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3 December 2018 | Sector Update

Construction

Maintain POSITIVE

Zoom Out to Appreciate the Long Term Potential

- **Mixed results in 3Q18, but overall performance relatively fine**
- **RM50b allocated for DE was significant, which denotes positive sign on the near term developments**
- **The sector's long term outlook will be driven by sustainable measures**
- **We expect recovery in investors' sentiment will be heavily weighted by the development potential in East Malaysia**
- **Despite near-term directional swing, we see the headroom is still ample for the sector to grow**
- **Maintain POSITIVE on the sector**

Mixed results in 3Q18. Companies under our coverage ended the quarter on a mixed note. Notable stocks namely Muhibbah Engineering and KKB Engineering proved its resilience, posting better than expected results. To recall, six out of eleven stocks, have performed within and above our expectations. Despite the recent cost revisions on mega projects, construction companies with healthy order book have managed to sustain its revenue YTD. While we consider these progressions as positive, few concerns should be given attention, so as to mitigate any hard landing in the near term.

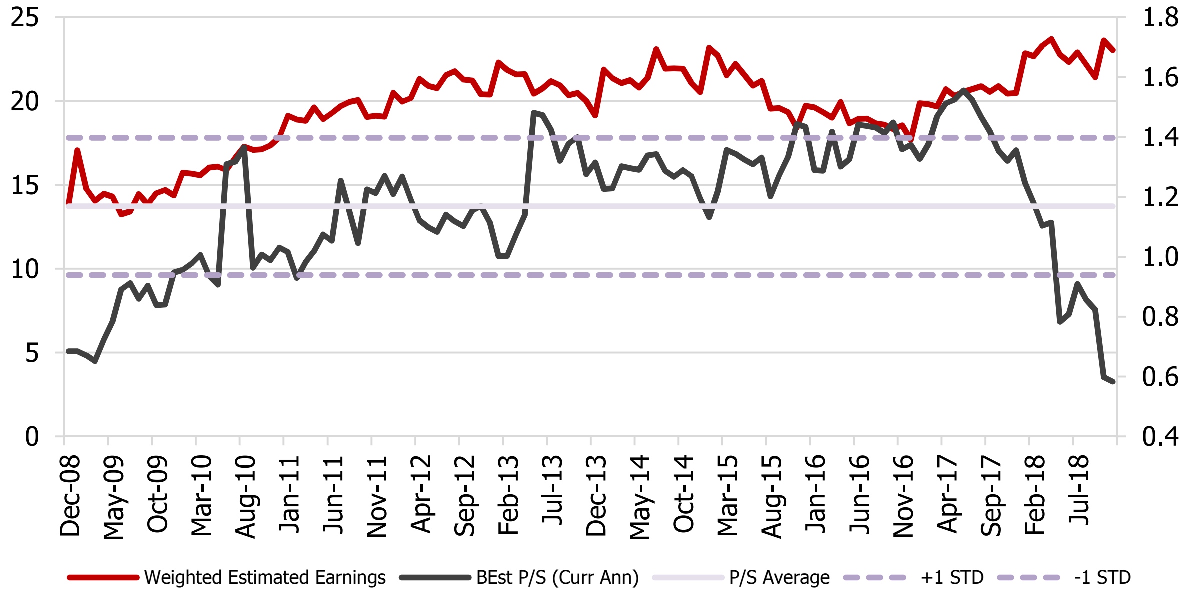
Addressing the concerns. In our previous sector write-up, we highlighted several concerns which have led to the sector's grim outlook. This was subsequent to a revision call made on mega projects, which were considered expensive. Consequently, recent proclamation by the government has confirmed that several projects were put to shelf, namely HSR and ECRL. Any potential revivals will depend on the negotiation outcomes between key stakeholders, which we believe will not conclude anytime soon. This was on the account of government's current position to (1) minimize expenditure on mega projects, (2) prioritize budget allocation on social development, and (3) improve fiscal discipline. Whilst the new course charted seemed conservative, we consider it as a precautionary and reasonable at a time when internal and external risks are becoming more pronounced.

Looking at the bigger picture. In reference to Budget 2019, the amount of DE spent at circa RM50b was significant, which denotes positive sign on the near term developments. Despite the recent cancellation and deferment of mega projects aforementioned, we should highlight that the anticipated drag to the sector was less than initially thought. While certain review exercise on mega projects has put a strain on sentiment, we believe the sector's long term outlook will be driven by sustainable measures. We are encouraged to see that meaningful allocations were secured, giving reasonable attention to residential, non-residential, social amenities and infrastructure developments.

Trends in 2019. We expect construction works mainly for MRT2, LRT3 and Pan Borneo Highway (PBH) to pick up pace soon following the green light granted by the government to complete the projects. Despite significant cost reductions for both MRT2 and LRT3, the combined contracts amount was still significant at RM41.5b, providing earnings visibility beyond CY2020. On PBH, we have seen some improvements in revenue recognition by the related contractors namely KKB Engineering and Cahya Mata Sarawak. Moving forward, we expect the recovery in investors' sentiment will be heavily weighted by the development potential in East Malaysia. In 2019, we expect the pending implementation of mega projects especially in Sarawak will likely provide a boost on the state's construction outlook. The potential roll out of Sarawak infrastructure packages includes the Coastal Road, the Second Trunk Road and the state's water grid projects worth RM9.1b.

Maintain POSITIVE on the sector. Despite the near-term directional swing, we see the headroom is still ample for the sector to grow. This was mainly a recognition of (1) stable DE allocation in Budget 2019, 2) continuation of mega projects such as LRT3, MRT2 and PBH, and 3) pending implementation of infrastructure projects, namely the Coastal Road, Second Link Road and the State's Water Grid projects. At this juncture, there are few stocks which we believe are trading at attractive levels. They are **Gabungan AQRS (BUY, TP: RM1.87)** and **Muhibbah Engineering (BUY, TP: RM3.15).** This observation was on the account of 1) P/S ratio below the sector 10-year average at 1.2x, (2) widening gap between P/S ratio and earnings, and (3) healthy earnings posted YTD18. Additionally, we also have a BUY call on **Cahya Mata Sarawak (TP: RM4.13)** and **KKB Engineering (TP: RM1.13),** which we opine will benefit from the pending roll-out of Sarawak infrastructure developments.

KLCON P/S RATIO VS WEIGHTED EARNINGS



Source: MIDFR, Bloomberg

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 *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.