

25 September 2017 | Sector Update (Part 1)

Construction

Maintain POSITIVE

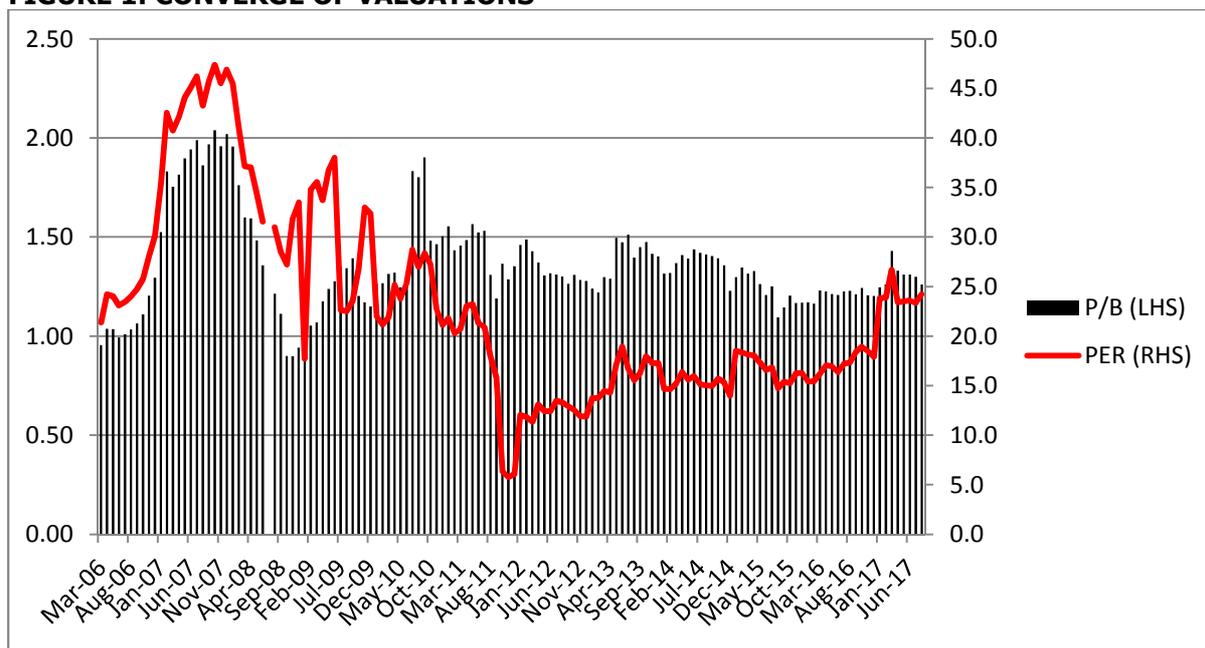
Plagued by Temporary Setback and Ominous Signs

INVESTMENT HIGHLIGHTS

- Valuation shifts to higher gear but ominous signs sprouting
- Plagued by uneven earnings
- Embracing the new anchor
- Maintain Positive

Valuation shifts to higher gear but ominous signs sprouting. Valuation of KL Construction Index is set to climb higher as the price-to-earnings (PER) and price-to-book (PBR) starts to converge again to reflect (Figure 1) the intensifying news flow on the sector. Sectoral PER climbed to 22.9x which is closer to its 11-year average of 24.2x. From PBR standpoint, the sector fetches only 1.26x PBR below its mean of 1.36x. Despite that, ‘writings on the wall’ such as (i) drop in infrastructure projects and (ii) uneven earnings for big caps and small-mid caps construction companies are ominous for the sector.

FIGURE 1: CONVERGE OF VALUATIONS



Bloomberg, MIDFR *

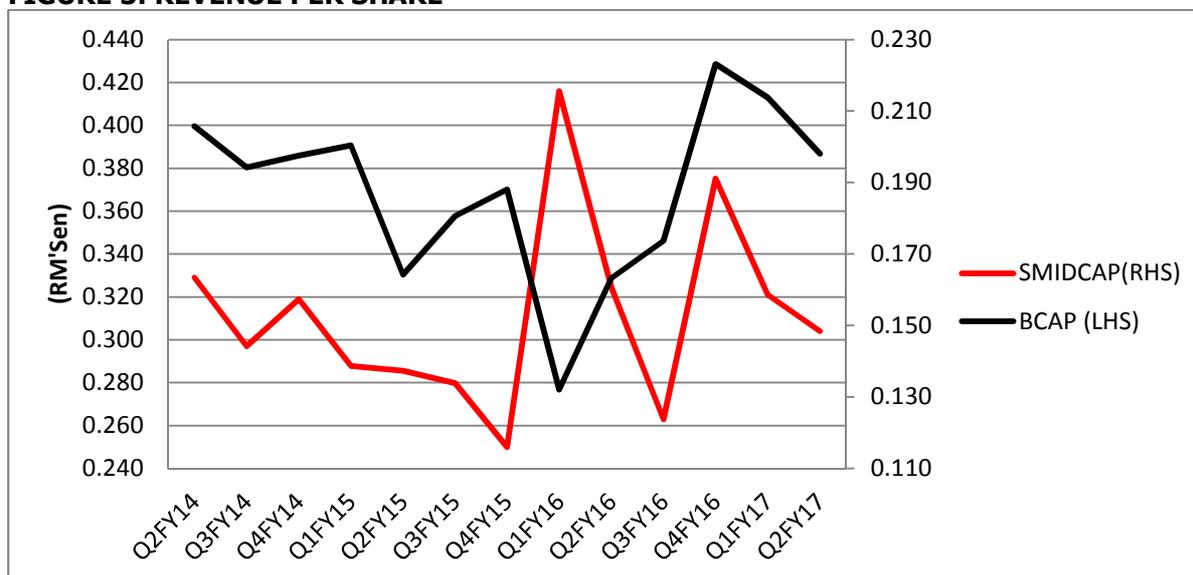
Plagued by uneven earnings. Compression and uneven earnings in big-caps is seen through the accretion of infrastructure projects to the construction company’s bottom line. For example, Pan Borneo Highway (Sarawak) was awarded to several companies such as WCT Holdings Berhad and Cahya Mata Sarawak in July, 2016. Despite that, the progress is still at an early stage hence meaningful impact to WCT and Cahya Mata 1HFY17 earnings is still undemonstrative. (Figure 2) We reckon that the trend will persist due to joint-venture (JV) and project delivery partner (PDP)

structure of the mega-projects is regressive to earnings upside. For instance, the revenue per share (RPS) of big caps construction companies (BC3*) has lagged the RPS of small-mid caps construction companies (SMC3*). Eventhough, BC3 CAGR grows +18.6% QoQ but SMC3 registered a better growth of +30.9%QoQ. However, revenue growth does not always translate into healthy earnings. Earnings per share (EPS) for BC3 (CAGR: +4.6%QoQ) and SMC3 (CAGR: +2.9%QoQ) under our observation have decreased due to; (i) higher expenses, (ii) longer project period and (ii) gaps in billings recognition. We opine that longer termed contract yields lower margin compared to packages with shorter duration hence the dovish EPS growth for SMC3. (Figures 3 and 4)

FIGURE 2: 1HFY17 RESULTS UNDEMONSTRATIVE

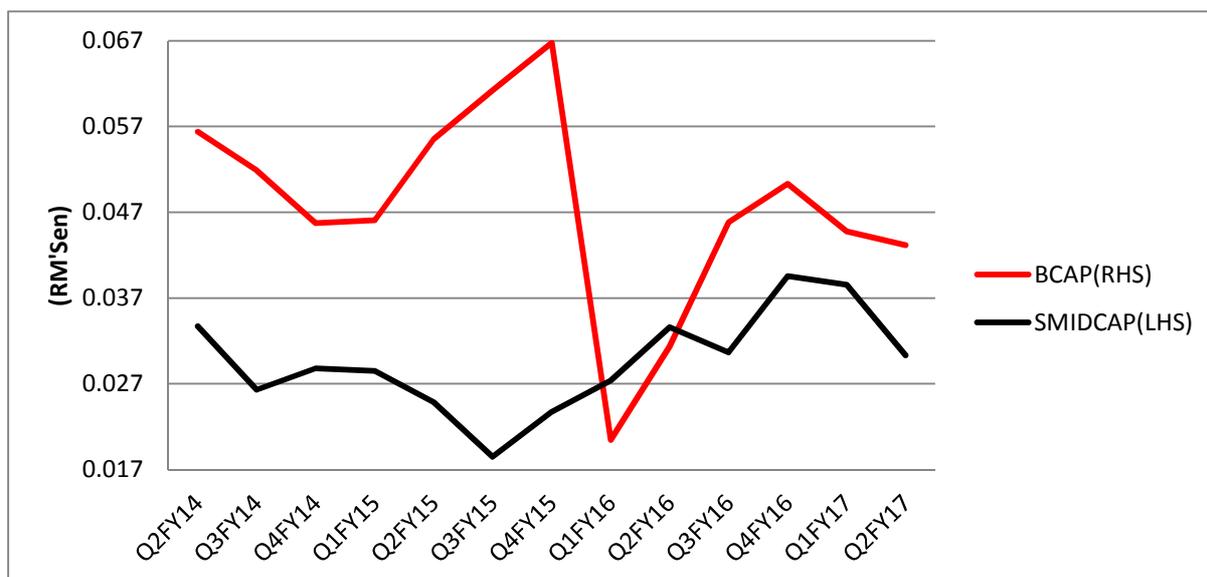
Companies	1HFY17/18 Results Expectation	Comments
IJM Berhad	Below	Higher finance cost
CMS	Below	Lower revenue from key divisions
WCT	Below	High liabilities
VIVO	Below	Billings gap
Gabungan AQRS	Below	Revised expectations
HSL	Below	Billing gap
Sunway Construction	Below	Lower contribution from pre-cast segment
Muhibbah	Met	Consistent PBT from airport concession

FIGURE 3: REVENUE PER SHARE



Bloomberg, MIDFR

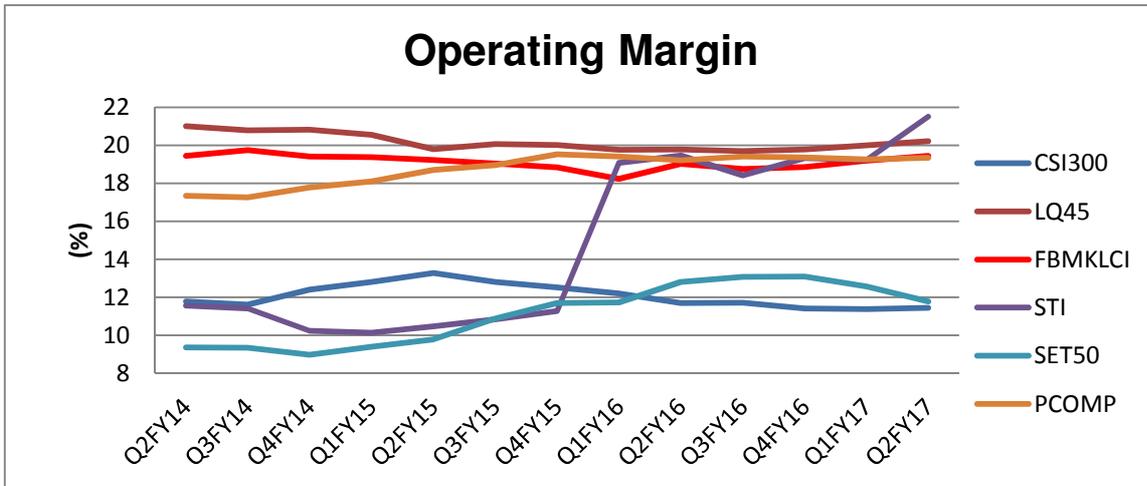
FIGURE 4: EARNINGS PER SHARE



Bloomberg, MIDFR

Embracing the new anchor. Furthermore, the policy of the Malaysian government opening its wide arm to the One Belt One Road Policy enables China state-owned enterprises (SOEs) to participate freely in construction projects to improve its risk-reward profile. Large China's construction SOE such as the China Railways Engineering Corp. and China Railways Construction Corp has made strong developments in Malaysian construction sector – shrinking the impact to local companies further. The 'Buffett Indicator' or total market cap to GNI (gross national income) of China is 92.5% and its 3-y forward earnings are -0.86%. With an anaemic earnings climate in China is only natural for its SOEs to look for better opportunities. We believe the push factor for China's SOE to Malaysia is the insipid 3- year operating margin of CSI300 (Mean:+12.1%) compared to rest of FBMKLCI and ASEAN. Generally, Malaysia's stable operating margin proxied by FBMKLCI's average of +19.12% is a boon for China's SOE. (Figure 5). We maintain our positive stance despite blips in our expectation as we believe FYE18 beckons better results due to higher revenue recognition coupled with catalysts of subcontracting packages from China's SOE.

FIGURE 5: FBMKLCI OPERATING MARGIN VS. ASEAN & CSI300



Bloomberg, MIDFR

***BC3:** Sample of Big Caps Construction Sector is represented by Cahya Mata Sarawak, IJM Bhd. Gamuda Bhd. and WCT Holdings Bhd. We exclude Sunway Construction due to the comparability of timeline and its recent status in KL Construction Index and MRCB due to its exposure in property development.

***SMC3:** Sample of small-caps construction companies are represented by Gadang, Vivocom, Gabungan AQRS, Ekovest, Econpile, Kerjaya Prospek, Fajar Baru Builder, Hock Seng Lee, Pintaras Jaya and Muhibbah due to its orderbook and revenue growth.

DAILY PRICE CHART



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

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 >15% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	Total return is expected to be <-15% over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >15% 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.