

14 December 2017 | Sector Update

Construction

Maintain POSITIVE***Fallow Period Unravel Good Candidates***

SECTOR HIGHLIGHTS

Tapering liquidity illustrating weak expectation for FYE18**Earnings expectation and risk-seeking expectation hits a fallow period****Operating margin highlight the best performers****Maintain Positive**

Tapering liquidity illustrates weak expectation for FYE18. Construction sector loan illustrates a lethargic rate for Oct-17 of RM5.58bn registering only +1.3%MoM growth compared to Sept-17 of RM5.51bn. The liquidity flow is weaker compared to the Oct-16 of RM6.10bn (-8.5%YoY). At first instance, despite the headlines of big ticket projects such as East Coast Railway, KL-Singapore High Speed Railway and LRT3 liquidity for the construction projects appears muted. However, till Oct-17 construction loans disbursed amounted to RM63.25bn whereas the preceding period of 10-months FY16 recorded a RM56.11bn documenting a whetted growth of +12.7%YoY. By comparing 10-months FY16 total construction loans disbursed to 10-months FY15 of RM53.85bn – growth seems continuous albeit at slower pace of +4.19%YoY. Repetitive trends from Aug-FY16 to Oct-16 where construction loans in disbursed hovered between the ranges of RM5.5bn to RM6.1bn are emerging in Aug-17 to Oct-17 where the amount fluttered between the ranges of RM6.5bn to RM5.5bn. We believe that the liquidity trend may at first glance turn up muted but comparatively it is the seasonal year-end factor. Thus, upcoming months may repeat the optimism for risk taking reflecting a potential +3.5%YoY increase from the total loans disbursed in FY16 of RM67.41bn. (Figure 1)

Earnings and risk-seeking expectation hits a fallow period. As a result of the fallow liquidity period, the construction sector earnings expectation is tapering - correlating to the lethargic liquidity level. Whilst Street are expecting construction sector's 21.7x* PER to exceed the FBMKLCI PER of 16.76x* we believe the upside may lie in FYE18 instead of the 4QFYE17. This is due to the weak results of big-caps construction companies (BC3) which in the 3QFY17. Most of the BC3 earnings lack the charm of the small-cap construction construction companies (SC3) citing slower progress billings. Although, BC3 may appear to have sturdier orderbook but SC3's smaller project scale has shorter project duration. (Figure 2 & 3)

Operating margin highlights the best performers. On hindsight, despite the aggressive news headlines of big ticket projects, operating margins for the construction sector have not improved. For 3QFY17 construction sector, the operating margin is decreased to 10.33% (-9.1%YoY). We relate this to the weak performance of BC3's operating margin i.e. IJM, Gamuda and WCTHG with the exception of Cahya Mata Sarawak for 3QFY17. However, companies such as Gabungan AQRS bucked the trend by maintaining strong operating margin with a consistent growth in working capital. Although Muhibbah's operating margin was compressed to +7.7% (-28.7%YoY), we can dispel the negative undertone by looking at the contribution of its concession assets in Cambodia. The three airports; Siem Reap, Sihanoukville and Phnom Penh contributes on average 30.24% of PBT for the past 2 years. Supported by growth in tourist arrivals to Cambodia, we reckon that any earnings blips from Favelle Favco's insipid performance would be balanced out by PBT contribution from the concession. (Figure 4)

Maintain Positive. We maintain our positive stance on the sector premised on the available liquidity to the sector. We introduce our top picks for FYE18 as follows; Cahya Mata Sarawak (TP: RM4.62), Muhibbah (TP: RM3.45) and Gabungan AQRS (TP: RM2.08). We premised our call based on;

1. Ample credit liquidity

Although the loans to the sector decreased, in Oct-17 construction loans disbursed of RM5.58bn is still above the 11-y monthly average of RM4.23bn (+31.9%YoY).

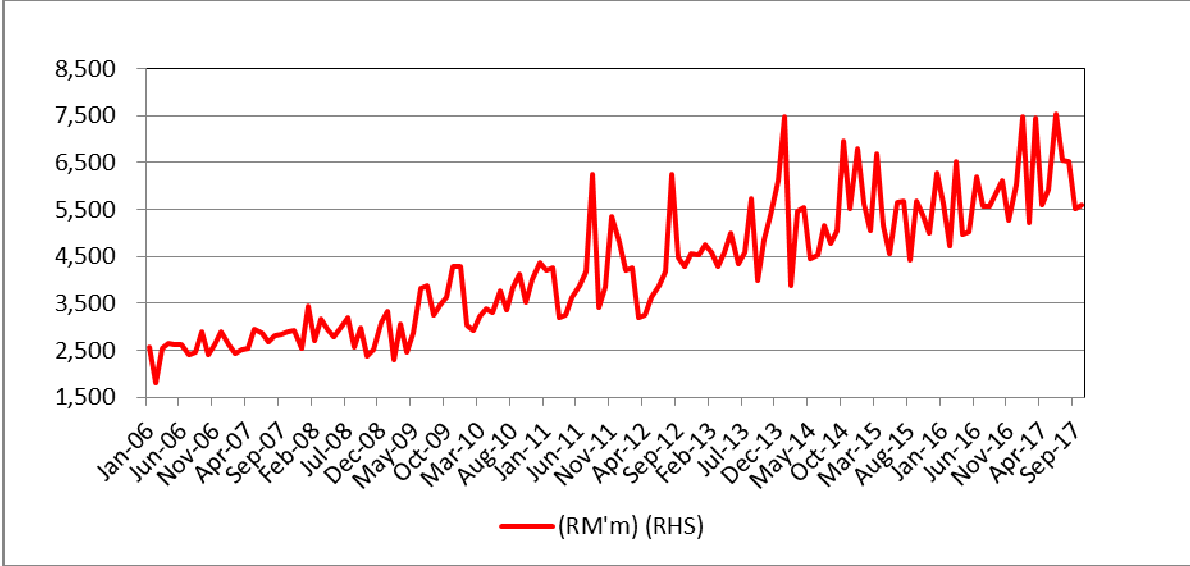
2. Parity of valuation signals tapering view of construction sector

The convergence of valuations may welcome weaker estimates in FYE18 for construction sector due to the 3QFY17's weak earnings performance proxied by BC3. In light on the parity of valuations we reckon its best to stick to companies with durable competitive advantage displayed by the tenacity of operating margin. (Figure 5)

3. Strategic position in the value chains

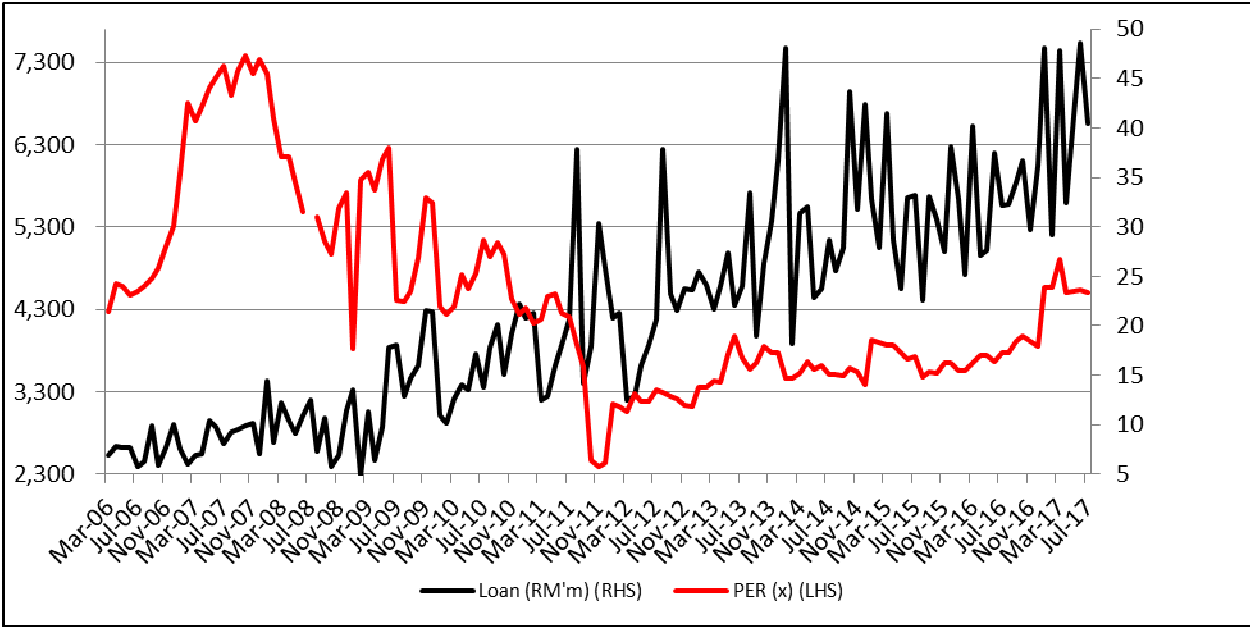
Cahya Mata Sarawak (CMS) due to its strategic position in Sarawak construction sector's value chain presents a sturdy operating margin for the past 5 years. Despite earnings blip in the 3QFY17 for CMS we believe this position may be short-lived as billings from Pan Borneo are yet to kick in. Lastly, SM3 such as Muhibbah and Gabungan AQRS will be able to benefit from its unique position in Cambodia, and Pahang/Sabah. Thus, operating margin will be supported.

Figure 1: Construction Loans Disbursed



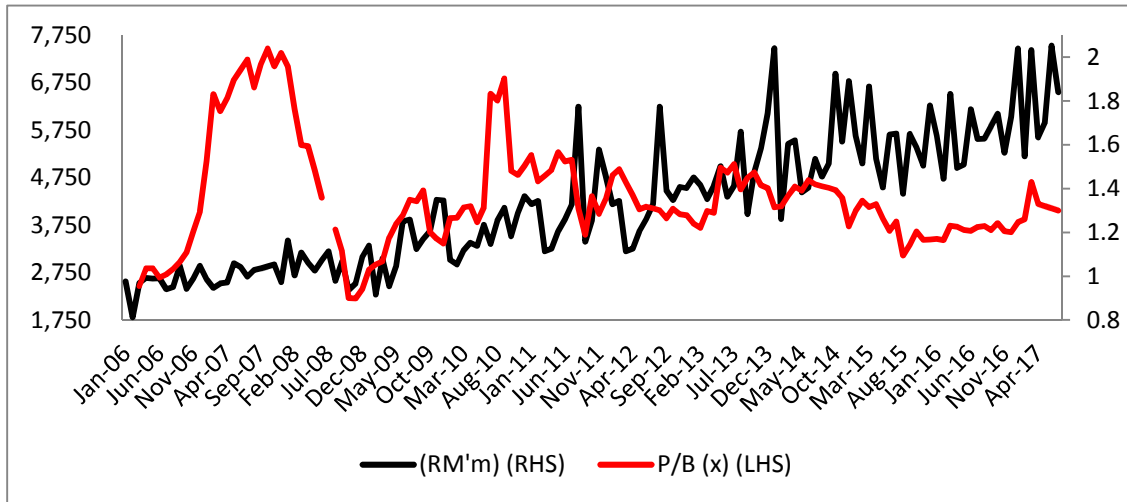
Source: Bloomberg & DOS

Figure 2: PER Vs. Construction Loans Disbursed



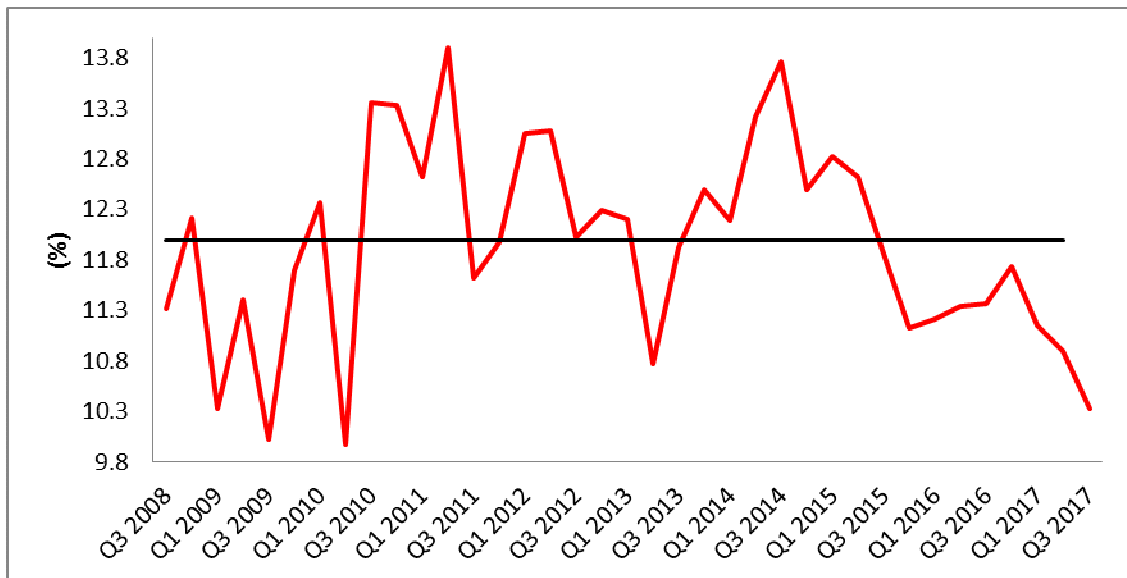
Source: Bloomberg & DOS

Figure 3: PB Vs. Construction Loans Disbursed



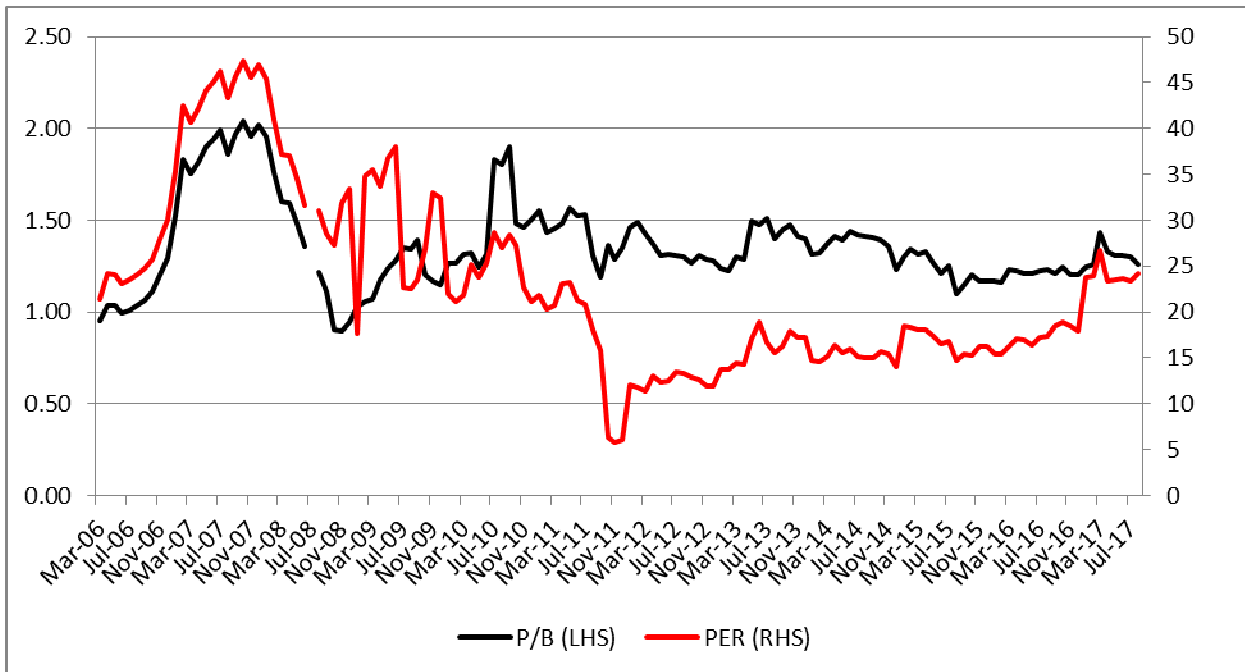
Source: Bloomberg & DOS

Figure 4: Operating Profit Margin



Source: Bloomberg & DOS

Figure 5: Convergence of Valuation

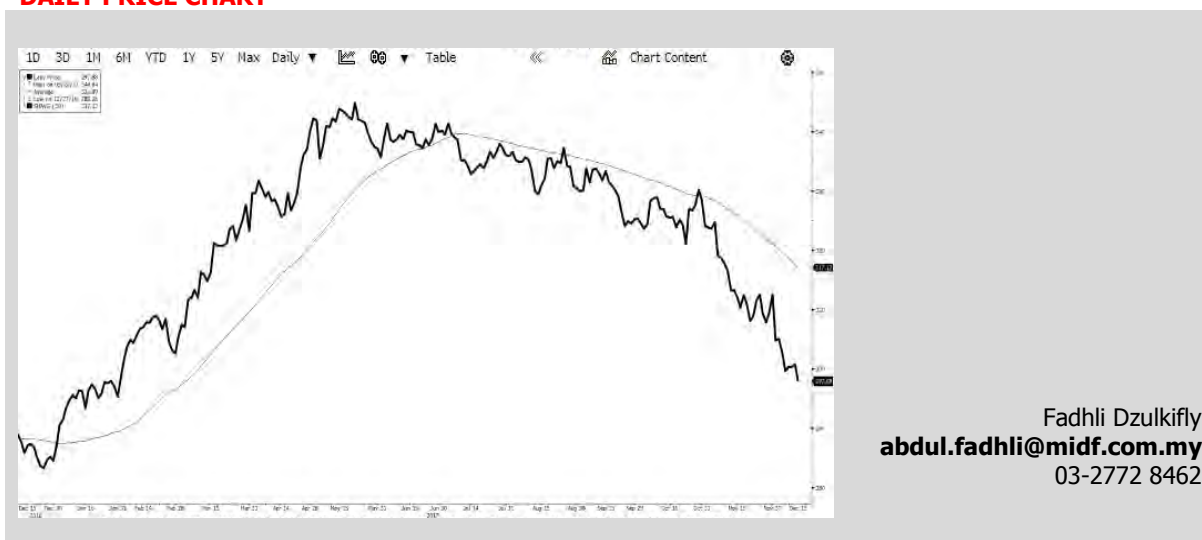


Source: Bloomberg & DOS

***Exception.** We exclude figures for July-2008 as it skews our observation as the figures for p/e and p/b ratio reflects the significant drop in sectoral earnings causing p/e and p/b ratios to reach 1619.2x and 164.4x respectively.

***P/BR :** Price to Book Ratio * **PER :** Price to Earnings

DAILY PRICE CHART



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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.