due for completion in 2017-2018.

**Fig 8: Segmental revenue breakdown**



Source: Affin Hwang, Company data

## Property business a second pillar of support

### Longer term prospects if property sentiment improves

Jaks has built up itself as a property player of decent size with unbilled sales of c.RM400m and this should help underpin the group's revenue base over the medium term. While the property segment has emerged as Jaks' largest revenue contributor in FY14 with property sales of RM265m booked, management is currently revising the timeline for its USJ 1 project given the prevailing weak sentiment in the property sector.

Currently, Jaks has two major property developments (both are mixed development projects) in the pipeline that are worth about RM3bn, and is still actively exploring for new land bank to sustain future growth. The first is Pacific Star (GDV of RM1.2bn) and the other project is Jaks USJ 1 (GDV of RM2bn).

Underpinning Jaks' earnings base in FY15-16 is Pacific Star in Section 13, Petaling Jaya that was launched in Sep14 (due for completion in Sep16). This mixed development project is estimated to command a GDV of RM1.2bn comprising a 9-storey retail podium, 2 blocks of office towers and 3 blocks of apartment.

Pacific Star is mostly fully sold (c.90%), and only the 3<sup>rd</sup> apartment block which was launched last year is not yet fully sold with take-up rate at c.30%. Recall that 1 block of office tower was transferred to Star Media (STAR MK, HOLD, RM2.40) as consideration for acquiring the land.

The USJ 1 project involves redeveloping the site of its existing headquarters in Lot 526, Persiaran Subang Permai into a mixed-use development with a GDV of about RM2bn. The proposed development will mainly be comprised of Jaks Tower, 3 blocks of office suites and 6 blocks of service apartments. In addition, there will be a 3-storey commercial podium within the mixed-use development.

In the longer term, management aims to be on par with other niche property players, which typically generate annual sales of between RM300-400m. Jaks has built up its property portfolio quickly, having started with maiden property revenue of RM132m in FY13.

**Fig 9: Jaks USJ 1**



Source: Company data

## Latent potential in water pipe business

### Government needs to address high non-revenue water issue

While the water pipe business contributes less than 20% of Jaks' revenue, management believes there is still latent potential in the business. There is renewed optimism after the federal and state governments signed a supplemental agreement on the Selangor's water restructuring plan on 10 July 2015. Both parties have 60 days to complete the master agreement, which will eventually pave the way for Pengurusan Aset Air Bhd (PAAB) to take over the operations and maintenance of the water treatment plants and water supply services.

We believe when the state and federal governments eventually resolve Selangor's water restructuring exercise, this will finally kick off the much needed pipe replacement programme to address water pipe leakages. In Selangor, this programme is estimated to be worth as much as RM1bn out of the RM10bn for the country.

Selangor has among the worst Non-Revenue Water (NRW) in the country, losing nearly RM667mn annually, as a result of years of under investment in the infrastructure amid a fast growing population.

In the Klang Valley alone, Syarikat Bekalan Air Selangor Sdn Bhd (SYABAS) has estimated RM4.3bn is required over 5 years to improve water supply services. SYABAS is responsible for water distribution in the Klang Valley and Selangor. According to SYABAS, RM2.41bn of the total RM4.3bn will be allocated as capex to address the high NRW issue, while the remaining RM1.92bn would be used to increase treated water supply capacity in the system to at least a 25% reserve margin in order to overcome water shortage and low pressure issues.

**Fig 10: Non Revenue Water in Peninsular Malaysia**

State	NRW (%) in 2015
Johor	31.95
Kedah	44.97
Kelantan	48.32
Melaka	29.71
N.Sembilan	49.16
Pahang	59.90
Perak	30.68
Perlis	44.67
Pulau Pinang	19.08
Sabah	49.41
Sarawak	29.52
Selangor	32.49
Terengganu	37.85
<b>NATIONWIDE</b>	<b>36.63</b>

Source: Keththa

Management is confident that Jaks is in a good position to win more water-pipe jobs. Based on our assumption that 1km of water pipe costs RM500k, the guidance from SYABAS suggests that there is 4,820km of water pipes that need to be replaced based on the capex of RM2.41bn over 5 years.

Jaks has a proven track record in the water pipe business and is ready to ramp up its existing plant utilisation at a moment's notice. In 1Q15, Jaks won the award for Package 5 of the supply and installation of pipes for the Langat 2 water treatment plant for a contract sum of RM55m. The contract tenure is 24 months and will be completed by Jan17.

## Balance sheet and cash flow

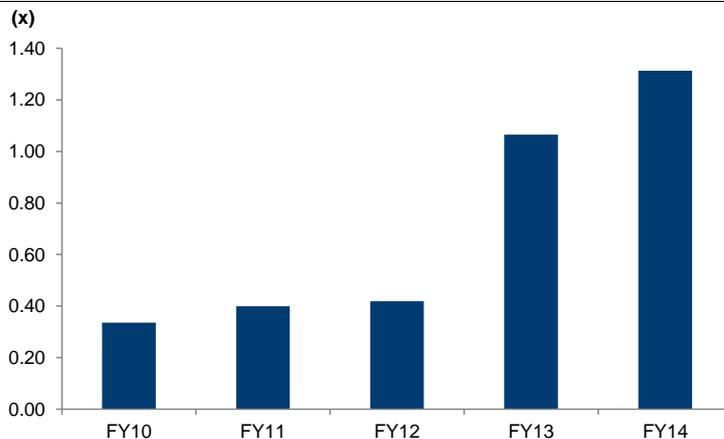
### Monetising mall a possible key step to deleverage

We note that Jaks is quite highly geared, with gross borrowings of RM602m as at 1Q15, implying a gross debt/equity ratio of 1.3x. To reduce its gearing, we believe Jaks may possibly monetise its shopping mall (Evolve Concept Mall) in Petaling Jaya if valuations are right. Jaks has a 51% stake in Evolve Concept Mall, which is slated to open in 2H15 and currently has a 70% tenancy ratio based on the current net lettable area (NLA) of 400k sq ft.

We estimate Jaks may be able to raise RM460m, assuming the mall fetches a price tag of RM1,000 psf. This is based on our understanding from management that Evolve Concept Mall has the potential to expand by a further 60k sq ft to achieve a total NLA of 460k sq ft.

We believe our RM1,000 psf assumption is fairly reasonable when benchmarked against CapitaMalls Malaysia Trust's (CMMT MK, Not Rated) acquisition in Jan15 of Tropicana City mall (also located in Petaling Jaya) with its office tower for RM540m, thereby translating to RM983 psf. The property comprises a 4-storey shopping mall known as Tropicana City Mall (NLA of 448k sq ft with 89% occupancy), 4 levels of car park (1,759 car park bays) and a 12-storey office building known as Tropicana city office tower (NLA of 101k sq ft with 100% occupancy).

**Fig 11: Jaks' leverage (gross debt/equity) has risen significantly**



Source: Affin Hwang, Company data

### Jaks should have enough internal funding to finance Vietnam project

As far as short term requirements are concerned for its Vietnam project, we do not expect Jaks to face difficulties in funding. While the overall funding requirements for the Vietnam project would be substantial in the long term, we understand from management that its funding requirements would be done on a staggered basis.

Based on our simulation, the revenue generated from Jaks' portion of EPC work in the Vietnam project could be ploughed back to partially meet its 30% equity commitment in the project. If management is successful in monetising the mall, we believe Jaks could even pare down its gearing over time.

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Recall that under the share subscription agreement, Jaks has an equity commitment of US\$140.1m (RM528.8m), and CPECC has to inject a total of US\$327m (RM1.23bn). We estimate that Jaks would have to top up the balance of US\$90.9m (RM345.4m) after the first and second calls under the subscription agreements between both parties as well as following a refund on its Vietnam project.

Under the first call of the subscription agreements between both parties, CPECC would essentially refund Jaks about US\$34.4m (RM130.7m), i.e. 70% of the total investment in the Vietnam project amounting to US\$49.2m (RM186.9m) within 14 days from the conditions precedent.

In the second call within 3 to 6 months from the date the subscription agreements become unconditional, Jaks shall pay US\$13.1m (RM49.8m) to subscribe for shares in JPP while CPECC would invest a further US\$30.6m (RM116.3m) for its portion of JPP shares.

After completing the first and second calls of the subscription agreements, both parties shall subscribe for the remaining JPP shares for an aggregate sum of US\$375.5m (RM1.43bn) in a manner to be mutually agreed.

In the longer term, assuming the Vietnam project takes off, and our assumption that the mall is monetised, we believe Jaks would likely have enough funding without leveraging its balance sheet further. Based on Figure 12, the RM1.72bn non-technical work of the Vietnam project (assuming a conservative 12% profit margin) should mitigate the risk of shortfall in terms of funding.

**Fig 12: How would Jaks meet its US\$140.1m (RM528.8m) commitment?**

Item	RMm
Total equity commitment on Vietnam project	528.8
Less : Total investments into Vietnam project so far	(186.9)
Less : Potential gross proceeds from monetizing mall	(460.0)
Add : Borrowings associated with mall	250.0
Add : Minority interest (49%) associated with mall	102.9
Less : Profits from RM1.72bn work on Vietnam project	(206.4)
Less : Cash and bank balances as at 1Q15	(41.6)
Excess cash	(13.2)

Source: Affin Hwang estimates

### Earnings sensitivity analysis if Jaks gears up

In the worst case scenario that Jaks faces a delay in monetising its mall, we set out an earnings sensitivity analysis below as a result of the additional gearing to finance the remaining equity commitments of the Vietnam project. Under this worst case scenario, we assume that Jaks would borrow an additional RM300m. Nonetheless, as mentioned earlier, both parties would fund their equity commitments in the Vietnam project on a staggered basis and therefore imply that the leakage to earnings from higher financing costs would not be as significant.

**Fig 13: Sensitivity analysis of net profit from additional RM330m debt**

RMm	FY15E	FY16E	FY17E
Base case net profit	22.5	67.7	68.9
Less: Finance cost @ 4.5% interest rate	(18.0)	(18.0)	(18.0)
Proforma net profit	4.5	49.7	50.9
Proforma EPS (sen)	1.0	11.3	11.6
Proforma PE (x)	Nm	7.3	7.1

Source: Affin Hwang estimates

## Forecasts and assumptions

### Earnings growth projection

We expect Jaks to record a strong FY14-17E earnings CAGR of 70.2%, mainly driven by a low earnings base, non-technical work on the Vietnam project (we assume a conservative 10% construction profit margin), and recognition of unbilled sales of Pacific Star.

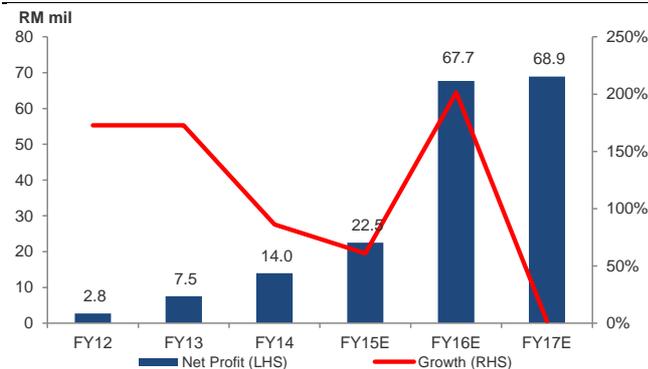
Also underpinning Jaks' strong earnings growth is our assumption that management secures new domestic construction orders of c.RM250m annually, given its tender book of c.RM2bn (historical conversion rate of 50%). While the water restructuring exercise in Selangor appears back on track, we prefer not to factor in any growth for the water pipe manufacturing business yet. In any case, management is confident of winning more water-pipe jobs given its good track record and is ready to ramp up its underutilised plant at a moment's notice.

We have not factored in contributions from the USJ 1 project, as the timeline of project launch remains uncertain in view of the prevailing weak property sentiment. Meanwhile, IPP earnings contribution from the Vietnam project is beyond our FY15-17E horizon forecast, as the plant would only be commissioned from 2020 onwards.

Jaks has seen a sharp rebound in FY13-14 earnings mainly due to its successful foray into the property business. This can be traced back to its acquisition of a 51% equity interest in MNH Global Assets Management Sdn Bhd (MNH) from Island Circle Development Sdn Bhd for a cash consideration of RM93.2m in 2013. MNH was then developing the RM1.2bn GDV mixed development known as Pacific Place Ara Damansara, Petaling Jaya which was completed in 2014.

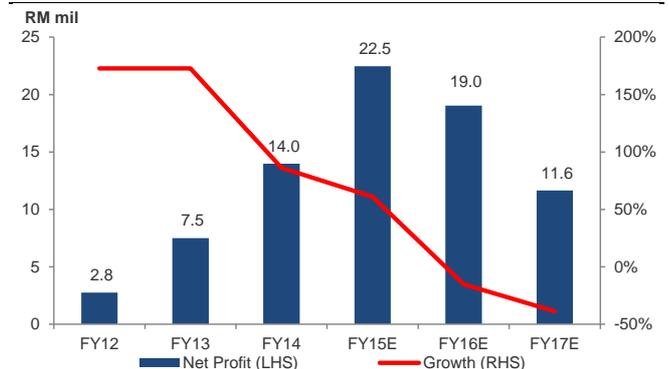
The key risk in our earnings forecasts lies in Jaks' and its new JV partner's ability to get the Vietnam project off the ground, since Jaks' earnings growth will be mainly driven by carrying out the non-technical work on the Vietnam project.

**Fig 14: Earnings forecasts (includes non-technical work from Vietnam project)**



Source: Affin Hwang, Company data

**Fig 15: Earnings forecasts (excludes non-technical work from Vietnam project)**



Source: Affin Hwang, Company data

We forecast Jaks' to improve its PBT margin to 18-19% in FY16-17E from 8% in FY15E due to better profit margins from the non-technical work from its Vietnam project.

## Investing in the valuation gap

### RNAV valuation suggests that Vietnam IPP is the crucial driver

We derive a target price of RM1.20 for Jaks, based on a 40% discount to our RNAV (realisable net asset value) valuation of RM2.00. We believe the discount is appropriate to account for the uncertainty leading up to the financial closure on the Vietnam project on 31 Oct 2015.

At our target price of RM1.20, Jaks is valued at FY16E PE of 7.8x, which is a c.40% discount to the target PE multiples for the construction sector (12-14x) and c.30% discount vs. the property sector (9-12x).

Note that our RNAV valuation assumes Jaks is successful in both achieving financial closure on the Vietnam project, earning a healthy margin from non-technical work on the Vietnam project and monetising its mall (which has a carrying cost of RM291m).

Our RNAV valuation suggests that the Vietnam project is the key longer term re-rating catalyst for Jaks. However, should there be any hiccups to the Vietnam project (given the long history on this project) if CPECC does not go through with the JV, we estimate that the RNAV for Jaks would be RM0.70, which mainly reflect only the value of the ongoing businesses in property and construction, as well as the potential value of the mall.

**Fig 16: Jaks' RNAV Valuation**

Jaks' RNAV Segmental	Equity Value (RMm)	Comment
Property		
- Pacific Star	33.3	51% stake in RM1.2bn GDV due for completion by 2016; c.RM400m in unbilled sales plus c.RM100m of unsold units.
- USJ 1	107.1	100% stake in GDV of RM2.0bn (5-year development) assuming 2016 launch
Construction	490.0	PER at 10x based on 2016E net profit of RM49m which includes non-technical work from Vietnam project
Mall	234.6	51% stake of 460k sq ft NLA @ RM1,000 psf
Gross debt	(601.6)	As at 1Q15
Cash balance	41.6	As at 1Q15
<b>Total RNAV (without Vietnam project)</b>	<b>305.0</b>	
<b>RNAV/per share (RM)</b>	<b>0.70</b>	
Vietnam IPP	571.7	With financial close @ 30% stake (WACC: 10.2%, IRR: 14%)
<b>Total RNAV (with Vietnam project)</b>	<b>876.7</b>	
<b>RNAV/per share (RM)</b>	<b>2.00</b>	
Discount to total RNAV (with Vietnam project)	40.0%	
<b>Target price (RM)</b>	<b>1.20</b>	
No of shares (mil)	438.4	

Source: Affin Hwang estimates, Company data

**Fig 17: Key milestones for Jaks**

Event	Timing	Comment
EGM for Jaks shareholders to approve JV with CPECC	Aug/Sep 2015	Circular to be issued prior to EGM
Financial close of Vietnam project	31 Oct 2015	
Start construction of Vietnam project	1H16	
Completion of Vietnam project	2020	
Launch of USJ1 project	NA	Depending on property sentiment

Source: Affin Hwang, Company data

### Possibility of dividends in future

In the longer term, we believe there is a possibility of Jaks paying dividends once there is certainty that internally generated funds can help meet its equity commitments on the Vietnam project. As an illustration, a 20% dividend payout in FY16E implies a DPS of 3.1 sen or 3.7% yield.

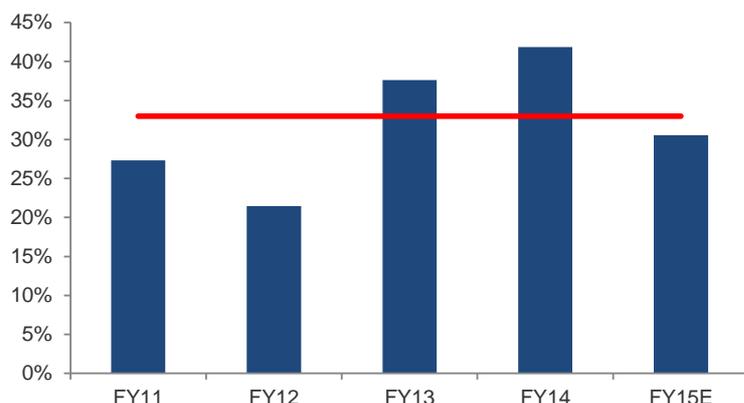
### Eligibility for Shariah compliance a possibility going forward

Assuming Jaks is successful in monetising the mall, we believe the group's valuation may benefit in the longer term from gaining Shariah compliance as Jaks would benefit from reducing its gearing and rebuilding its cash reserves.

Jaks is currently non-Shariah compliant mainly due to its high gross leverage (gross debt/total assets) of 41.7%. This exceeds the 33% limit needed to comply with for maintaining Shariah compliance. We estimate that Jaks gross leverage will fall to 30.6% from 41.7%, assuming Evolve Concept Mall is monetised, since the mall is financed with debt of RM250m.

In our market strategy report in May15, we had highlighted that the EPF's proposal to offer the Shariah compliant investment option by 2017 reinforces our view that the valuation disparity against non-Shariah listed stocks will further widen. While having Shariah compliance is relatively less important for companies with lower market capitalisation (as they are less investable to the institutional funds), improving earnings and cash flow upon successfully executing the Vietnam project are likely to have a positive impact on Jaks' market capitalization.

**Fig 18: Jaks' FY15E proforma gross debt/total assets if mall is sold**



Source: Affin Hwang, Company data

## Risks

### Downside risks

The key downside risk lies in a potential delay or inability to secure financial closure for the Vietnam IPP, as the project is a significant component of Jaks' valuation. Other risks include: 1) slow property sales; 2) delay in monetising the mall; 3) slow replenishment of construction order book; and 4) a protracted water-restructuring scenario in Selangor.

# JAKS Resources – FINANCIAL SUMMARY

## Profit & Loss Statement

FYE 31 Dec (RMm)	2013	2014	2015E	2016E	2017E
Revenue	586.4	491.1	552.6	924.7	939.7
Operating expenses	(543.7)	(417.3)	(476.4)	(735.7)	(747.9)
EBITDA	42.7	73.8	76.1	189.0	191.8
Depreciation	(5.2)	(4.2)	(4.3)	(4.1)	(3.9)
EBIT	37.6	69.6	71.8	184.9	187.9
Net int inc/(exp)	(17.8)	(15.6)	(15.6)	(15.6)	(15.6)
Exceptional items	-	-	-	-	-
Pretax profit	19.8	53.9	56.2	169.3	172.3
Tax	(9.1)	(19.8)	(14.0)	(42.3)	(43.1)
Minority interest	(3.2)	(20.2)	(19.7)	(59.3)	(60.3)
<b>Net profit</b>	<b>7.5</b>	<b>14.0</b>	<b>22.5</b>	<b>67.7</b>	<b>68.9</b>

## Balance Sheet Statement

FYE 31 Dec (RMm)	2013	2014	2015E	2016E	2017E
Fixed assets	38.0	28.0	26.4	25.0	23.8
Other long term assets	359.2	671.9	671.9	671.9	671.9
<b>Total non-curr assets</b>	<b>397.1</b>	<b>699.9</b>	<b>698.3</b>	<b>696.9</b>	<b>695.7</b>
Cash and equivalents	94.2	80.3	72.3	214.8	345.8
Stocks	15.6	25.7	29.3	49.0	49.8
Debtors	75.8	110.1	123.8	207.2	210.6
Other current assets	678.5	527.2	583.0	583.0	583.0
<b>Total current assets</b>	<b>864.1</b>	<b>743.2</b>	<b>808.4</b>	<b>1,054.0</b>	<b>1,189.1</b>
Creditors	183.0	152.7	174.1	291.3	296.1
Short term borrowings	280.6	260.7	260.7	260.7	260.7
Other current liabilities	88.9	137.6	137.6	137.6	137.6
<b>Total current liab</b>	<b>552.6</b>	<b>551.0</b>	<b>572.4</b>	<b>689.6</b>	<b>694.3</b>
Long term borrowings	193.9	343.1	343.1	343.1	343.1
Other long term liabilities	0.2	0.2	0.2	0.2	0.2
<b>Total long term liab</b>	<b>194.1</b>	<b>343.3</b>	<b>343.3</b>	<b>343.3</b>	<b>343.3</b>
<b>Shareholders' Funds + MI</b>	<b>514.5</b>	<b>548.9</b>	<b>591.0</b>	<b>718.0</b>	<b>847.2</b>

## Cash Flow Statement

FYE 31 Dec (RMm)	2013	2014	2015E	2016E	2017E
Pretax profit	19.8	53.9	56.2	169.3	172.3
Depreciation & amortisation	5.2	4.2	4.3	4.1	3.9
Working capital changes	30.5	192.9	4.0	14.1	0.6
Cash tax paid	(13.8)	(19.8)	(14.0)	(42.3)	(43.1)
Others	1.8	6.3	15.6	15.6	15.6
<b>Cashflow from operations</b>	<b>43.5</b>	<b>237.5</b>	<b>66.1</b>	<b>160.8</b>	<b>149.3</b>
Capex	(1.3)	(2.7)	(2.7)	(2.7)	(2.7)
Others	(53.0)	(314.1)	0.0	0.0	0.0
<b>Cash flow from investing</b>	<b>(54.3)</b>	<b>(316.8)</b>	<b>(2.7)</b>	<b>(2.7)</b>	<b>(2.7)</b>
Debt raised/(repaid)	107.0	126.9	0.0	0.0	0.0
Equity raised/(repaid)	0.0	0.0	0.0	0.0	0.0
Net int inc/(exp)	(2.4)	(4.9)	(15.6)	(15.6)	(15.6)
Dividends paid	0.0	0.0	0.0	0.0	0.0
Others	(19.8)	(70.9)	0.0	0.0	0.0
<b>Cash flow from financing</b>	<b>84.8</b>	<b>51.2</b>	<b>(15.6)</b>	<b>(15.6)</b>	<b>(15.6)</b>
<b>Free Cash Flow</b>	<b>42.1</b>	<b>234.8</b>	<b>63.4</b>	<b>158.2</b>	<b>146.7</b>

Source: Company, Affin Hwang forecasts

## Key Financial Ratios and Margins

FYE 31 Dec (RMm)	2013	2014	2015E	2016E	2017E
<b>Growth</b>					
Revenue (%)	55.8	(16.2)	12.5	67.3	1.6
EBITDA (%)	87.4	72.8	3.1	148.3	1.5
Net profit (%)	172.8	86.1	60.9	201.3	1.8
<b>Profitability</b>					
EBITDA margin (%)	7.3	15.0	13.8	20.4	20.4
PBT margin (%)	3.4	11.0	10.2	18.3	18.3
Net profit margin (%)	1.3	2.8	4.1	7.3	7.3
Effective tax rate (%)	46.1	36.7	25.0	25.0	25.0
ROA (%)	0.6	1.0	1.5	3.9	3.7
Core ROE (%)	1.7	3.0	4.7	12.3	11.1
ROCE (%)	1.1	1.6	2.4	6.4	5.8
Dividend payout ratio (%)	-	-	-	-	-
<b>Liquidity</b>					
Current ratio (x)	1.6	1.3	1.4	1.5	1.7
Op. cash flow (RMm)	42.7	73.8	76.1	189.0	191.8
Free cashflow (RMm)	42.1	234.8	63.4	158.2	146.7
FCF/share (sen)	9.6	53.6	14.5	36.1	33.5
<b>Asset management</b>					
Debtors turnover (days)	47.2	81.8	81.8	81.8	81.8
Stock turnover (days)	11.2	24.5	24.5	24.5	24.5
Creditors turnover (days)	131.6	145.6	145.6	145.6	145.6
<b>Capital structure</b>					
Net gearing (%)	85.4	113.9	110.2	70.7	41.7
Interest cover (x)	2.4	4.7	4.9	12.1	12.3

## Quarterly Profit & Loss

FYE 31 Dec (RMm)	1QFY14	2QFY14	3QFY14	4QFY14	1QFY15
Revenue	109.7	98.3	93.8	189.4	111.8
Operating expenses	(97.1)	(78.8)	(81.2)	(160.3)	(99.1)
EBITDA	12.6	19.5	12.6	29.1	12.8
Depreciation	(1.0)	(0.9)	(1.2)	(1.2)	(1.0)
EBIT	11.6	18.7	11.4	27.9	11.8
Int expense	(3.7)	(4.0)	(2.8)	(5.1)	(3.6)
Exceptional items	-	-	-	-	-
Pretax profit	7.9	14.6	8.6	22.8	8.2
Tax	(3.2)	(4.8)	(3.1)	(8.8)	(2.6)
Minority interest	(3.8)	(6.4)	(2.8)	(7.1)	(2.5)
Net profit	0.9	3.4	2.8	6.9	3.1
<b>Margins (%)</b>					
EBITDA	11.5	19.9	13.4	15.4	11.4
PBT	7.2	14.9	9.2	12.0	7.4
Net profit	0.8	3.5	3.0	3.6	2.7



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