

18 March 2019 | Sector Update

## Construction

*Fear subsides, but solid catalysts remain lacking*

**Downgrade to NEUTRAL  
(from POSITIVE)**

- **Mixed results in CY18**
- **Valuation rebounded off rock bottom lows**
- **Further gains must be earnings driven, to sustain higher levels**
- **Risk to earnings, contractors must manage**
- **Downgrade to NEUTRAL**
- **Immediate prospect looks brighter in Sarawak**

**Mixed results in CY18.** The construction companies under our coverage universe ended the year mixed with seven out of eleven performed within and above our yearly estimates. Muhibbah and KKB have again proved their mettle, posting results beyond our expectations. We downgraded **SunCon** (+30.8% gain since Jan) and **Gamuda** (+29.0% gain since Jan) to **NEUTRAL (from BUY)** as the previously beaten-down counters have recently risen up close to their fair values.

### Exhibit 1: Changes in Recommendations & Target Prices

Stock	Recommendation		Target Price (RM)	
	Old	New	Old	New
Lafarge Malaysia Berhad	Neutral	Sell	2.17	1.60
Sunway Construction Group Berhad	Buy	Neutral	1.78	1.81
Cahaya Mata Sarawak	Buy	Buy	4.13	4.13
IJM Corp Berhad	Neutral	Neutral	1.92	1.85
Hock Seng Lee	Neutral	Neutral	1.54	1.54
Malaysian Resources Corporation Berhad	Buy	Buy	0.83	0.90
KKB Engineering	Buy	Buy	1.22	1.33
Gabungan AQRS	Buy	Buy	1.87	1.87
Muhibbah Engineering	Buy	Buy	3.15	3.73
WCT Holdings Berhad	Buy	Neutral	1.05	0.88
Gamuda Berhad	Buy	Neutral	2.89	2.89

Source: MIDFR

### Exhibit 2: Coverage Ratings Breakdown (Old VS New)



Source: Bloomberg, MIDFR

### Exhibit 3: Outperformers and Underperformers

Companies	Expectation (Above/Below)	Remarks
IJM Corp Berhad	Below	Slowdown in key segments namely construction, industry and plantation
Hock Seng Lee	Below	Driven by lower margin fetched under construction segment
KKB Engineering	Above	Higher contribution from construction segment, due to better progress billings for Pan Borneo projects
Gabungan AQRS	Below	Slower progress billings from LRT3 packages and slower property sales
Muhibbah Engineering	Above	Improvement in group's bottom-line margins, supported by airport concession expanded earnings
WCT Holdings Berhad	Below	Lower sales in property segment, coupled with higher impairment and finance costs

Source: MIDFR

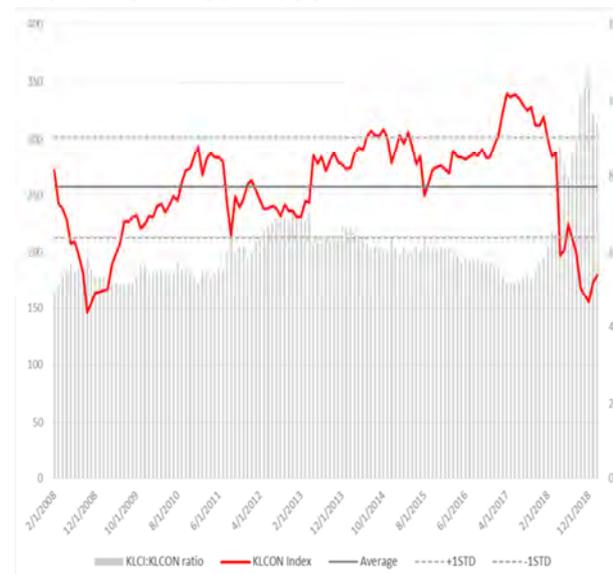
**Valuation rebounded off rock bottom lows.** KLCON Index was beaten down by marred sentiment last year but has since rebounded by +26.1%ytd. To recall, the sector-wide outlook was impaired in 2HCY18 with KLCON recording loss in value of -48.7% following several announcements that were deemed negative by investors. The sectoral index tumbled from its pre-election highs following a series of revisions, postponements and shelving of major infra projects which include KVMRT2, KVLRT3, KVMRT3, KL-SG HSR and the ECRL. Subsequently, the index fell down to its new lows, trading at a reduced multiple below its 10-year average.

**Exhibit 3: KLCI VS KLCON**



Source: MIDFR, Bloomberg

**Exhibit 4: KLCI: KLCON Ratio**



Source: MIDFR, Bloomberg

**Further gains must be earnings driven, to sustain higher levels.** We opine sentiment has somewhat recovered, evident by the recent improvement in KLCON performance. To note, we have previously expected sentiment to improve (albeit gradually) on the back of still healthy fundamentals and near-term visibility following the Budget 2019 release. Going ahead, further gains must be driven by strength in earnings and prospects. Positively, the sector players will remain beneficiaries of existing projects namely LRT3 and MRT2, and given its size of more than RM40b (combined) is expected to support earnings in the immediate to medium term. We believe public projects comprising railways will continue to hold a significant share in the local industry, as potential roll-out of similar scale remains a possibility.

**Exhibit 5: Major Infrastructure Projects in the Pipeline**

Projects	Estimated Value (RM'b)	Remarks
KVMRT2	30.5*	Overall progress at 45%, with completion expected in July 2021
KVLRT3	16.6*	Progress will resume in 2HFY19
Gemas-JB Double Tracking	8.9	Sub-contracting works being awarded, with expected completion by October 2021
Klang Valley Double Track Upgrade (Phase 2)	4.5	New consultant to be appointed, followed by re-tendering
Johor –SG BTS Link	4.0	To be implemented, but no particular timeline was announced

Pan Borneo Sarawak Highway	16.1	Progress of 11 packages (awarded previously) are ongoing, but expected to be cut
Pan Borneo Sabah Highway	12.8	Under review. 7 out of 35 packages of Phase 1 were awarded to Sabah contractors
West Coast Expressway	6.5	Overall progress at 60% as of Oct 2019. Expected completion is 2022
Central Spine Road	4.0	Implementation to be continued
Sarawak Coastal Road, Second Trunk Road and State Water Grid	9.1	Few packages for Coastal Road and Water Grid were already awarded in 2019. Works expected to start by 1HFY19.
Penang Transport Master Plan	27.0	LoA for PDP appointment has been extended to August 2019.
East Coast Rail Link	81.0	Undergoing cost review.
KVMRT3	60.0	Cancelled until construction of KVMRT2 is completed.
KL-SG High Speed Railway	110.0	Deferred.
Trans Sabah Gas Pipeline-662km	4.1	Cancelled.
Multi-product Pipeline-600km	5.4	Cancelled.

*\*Cost revised down  
Source: MIDFR, Various*

**Risk to earnings, contractors must manage.** Near term challenges will gravitate toward execution. The conversion from PDP to turnkey structure means contractors will need to bear the execution risk. Managing it well will likely translate to better margin, derived from the work progress completed. The extension period given for LRT3 should provide headroom for contractors to better allocate and spread out their resources. Upside risk to the sector could potentially be the revival of ECRL, should a meaningful portion is shared with local contractors. However, its fate remains uncertain as negotiations could still be prolonged due to challenges on reaching friendly agreement between the stakeholders. We recall that previously local contractors could be allotted at least 30 per cent of the civil works, as sub-contractors, worth about RM16.5 billion.

#### **Exhibit 6: ECRL Project Details**

<b>Component</b>	<b>Cost (RM'm)</b>	<b>Total Cost (RM'm)</b>
<b>Development Cost</b>		<b>69,830.00</b>
Construction Cost	66,780.00	
Land Acquisition Cost	2,500.00	
Working capital	50.00	
Other operational cost	500.00	
<b>Financing cost</b>		<b>11,090.00</b>
Interest	7,444.00	
Sukuk coupon	3,192.00	
Commitment fee	238.00	
Management fee	216.00	
<b>Total</b>		<b>80,920.00</b>

*Source: MIDFR, MoF*

### Exhibit 7: ECRL Construction Cost Breakdown

Phase	Scope	Cost (RM'm)
Phase 1	ITT Gombak-Wakaf Bharu	46,000.00
Phase 2	ITT Gombak-Port Klang	9,000.00
Enhancement	Double Tracking	10,500.00
	Extension line: Wakaf Bharu-Pengkalan Kubor	1,280.00
<b>Total</b>		<b>66,780.00</b>

Source: MIDFR, MoF

**Downgrade to NEUTRAL.** Whilst sectoral price momentum has thus far outperformed the broader market, we opine that further extension to the gains must be underpinned by commensurable growth in forward earnings. As of writing, we think the sector is still lacking solid catalysts which extend beyond the current visibility. Additionally, we opine that the recent announcement on the takeover of Gamuda (a KLCON heavyweight) toll highways is an added overhang factor. For potential exposures, we suggest investors to take a closer look on companies with niche expertise and healthy balance sheet. In that regard, our financial screen had discovered several stocks which fit nicely into these categories, namely **Gabungan AQRS (BUY, TP: RM1.87)** and **Muhibbah Engineering (BUY, TP: RM3.15)**.

**Immediate prospect looks brighter in Sarawak.** The state government has recently announced a record budget of RM9.1b for development. Accordingly, the amount will be utilized to fund few major infra projects including the Coastal Road, Second Trunk Road and the Water Grid Project. Approximately 67 per cent of the RM9.1b allocation for development expenditure (DE) will go to the development of rural areas. Note that the RM9.1b allocated for DE is also the biggest in the history of Sarawak, since the previous budgets for 2017 and 2018 allocated only RM2.982 billion and RM3.062 billion respectively. From the RM6.049 billion for rural development, RM1.535 billion will go to Projek Rakyat, RM500 million for Rural Transformation Projects (RTP), RM243 million for Minor Rural Projects, and RM72 million for 'Program Penambahbaikan Rumah Miskin Sarawak' (PPRMS), which will repair houses for the poor.

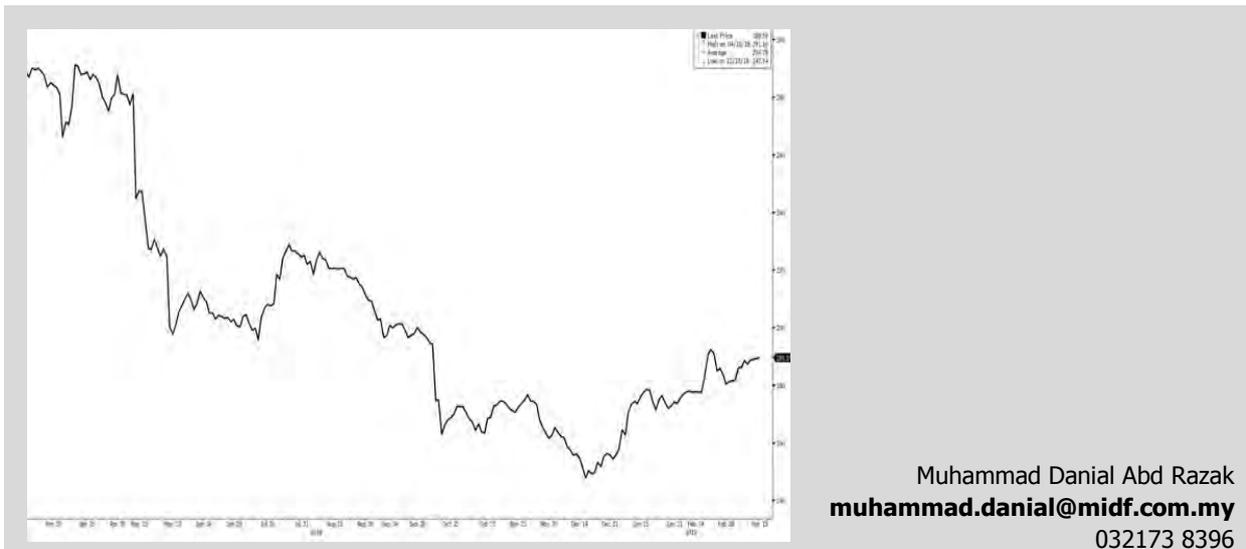
### Exhibit 8: Some Projects for Sarawak Rural Developments

Projects	Cost (RM'm)
Project Rakyat	1,535.00
Rural Transformation Projets (RTP)	500.00
Minor Rural Projects	243.00
Program Penambahbaikan Rumah Miskin Sarawak (PPRM)	72.00
<b>Total</b>	<b>2,350.00</b>

Source: MIDFR, Various

In addition, a sum of RM1.1b will be allocated for the implementation of various projects because Sarawak is investing in more infrastructure projects such as roads, bridges, and jetties to further improve connectivity. Following our optimistic view on Sarawak, we would recommend investors to consider **Cahaya Mata Sarawak (BUY, TP: RM4.13)** and **KKB Engineering (BUY, TP: RM1.33)**, which we opine to be the front-runner for the pending roll-out of the infrastructure projects aforementioned. 

## 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.