

THEMATIC REPORT | East Coast Rail Line (ECRL) 2.0

It's Back on Track

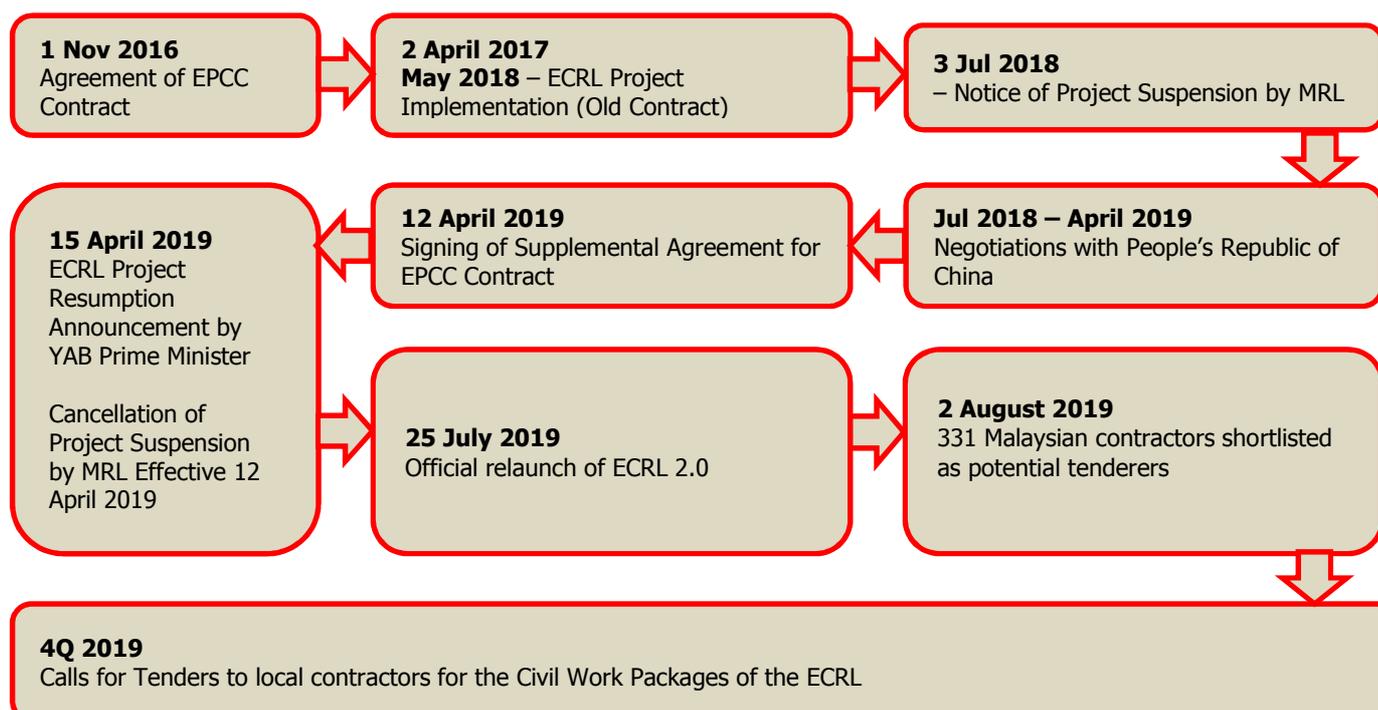
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KEY HIGHLIGHTS

- Relunched after ten months suspension
- ECRL to boost economic growth by 2.7%
- Pre-qualification ("pre-q") round concluded last week
- Public inspection for new alignments required
- To continue with the land acquisition exercise for the unchanged alignment.
- Moving beyond 10% (excluding stretch in Bentong)
- Expecting four years period for civil works, estimated at RM10b
- Positive impact to bottom line among local sub-contractors

Relunched after 10 month suspension. The East Coast Rail Link was officially relaunched last week (on July 25, 2019) in Dungun, Terengganu. The revival was a positive turnaround since the news on possible cancellation back in January, 2019. It was a result of both parties (China and Malaysia) reaching an amicable deal in a prolonged negotiation process. ECRL 2.0 closed at RM44b price tag, -30% reduced from its initial RM67b.

EXHIBIT 1: ECRL PROJECT CHRONOLOGY



Source: MRL, MIDFR

Pre-qualification ("pre-q") round concluded last week. In a press statement released by Malaysia Rail Link ("MRL") on August 2, 2019, it was confirmed that 331 local construction companies were shortlisted for the final commissioning round. It is worthwhile to note that circa 71% represents Bumiputra companies ranging from G3 to G7 contractors. To recall, the pre-q round has received huge submissions of 1,321 in the running for 40% civil works portion. MRL added that calls for tenders will soon commence in the 4Q19, involving tender packages for 223km Section B stretch (Dungun-Mentakab). The details on pre-q submission tiers as below:

EXHIBIT 2: PRE-QUALIFICATION SUBMISSIONS FOR ECRL 2.0

Registration Grade	Job Scope Categories	Value of Work Procurement (RM)	Type of Procurement	Paid Up Capital (RM)	Submissions in ECRL Pre-q round	Percentage
G1	Civil	200,000 and below	Quotation	5,000		
G2	Civil	200,001 to 500,000	Quotation	25,000		
G3	Civil	500,001 to 1,000,000	Tender	50,000	104	8%
G4	Civil	1,000,000 to 3,000,000	Tender	150,000	132	10%
G5	Civil	3,000,001 to 5,000,000	Tender	250,000	134	10%
G6	Civil	5,000,001 to 10,000,000	Tender	500,000	92	7%
G7	Civil	Exceeding 10,000,000	Tender	750,000	859	65%
Total Submissions----->					1,321	100%

Source: CIDB, MIDFR

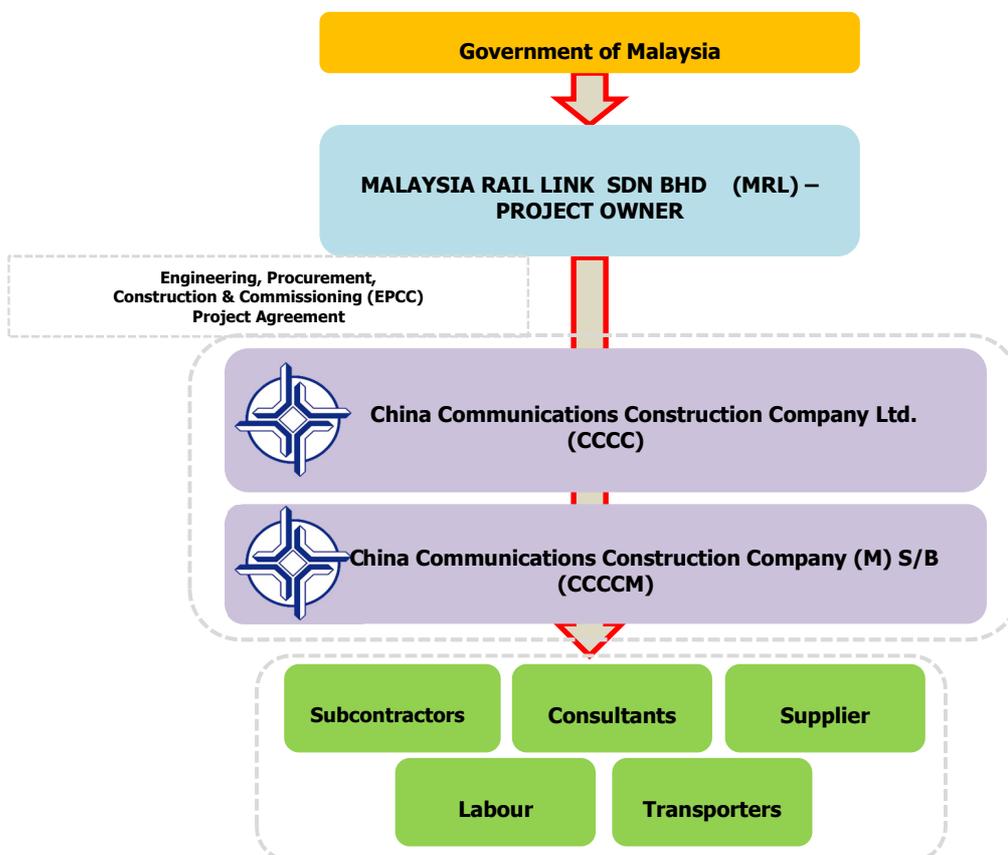
EXHIBIT 3: SHORTLISTED CONTRACTORS IN PRE-Q ROUND

Registration Grade	Job Submitted	Value of Work Procurement (RM)	Paid Up Capital (RM)	Shortlisted Contractors	Passing Rate	Percentage
G1	Civil	200,000 and below	5,000			
G2	Civil	200,001 to 500,000	25,000			
G3	Civil	500,001 to 1,000,000	50,000	45	43%	14%
G4	Civil	1,000,000 to 3,000,000	150,000	69	52%	21%
G5	Civil	3,000,001 to 5,000,000	250,000	33	25%	10%
G6	Civil	5,000,001 to 10,000,000	500,000	20	22%	6%
G7	Civil	Exceeding 10,000,000	750,000	164	19%	50%
Total Shortlisted----->				331	25%	100%

Source: CIDB, MIDFR

RM10b contracts up for grabs? Our estimates reveal that the value of civil works could fall within a narrowed range of RM9b-RM11b. The scope of civil works could comprise earthworks, foundation and structural works, construction of viaducts and stations, as well as road works. The value was reached after calculating 40% share for local contractors, which was contractually locked-in during the negotiation process. This was based on civil works portion which we believe make up almost 60% of RM44b construction cost. As a turnkey contractor, CCCC has the right to execute the remaining infra works without commissioning to local companies. However, local contractors could still vie for the remaining share (of civil works) as well as 100% of system works.

EXHIBIT 4: PROJECT STRUCTURE OF ECRL 2.0



Source: MRL, MIDFR

As previously mentioned, 40% of civil works was set aside for local companies, with tunnelling works excluded. However, the tunnelling works remain open to local bids, albeit at minimal quantum. In the near term, all eyes are on the upcoming award announcements which could manifest towards the year end.

Benefits flowing down to local contractors as early as 4Q19. The completion of pre-q round denotes a positive tone to local construction industry previously plagued with uncertainties post ECRL suspension. Subsequent to the shortlisting phase, we expect to see a large number of the 331 local companies to competitively bid for a share of the pie. Given a huge reduction in the project's cost, we expect pricing and execution factors to take a centre stage, with contractors possessing respectable track record and extensive rail job experience having a huge advantage. We previously learned that the quantum of large-scale award is usually in the conservative range of RM500m to RM1.5b (depending on the job scope).

Getting down to brass tacks... We note that the 10% completion rate was largely derived from the Mentakab to Dungun alignment which falls under Section B. The alignment of said section was 223km (the longest sectional mainline) in length, which subsequently branches out into several spur lines of 43km long. Post suspension, construction of the whole ECRL alignment is broken down into three main sections. These are dubbed as Section A, Section B and Section C (Details as below). Infra works for the said sections will commence in varying phases, subject to completion of land acquisition and submission of Railway Scheme. Section B will have a head start in construction work, subsequent to tender calls to be held in 4Q19. This was on the account that re-alignment didn't involve Section B and most plot acquisitions in Pahang are already in completion stage.

Public inspection required for new alignments. As for Section A and C, MRL will first have to go through Environmental Impact Assessment ("EIA"), considering the changes made to its alignment. This will then be followed by public displays which would likely run for three months beginning January to March 2020. Whilst delay could be a potential hurdle, the outcome from public inspection is unlikely to have any material impacts to its design scope. We understand that land acquisition for Dungun to Mentakab (Section B) stretch is already on-going. It involves a total of 1,235 lots, covering areas in Pahang with most of the lots already being gazetted by authorities. As for the new alignment comprising Mentakab-Bangi-Klang, land acquisition is expected to start in the 2H20. Challenges could possibly emerge in the southward alignment, which will involve four hotspots namely Mentakab, Nilai, Putrajaya and Port Klang. Based on our channel check, the deadline for land acquisition is end-2021.

Civil works would potentially take almost four years to complete. The timeline for each section largely depends on the progress speed and length. We estimate that the scope for civil works would likely require an average of 46-month period based on the completion deadline in December 2026. The estimated timeline is in consideration of the post-construction stage involving system work installation, site acceptance test and a trial run. According to industry source, the progress on civil work for Section B will start peaking beginning 2H20 until 1H22. We have yet to ascertain the timeline for Section A and C, pending the outcome on public displays and land possessions. However, basing on our projection, we anticipate the construction progress of both Section A and C will peak in between CY21 and CY23.

EXHIBIT 5: SNAPSHOT OF ECRL 2.0

EAST COAST RAIL LINK (ECRL) PROJECT

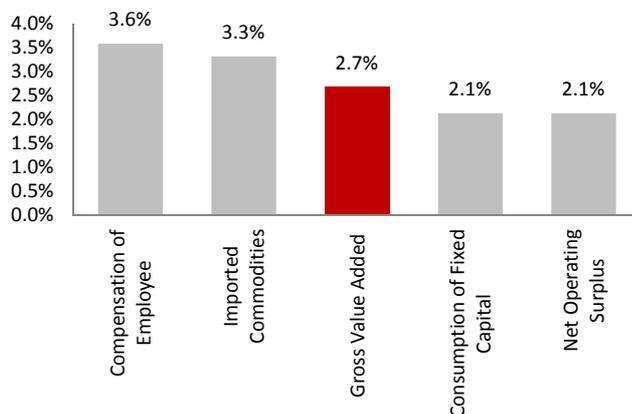
CONNECTING LIVES, ACCELERATING GROWTH



Source: MRL

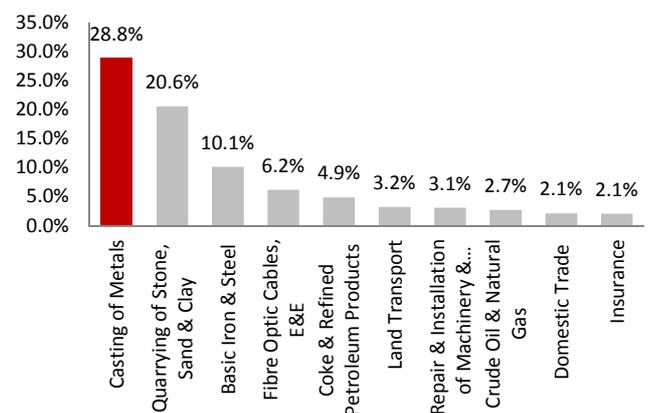
ECRL's resumption, a huge relief to Malaysia. We previously forecasted that the RM44 billion railway project will contribute 2.7% to Malaysia's economic growth. The boost for the growth is expected to kick-in from the project inception until completion. However, the full estimated GDP contribution will depend on the pace of spill-over effects to other economic sectors. In addition, compensation of employees and net operating surplus are projected to rise by 3.6% and 2.1% respectively. As the project requires machinery and transport equipment, our estimate shows imported commodities and consumption of fixed capital to increase by 3.3% and 2.1% respectively. Moving forward, the railway project would affect economic expansion through both direct and indirect medium in the long run, partly by jobs creation, opening-up new areas, foreign direct investment, increase external trade activities and strengthening domestic demand.

EXHIBIT 6: GDP BY INCOME PERFORMANCE (% CHANGE)



Source: DOSM, MIDFR

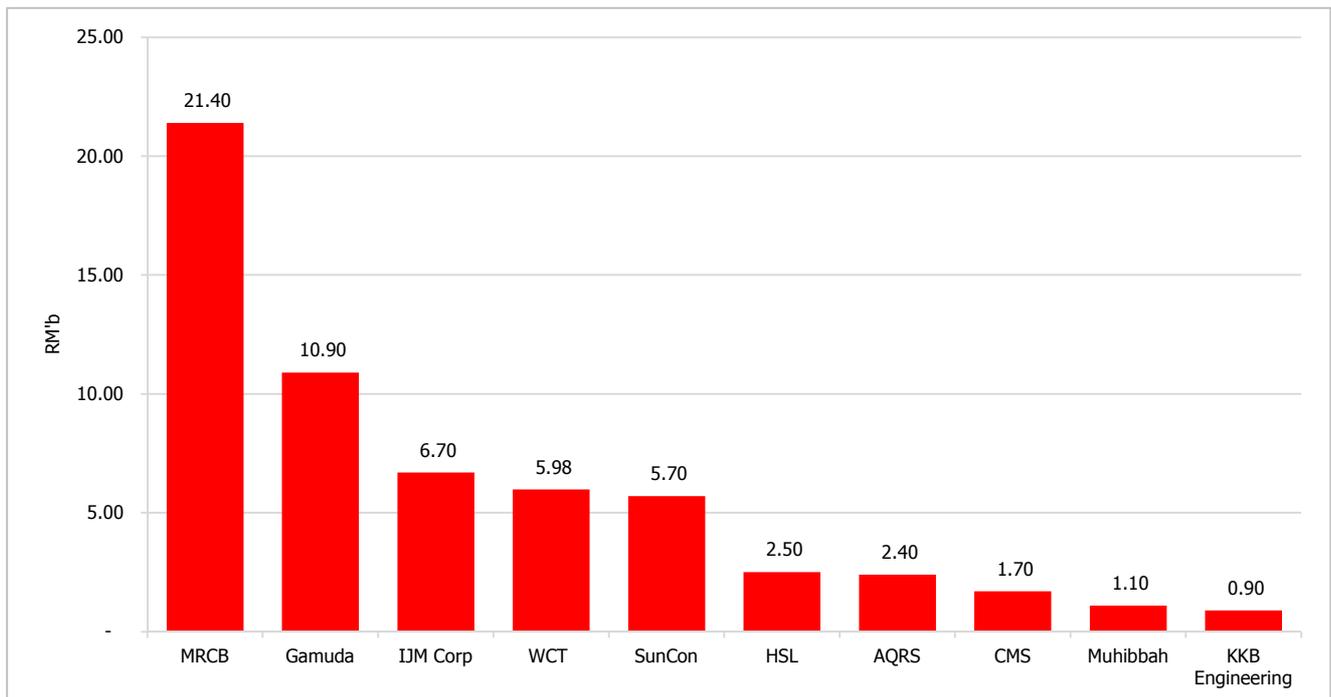
EXHIBIT 7: GDP BY SECTOR PERFORMANCE (% CHANGE)



Source: DOSM, MIDFR

Still NEUTRAL on the sector. While the news on ECRL is positive, we have to recognize that expectation on its revival have already been priced in. This was reflective on the KLCON performance, which was seen moving faster than its fundamentals, ahead of the announcements. We do not rule out possibility of rerating, should the incoming roll outs firm up positively. In our coverage, **Gabungan AQRS (BUY, TP:RM1.72)**, **Muhibbah Engineering (BUY, TP:RM3.73)**, **IJM Corp (SELL, TP:RM2.00)**, **MRCB (BUY, TP:RM1.02)**, **Sunway Construction (BUY, TP:RM2.21)** and **WCT (NEUTRAL, TP:RM0.88)** are touted as potential beneficiaries. These counters are among the active players for local railway jobs.

EXHIBIT 8: OUTSTANDING ORDERBOOK AS OF 1Q19 (COVERAGE STOCKS)



Source: Bloomberg, Companies, MIDFR

Muhibbah Engineering (BUY, TP: RM3.74). Muhibbah received encouraging support from its airport business, which has since recorded incremental contribution to its bottom-line. Contribution from airport offers unique value proposition to investors, providing stable earnings to cushion the downside stemming from cyclical trend of construction activities. The relaunch of ECRL ignites a brighter light, leaving contractors like Muhibbah to benefit. As of 1Q19, Muhibbah orderbook stood at RM1.1b. Hence, a potential win of RM500m of ECRL job will raise its orderbook by a meaningful +45%.

Gabungan AQRS (BUY, TP:RM1.74). Gabungan's construction is currently involved with a project in the state of Pahang. Geographically, the site area is located in Kota SAS, in proximity with ECRL stretch for Section B. We are in the view that its geographical factor will give an advantage, for an ECRL share in the area. Its outstanding orderbook as of 1Q19 stood at RM2.4b. Besides the huge tender bids place for projects in Sabah, ECRL is another potential for replenishment within CY19. Clinching a package worth RM500m to RM1b would increase its unbilled job by +21% and +42% respectively. Based on our channel check, its bidding for ECRL will likely concentrate in the state of Selangor and Pahang.

We also have BUY calls for MRCB (BUY, TP:RM1.02) and SunCon (BUY, RM2.21). As a group, MRCB has the highest outstanding orderbook in the industry, with RM21.4b yet to be recognized. Contract award from CCCC in the range of RM500m to RM1.5b will potentially elevate its value by +2.0% to +7% respectively. In the meantime, we continue to be positive on SunCon given its strength in new job flow. RM500m-RM1.5b orderbook win from ECRL will potentially raise its orderbook by +9% and +26%.

A rerating is likely for IJM (SELL, TP:RM2.00). It stands a good chance of winning the spur line scope into the Kuantan Port. It would possibly clinch packages of design and build for stations Kuantan Port City 1 and 2 as well as site clearing or civil works. It is possible due to the proximity of the station sites and Kuantan Port which is a subsidiary of IJM and Malaysia-China Kuantan Industrial Park - its joint venture project with Guanxi Beibu Gulf ASEAN Investment. A package worth RM500m to RM1.5b would increase its unbilled job by 7% and 22% correspondingly.

WCT (NEUTRAL, TP:RM0.88). Its orderbook as of 1Q19 stood at RM6.0b, indicating 3x visibility to construction earnings. Currently, infra unbilled jobs comprise LRT and MRT2, for the construction of viaduct guideway, stations and associated works. In recognition of this, its presence in the railway business is expected to lend support in the bidding for ECRL packages. RM500m-RM1.5b new orderbook from ECRL will likely translate to +8.0% to 25% rise in outstanding orderbook.

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STOCK RECOMMENDATIONS

BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +15% over the next 12 months.
SELL	Total return is expected to be <-10% over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.

SECTOR RECOMMENDATIONS

POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.