April 2019 | Sector Update

Construction

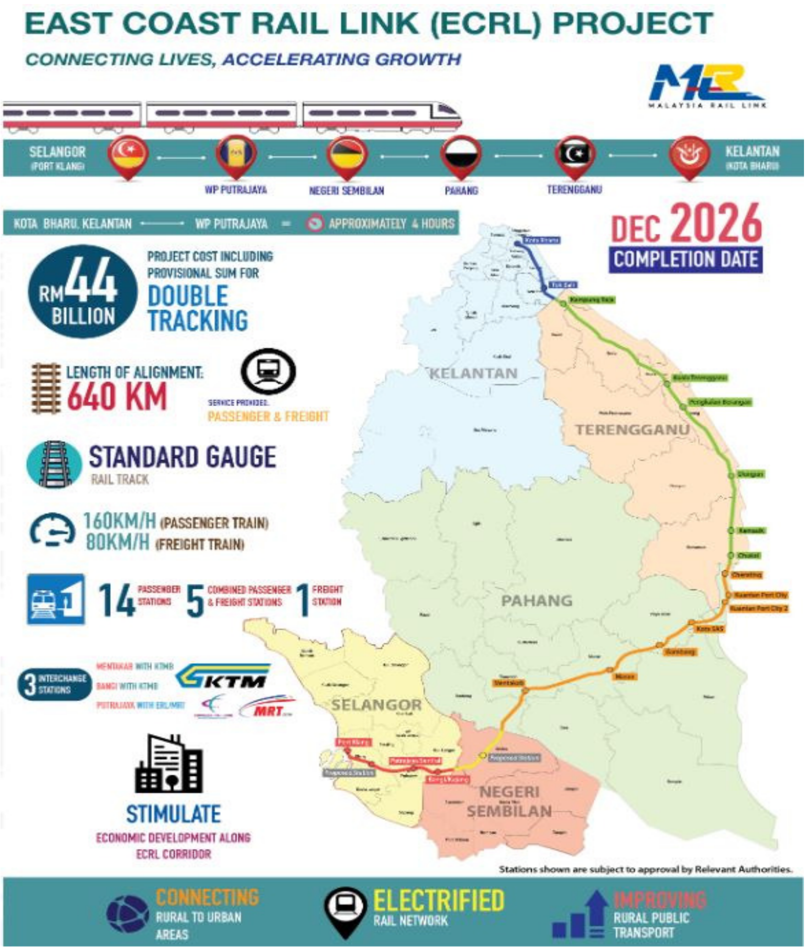
***Maintain* NEUTRAL**

Further details on ECRL 2.0

- **ECRL will proceed at a lower cost of RM44 billion**
- **A press statement was held by the PM to announce further details**
- **The revival is positive, but not a catalyst**
- **We maintain our NEUTRAL call, as expectation already priced-in**

A quick recap from our previous *report*. Last week, we note that Malaysia Rail Link Sdn Bhd (MRL) and China Communications Construction Co Ltd (CCCC) have signed a supplementary agreement pursuant to the East Coast Rail Link (ECRL) project. Accordingly, it was confirmed that ECRL will proceed at a lower cost of RM44 billion compared with its original cost of RM65.5b. This was after nine months of bilateral negotiations, between the government of Malaysia and China. Under the new supplementary agreement, CCCC will offer local contractors 40% of the ECRL civil works. We note that the percentage would amount to approximately RM17.6b worth of construction jobs.

Exhibit 1: Snapshot of Revised ECRL



Source: MRL

Today, a press statement was held by the Prime Minister to announce further details on the project. Below are the key takeaways:

1. Terminating ECRL will cost Putrajaya RM21.8b
2. 85% of the project cost will be funded by China-EXIM Bank loan
3. CCCC agrees to refund part of the RM3.1b in advance payment
4. Local role will be raised to 40% from 30%, under the original deal
5. CCC agreed to form 50:50 JV with MRL to operate and maintain the ECRL

Terminating ECRL will cost Putrajaya RM21.8b. In order to move forward, the PH government was previously left with the choice to either negotiate or pay a termination cost of approximately RM21.8b. By extension, the contract termination would lead to a loan default that would need to be repaid within 30 business days. We note that the amount would include payment to suppliers, dismantling costs, the loan principal, interest charges and committed orders for supplies and services.

CCCC agrees to refund part of the RM3.1b in advance payment. CCCC has agreed to refund RM1.0b to the Malaysian government, which forms a portion of the RM3.1b advance payment for Phase 2 of the proposed ECRL project, Double Tracking and the Northern Extension under the original contract. The first RM500m will be refunded within a week from April 12, 2019 and the remaining RM500m within 30-day from the aforementioned date.

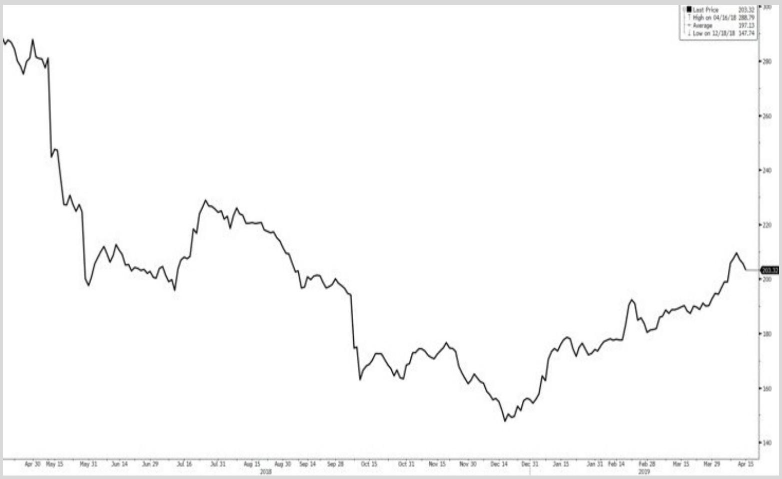
Local role will be raised to 40%, from 30% under the original deal. Under the new supplementary agreement, CCCC will offer local contractors 40% of the ECRL civil works. We note that the percentage would amount to approximately RM17.6b worth of construction jobs. In respect of the previous arrangement (of 20%-30% local content), we had expected a range of RM13.1b to RM19.7b to be awarded. In absolute term, the amount is respectable, as it fell within the originally proposed range.

CCC agreed to form 50:50 JV with MRL to operate and maintain the ECRL. We noted that sharing of operational risk was one of the agenda involved during the project's negotiation. In reaching this objective, CCCC has agreed to form a JV with MRL, with each to have equal stake. Under this arrangement, CCCC will provide technical support and share the operational risk after the project's completion. This will also allow Malaysia to leverage on CCCC's expertise in the operation and maintenance of ECRL, and hence improving the long-term viability of the project. Consequent to this, MRL's role in this project is further extended to a joint operator. Based on our understanding, the 50:50 JV pertains to only the management, operation and maintenance of ECRL assets and would not involve the transfer of ownership of the asset to the JV Company.

85% of the project cost will be funded by China-EXIM Bank loan. The loan amount from China-EXIM Bank is expected to be reduced substantially. Details on the loan are still scarce as the final amount is still being negotiated. According to MRL CEO, the current funding structure will be based on the original 85:15 mix. Recall that the loan amount at 85% of the project original cost would be equivalent to RM56.7b. Hence should the amount be reduced accordingly, a revised loan amount could be reduced to RM37.4b. We learned that the balance 15% (of RM6.6b) will be financed through a sukuk program by local banks.

Maintain 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. Immediate beneficiaries to ECRL are **Lafarge (SELL, TP: RM1.60)** and **HSS Engineers (NR)**, whereby both counters have clinched sizable jobs from China Communications Construction (ECRL) Sdn Bhd (CCC) previously. Other potential beneficiaries (in our coverage) are **Gabungan AQRS (BUY, TP: RM1.87)**, **Muhibbah Engineering (BUY, TP: RM3.73), IJM Corp (NEUTRAL, TP: RM1.85)**, **MRCB (BUY, TP: RM0.90)** and **WCT (NEUTRAL, TP: jRM0.88).**

DAILY PRICE CHART (KL CONSTRUCTION INDEX)



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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 *rise* 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 *fall* 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.