

02 June 2015 | Sector update

Hafiz Hassan  
mohd.hafiz@midf.com.my

# CONSTRUCTION

*1QCY15 Earnings Wrap***Maintain POSITIVE****KLCON: 294.19 (+5.66%ytd)****INVESTMENT HIGHLIGHTS**

- **6 out of 7 construction companies met or exceeded earnings expectations.**
- **Earnings are expected to continue improve in the coming quarters on account of strong job progress and margin improvement**
- **The KL Construction Index (KLCON) is trading below its 5-year quarterly average PER of 17x. We see limited downside risk given the forward PER is only at 12x.**
- **We reaffirm our POSITIVE recommendation on the sector.**

**Only 1 came below expectation.** In our universe of 7 construction stocks, the earnings of 4 stocks (Protasco, Muhibbah Engineering, Hock Seng Lee and WCT Holdings) came in line with our expectations. However, we were surprised that IJM Corp recorded below estimated net profit on the account of lower-than-expected earnings contribution from the construction, property and plantation segments. As for Eversendai, its earnings continued to beat street expectation due to improvement in the execution of steel fabrication and erection projects particularly in the Middle East, India and Malaysia. Meanwhile, Gamuda will only release its results by end of this month.

**Earnings expected to continue its momentum.** As the earnings outlook of construction companies has greeted 1QCY15 on a promising note, we deem the positive earnings momentum will continue into 2QCY15. Although raw materials prices were slightly inflated following the implementation of GST, we reckon the price environment is still generally healthy. Building material prices, in particularly steel bars, have been declining in the past few years. Meanwhile, cement producers have been under pressure to hold their prices for cement as oversupply continues to haunt the industry.

**Healthy job replenishment ahead.** While there was lack of positive surprises in 11MP announcement, at least the government has reiterated its stance to implement the already announced mega roads and rail infrastructure projects. This reaffirm our view that construction sector shall continue to be a boom story in the next five years. Therefore, we believe the earnings prospects of construction companies will continue to show healthy growth on expectation of better construction job replenishments. It is notable that the consensus earnings estimates of construction companies thus far this year have not subjected to material downward revisions.

**Limited valuation downside on construction stocks.** Although the 11MP construction projects are real possibility, the execution challenges will be high and earnings delivery is not clearly visible due to uncertainties over the actual timing of the projects roll-out. Thus, pursuant to previous price run-up of some big-cap construction stocks in our universe, the P/E CY15 particularly of IJM Corp (22x), Gamuda (16x) and WCT Holdings (12x) are now slightly stretched. On the other hand, the price of our small- to-mid caps top pick, namely Protasco (8x) and Eversendai (6x) have yet to reflect its fundamental prospects. Similarly, KLCON Index's forward PER of 12x is still trading at a discount to its historical 5 years rolling 4-quarter PER of 17x. This implies that the market has yet to fully priced-in construction sector's earnings prospects, particularly among the small-to-mid caps.

**Recommendations.** Premised on above, we maintain our **POSITIVE** stance on the Construction sector. Our top picks for the sector at this juncture are **IJM Corp (NEUTRAL, TP: RM7.16)**, **Protasco (BUY, TP: RM2.45)** and **Eversendai (BUY, TP: RM1.28)**. For **Gamuda (TP: RM4.83)**, we opine the Group is a favourite to win large package of railway projects and its PDP role despite the strong challenge from foreign bidders. Meanwhile, we expect

strong potential candidates for the upcoming implementation of aforesaid mega projects are **WCT Holdings (TP: RM1.84)**, **Muhibbah Engineering (TP: RM2.73)**, **Hock Seng Lee (TP: RM2.06)**, soon to be listed **Sunway Construction (non-rated)**, **Mitrajaya (non-rated)**, **Econpile (non-rated)**, **Gadang (non-rated)**, **Fajarbaru (non-rated)**, **TRC Synergy (non-rated)**, **AZRB (non-rated)**, **Melati Ehsan (non-rated)** **Cahaya Mata Sarawak (non-rated)** and **KKB Engineering (TP: RM1.96)**.

**TABLE 1: OUR UNIVERSE**

Company	Rating	Last Price (RM)*	TP (RM)	EPS (sen)		PER (x)		DPS (sen)		Yield (%)	
				FY15F	FY16F	FY15F	FY16F	FY15F	FY16F	FY15F	FY16F
<b>Gamuda</b>	NEUTRAL	4.99	4.83	31.5	30.3	16	16	13.0	13.0	2.6	2.6
<b>IJM Corp**</b>	NEUTRAL	7.03	7.16	31.5	35.6	22	20	15.0	16.0	2.1	2.3
<b>WCT Holdings***</b>	NEUTRAL	1.70	1.84	13.7	15.0	12	11	4.0	4.5	2.4	2.6
<b>Muhibbah Eng.</b>	BUY	2.42	2.73	22.5	23.0	11	11	5.0	5.0	2.1	2.1
<b>Eversendai</b>	BUY	0.74	1.28	11.5	12.2	6	6	1.9	2.0	2.6	2.7
<b>Hock Seng Lee</b>	BUY	1.84	2.06	16.0	18.3	12	10	3.0	4.0	1.6	2.2
<b>Protasco</b>	BUY	1.90	2.45	23.5	23.9	8	8	10.0	10.0	5.3	5.3

\* As at 29 May 2015

\*\* FY16 and FY17

\*\* Ex-rights TP: RM1.70

Source: MIDFR

**TABLE 2: RESULTS SUMMARY**

Stock	Period under review	Expectation		Comment
		MIDFR	Consensus	
IJM Corp	FY15	Below	Below	Lower-than-expected net profit from three major segments namely construction, property and plantation
WCT Holdings	1QFY15	Within	Within	
Muhibbah Eng.	1QFY16	Within	Within	
Eversendai	1QFY17	Above	Above	Normalised PATAMI was at RM25.8m due to higher local construction projects billings
Hock Seng Lee	1QFY18	Within	Within	
Protasco	1QFY19	Within	Within	

Source: Company, MIDFR

**TABLE 3: 11<sup>th</sup> MP PROJECT**

Measures	Estimated value (RM'm)
<b>Rail-lines</b>	
1. KVMRT Line 2	RM28.0b
2. LRT 3	RM9.0b
3. Gemas-JB Double Track	RM8.0
4. KL-Singapore High Speed Rail	RM40.0b
<b>Roads and Highways</b>	
1. 1,663-km Pan-Borneo Highway	RM27.0b
2. 276-km West Coast Expressway	RM5.0b
3. Kota Bharu-Kuala Krai Highway	N.A.
4. Central Spine Road	N.A.
5. Lebuhraya Pantai Timur	N.A.
6. 3,000 kilometres of paved roads	N.A.

Source: Various, MIDFR

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### 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.