

14 September 2018 | Sector Update

Construction

Maintain NEUTRAL

A Pronounced Setback Following the Fallow Period

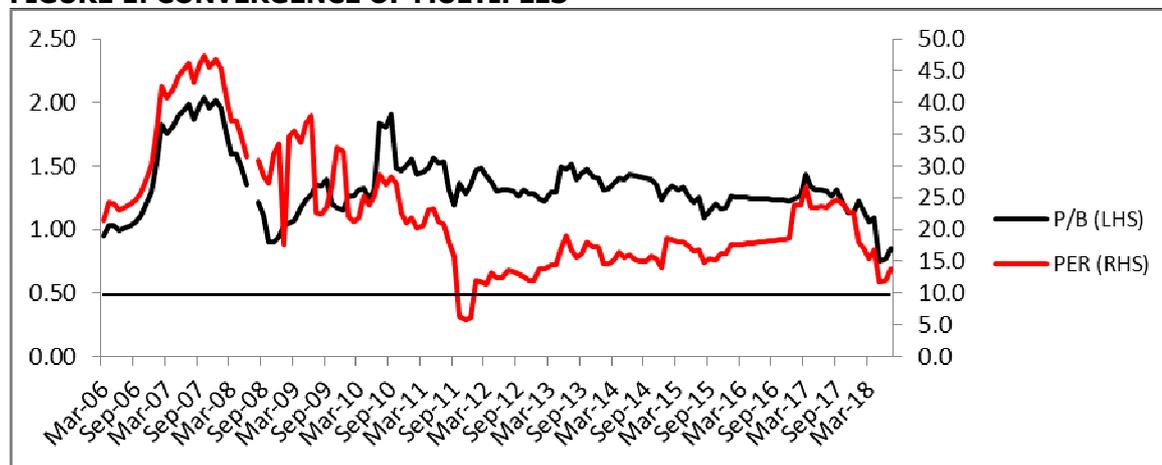
KEY HIGHLIGHTS

- **Uncertainty will continue**
- **Indispensable delays on construction works.**
- **Negative outlook on business confidence despite ample liquidity**
- **Maintain NEUTRAL**

Uncertainty will continue. The lingering uncertainties on mega projects will continue to influence the market reaction in the immediate term, we believe. While it is clear that projects such as HSR and MRT3 have been deferred and cancelled respectively, ECRL's status is still unclear. We opine that the governments are still mulling on the options available, in which further cost reductions could be desirable. Given this situation, we are not ruling out any positive outcomes moving forward as the governments continue their feasibility studies of those projects.

Indispensable delays on construction works. We believe that; i) government policies, and ii) restrictive elements on government finances, are pointing towards a further slowdown for infrastructure expenses in 4QCY18. Thus, development spending could be the first component impacted as the government realigns its priorities in the soon-announced Budget 2019 in early November. We are expecting some cut back in projects and infrastructure investments, owing to its cancellation or postponement. Evidentially, Street has priced in the weak prospects of the sector. Indicators such as the convergence of price-to-book (PB) and price-to earnings (PE) ratios illustrate that the lofty PE multiples between the ranges of 18.0x to 23.0x from have subsided and normalized towards the lower range of 15.0x to 11.0x. This is balanced by with the level of PB of 0.85x. In searching for parallel, similar scenario has occurred during the fallow period between Jan-12 to Apr-13 where the KL Construction Index traded between the ranges of 11.4x to 14.4x. The period lasted for >14 months. Hence, we estimate that revival for projects would potentially resume in Q1FY20. (Figure 1)

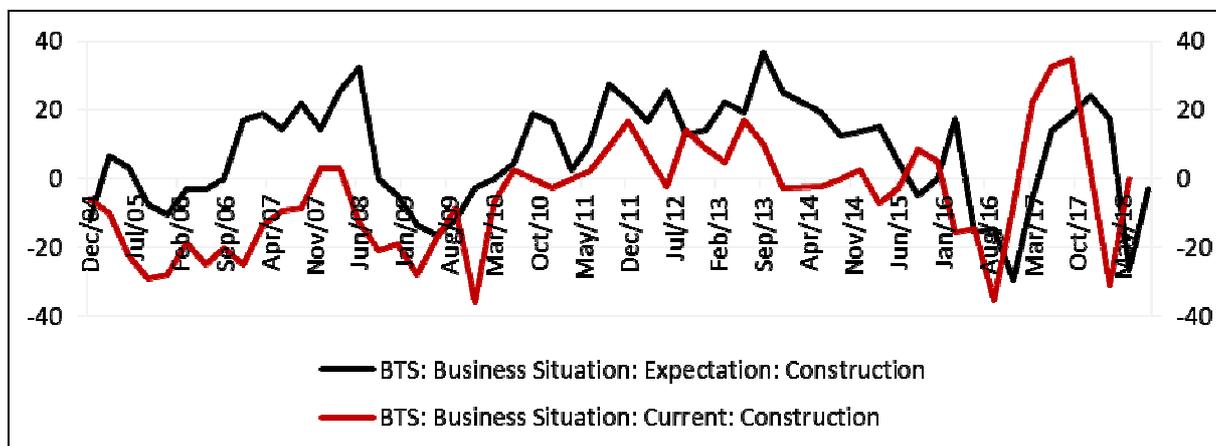
FIGURE 1: CONVERGENCE OF MULTIPLES



Source: Bloomberg, MIDFR

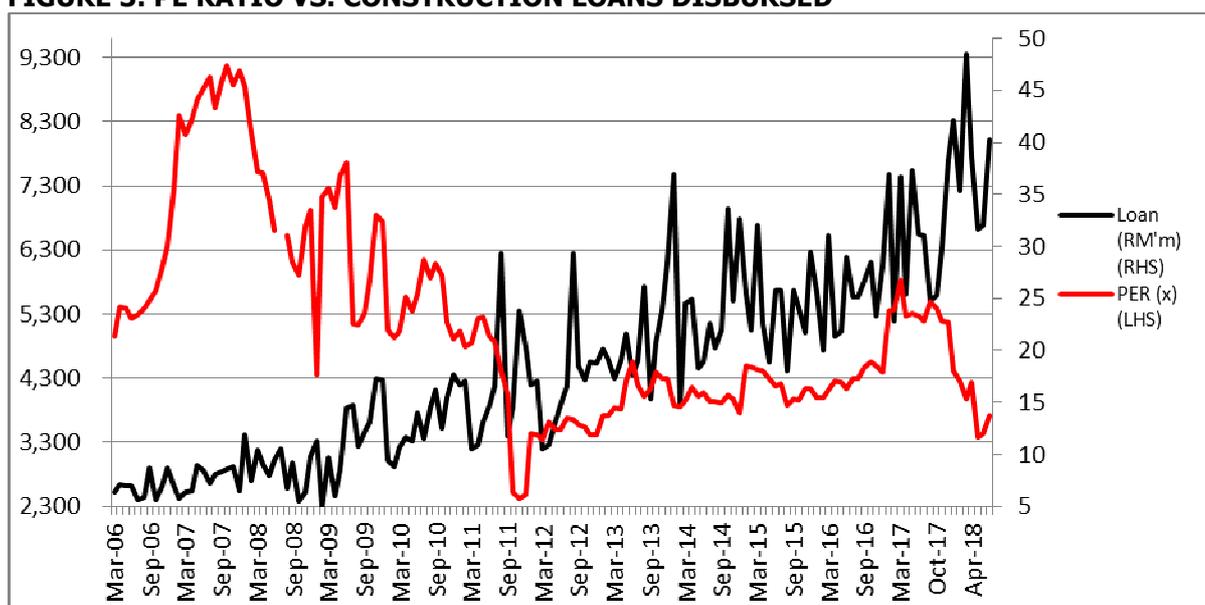
Negative outlook on business confidence despite ample liquidity. Consequent to policy changes, the business confidence was impacted negatively in the recent months post GE14. Notably, the index of construction sector went down by -7.7% in 3QCY18. Despite the continuous drop, it was encouraging to see that the declining rate narrowed from the 2QCY18 number of -24.8%. While the index could see further improvement moving forward, it is apparent that the change in policy is highly sensitive to the sector (Figure 2). Given the current uncertainties, we believe the lack of clarity will continue to put immediate term hurdles to our construction stocks' price performance. In contrast, liquidity continued to mop-up the sector where in July-18, RM8.0bn of loans was disbursed to the sector which is above the mean of RM4.2bn. We reckon that loans disbursed to the sector will gradually decrease to the ranges of RM4.7bn to RM5.7bn in upcoming months following the indicator of the dwindling business confidence index. Furthermore, current lower PE multiples correlating liquidity levels elucidates the view of the setback of earnings prospects. (Figure 3)

FIGURE 2: BUSINESS CONFIDENCE INDEX (CONSTRUCTION)



Source: Bloomberg, MIDFR

FIGURE 3: PE RATIO VS. CONSTRUCTION LOANS DISBURSED



Bloomberg, MIDFR

RECOMMENDATION. Consequently, we posit a **NEUTRAL** stance on the sector, with cautious overtone on the immediate term prospect. This is to reflect on the government new policies that would be reducing the potential orderbook replenishment rate for FYE19/FYE20. Nonetheless, we continue to favor (1) **AQRS (BUY, TP: RM2.30)** and 2) **Muhibbah (BUY, TP: RM3.15)** as our top picks due to its defensive model (Muhibbah) and potential earnings upside from progress billings (AQRS). We believe the recent sell down on the construction counter have increased the appeal of these stocks, from valuation perspective.

DAILY PRICE CHART



Fadhli Dzulkifly
abdul.fadhli@midf.com.my
03-2772 8462

Muhammad Danial Abd Razak
muhammad.danial@midf.com.my
03-2173 8396

MIDF RESEARCH is part of MIDF Amanah Investment Bank Berhad (23878 - X).
 (Bank Pelaburan)
 (A Participating Organisation of Bursa Malaysia Securities Berhad)

DISCLOSURES AND DISCLAIMER

This report has been prepared by MIDF AMANAH INVESTMENT BANK BERHAD (23878-X). It is for distribution only under such circumstances as may be permitted by applicable law.

Readers should be fully aware that this report is for information purposes only. The opinions contained in this report are based on information obtained or derived from sources that we believe are reliable. MIDF AMANAH INVESTMENT BANK BERHAD makes no representation or warranty, expressed or implied, as to the accuracy, completeness or reliability of the information contained therein and it should not be relied upon as such.

This report is not, and should not be construed as, an offer to buy or sell any securities or other financial instruments. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. All opinions and estimates are subject to change without notice. The research analysts will initiate, update and cease coverage solely at the discretion of MIDF AMANAH INVESTMENT BANK BERHAD.

The directors, employees and representatives of MIDF AMANAH INVESTMENT BANK BERHAD may have interest in any of the securities mentioned and may benefit from the information herein. Members of the MIDF Group and their affiliates may provide services to any company and affiliates of such companies whose securities are mentioned herein. This document may not be reproduced, distributed or published in any form or for any purpose.

MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

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 +10% 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.