

INITIATION REPORT

1 March 2011

AWC Bhd

Price : RM0.26

Market Capitalisation : RM58.8 mln

Board : Main Market

Sector : Trading/Services

Recommendation : HOLD

Bursa / Bloomberg Code: 7579 / AWC
Stock is Shariah-compliant.

Key Stock Statistics

| FYE June | FY09 | FY10 | FY11E |
|--------------------------------|---------------|------|-------|
| EPS (sen) | 1.40 | 5.20 | 2.56 |
| P/E (x) | 18.6 | 5.0 | 10.2 |
| Dividend/Share (sen) | 0.00 | 1.00 | 1.00 |
| NTA/Share (sen) | 19.9 | 23.8 | 24.4 |
| Book Value/Share (Sen) | 26.1 | 30.9 | 32.4 |
| Issued Capital (m shares) | 226.44 | | |
| 52-week Hi-Low (RM) | 0.225 - 0.335 | | |
| Major Shareholders (%): | | | |
| Dato' Ahmad Kabeer | 36.57* | | |

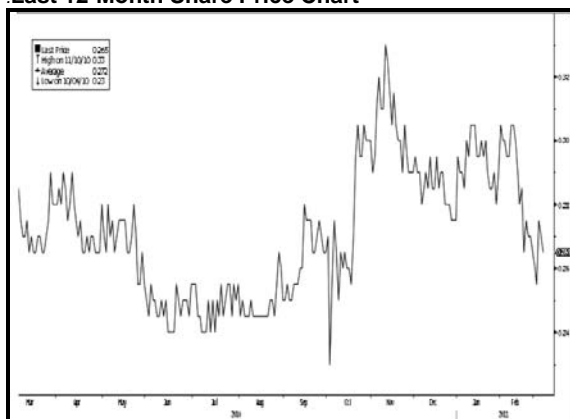
Note: *held through K-Capital, Slam Resources, AKN Capital

Per Share Data

| FYE June | FY09 | FY10 | FY11E |
|------------------|-------|-------|-------|
| Book Value (RM) | 26.11 | 30.89 | 32.45 |
| Cash Flow (sen) | 5.29 | 14.78 | 6.83 |
| Earnings (sen) | 1.40 | 5.20 | 2.56 |
| Dividend (sen) | 0.00 | 1.00 | 1.00 |
| Payout Ratio | 0.00 | 0.19 | 0.39 |
| PER (x) | 18.6 | 5.0 | 10.2 |
| P/Cash Flow (x) | 4.9 | 1.8 | 3.8 |
| P/Book Value (x) | 1.0 | 0.8 | 0.8 |
| Dividend Yield | 0.0% | 3.8% | 3.8% |
| ROE | 5.4% | 16.8% | 7.9% |
| Net gearing (x) | * | * | * |

Note: * Net cash position

Last 12-Month Share Price Chart



Investment Highlights / Summary

- **Business transformation plan in action** – since 2008 AWC has been in the process of transforming itself operationally through better financial management and more aggressive pursuit of new markets.
- **Strong Middle East presence** – Succeeded in positioning itself to be a major player in the Middle East and is currently boosting its expertise in building management by offering eco-friendly management methodology.
- **International Brand** - One of its businesses, the waste collection system, marketed under the STREAM brand, has been successfully installed at Resort World-Sentosa, SATS Inflight Catering Centre and Novena Hospital in Singapore. In Abu Dhabi it has been installed at Aldar Headquarters, and has been selected for the prestigious Al-Reem and Al-Raha development.
- **A strong balance sheet** with net cash representing 87% of NTA and minimal borrowings.
- **Earnings in FY11 are expected to take a dip** as a consequence from the construction delays at Al-Reem in Abu Dhabi. Apart from the FY11 profit dip, and (for now) a battered order book, AWC is likely to emerge unscathed from the Gulf States' property slump – with its reputation and cash pile intact.
- **Risks** include the possibility of current contracts at Al-Reem being unfavourably revised. The other is the requested rates adjustment for the maintenance of Government buildings may not be satisfactorily met.
- **Recommend to Hold at the current price of RM0.26**, The share prices is supported by net cash per share of RM0.20 and positive operating cash flow in the current year.

Background

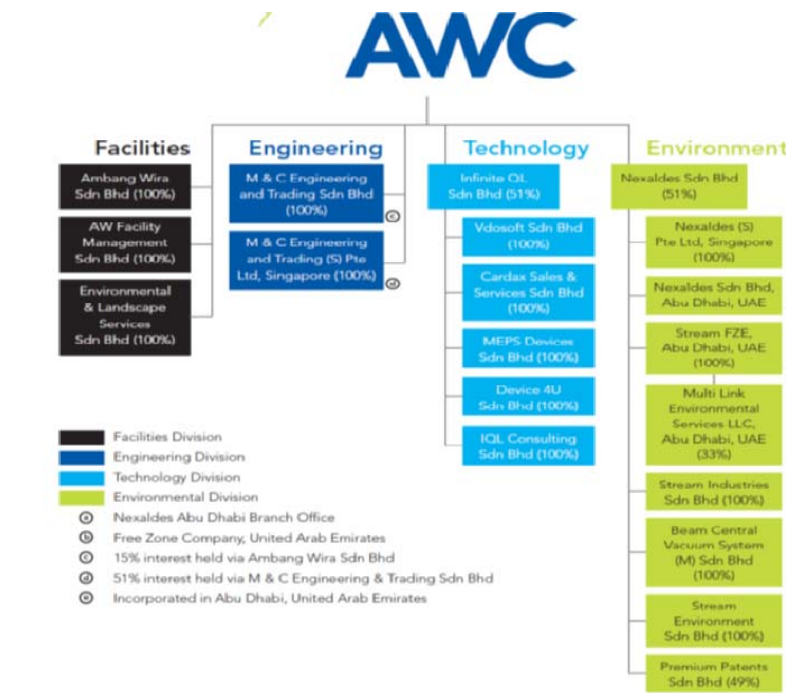
Corporate profile and Management

Now on the Main Market of the Bursa, AWC Bhd was listed on the Second Board of the Kuala Lumpur Stock Exchange on 9 September 2003 as AWC FACILITY SOLUTIONS BERHAD. The listing was accomplished by the existing major shareholder and associates through the injection of AWC's assets into the then listed TRANS CAPITAL HOLDING BERHAD.

The single largest shareholder, with an effective stake of 36.6%, is Dato' Ahmad Kabeer bin Mohamed Nagoor, who is also the Deputy Chairman. The other directors are all professional appointees who, individually, owns less than 0.5% of the company.

On 13 August 2007, 36 year old Azmir Merican bin Dato' Azmi Merican, an expert in strategic business planning was appointed as Group Chief Executive/Managing Director. Prior to AWC, Azmir was a key member of the Private Equity division of CIMB Investment Bank where, amongst others, he was responsible for the development of post investment business plans and to carry out their implementation

Corporate structure



Business ~ Business Transformation Program to focus on core business, each under 4 business units

At the time of listing, the main business was to provide the full suite of maintenance services to Federal Government Common User buildings within the Southern Zone (states of Johor, Malacca, Negeri Sembilan) and Sarawak. The services were provided under a 10+5 year Concession Agreement with the Federal Government for the period 1998-2008 for the first 10 years. The other business then was to provide M&E Engineering Services for buildings

Subsequently, AWC made two strategic acquisitions namely;

In November 2004 - 51% of Nexaldes Sdn Bhd ("NSB") which employs its own proprietary pneumatic technology for large scale waste collection in residential, commercial or industrial establishments, including large scale township .

In September 2006 - 51% of Infinite QL Sdn Bhd ("IQL") an expert in micro-electronics specializing in providing softwares and products for CCTVs and card access security systems in buildings.

Consequently AWC , by 2007, had established the foundation for a new business model to capitalize on the opportunities opened up by the rapidly urbanizing Malaysia and the region.

A Business Transformation Plan was then formulated with the aim of making AWC to be more focused on the core businesses, and also to create a leaner organization through better financial management and monitoring, costs control and human resource development. The plan was formulated with the aim of making AWC to be more focused on the core businesses, and also to create a leaner organization through better financial management and monitoring, costs control and human resource development.

Two subsidiaries associated with M&E Services were disposed, whilst the 51% owned Nexaldes established new joint ventures with Middle East partners. Steps were taken to improve operational processes and procedures, particularly procurements at the 100% owned Concession holder.

Presently companies are organized under 4 reportable segments, which are also the Group's strategic business units. The strategic business units are managed separately because they require different technology and marketing strategies. Each of the strategic business units operating results are reviewed regularly by the Group's Chief Executive / Managing Director. Except for the Environment business unit, these businesses operate mainly in Malaysia.

Facilities ~ Provision of integrated maintenance services for Government under Concession

This is the original business of provision of an integrated range of maintenance services for office, commercial, industrial, residential and administrative buildings, to the Federal Government under the Concession Agreement as well as the private sector. The Concession Agreement has since been renewed for another 5 years to 2013.

Services include electrical, mechanical, civil, structural, energy and utility management and maintenance, vertical transport management, security and safety management and central monitoring systems, landscaping and ground care.

To differentiate and add value to its services vis-à-vis its competitors, AWC's facilities management services will incorporate methodology that correlates carbon emission reduction and savings in energy consumption. This eco-friendly management practice will be the value proposition that AWC hope will accelerate its expansion into managing more private sector buildings.

Engineering ~ Provision of M&E services and products for building industry

This comprises the remaining companies engaged in M&E services and trading of M&E products for the building industry.

These include computerised Building Automation Systems (BAS), Heating, Ventilation and Air-Conditioning Systems (HVAC), hydronic balancing system and industrial cooling system.

Technology ~ Offers solutions in Electronic Security Systems

This is headed by the 51% owned Infinite QL which offers turnkey research and development for microelectronics and software products for buildings' security and access needs. It also manufactures and distributes consumer electronics and security related products

Products comprise; BLACK BOX SOLUTIONS products, DIGITAL VIDEO SYSTEMS, SMARTCARD SYSTEMS, and ENTERPRISE WIDE SECURITY SYSTEMS.

Environment ~ Strong Middle East presence and international brand

This headed by the 51% owned Nexaldes which offer a waste collection system.

Operating in Malaysia, Singapore and the Middle East, and marketed under the STREAM brand it employs a proprietary pneumatic technology in material handling processes.

The system transports municipal solid waste at high speeds through underground or surface pipes to a central waste handling facility where it is collected and compacted into sealed containers that are then removed periodically to sorting facilities, landfills or incinerators.

Waste can be moved over a distance of more than two kilometres and the consolidation of waste from several buildings means that waste leaves the premises within 2-3 hours after being thrown into the vertical chutes in the respective buildings.

STREAM offers several advantages offer the conventional practice of garbage disposal and collection. Firstly, it eliminates the negative side effects of the conventional practice – unhygienic, unsightly, smelly, traffic inconvenience (try to overtake a fully loaded garbage truck!) and security hazards (no one does security check on garbage or the garbage man).

These advantages (no garbage trucks, no stray cats/dogs rummaging bins) do contribute towards enhancing property value.

STREAM was selected by the Singapore Changi Airport authorities, after they re-assessed their security plans for the new terminal (following the Sept 11 tragedy) and realized that the only vehicle that will enter the terminal on a regular basis and virtually un-checked is a garbage truck!

Unfortunately for KLCC in Malaysia, AWC's engineers have yet to figure out how to adapt STREAM to existing properties. As STEAM deploys a network of underground pipes, it has to be integrated into the building plan.

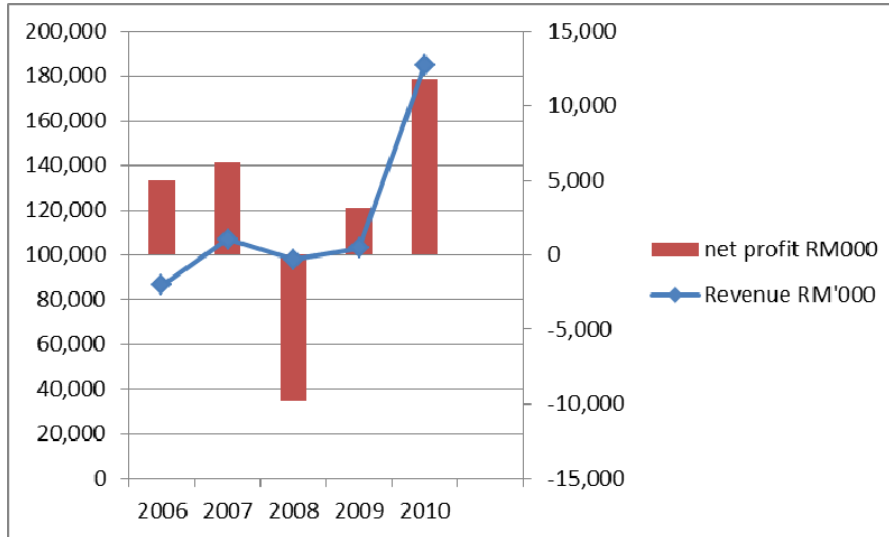
Meanwhile, The Binjai on the Park KLCC is running on STREAM, and so will the KIA PENG Condominium. Slightly further away, the Mutiara Upper East Condo is also on STREAM.

Capital Restructuring

With a working business model in place, AWC will be implementing a capital restructuring scheme whereby the par value of RM0.5 will be reduced to RM0.3 (thereby offsetting the accumulated losses carried forward from Transcap) and will be issuing new shares up to 15% of issued capital under ESOS. Currently, Azmir the CEO, owns an effective 1.02% of the company

Financial Highlights

Net Profit & Revenue (FYE2006-FYE2010) ~ *Achieved new record in revenue & profit FYE 2010*



AWC's revenue comprise both recurrent income and from specific contracts/projects. Recurrent income is accounted for mainly by Facilities division, specifically from the Federal Government for maintenance of its buildings under the Concession. Revenues from the other divisions are substantially contracts or projects based and they are booked according to their respective stages of completion.

In FY2008, AWC reported lower y-o-y revenue following the completion of several projects. Final accounting of these projects also led to a sharp increase in provisions and write-offs and which then resulted in pre-tax loss of RM9.7million.

With new projects secured in 2009 profits subsequently recovered and achieved a new record at RM27.4m in FY2010, which was accounted for substantially by the Environment Division - 55% of revenue and 79% of pretax profit

At the **Environmental Division**, the 51% owned Nexaldes was successful in securing contracts totaling more than RM200m in Abu Dhabi in FYE2009. The bulk of this was for the supply and installation of its STREAM waste collection system at the Al Reem Island and the Al Raha real estate developments.

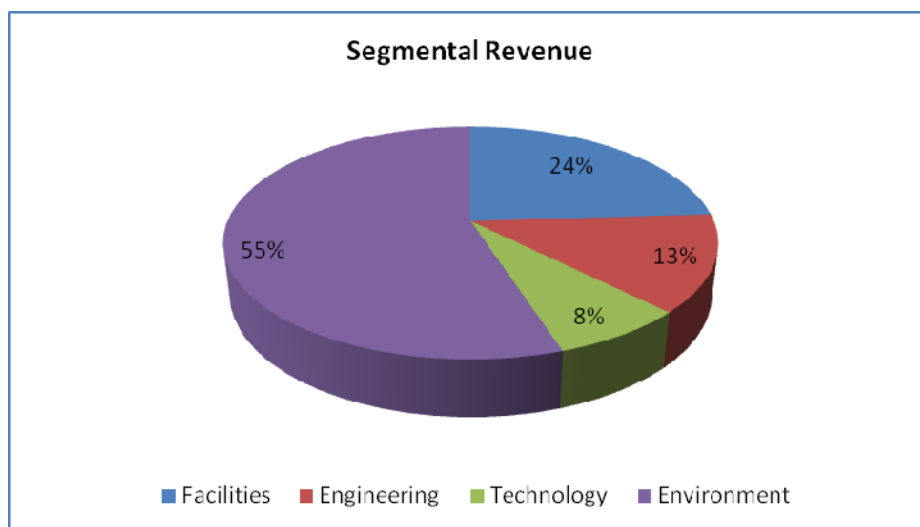
The sharp rise in reported profits at the Environment Division in FY10 was substantially accounted for from the progressive accounting of the STREAM installation at the Al-Raha development.

Thus in FY2010, at the attributable level, net profit rose 270% y-o-y from a 90% increase in revenue

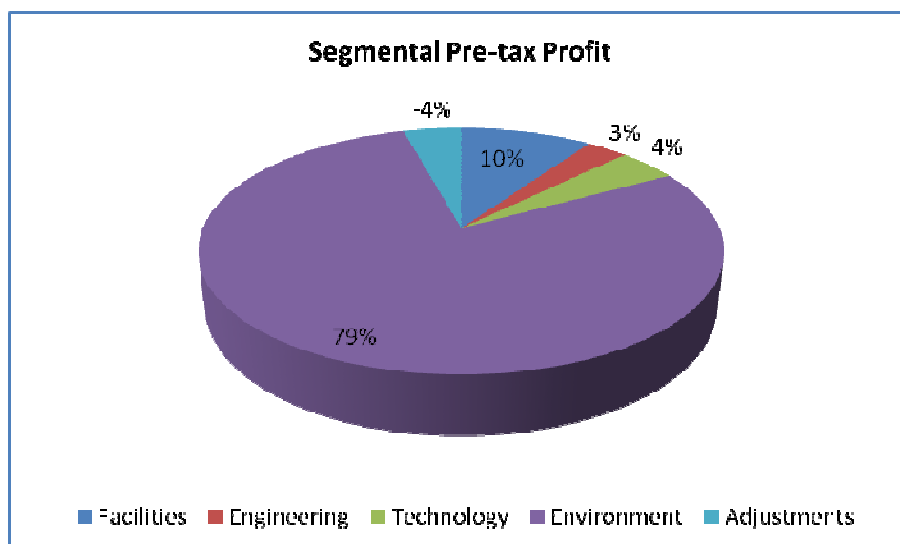
Segmental Breakdown ~ Environment segment is the main contributor for FYE2010

| FYE June (RMm) | 5yr Audited Annual Results | | | | |
|----------------------------------|----------------------------|--------------|-------------|-------------|--------------|
| RMm | 2006 | 2007 | 2008 | 2009 | 2010 |
| Revenue by segments | | | | | |
| Facilities | 40.4 | 44.5 | 56.0 | 41.0 | 44.4 |
| Engineering | | 34.3 | 22.1 | 26.6 | 24.9 |
| Technology | 46.1 | 13.8 | 9.0 | 7.8 | 13.8 |
| Environment | | 14.6 | 11.0 | 21.9 | 101.7 |
| | 86.5 | 107.2 | 98.1 | 97.3 | 184.7 |
| Pretax Profit by segments | | | | | |
| Facilities | 4.0 | 7.6 | -7.0 | 3.1 | 2.9 |
| Engineering | | 0.8 | -1.3 | 2.1 | 0.9 |
| Technology | 7.3 | 2.7 | -0.8 | 1.2 | 1.3 |
| Environment | | 2.3 | 0.9 | 3.2 | 23.6 |
| Adjustments | | -1.5 | -0.8 | -2.8 | -1.3 |
| | 10.2 | 11.9 | -9.7 | 6.8 | 27.4 |
| Net Attributable Profit | 5.0 | 6.2 | -9.8 | 3.2 | 11.8 |

Segmental Revenue FYE 2010 (by %)



Segmental Pre-tax Profit FYE 2010 (by %)

**Cash Flow & Balance Sheet- strong balance sheet with net cash and minimal borrowings**

| FYE June | 2007 | 2008 | 2009 | 2010 | Dec |
|---------------------------------------|-------------|-------------|-------------|-------------|-------------|
| Balance Sheet Highlights (RMm) | | | | | |
| Total Assets | 120.7 | 103.5 | 115.8 | 171.4 | 162.1 |
| Intangible Assets | 23.4 | 13.4 | 14.0 | 16.0 | 16.1 |
| Cash and bank balances | 19.5 | 24.8 | 20.3 | 57.1 | 53.9 |
| Bank Borrowings | 8.7 | 10.2 | 10.1 | 7.5 | 7.5 |
| Shareholders' equity | 65.5 | 55.6 | 59.1 | 69.9 | 70.0 |
| Minority Interests | 12.5 | 12.4 | 14.4 | 24.7 | 25.3 |
| Net Tangible Asset | 42.1 | 42.2 | 45.1 | 53.9 | 53.9 |

AWC has maintained a positive EBITDA throughout the years from FYE2006 to FYE2010 under review. This has contributed to a steady improvement at its balance sheet. As at 31st December 2010, group's cash reserve stood at RM54m against total borrowings of RM7.5m. Net cash is 86% of NTA.

6 months FY 2011 ~ Declined Y-O-Y net profit

| FYE June (RMm) | Latest Quarterly Results | | | % Change | | Yr to date | | % |
|----------------------|--------------------------|-------------|-------------|-------------|-------------|-------------|-------------|--------------|
| | 2QFY11 | 2QFY10 | 1QFY11 | y-o-y | q-o-q | 6mFY11 | 6mFY10 | |
| Revenue | | | | | | | | |
| Facilities | 10.6 | 10.3 | 10.2 | 3 | 4 | 20.8 | 22.7 | -8 |
| Engineering | 7.2 | | 6.2 | | 16 | 13.4 | | |
| Technology | 1.3 | 19.8 | 2.6 | 16 | -49 | 4.0 | 43.4 | 12 |
| Environment | 14.4 | | 16.9 | | -15 | 31.4 | | |
| | 33.6 | 30.1 | 35.9 | 11.7 | -6.4 | 69.6 | 66.2 | 5.1 |
| Pretax Profit | | | | | | | | |
| Facilities | 1.4 | 0.2 | 1.5 | | -7 | 2.9 | 2.9 | -3 |
| Engineering | 0.6 | | 0.6 | | -1 | 1.2 | | |
| Technology | -0.4 | 8.5 | -0.2 | -79 | | -0.6 | 11.5 | -52 |
| Environment | 1.6 | | 3.3 | | -51 | 5.0 | | |
| Others | -1.4 | -0.6 | -1.0 | | | -2.3 | -0.8 | |
| | 1.8 | 8.1 | 4.3 | 77.9 | 58.2 | 6.1 | 13.4 | -54.9 |
| Net Profit | 1.0 | 3.1 | 2.4 | 66.4 | 55.8 | 3.4 | 6.1 | -44.7 |

In the first 6 months of FY11, net profit declined 45% y-o-y although revenue was marginally higher. Profits included the tail-end contribution from Al-Raha, but were also affected by adverse currency movement of the dirham relative to the ringgit and the one-off expenses incurred for the capital restructuring exercise.

Earnings Outlook

Forecast for full year FY11 ~ *Earnings FY2011 to take a dip*

The results in FY11 also reflect the impact of the delay in the installation of STREAM at Al-Reem development in Abu Dhabi, even after some preliminary expenditure have already been incurred. The property sector there continue to remain in a slump following the Dubai financial crisis in 2010.

Since 2007, AWC made a strategic decision to focus its resources to capitalize on the Middle East boom. The subsequent downturn there has caught AWC “wrong-footed”. The Al-Reem contract was valued at more RM110m, and represented the next major order on the book after Al-Raha, and was originally slated for booking in FY11.

Without this contract, prospects for 2nd half of FY11 look likely to be bleak for AWC’s profits. The other divisions, combined, are only expected to report profit similar to last year’s.

Our full year forecast for FY11 is for net profit to decline by more than 50% from that in FY2010 to RM5.8m.

P&L Summary

| P&L Analysis (RM m) | | | | | |
|---------------------|--------|--------|--------|--------|---|
| | - | - | - | - | - |
| FYE June | FY08 | FY09 | FY10 | FY11E | |
| Revenue | 98.1 | 97.3 | 184.7 | 148.9 | |
| EBITDA | 3.3 | 12.0 | 33.5 | 15.5 | |
| Depreciation | 12.2 | 4.0 | 5.2 | 5.0 | |
| Interest Expense | -0.7 | -1.1 | -0.9 | -0.9 | |
| Pre-tax Profit | -9.7 | 6.8 | 27.4 | 9.6 | |
| Eff. Tax Rate | 3.0% | -24.1% | -18.1% | -15.4% | |
| Net Profit | -9.8 | 3.2 | 12.2 | 5.8 | |
| EBITDA Margin | 3.4% | 12.3% | 18.1% | 10.4% | |
| Net Margin | -10.0% | 3.3% | 6.6% | 3.9% | |

Beyond FY11 ~ *Cautious on prospect of engineering and technology division*

The Facilities Division is expected to remain the major contributor to recurrent income. 80% of its revenue is presently accounted for by the maintenance of Federal Government Buildings under the Concession Agreement. This agreement is expiring in 2013.

The Concession Agreement is a fixed-price contract and the current rates were fixed in 2004. In addition these buildings are in dispersed locations - Negeri Sembilan, Malacca and Johor in the Peninsular and Sarawak in East Malaysia. Thus logistics issues and escalating costs were the main factors that have adversely affected profitability in the face of a fixed income. AWC's efforts at expanding the services to the private sector, in the respective locations, has so far achieved limited success.

To mitigate the rising costs AWC have submitted a proposal to revise the concession rates. It has received a positive response from the Government and expect this to take place in FY2012. In the meantime, AWC's is aggressively trying to cut delivery costs and improve staff performance through better and stricter monitoring and accounting.

Management is cautious on prospects of the Engineering Division. In its FY2010 Performance Review dated 30th October 2010 the CEO said;

"In coming years, we expect this (Engineering) Division to be challenged by depleting gross margin, escalating operating expenses, saturated prospects and dormant market size. The management is exploring new products and services to be introduced to diversify the existing product and services mix and to unlock new business potential to moderate the Division's peg against the cyclical construction sector."

At the Technology Division, there appears to be unresolved issues between Management and the original vendor of Infinite QL which still owns the balance 49% and continue to run the Division.

The Environment Division's current focus is to rebuild its order book, whilst not discounting the possibility that the installation at Al-Reem may resume earlier than anticipated. Given that its man power resources had in the past been highly concentrated to the middle east, diverting them to other places might make require some adjustments.

AWC is nevertheless confident that the successful track record of STREAM (see below) and its proven superiority over the current practice of waste disposal will make a strong value proposition to prospective clients.

Current Customers of STREAM

| Completed Projects | | | | | | |
|---------------------------|------------|-----------------------------|------------|--------------------|------------|--------------|
| Singapore | RMm | Malaysia | RMm | Middle East | RMm | Total |
| Ministry of Home Affairs | 24 | Tasik Selatan Terminal | 11 | Al-Reem Island | | |
| Resorts World @ Sentosa | 9 | The Troika | 5 | (Contract 1) | 39 | |
| Changi Airport Terminal 3 | 6 | Nusajaya New Admin Centre | 5 | | | |
| Dakota Crescent | 2 | Binjai KLCC | 4 | | | |
| Aalto | 2 | CIMB HQ | 3 | | | |
| Biopolis | 2 | Islamic Arts Museum | 3 | | | |
| Hotel Quincy | 1 | Mutiara Upper East | 3 | | | |
| | | Kastam Diraja Malaysia | | | | |
| | | Prai | 3 | | | |
| | | Gelugor | 2 | | | |
| | | PJ | 1 | | | |
| | | Private Hospital | 1 | | | |
| | | KL Convention Centre | 1 | | | |
| | | Putrajaya Convention Centre | 1 | | | |
| | | Maju Perdana Tower | 1 | | | |
| | 45 | | 44 | | 39 | 128 |
| Current Order Book | | | | | | |
| SICC 2 | 4 | Lot E, KL Sentral | 3 | Al-Raha Beach | 115 | |
| Novena Hospital | 2 | Kia Peng Condo | 2 | Al-Reem Island | | |
| The Parvis (Cliff) | 2 | | | (Contract 2) | 102 | |
| | | | | Al-Muneera | 14 | |
| | | | | New Doha Airport | 17 | |
| | | | | Barwa | 6 | |
| | 9 | | 4 | | 255 | 268 |

Investment Risks

Rising Costs at the Facilities Division. Under the agreement with the Government, AWC is committed to perform its obligation until June 2013 at rates which are increasingly becoming out of sync with current costs. Unless a timely adjustment in rates is achieved, or a more profitable major private sector contract is secured during the period, AWC could be faced with a prospect of completing a major “out-of-money” contract.

Changing terms of contract for STREAM. For now the impact of the current slowdown in Abu Dhabi is already factored in our FY11 forecast. Whilst we do not expect these projects to be abandoned, AWC could find itself having to renegotiate the existing contracts into new terms which may no longer be as profitable as the existing terms.

Lower-than-expected profits at Engineering and Technology. As their revenue is project driven, they are vulnerable to delays and cost overruns.

Valuation

Given that AWC’s profits are substantially exposed to business conditions in the Middle East we have listed in the table below several construction players in Malaysia who are similarly exposed.

| Company | FYE | Mkt Cap | P/E | P/BV | Yield |
|------------------|------|---------|------|------|-------|
| AWC BHD | June | 63 | 10.2 | 0.8 | 3.8% |
| WCT BHD | Dec | 2,346 | 13.1 | 2.0 | 2.4% |
| IJM CORP BHD | Mar | 8,120 | 16.8 | 1.6 | 1.2% |
| ZELAN BHD | Mar | 265 | 24.0 | 0.7 | nil |
| Average excl AWC | | | 18.0 | 1.4 | |

Source: Bloomberg, Company data

At current prices, AWC appears to be trading at a discount to its peer. AWC’s valuation is on a cheaper side, both on PE and P/BV.

Recommendation

We recommend a Hold call on AWC at the price of **RM0.26** supported by net cash per share of RM0.20 and positive operating cash flow in the current financial year.

Long term, AWC offers a relatively cheap exposure to the rapidly urbanizing Malaysia and the Region through its building management expertise, security and access systems for buildings and waste management expertise. We will continue to monitor its business developments, especially those in the Middle East.

Analyst: Wan Ahmad (ahmad@zj.com.my)

RATING GUIDE

| | |
|------|--|
| BUY | Price appreciation expected to exceed 10% within the next 12 months |
| SELL | Price depreciation expected to exceed 10% within the next 12 months |
| HOLD | Price movement expected to be between -10% and +10% over the next 12 months from current level |

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ZJ Advisory Sdn Bhd (Co No: 645449-V)

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Suite 22B, 22nd Floor, Wisma Denmark,
No 86, Jalan Ampang, 50450 Kuala Lumpur
Tel (603) 2032 2328 Facsimile (603) 2032 1328
