

20 May 2021

Utilities | Utilities

Taliworks Corporation (TWK MK)

Buy (Maintained)

A Tale Of Two Halves; Stay BUY

Target Price (Return): MYR0.94 (11.9%)
 Price: MYR0.84
 Market Cap: USD409m
 Avg Daily Turnover (MYR/USD) 0.72m/0.18m

- **BUY, new SOP-derived MYR0.94 TP from MYR0.98, 12% upside, c.8% FY22F yield.** 1Q21 results missed expectations. Core earnings of MYR10.3m were lower on the impact of reduced traffic at its toll roads, and the absence of contribution from Langkawi. We expect contributions from the solar plant, and government compensations for toll hike deferrals to boost earnings in the subsequent quarter. We still like the stock for its defensive earnings base, stable growth outlook, and attractive c.8% FY21F yield. A 1.65 sen first interim dividend was declared for the quarter.
- **Missed expectations.** Taliworks booked 1Q21 core net profit of MYR10.3m, meeting our and Street's estimates at 17%. Core net profit fell 14% YoY, primarily due to the absence of the Langkawi contribution and a broad-based drop in other segments due to MCO 2.0 during the quarter. In deriving our 1Q21 core net profit, we stripped out items related to investments designated at fair value through profit or loss or FVTPL, the loss allowance on trade receivables, and amount due from contract customers, as well as fair value changes totalling c.MYR1.4m.
- **Expecting a toll hike in FY21F.** We leave our base case scenario unchanged at this juncture, and expect a toll hike in FY21F. We note that traffic volumes were impacted due to the MCO, with Grand Saga highway's average daily traffic (ADT) declining 9% during the quarter. On the other hand, Grand Sepadu charted a 2.1% ADT growth YoY, as it benefitted from the closure of a toll-free highway, which directed traffic to the toll road. All in, we think ADT will remain under pressure, given the reimposition of MCO in 2Q21.
- **We lower our FY21F-23F earnings by 8-10%** after imputing lower traffic volumes, as well as expectations of a slower ADT recovery. However, we note that potential contributions from the recently acquired solar assets are not yet reflected in our forecast, pending the deal's completion – slated for 1H21. We understand that approvals from the Sustainable Energy Development Authority have been obtained, and it is currently awaiting approval from the Energy Commission Malaysia. We roll forward our valuation base year to FY22F. TWK is trading at 10.7x FY22F EV/EBITDA, about 1.3SD from its 5-year average rolling forward mean.
- **Risks.** Unfavourable tariff revision outcomes, a broad-based economic slowdown, deteriorating asset quality that gives rise to higher operating costs, and escalating waste management costs that drags TWK into losses.

Analyst

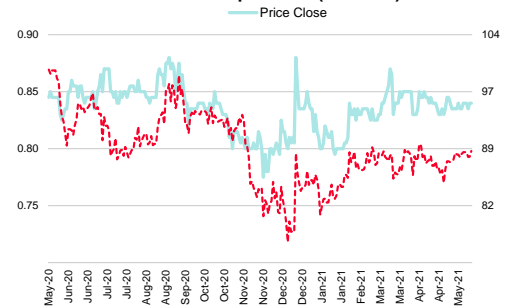
Eddy Do Wey Qing
 +603 9280 8856
wey.qing.do@rhbgroupp.com



Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	0.6	0.0	1.2	5.0	(1.2)
Relative	3.5	1.2	1.5	5.2	(12.2)
52-wk Price low/high (MYR)				0.78	– 0.88

Taliworks Corporation (TWK MK)



Source: Bloomberg

Overall ESG Score: 3.0 (out of 4)

E: Good

TWK integrates environmental management throughout the lifecycle of each project. Some practices include tracking, managing and minimising air pollution and greenhouse gas emissions, and waste and effluents generated from across all areas of operations.

S: Good

The company prioritises work-life balance, and as such, provides for its employees' welfare and well-being towards better integration of life and career. Employee training and development expenses were up >100% to MYR1.1m in 2019, with up-to-date health & safety policies in place.

G: Good

Whilst some elements of integrated reporting are seen in its Annual Report, overall, it is not an integrated report, based on the parameters set out by the International Integrated Reporting Council. Only 16% of board is represented by women directors and the Remuneration Committee does not provide information on remuneration of the senior management. It engages a third-party investor relations outfit to facilitate communications with the investment community, with periodic meetings held.

Note:

Small cap stocks are defined as companies with a market capitalisation of less than USD1bn.

Forecasts and Valuation	Dec-19	Dec-20	Dec-21F	Dec-22F	Dec-23F
Total turnover (MYRm)	377	318	297	306	314
Recurring net profit (MYRm)	45	58	55	65	56
Recurring net profit growth (%)	35.3	28.0	(5.4)	19.1	(14.6)
Recurring P/E (x)	37.41	29.23	30.91	25.94	30.39
P/B (x)	1.6	1.8	1.9	2.1	2.3
P/CF (x)	2.63	26.02	12.96	12.89	13.29
Dividend Yield (%)	6.3	7.9	7.9	7.9	7.9
EV/EBITDA (x)	8.18	12.43	11.02	10.73	11.89
Return on average equity (%)	7.3	6.0	6.0	7.7	7.2
Net debt to equity (%)	net cash	net cash	net cash	net cash	1.7

Source: Company data, RHB

See important disclosures at the end of this report

Market Dateline / PP 19489/05/2019 (035080)

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Financial Exhibits

Asia	Financial summary (MYR)	Dec-19	Dec-20	Dec-21F	Dec-22F	Dec-23F
Malaysia	Recurring EPS	0.02	0.03	0.03	0.03	0.03
Utilities	DPS	0.05	0.07	0.07	0.07	0.07
Taliworks Corporation	BVPS	0.51	0.48	0.44	0.40	0.37
TWK MK	Return on average equity (%)	7.3	6.0	6.0	7.7	7.2
Buy						
	Valuation metrics	Dec-19	Dec-20	Dec-21F	Dec-22F	Dec-23F
Valuation basis	Recurring P/E (x)	37.41	29.23	30.91	25.94	30.39
SOP Valuation	P/B (x)	1.6	1.8	1.9	2.1	2.3
	FCF Yield (%)	37.8	3.8	7.4	7.5	7.2
	Dividend Yield (%)	6.3	7.9	7.9	7.9	7.9
Key drivers	EV/EBITDA (x)	8.18	12.43	11.02	10.73	11.89
i. Stable operations;	EV/EBIT (x)	10.20	16.53	14.70	14.46	16.65
ii. Favourable outcome on tariff hikes;						
iii. Lower losses at associate companies.						
Key risks	Income statement (MYRm)	Dec-19	Dec-20	Dec-21F	Dec-22F	Dec-23F
Risk to our call:	Total turnover	377	318	297	306	314
i. Unfavourable outcome on tariff revisions;	Gross profit	148	117	110	114	101
ii. Restrictive cash flow from its associates and JVs, given the step-up repayment of bonds/sukuk;	EBITDA	180	129	146	153	142
iii. Deteriorating asset quality, giving rise to higher operating costs;	Depreciation and amortisation	(36)	(32)	(37)	(40)	(41)
iv. A broad-based economic slowdown;	Operating profit	144	97	110	114	101
v. Escalating waste management costs, dragging the company into losses.	Net interest	(25)	(21)	(19)	(17)	(16)
	Pre-tax profit	110	79	94	102	91
	Taxation	(23)	(15)	(19)	(20)	(18)
	Reported net profit	76	59	55	65	56
	Recurring net profit	45	58	55	65	56
Company Profile	Cash flow (MYRm)	Dec-19	Dec-20	Dec-21F	Dec-22F	Dec-23F
TWK is a pure-play infrastructure company primarily engaged in water treatment, supply and distribution – which involves management, operations & maintenance (O&M) of water treatment plants and water distribution systems. It is also engaged in highway toll concessionaires (O&M), engineering & construction, and waste management	Change in working capital	523	(49)	3	(2)	4
	Cash flow from operations	643	65	131	131	127
	Capex	(3)	(0)	(5)	(5)	(5)
	Cash flow from investing activities	(541)	226	50	51	51
	Dividends paid	(97)	(157)	(100)	(133)	(133)
	Cash flow from financing activities	(120)	(277)	(139)	(166)	(166)
	Cash at beginning of period	90	73	65	107	123
	Net change in cash	(17)	14	42	16	13
	Ending balance cash	73	87	107	123	135
	Balance sheet (MYRm)	Dec-19	Dec-20	Dec-21F	Dec-22F	Dec-23F
	Total cash and equivalents	658	451	443	409	372
	Tangible fixed assets	12	9	9	9	9
	Total investments	291	277	275	274	273
	Total assets	2,354	2,075	2,026	1,960	1,889
	Short-term debt	40	30	30	30	30
	Total long-term debt	428	358	358	358	358
	Total liabilities	1,061	867	896	898	905
	Total equity	1,293	1,208	1,129	1,062	984
	Total liabilities & equity	2,354	2,075	2,026	1,960	1,889
	Key metrics	Dec-19	Dec-20	Dec-21F	Dec-22F	Dec-23F
	Revenue growth (%)	0.8	(15.7)	(6.6)	3.2	2.3
	Recurrent EPS growth (%)	35.3	28.0	(5.4)	19.1	(14.6)
	Gross margin (%)	39.2	37.0	36.9	37.2	32.3
	Operating EBITDA margin (%)	47.7	40.6	49.2	50.1	45.2
	Net profit margin (%)	20.2	18.7	18.4	21.3	17.8
	Dividend payout ratio (%)	138.9	223.7	242.9	203.8	238.8
	Capex/sales (%)	0.9	0.1	1.6	1.7	1.7
	Interest cover (x)	5.78	4.57	5.85	6.60	6.42

Source: Company data, RHB

Results At A Glance

Figure 1: Taliworks' 1Q21 results

FYE Dec (MYRm)	1Q20	4Q20	1Q21	QoQ (%)	YoY (%)	Comments
Revenue	84.3	74.9	65.6	-12%	-22%	Lower contributions across all business segments
EBIT	30.0	18.0	17.9	0%	-40%	
<i>EBIT margin (%)</i>	36%	24%	27%			
Finance cost	(5.6)	(5.2)	(4.7)	11%	17%	
Share of JV	0.2	4.0	0.4	-90%	157%	Benefitted from the closure of a toll-free highway, which directed traffic to its toll road for the duration of the MCO
Share of associate	(3.4)	2.4	2.3	-1%	169%	
Pretax profit	21.2	19.1	16.0	-16%	-24%	
<i>Pretax margin (%)</i>	25%	25%	24%			
Tax	(3.7)	(3.7)	(3.0)	21%	19%	
Effective tax rate (%)	17%	20%	19%			
Minority interest	(1.6)	0.4	(1.4)	-455%	12%	
Net profit	15.9	15.7	11.7	-26%	-27%	
Core profit	12.0	15.1	10.3	-32%	-14%	Missed expectations
<i>Core net margin (%)</i>	14%	20%	16%			

Source: Company data, RHB

Figure 2: Taliworks' 1Q21 segmental results

FYE Dec (MYRm)	1Q20	4Q20	1Q21	QoQ (%)	YoY (%)	Comments
Revenue						
Water treatment, supply and distribution	61.6	49.8	42.1	-15%	-32%	Lower due to the expiration of its Langkawi concession and lower metered sales & electricity rebates in SSP1 operations
Construction	1.7	4.5	3.9	-13%	137%	Absence of upward revision of construction revenue in the Langat 2-Package 7 Project
Toll highway	19.7	19.3	18.3	-5%	-7%	Lower ADT at Grand Saga highway on travel restrictions
Others	1.3	1.3	1.3	-5%	-5%	
EBIT						
Water treatment, supply and distribution	24.0	13.8	13.8	0%	-42%	
Construction	(0.2)	1.1	(0.9)	-182%	-374%	
Toll highway	8.7	5.6	7.7	37%	-11%	
Others	(2.5)	(2.6)	(2.6)	-1%	-5%	
EBIT Margins						
<i>Water treatment, supply and distribution</i>	39%	28%	33%			
<i>Construction</i>	-12%	25%	-23%			
<i>Toll highway</i>	44%	29%	42%			

Source: Company data, RHB

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Figure 3: Taliworks' SOP valuation

Highway assets	Stake	FY22F FCFE	Per share	Remark
Grand Saga	51%	603.3	0.30	WACC 6.3%, concession up to 2045 with four toll rate hikes assumed
Grand Sepadu (45% economic benefit)	45%	107.2	0.05	WACC 6.3%, concession up to 2032 with two toll rate hikes assumed
Water assets	100%	414.7	0.21	WACC 6.3%, concession up to 2036 with contracted base supply rate assumed. No extension to Langkawi water asset.
Waste management asset	35%	289.9	0.14	WACC 6.3%, concession up to 2033
		P/E		
Construction	100%	12.0	0.00	
Solar assets		180.35	0.09	Purchase price of MYR180.35m
Remaining unallocated FY22F net cash		296.7	0.15	Adjusted to exclude net debts included in FCFE calculation for Grand Saga and the water assets.
No. of shares		2,015.8		
SOTP		1,904.2	0.94	

Source: Company data, RHB

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2020-08-21	Buy	0.98	0.87
2020-07-02	Buy	0.97	0.86

Source: RHB, Bloomberg

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

RHB Investment Bank Bhd

Level 3A, Tower One, RHB Centre
Jalan Tun Razak
Kuala Lumpur 50400
Malaysia
Tel : +603 9280 8888
Fax : +603 9200 2216

JAKARTA

PT RHB Sekuritas Indonesia

Revenue Tower, 11th Floor, District 8 - SCBD
Jl. Jendral Sudirman Kav 52-53
Jakarta 12190
Indonesia
Tel : +6221 509 39 888
Fax : +6221 509 39 777

BANGKOK

RHB Securities (Thailand) PCL

10th Floor, Sathorn Square Office Tower
98, North Sathorn Road, Silom
Bangrak, Bangkok 10500
Thailand
Tel: +66 2088 9999
Fax :+66 2088 9799

SINGAPORE

RHB Bank Berhad (Singapore branch)

90 Cecil Street
#04-00 RHB Bank Building
Singapore 069531