

Getting a One-Third Discount for ECRL

- **ECRL project restored at RM44b**
- **Both sides made concessions after nine months of negotiations**
- **Major adjustment to the route favoring the southern option**
- **The news is positive, but unlikely a catalyst**
- **We maintain our NEUTRAL call, as expectation for revival already priced-in**

ECRL restored. 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.

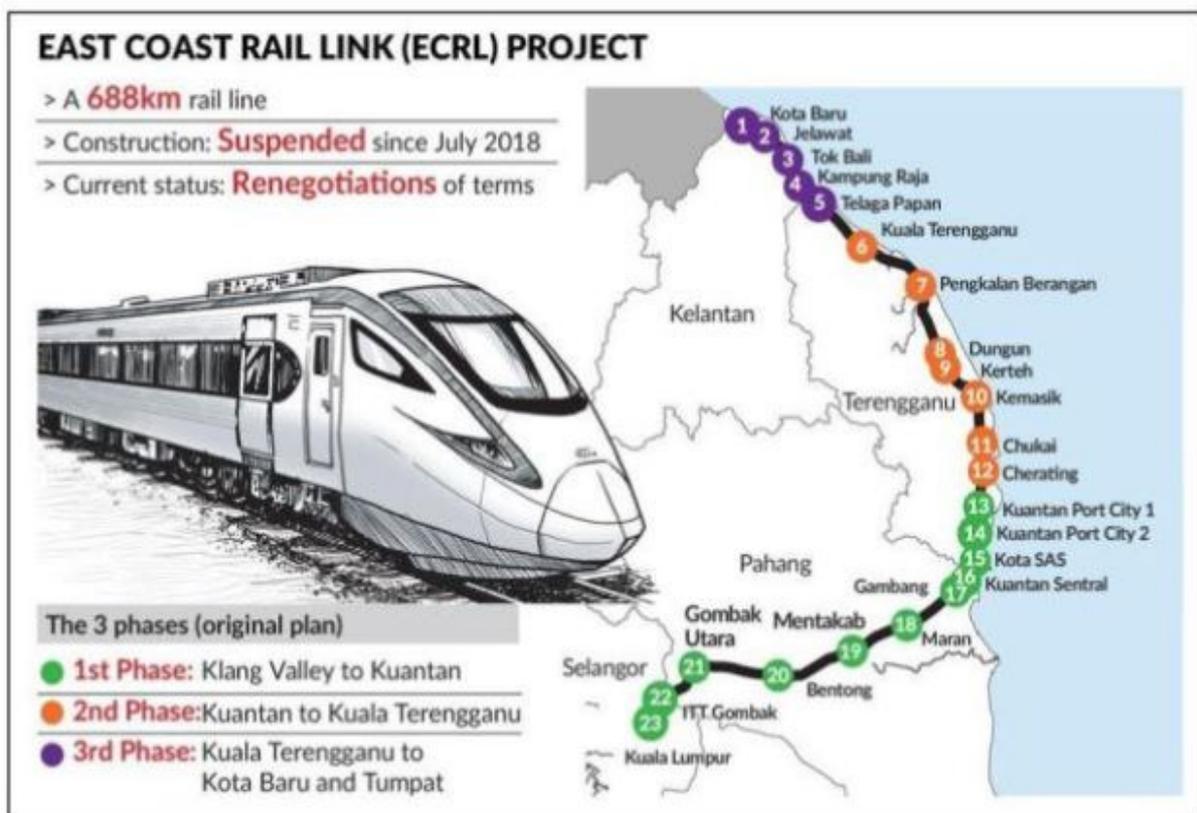
Both sides made concessions after nine months of negotiations. ECRL's revival is a positive progress for the sector, which was recently plagued with a series of cost revision and possible cancellations news. While we could praise on the outcome for its restoration, entirety of this deal remains under wraps until more details revealed by the Prime Minister, Tun Dr. Mahathir today.

What we know so far. Major revision was made on the original alignment, which will see part of the southern portion rerouted to Negeri Sembilan. Further into that, the current track is aligned to bypass the steep section of Titiwangsa Range (whereby two tunnels of 16.3km each were supposed to be built) as part of the cost cutting exercise. Based on the new alignment, the journey from Port Klang will have to go south to Jelebu, Negeri Sembilan first before moving up to Mentakab, Pahang. A news source specified that avoiding the steep section of Titiwangsa Range will provide gross savings of approximately RM8b to the government.

Would the impact be meaningful? In totality, the cost reduction of ECRL amounted to RM21.5b, leaving a sum of RM44b for construction works. Previously, local participation was estimated to be around 20-30% for the civil works which could range from RM13.1b to RM19.7b (based on original cost of RM65.5b). Should the share remain, the revised cost would only leave approximately RM8.8b to RM13.2b in values for local contractors. This would mean less opportunity for them by about RM4.3b, at least. While the portion for local content still left unverified, we opine a value worth higher than RM20b, could signal a meaningful quantum. This constitutes a 50% share of the total construction value.

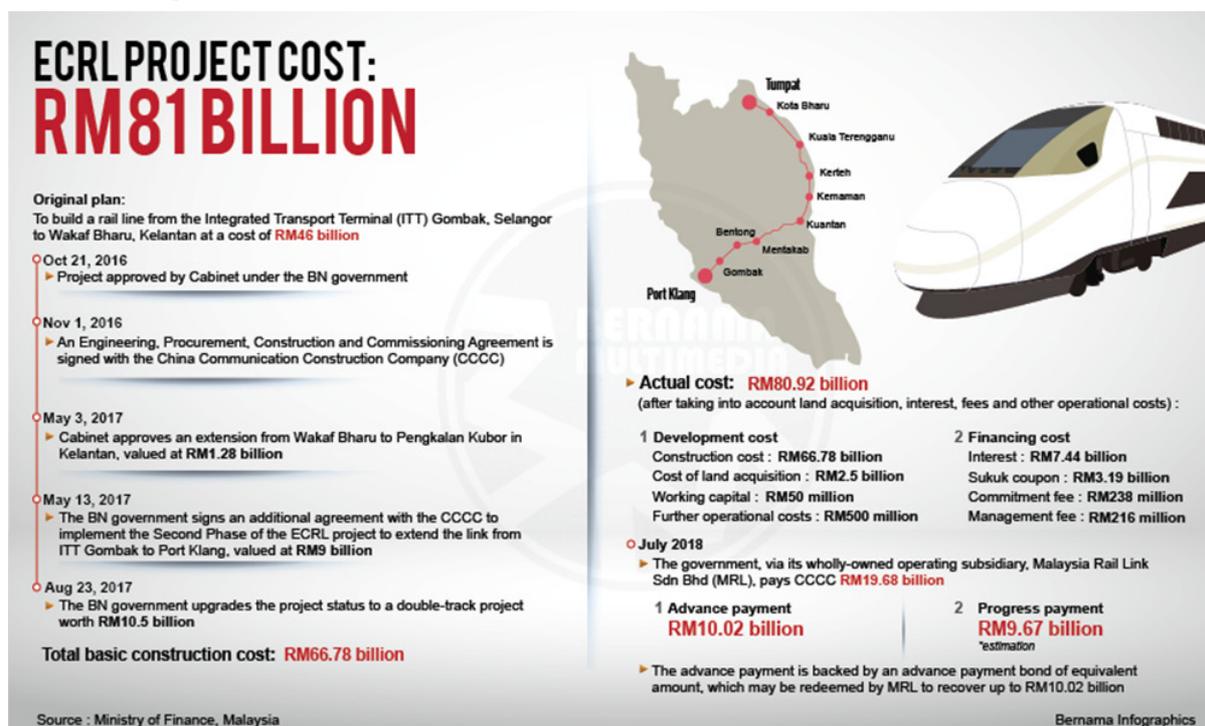
We maintain our NEUTRAL stance on the sector. While the news on ECRL is positive, we have to recognize that expectation on its revival have already been priced in. This was reflective on the KLCON performance, which was seen moving faster than its fundamentals, ahead of the announcements. Immediate beneficiaries of the ECRL project 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 namely **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:RM0.88)**.

Exhibit 1: Original Alignment of ECRL



Source: The Star

Exhibit 2: Project Timeline of ECRL



Source: Ministry of Finance, Bernama

ECRL restored at lower cost. 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 RM65.5 billion. We note that the stated cost of approximately RM65b only comprised of the construction cost. Given the latest revision, its entire cost for the government could be referred as below:

Exhibit 3: ECRL Project Details (Original)

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

Source: MIDFR, MoF

Exhibit 4: ECRL Project Details (Revised*)

Component	Cost (RM'm)	Total Cost (RM'm)
Development Cost		47,050.00
Construction Cost	44,000.00	
Land Acquisition Cost	2,500.00	
Working capital	50.00	
Other operational cost	500.00	
Financing cost		11,090.00
Interest	7,444.00	
Sukuk coupon	3,192.00	
Commitment fee	238.00	
Management fee	216.00	
Total		58,140.00

Source: MIDFR, MoF *Subject to announcement by Prime Minister

At a revised price tag of RM44b, the construction cost for the project is now at RM68mil per km, against RM98mil per km originally. We note that the reduced cost structure will enable the government to further reduce the interest to be paid. We think this is sensible, as the project will require a smaller loan from Exim Bank.

Both sides made concessions after nine months of negotiations. ECRL's revival is a positive progress for the sector, which was recently plagued with a series of cost revision and possible cancellations news. Cancelling the project will require the government to pay about RM22 billion in compensation and penalty charges. According to a source, a contract termination would lead to a loan default that would need to be repaid within 30 business days. We understand that the compensation package includes payment to suppliers, dismantling costs, the loan principal, interest charges and committed orders for supplies and services. Given this situation, terminating the project is unlikely a viable option. While we could praise on the outcome for its restoration at reduced cost, note that the entirety of this deal remains under wraps until more details revealed by the Prime Minister, Tun Dr. Mahathir today.

Exhibit 4: Snapshot of Revised ECRL

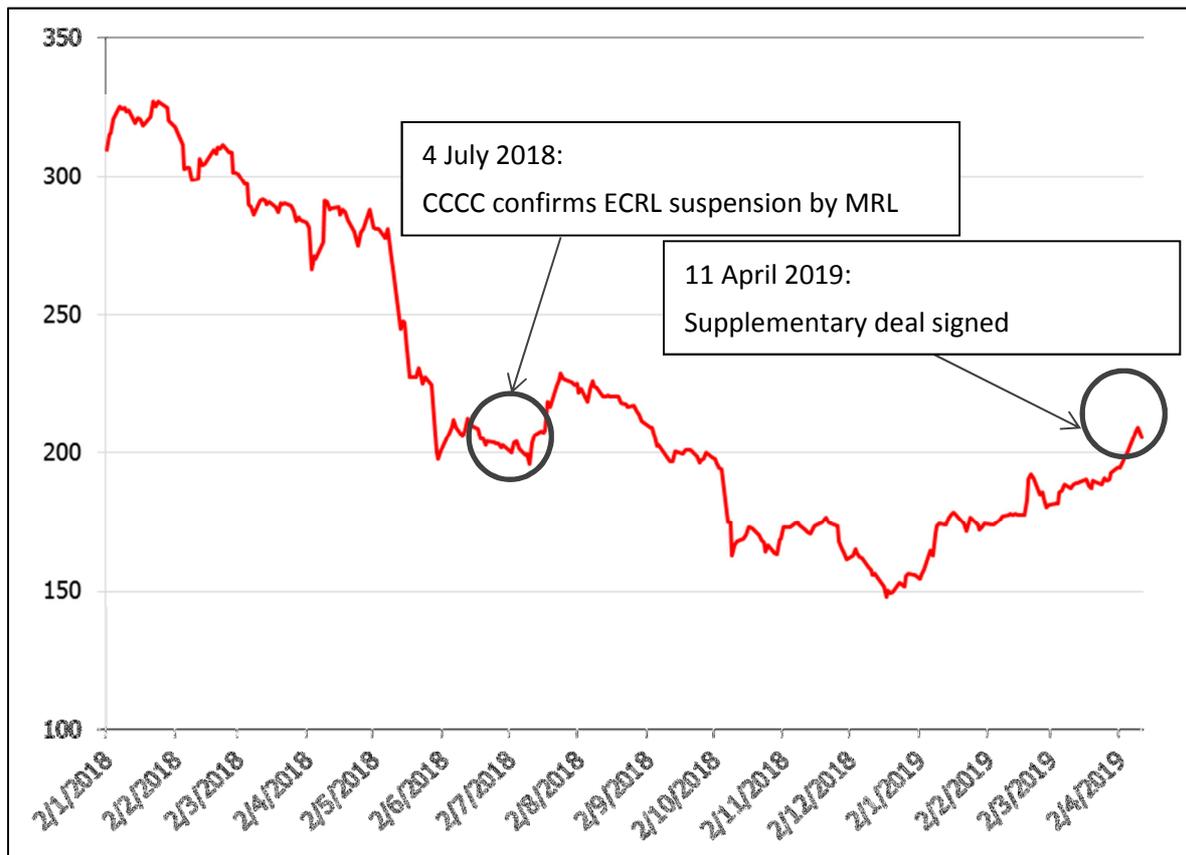


Source: MRL

Stocks which had existing exposure on ECRL are Lafarge (SELL, TP:RM1.60) and HSS Engineers (NR). Lafarge has previously secured RM270mil contract to supply cement to China Communications Construction (ECRL) Sdn Bhd (CCC). Meanwhile, HSS Engineering was awarded a package worth RM82.5m to provide supervising consultancy services for infrastructure works from Km 0 to Km 231.5 of the ECRL Package 1. The contract was supposed to commence in 1Q18 as the ECRL project moves to the construction stage. In a turn of event, both contracts were later suspended, following the action by government to review the project. In the light of ECRL continuation, reinstating both contracts will allow both Lafarge and HSS Engineers to see earnings contribution as the work resume. We recall that the contract awarded to Lafarge was for the supply of cement to all eight packages of work of the ECRL project, with a potential of renewable for a further two years. We estimated a possible offtake of approximately 1m tonne, spread out over three years. Accordingly, we opine that the amount is unlikely to be adequate to meaningfully improve the group domestic sales.

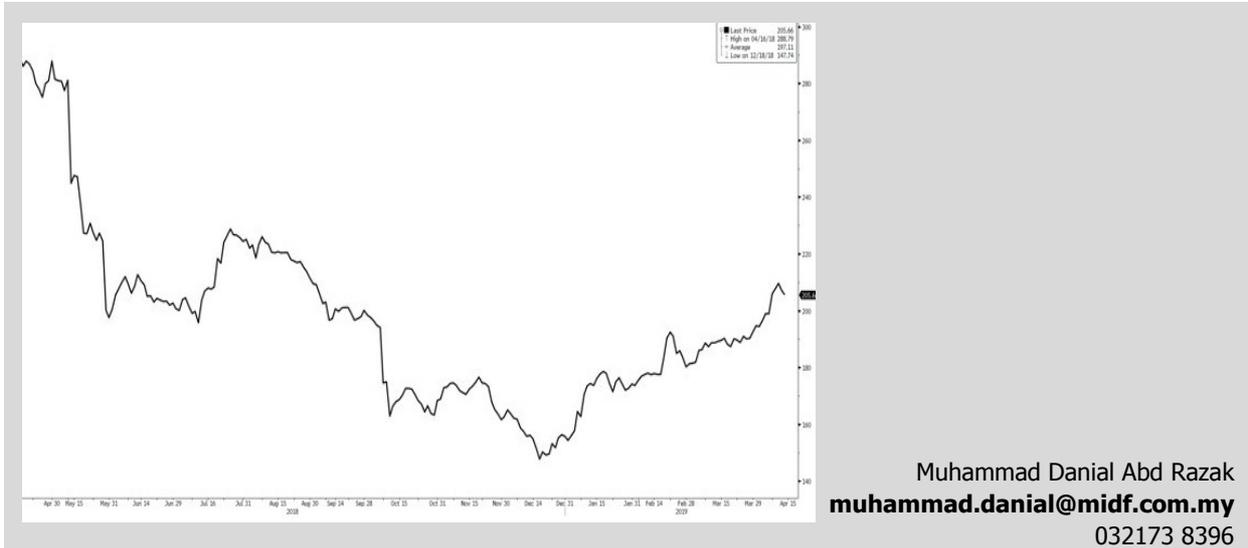
In our coverage, **Gabungan AQRS (BUY, TP:RM1.87)**, **Muhibbah Engineering (BUY, TP:RM3.73)**, **IJM Corp (NEUTRAL, TP:RM1.85)**, **MRCB (BUY, TP:RM0.90)** and **WCT (NEUTRAL, TP:RM0.88)** are touted as potential beneficiaries. These counters are among the active players for local railway jobs. Gabungan AQRS is our favorite to clinch a sizeable above ground job leading to Kota SAS station, due to its proximity and involvement for the development of Kota SAS. Meanwhile, IJM Corp 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.

Exhibit 4: KLCON Index performance since January 2018



Source: Bloomberg, MIDFR

DAILY PRICE CHART



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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 +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.