

Initiation Report

25 August 2017

HCK Capital Group Bhd

HOLD

The new kid on the block

Target price: RM1.24

KLCI	1775.50 points
Share Price	RM1.29
Target Price	RM1.25
Expected share price return	-3.9%
Expected dividend return	0%
Expected total return	-3.9%

Stock Data	
Bursa / Bloomberg code	7105 / HCK MK
Market / Board	Main / Property
Issued shares (m)	421.17
Market cap	RM543.31m
Par value	RM1.00
52-week price Range	RM0.60 – 1.56
Beta (against KLCI)	0.3
3-m Average Daily Volume	0.07m
3-m Average Daily Value [^]	RM0.09m

Share Performance			
	1m	3m	12m
Absolute (%)	11.0	21.9	108.1
Relative (%-pts)	10.2	19.1	97.1

Major Shareholders		%
HIICHIKOK EQUITIES SDN BHD	68.16	
HARMONI GENTING SDN BHD	5.10	
SYMPHONY DIVERSIFIED S B	4.02	
Estimated Free Float	19.72	



Source: Bloomberg

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This report is also accessible at www.bursamids.com

Investment Highlights

- HCK is a young and rising property developer by having a potential GDV of RM3.6b.
- HCK's property development activities will kick off when Phase 2 of EduSphere, Cyberjaya, with a gross development value (GDV) of RM245m, is launched in end-2017. Total GDV of EduSphere is RM1.5b with subsequent phases to be launched later.
- While property development would take years to build, in the meantime HCK is involved in property trading, management and investment services to generate near-term cashflow and build its track record.
- Under its property trading, bumper earnings are expected to be booked in 2019 with lump sum recognition of sales from The Duo serviced suites upon delivery of the units. The Duo's entire project GDV is RM285m and currently 64% or equivalent to GDV of RM180m has been sold.
- Revenue could grow exponentially by 209% YoY and 315% YoY to RM90.8m and RM376.6m in 2018F and 2019F respectively. Similarly, net profit is expected to increase 199% YoY and 301% YoY to RM3.5m and RM14.1m in 2018F and 2019F respectively.
- Gearing and interest cost are expected to increase due to borrowings to fund upcoming property trading, investments and development projects. However, gearing then will be reduced upon delivery of The Duo project.
- Its F&B business is still at infancy. As the master franchiser of Australian coffee chain Jamaica Blue, HCK is operating 2 outlets and has secured 4 franchisees that will open in 2H17.
- Going forward, HCK plans 3 new development projects with a combined GDV of RM1.73b in Sepang, Semenyih, Klang Valley and Kuching, Sarawak.
- HCK announced a share split of 1 into 5 ordinary shares with rights warrants on the basis of 1 warrant for 2 subdivided shares, rights warrants issue price of RM0.05 per warrant with exercise price of RM0.96 per warrant. The corporate exercise has gone EX yesterday. Assuming full subscription rights warrants and full conversion, HCK potentially could raise RM212.1m. Minimal earnings dilution is expected as the warrants expire in 10 years. The warrants will be listed on 29 Sept 2017 and could generate investor interest.

Valuation & Recommendation

- We are initiating coverage on HCK with a HOLD call at a target price of RM1.24** based 30% on its realizable net asset value (RNAV)/share of RM1.78.

Background

HCK Capital Group Bhd is a young and upcoming property developer with projects in the Klang Valley and Sarawak. In 2014, Tan Sri Clement Hii acquired a controlling stake of 37% and thereafter launched a mandatory general offer (MGO) for Golsta Synergy Bhd (GSB). On completion of the MGO, Tan Sri Clement controls 52.2% of GSB. The company's name was subsequently changed to HCK Capital Group Bhd ("HCK"). A year later, HCK disposed its industrial machinery business for RM34.5m to focus in its property business. The company also ventured into the food and beverage (F&B) industry after securing a master franchise from Australia's Jamaica Blue Coffee. Currently, HCK executive chairman Tan Sri Clement Hii controls 68% of HCK.

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Business units

1) Property management and investment

Being a new property developer, HCK has a short track record. As its new projects would take years to complete, the management is building its experience in the property sector and generating near-term cash flow through property management and investment.

The Duo and The Cubiz @ USJ1

Through property trading and investment, HCK made an en bloc purchase of a 415-unit serviced suites block (The Duo) and a 12-storey office tower (The Cubiz) in Subang Jaya thru a DIBS scheme. HCK bought The Duo for RM57.1m and paid by issuing 22.4m new HCK shares and bank borrowings. The project has a combined GDV of RM380m (serviced suites RM285m + office tower RM95m). So far, HCK has sold 64% of the serviced suites. Unlike property development where revenue is recognized on progress billing, revenue from investment in The Duo will be recognized in a lump sum in 2019 upon completion and units handed over to homebuyers by end-2019.



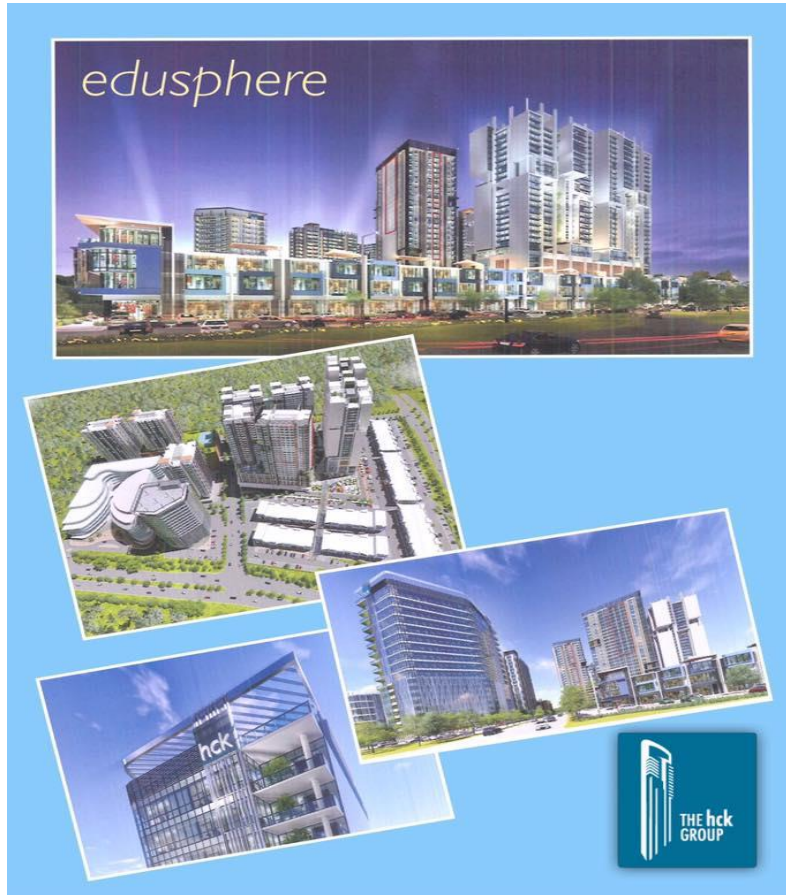
The Duo @ USJ1, Subang Jaya

2) Property development

From 2013 to 2016, HCK acquired several land banks in preparation for its property development and secured development rights for EduSphere, Cyberjaya. The EduSphere development in Cyberjaya will take off by year end with 3 more projects in the pipeline.

Edusphere @ Cyberjaya

HCK will be launching Phase 2 of Edusphere @ Cyberjaya by year end which mainly caters for students of Cyberjaya University College of Medical Sciences (CUCMS). Phase 1 is the university and college block that will be developed for CUCMS. Phase 2 consists of 3 blocks of residential tower (800 units) with GDV of RM245m. The entire Edusphere project has a GDV of RM1.5b and is expected to complete in 2023. Going forward, HCK will be launching subsequent phases with GDV of over RM1b consisting 1500 residential units, 66 shops and an office block.



Edusphere, Cyberjaya

3) Food & Beverage

HCK secured the master franchise of Jamaica Blue coffee chain from Australia and currently operates two outlets in Mid Valley and Setia City Mall. The company has signed four franchisees that will be opening new outlets by September. Going forward, HCK is looking to acquire more brands under the sub-franchising business model.



Jamaica Blue outlet in Mid Valley

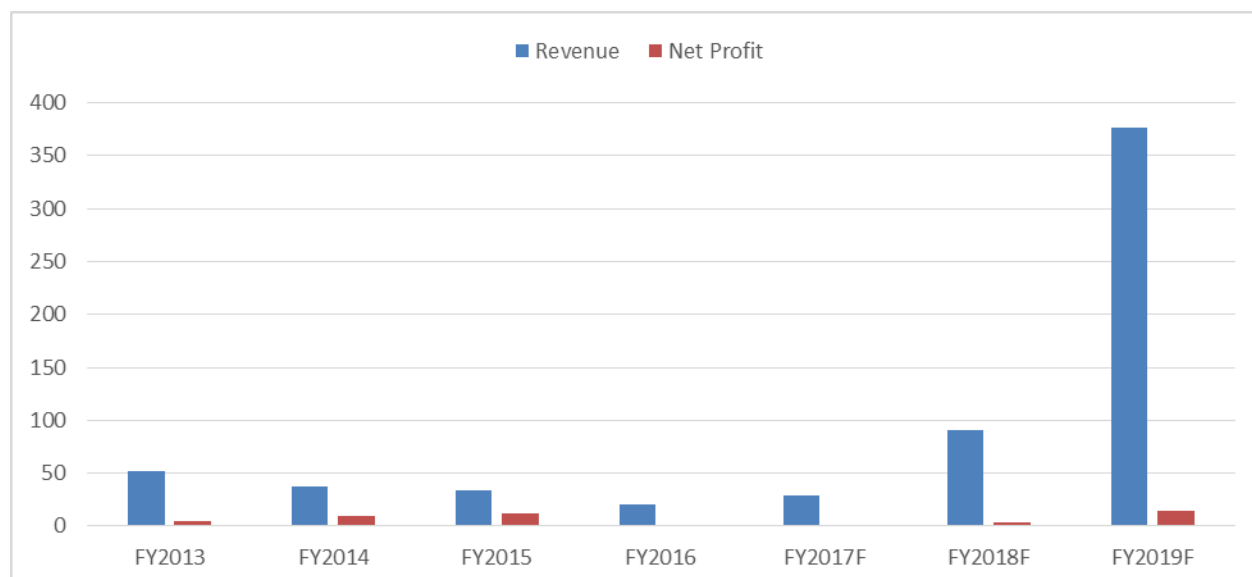
Financial Review

In 2016, revenue declined 38% YoY due to completion and delivery of projects in 2015. Similarly, 2016 net profit declined 87% YoY due to lower revenue and a fair value gain of RM7m recorded in 2015.

In 1Q17, HCK incurred a net loss of RM1.17m compared to net profit of RM5m in 4Q16 due to lower revenue and a one-off bargain purchase gain of RM3.5m recorded in 4Q16. Interest expense increased to RM722k from RM139k in 4Q16 due to borrowings to fund land acquisitions.

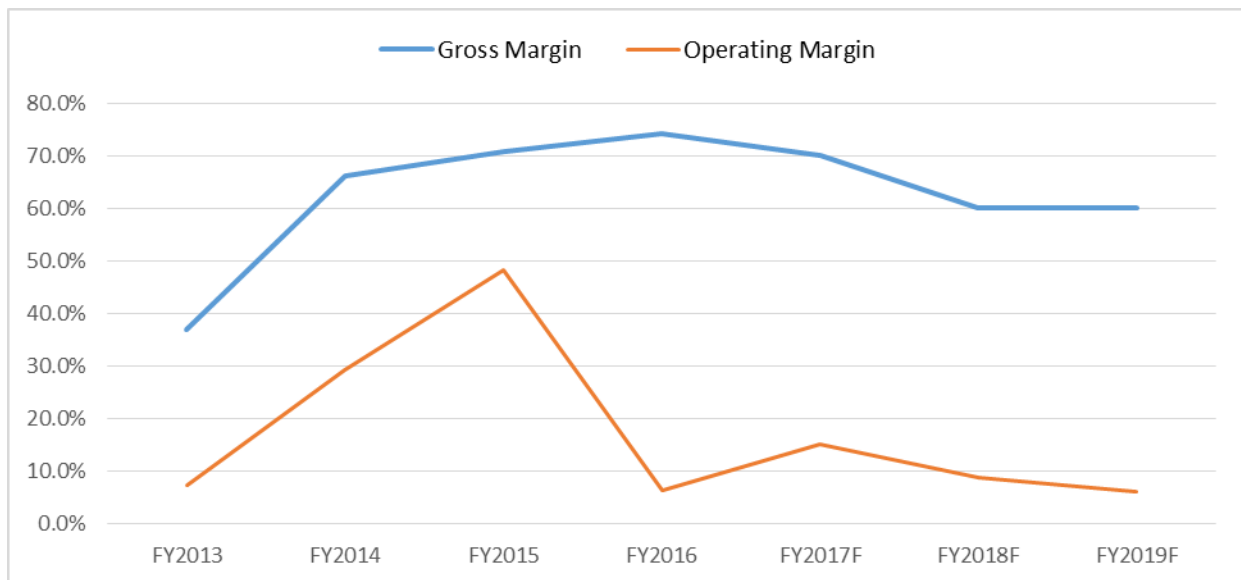
F&B division incurred loss before tax of RM1.9m in 2016 due to start-up costs despite revenue growing to RM2.6m from RM1.5m in 2015. We are not overly concern on the losses as the F&B division contributed only 9.8% of 1Q17 revenue.

Going forward, HCK’s earnings growth is expected to be flat in 2017 before some contribution from EduSphere flow in 2018 and bumper earnings in 2019 due to recognition of revenue from sale of serviced suites at The Duo. As such, revenue could grow exponentially by 209% YoY and 315% YoY to RM90.8m and RM376.6m in 2018F and 2019F respectively. Similarly, net profit is expected to increase 199% YoY and 301% YoY to RM3.5m and RM14.1m in 2018F and 2019F respectively.



Gearing and finance costs are expected to increase due to borrowings to fund property trading, investments and development. Upon delivery of The Duo project by end-2019, gearing will be reduced via the billings and collections from the end-purchasers.

Gross margin improved significantly following the disposal of its industrial machinery business as HCK moved into property investment and management services which render higher margins. Going forward, gross margin is expected to decline slightly as its property development takes off thus incurring higher overheads. Similarly, operating margin increased when HCK ventured into property but declined in 2016 due to absence of fair value gain and is expected to stay flat being weighed down by higher operating costs from property development.



Potential catalysts

Apart from its ongoing projects, HCK has planned 3 new developments with a combined GDV of RM1.73b to drive its earnings going forward.

Selangor Science Park 2 (SSP2)

The biggest project under HCK's pipeline is the Selangor Science Park 2 (SSP2) in Sepang, Selangor. The mixed development will be built on a 14.41 acres leasehold land with a GDV of RM1.2b. HCK bought the land for RM11.6m via issuance of 4.5m new HCK shares at RM2.55 each (RM0.51 after share split) and bank financing. The SSP2 is part of the Selangor State Development Corp (PKNS)'s masterplan for Selangor Cyber Valley aimed to provide a smart, green and sustainable development.



Selangor Science Park 2 (SSP2) model

Mixed development in Semenyih

In another development near to an education institution, HCK has planned to build a mixed development of commercial and residential on 35 acres of freehold land in Semenyih, Selangor. The project is close to Nottingham University and has a GDV of RM387m. HCK bought the land for RM4.7m paid by issuing 1.85m new HCK shares at RM2.55 each (RM0.51 after share split) and bank financing.

Industrial development in Kuching

In its first venture into East Malaysia, HCK will be developing an industrial area in Sarawak. The project will be built on 30 acres of leasehold land in Demak Laut Industrial Park, Kuching with a GDV of RM142m. HCK bought the land for RM15.2 million.

Summary of property trading, investments and proposed developments

PROJECT	LOCATION	TYPE		GDV (RM'm)
EduSphere	Cyberjaya	Mixed development		1500
The DUO	USJ1, Subang Jaya	415 SOFO apartments	Leasehold	284
The Cubiz	USJ1, Subang Jaya	12-storey office tower	Leasehold	105
Residential	Semenyih	Residential	Freehold	387
SSP2	Selangor Cyber Valley	Mixed development	Leasehold	1200
Industrial	Damai Laut, Kuching	Industrial	Leasehold	142
Jazz Residences	Ara Damansara	11 retail lots	Balance unsold	21
		8 apartments		
TOTAL				3639

Source: HCK

SWOT Analysis

Strengths <ul style="list-style-type: none"> - Potential GDV of RM3.6b with projects around Malaysia - Developing middle-range properties and near to education institutions which has genuine demand - Recent 1-into-5 stock split could enhance liquidity and trading volume - Experienced management team 	Weaknesses <ul style="list-style-type: none"> - Lack of track record in property development - Short earnings visibility pending new launches - F&B business still at infancy - Low free float as executive chairman Tan Sri Clement Hii holds 68% of the company
Opportunities <ul style="list-style-type: none"> - Acquired sufficient landbank for future development pipeline in the next few years - Operating in the niche of building accommodation catering to education institutions. Education is seen as a resilient sector during economic slowdown - Potential tie-up with sister companies which are involved in education businesses. 	Threats <ul style="list-style-type: none"> - Rise in building material cost - Shortage of foreign labour - Prolonged slowdown in property industry - Weak consumer sentiment and cautious spending pattern could affect F&B business

Recommendation

We are initiating coverage on HCK with a HOLD call and a target price of RM1.24 based on 30% discount to its realizable net asset value (RNAV) per share of RM1.78.

Income Statement (RM million)

Year to 30 June (RMm)	FY2013	FY2014	FY2015	FY2016	FY2017F	FY2018F	FY2019F
Revenue	52.4	37.8	33.2	20.6	29.4	90.8	376.6
Gross profit	19.3	25.0	23.5	15.3	20.6	54.5	225.9
Operating profit	3.8	11.1	16.0	1.3	4.5	8.0	22.8
Profit before tax	3.7	10.8	15.7	1.1	1.5	4.5	18.8
Net profit	4.2	9.4	11.5	1.5	1.2	3.5	14.1
Core net profit	4.2	9.4	11.5	1.5	1.2	3.5	14.1
EPS (sen)	1.0	2.2	2.7	0.4	0.3	0.8	3.4
DPS (sen)	0.0	0.0	0.0	0.0	1.0	2.0	3.0
P/E (x)	140.5	63.5	51.4	395.4	505.2	168.8	42.1
P/BV (x)	9.4	6.4	5.5	3.3	2.9	2.6	5.3
Diluted EPS (sen)	1.0	2.2	2.7	0.4	0.3	0.8	3.4
FD P/E	140.5	63.5	51.4	395.4	505.2	168.8	42.1
Revenue growth (%)	0.0	-27.8	-12.2	-38.1	42.7	209.0	314.7
Net profit growth (%)	0.0	121.3	23.4	-87.0	-21.7	199.4	301.3
Core net profit growth (%)	0.0	121.3	23.4	-87.0	-21.7	199.4	301.3
Gross margin (%)	36.8	66.0	70.8	74.3	70.0	60.0	60.0
Operating margin (%)	7.2	29.2	48.1	6.4	15.2	8.9	6.1
PBT margin (%)	7.0	28.6	47.1	5.5	5.0	5.0	5.0
Dividend yield (%)	0.0	0.0	0.0	0.0	0.7	1.4	2.1
Net gearing (%)	-18.9	-30.5	-3.4	69.1	59.3	42.0	18.1
ROE (%)	6.9	10.3	11.3	0.9	0.6	1.6	13.1
ROA (%)	3.9	6.3	8.8	0.4	0.3	0.8	5.4

Source: HCK, JF Apex

Balance Sheet (RM million)

(RM'm)	FY2013	FY2014	FY2015	FY2016	FY2017F	FY2018F	FY2019F
Balance Sheet							
<i>Cash</i>	16.8	41.9	16.9	3.0	18.0	38.0	68.0
Current assets	59.8	98.1	100.7	254.7	280.2	308.2	123.3
Non-current assets	48.1	49.7	30.9	119.1	125.1	131.4	137.9
Total assets	108.0	147.9	131.6	373.8	405.3	439.5	261.2
<i>Short term debt</i>	3.3	5.1	0.1	12.2	24.4	26.8	18.8
Current liabilities	41.3	44.4	10.3	75.8	79.6	83.6	58.5
<i>Long term debt</i>	1.5	9.1	13.3	112.8	116.2	119.7	59.8
Non-current liabilities	3.5	10.9	13.7	116.5	122.3	128.5	64.2
Total liabilities	44.8	55.3	24.0	192.3	201.9	212.0	122.7
<i>Shareholders' equity</i>	61.5	90.7	102.3	176.4	198.2	222.4	133.4
MI	1.7	1.8	5.3	5.1	5.1	5.1	5.1
Total equity	63.2	92.6	107.6	181.5	203.3	227.5	138.5
Total liabilities & equity	108.0	147.9	131.6	373.8	405.3	439.5	261.2

Cashflow Statement

(RM'm)	FY2013	FY2014	FY2015	FY2016	FY2017F	FY2018F	FY2019F
Cash Flow							
Cash flow from operations	9.7	4.3	21.5	8.1	10.0	30.0	200.0
Cash flow from investing	-13.8	-2.6	-33.9	-15.2	-15.0	-40.0	-70.0
Cash flow from financing	7.3	31.0	-12.5	-6.8	20.0	30.0	-100.0
Cash generated	3.1	24.1	-24.9	-13.8	15.0	20.0	30.0
Cash at beginning	13.5	16.7	41.8	16.9	3.0	18.0	38.0
Cash at end of period	16.7	41.8	16.9	3.0	18.0	38.0	68.0

Valuation

On-going projects	Remaining GDV RM(m)	Stake	DCF of development profits	Basis
Edusphere, Cyberjaya	1500	70%	189.1	Cost of equity 5.47%
The Duo serviced suites	285	100%	58.5	
The Duo office tower	105	100%	21.5	
Semenyih residential development	387	100%	75.3	
Selangor Science Park 2	1200	100%	205.0	
Kuching industrial development	142	34.17%	8.9	
Jazz Residences	21	100%	4.4	
Project Management	21	100%	4.0	
Total	3661		566.7	
Shareholders' equity			198.2	
Proceeds from Warrants			22.5	10 year expiry
RNAV			787.5	
Enlarged no. of shares			442.2	
FD RNAV/share			1.78	

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STOCK RECOMMENDATIONS

- BUY** : The stock's total returns* are expected to exceed 10% within the next 12 months.
- HOLD** : The stock's total returns* are expected to be within +10% to – 10% within the next 12 months.
- SELL** : The stock's total returns* are expected to be below -10% within the next 12 months.
- TRADING BUY** : The stock's total returns* are expected to exceed 10% within the next 3 months.
- TRADING SELL** : The stock's total returns* are expected to be below -10% within the next 3 months.

SECTOR RECOMMENDATIONS

- OVERWEIGHT** : The industry as defined by the analyst is expected to exceed 10% within the next 12 months.
- MARKETWEIGHT** : The industry as defined by the analyst is expected to be within +10% to – 10% within the next 12 months.
- UNDERWEIGHT** : The industry as defined by the analyst, is expected to be below -10% within the next 12 months.

*capital gain + dividend yield

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