

March 2018 | Sector Update

Construction

Strongest Liquidity But A Phantom Menace Peeks

Maintain POSITIVE

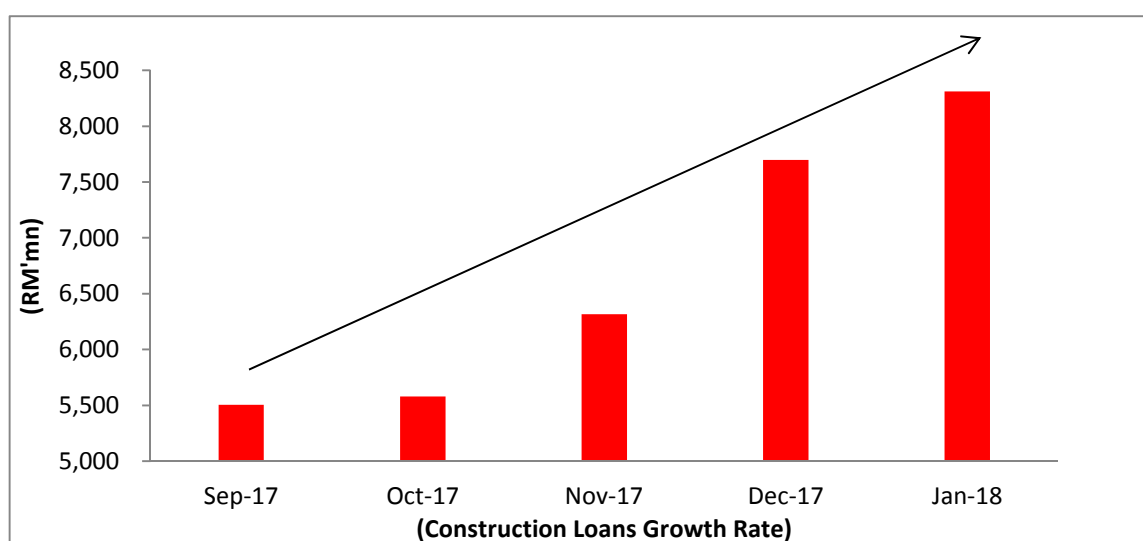
SECTOR HIGHLIGHTS

- Highest credit liquidity unleashed
- Given an upshot
- Multiples unswerving
- Take the wait-and-see situation as fortuitous
- Realization of a phantom menace
- Maintain Positive on sector

Highest monthly construction loan recorded. The KL Construction Index has digressed recording -6.98% YTD despite the news influx and anticipation of mega projects roll-out. Its big-cap heavyweights reported at writing dismal and negatively skewed YTD returns; a) IJM (TP: RM4.00, YTD: -14.75%), Gamuda (TP: RM5.05, YTD: +2.03%), WCTHG (TP: RM1.47, YTD:-9.87%) with the exception of Cahya Mata (TP: RM4.62, YTD: +5.87%).

Given an upshot. Loans to the sector is filled by an impelling shot of the highest monthly loan disbursement rate of RM8.3bn (+4.32%MoM or +10.8%YoY) for the past 11-years. (Figure 1) We believed that the current high tide of liquidity took valuations (PER and P/B) from swooning lower than its 11-year lowest of 6.0x and 0.6x respectively. Moreover, robust liquidity this level liquidity shapes the construction backdrop as the current disbursement rate of RM8.3bn is well above the sector's 11-year median of RM4.3bn or +93.14%. For the past 5-months the CAGR of liquidity has amplified at staggering rate of +8.58% on monthly basis (*see below*). We should not underemphasize the combustible nature of the liquidity setting the stage for an uptick in construction stocks price movement in Q2FY18.

FIGURE 1: LOANS DISBURSED TO CONSTRUCTION SECTOR



Source : MIDFR

Multiples unswerving. As a result, we see the unfaltering valuation - supported by the liquidity largesse. Consequently, the valuation of KLCON Index i.e. price-to-earnings (PER) and price-to-book (PB) ratios are unswerving. The current PER for the sector is unwavering - recording 23.0x concurrent with PB which is steadfast at 1.13x which is lower than its 11-year median month-on-month basis of 1.35x. (Figure 3 & 4) The truculent clutter of excess liquidity and an inexorable valuation suggest that Street is anticipating the result of the 14th General Election of Malaysia. If not, the excess liquidity should commensurate with higher risk-taking and higher influx of project awards thus potentially stimulating the valuation levels of PE beyond 27.0x and PB of 1.43x as we have seen in March-17. (*Refer to Figures 3 & 4*)

Take the wait-and-see situation as fortuitous. We reckon that the current wait-and-see mode sweeping the market should be taken as an opportunity to increase exposure from valuation angle and recommends taking long/short position of construction companies now regardless of market capitalization based on the balance of parity between p/b and p/e ratio for KL Construction Index. To comfort any rude shock in excess valuation level the book value of the sector has improved to 1.13x below the PER of 23.0x indicating balance sheets and working capitals are still sensible to absorb big-tickets project award. (see Figure 6)

Realization of a phantom menace. Street's euphoria of higher valuation (earnings expectation and improved working capitals) stemming from mega projects shifted to realization of a phantom menace. Apart from political risks another factor that could upset expectation is the flattish levels of operating margin for big-caps construction companies such as IJM, Gamuda, and WCT but with the exception of Cahya Mata Sarawak. (Figures 5A to 5D) We assessed that the mega-rail project apart from its revenue and orderbook benediction comes with a phantom menace of shrivelled operating margin. Normally, big-ticket projects come at a hefty price tag of higher mobilization costs, tender expenses and performance bond. We believe these mentioned costs are unavoidable for all the rail related projects announced; ECRL, HSR and Putrajaya Tramways. So far, costs have increased with the exception of WCTHG. (Figure 7A & 7B)

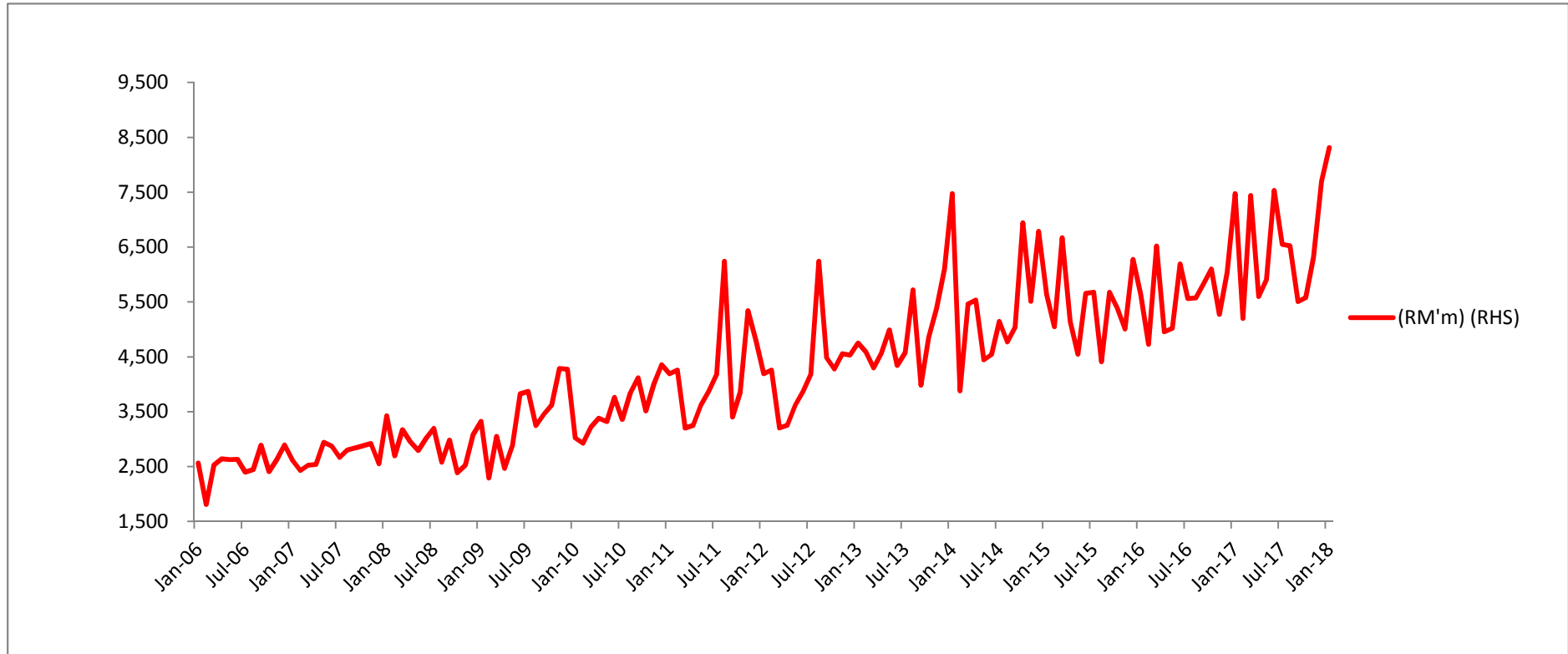
Maintain Positive. That's why; we surmised that working capital coupled with operating margin is more appropriate to filter the weak from the strong performers (*Refer to Figures 5A to 5D*). Having said that, we maintain our positive stance on the construction sector, submitting IJM (TP: RM4.62), Cahya Mata Sarawak (TP: RM4.62), Muhibbah (TP: RM3.60) and Gabungan AQRS (TP: RM2.30) as our top picks. Our picks for IJM and CMS are premised on sturdy orderbook and strong operating margin and attractive upside for AQRS and Muhibbah. Despite making an admirable comeback in rejuvenating its operating margin, we are in the midst of reassessing WCT's strategy to re-rate. (Figure 8A)

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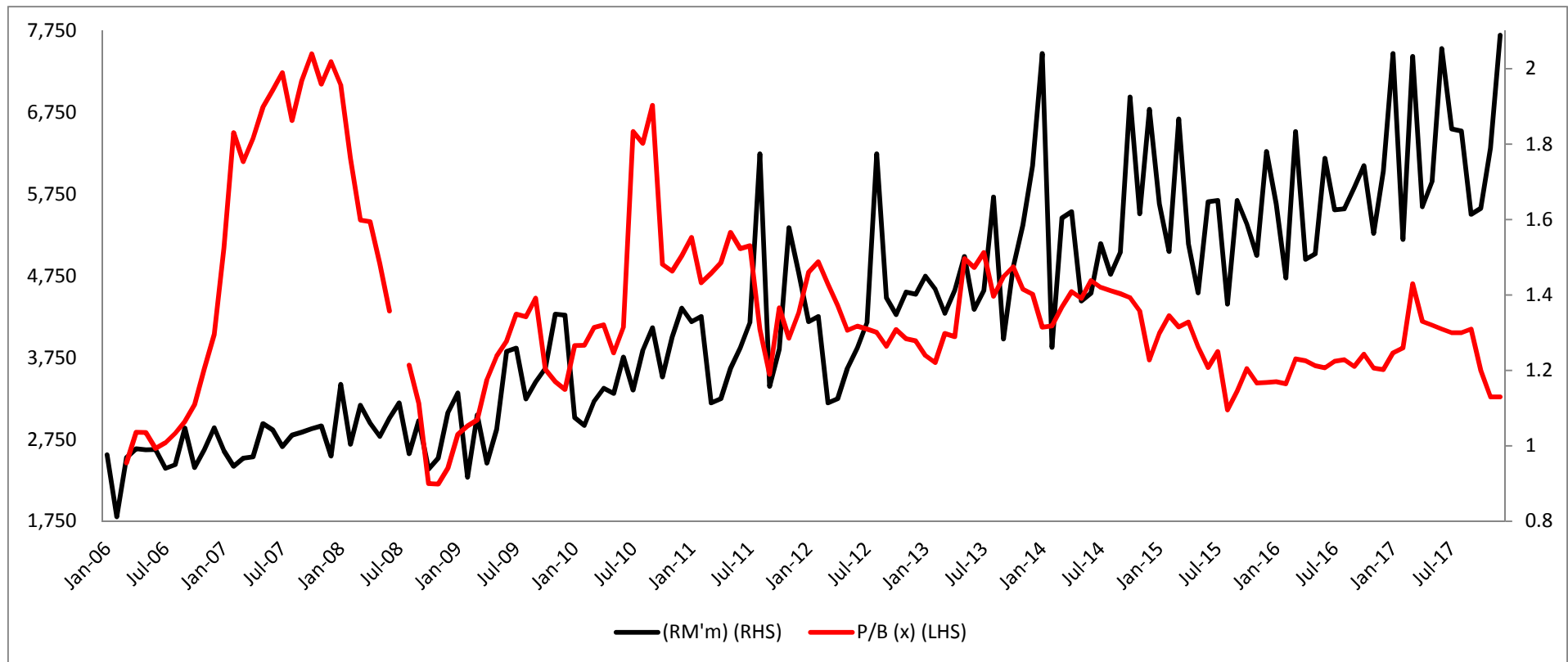
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FIGURE 2: LOANS DISBURSED TO CONSTRUCTION SECTOR



Source: CEIC, DOS, CIBD

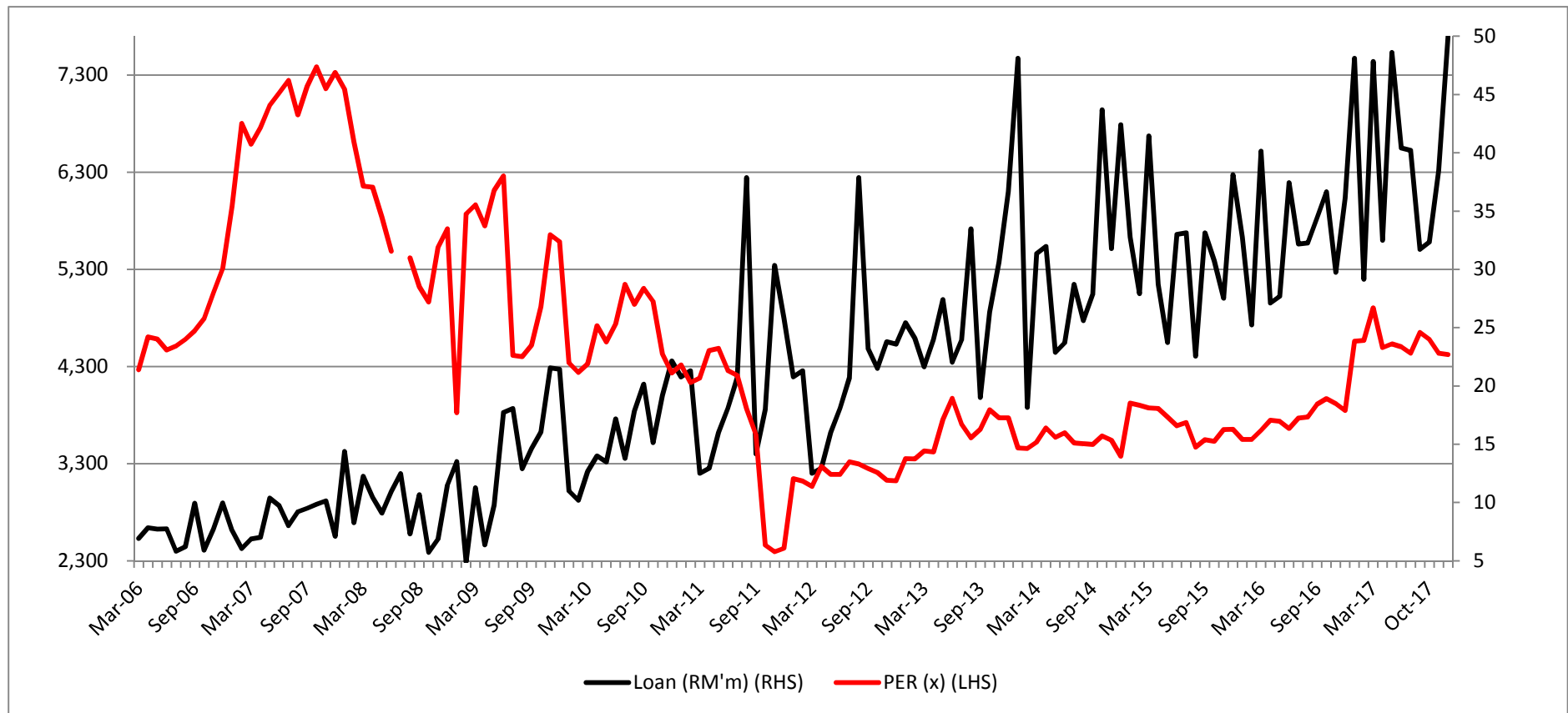
FIGURE 3: LOANS DISBURSED TO PRICE-TO-BOOK



Source: CEIC, DOS, CIBD

FIGURE 4: LOANS DISBURSED TO PRICE-TO-EARNINGS

Source: CEIC, DOS, CIBD



MIDF RESEARCH

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FIGURE 5A: CMS

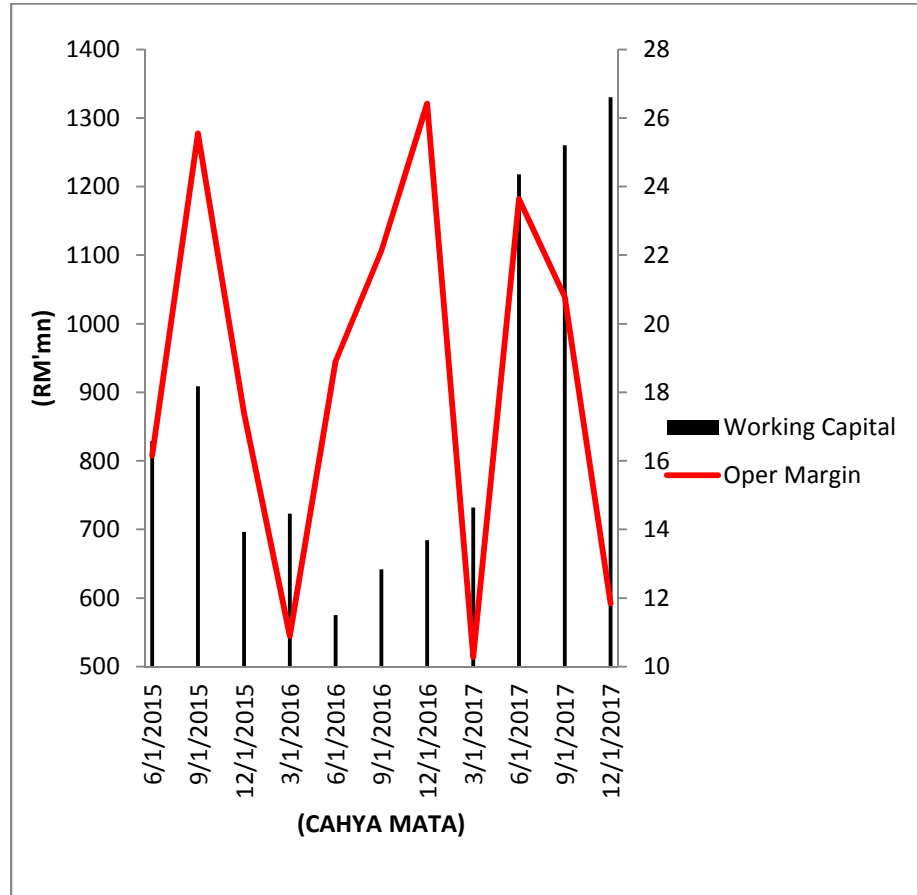
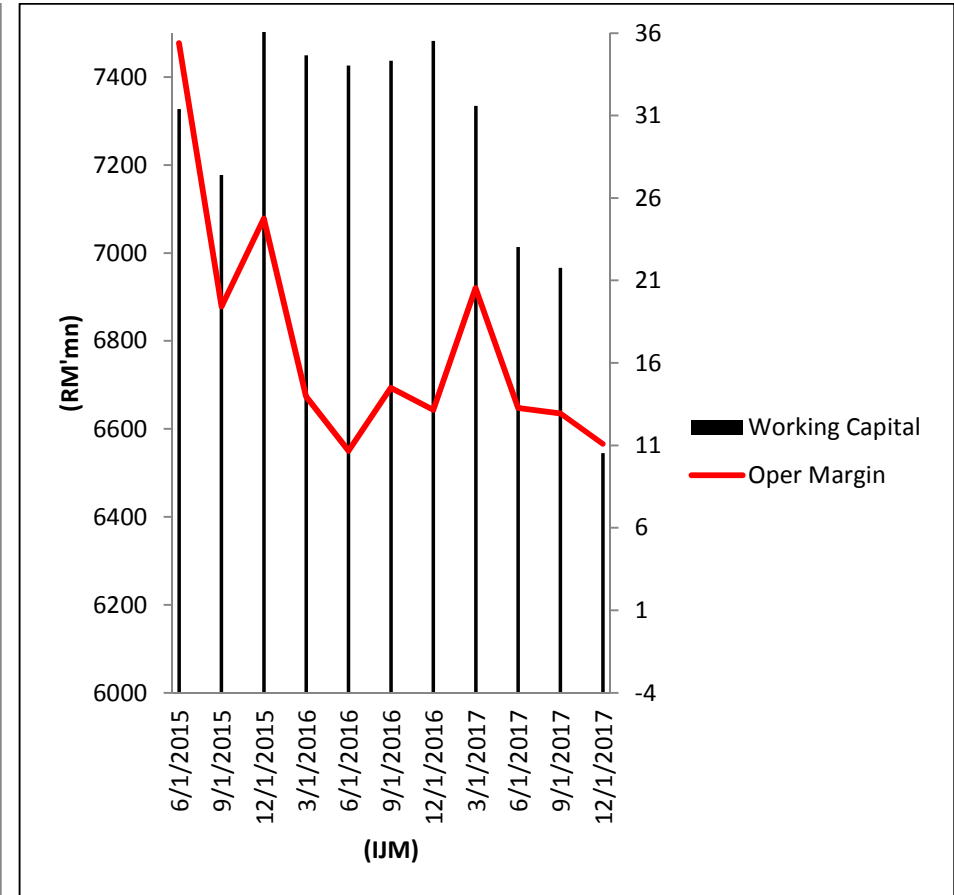


FIGURE 5B: IJM



Source: CIDB, & DOS

FIGURE 5C: FEDERAL TERRITORY

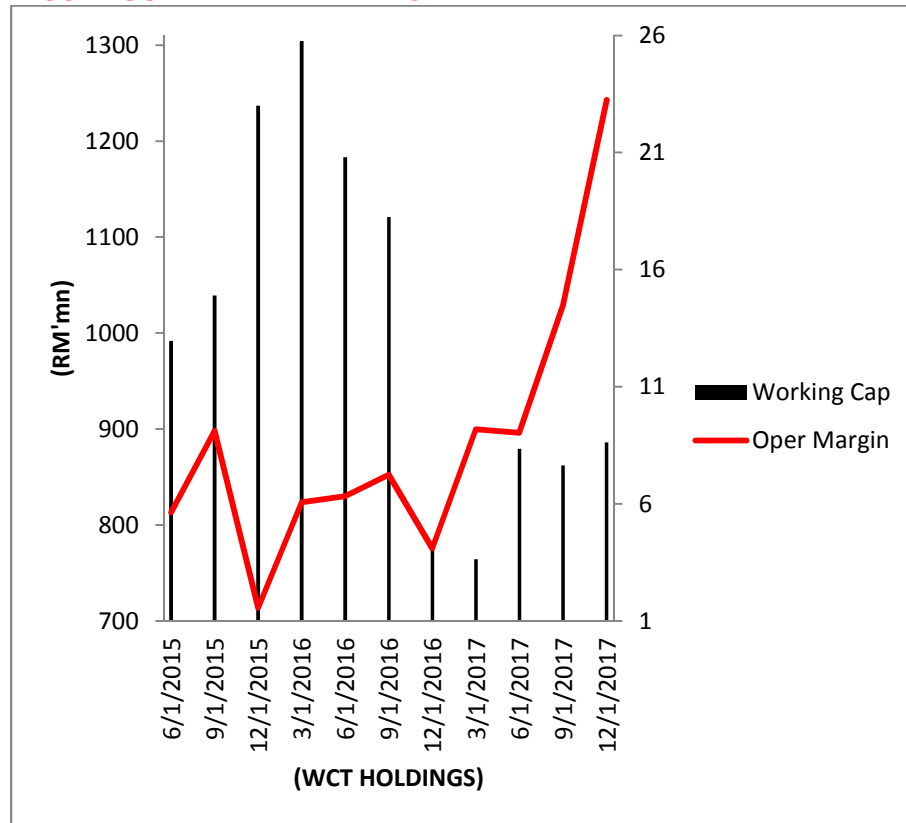
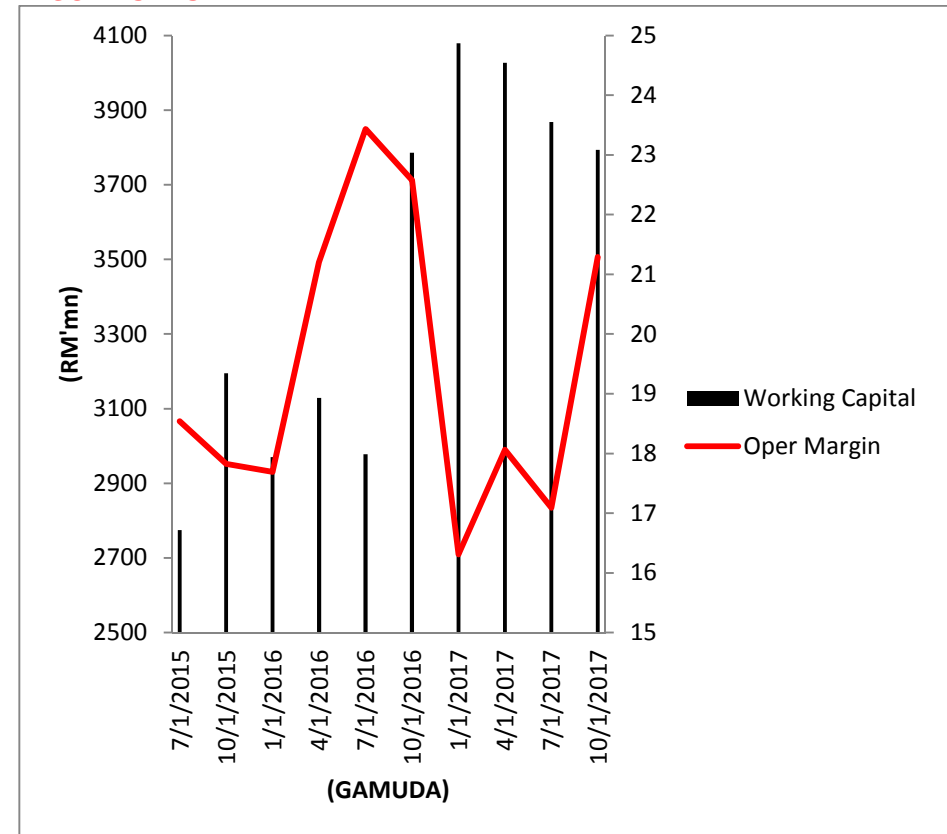
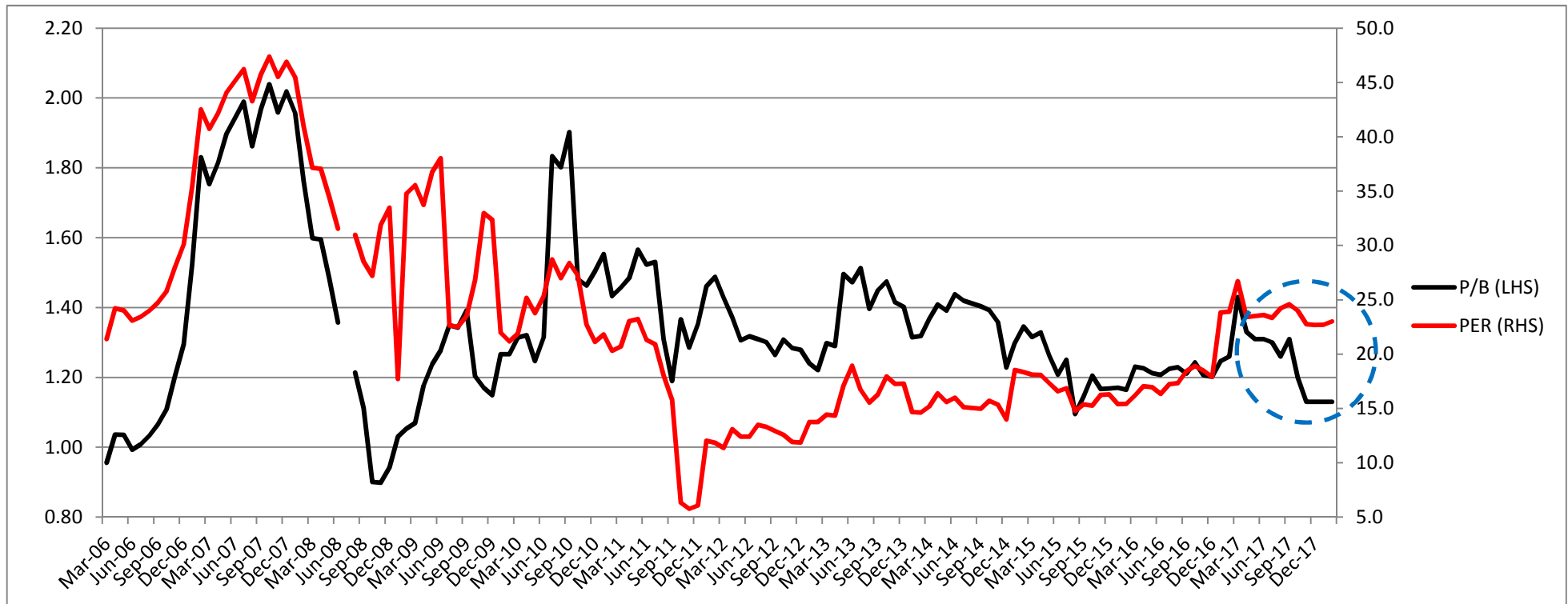


FIGURE 5D: SARAWAK



Source: CIDB, & DOS

FIGURE 6: BALANCING VALUATIONS: PE AND PB



Source: Bloomberg, MIDFR

FIGURE 7A AND 7B: REVENUE AND COST

FIGURE 7A: IJM BERHAD

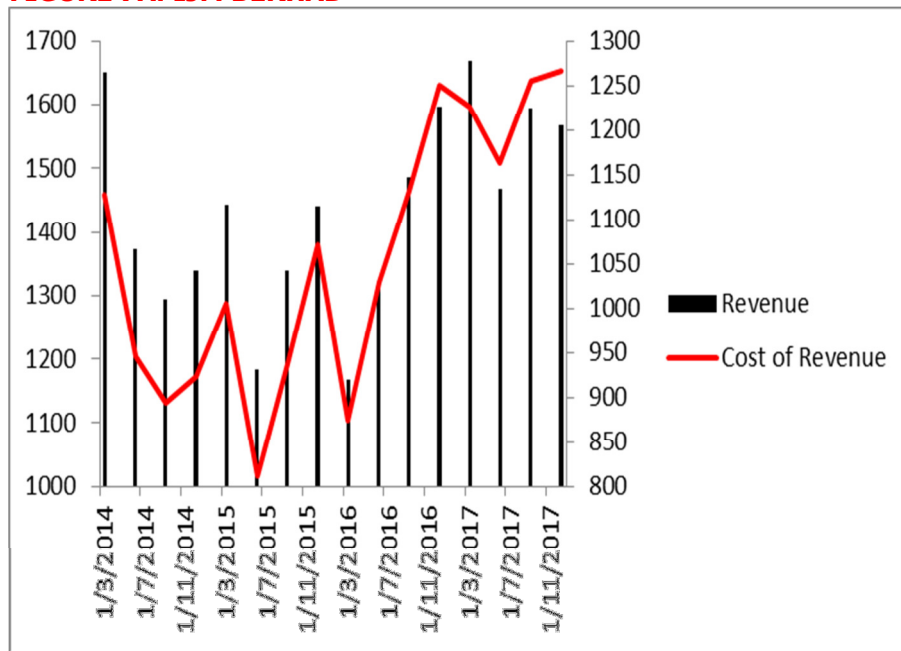
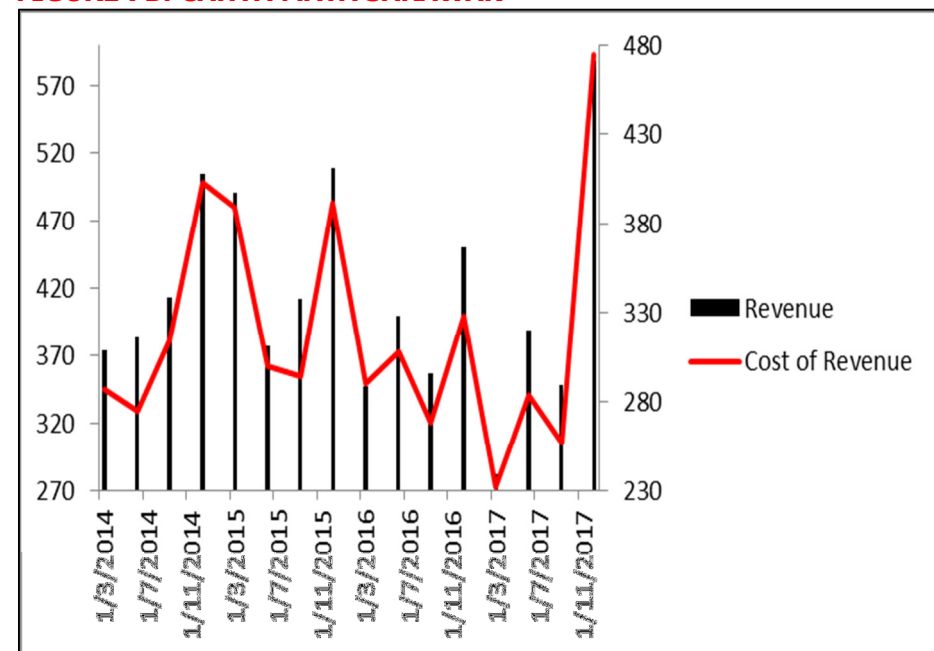


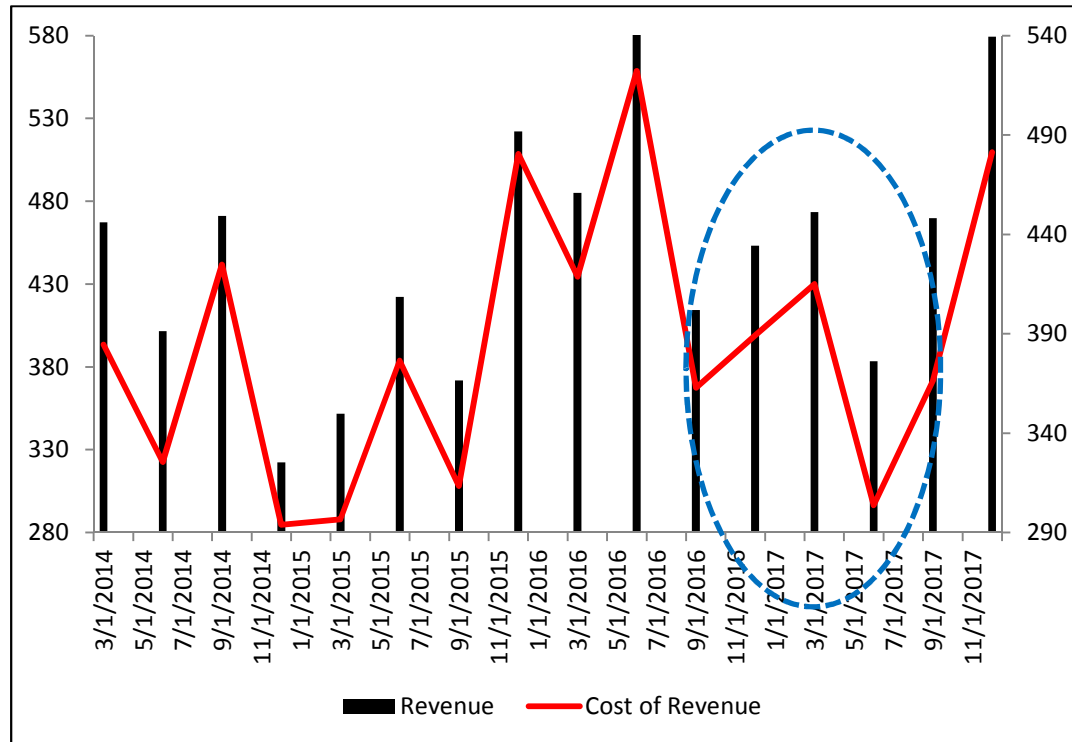
FIGURE 7B: CAHYA MATA SARAWAK



Source: Bloomberg, MIDFR

FIGURE 8: REJUVENATED ITS PROFITABILITY

FIGURE 8A: WCT BERHAD



Source: Bloomberg, MIDFR

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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.

