

06 March 2015 | Sector Update

Hafiz Hassan
mohd.hafiz@midf.com.my

Construction Sector 4QCY14 Earnings Wrap

Maintain POSITIVE

KLCON: 300.78
FBMKLCI: 1,806.09

INVESTMENT HIGHLIGHTS

- 5 out of 7 construction companies met or exceeded earnings expectations.
- Earnings are expected to improve in the coming quarters on account of lower raw material prices.
- The pace of new contract awards thus far has improved.
- 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.

5 out of 7 construction companies met or exceeded earnings expectations. In our universe of 7 construction stocks, the earnings of 4 stocks (Gamuda, IJM Corp, Muhibbah Engineering and Protasco) came in line with our expectations. However, two stocks (WCT Holdings and Hock Seng Lee) recorded lower than expected net profit on the account of particularly poor construction margins. As for Eversendai, its earnings were above our expectation due to improvement in the execution of local construction projects. Overall, we opine that competitive tender awards particularly on those big government-linked projects have squeezed the operating margin of construction companies. It must be highlighted that had these construction players failed to tighten its cost control on contract executions, it would have dragged its margin even further.

Earnings expected to regain momentum. Nonetheless, the earnings outlook of construction companies may greet 1QCY15 on a more promising note. We reckon the lower raw materials prices (refer to appendix) could lower their operation costs and help margin to improve. We expect the average FY15 EPS for the construction stocks under our coverage to grow by a 23.0%yoy. Looking ahead, we believe the earnings estimates shall remain stable at prevailing levels on expectation of better construction job replenishments and improvement in construction work progress. Also, thanks to the government's reaffirmation to implement its development projects under Budget 2015, the consensus earnings estimates of construction companies have thus far not subjected to material downward revisions this year. This suggests that the industry has maintained its faith in the earnings growth prospect of the construction stocks.

Contracts award still robust. We note the improvement in the pace of contract awards for the first two months of this year. Total value of contracts awarded to listed construction companies so far came in at RM3.5b (>100%yoy) as compared to RM1.4b in the 1QCY14. Of which, foreign contracts contributed 14% or RM497m of the total. Although we could see "flattish" growth in new property sales this year following the more stringent bank's lending criteria coupled with the potential interest hike in 2H15, we expect more commercial buildings, infrastructure works and on-going mega projects (e.g. KL MRT, RAPID project) will continue to support the sector's growth going forward.

Limited valuation downside on construction stocks. Valuation-wise, KLCON Index is still relatively cheap as it is trading at a discount to its historical 5-year quarterly average PER of 17x. As at end of last week, the KLCON Index's current and forward PER were trading at 14x and 12x respectively. Moreover, while we are in the final year of the 10th Malaysian Plan, we believe there shall be no let down in the momentum of infrastructure project awards going forward. Evidently, the government has finally given the nod to the concessionaire to commence physical works on the East Klang Valley Expressway. Thus, we foresee the government's commitment to implement development projects highlighted in the Budget 2015.

Maintain POSITIVE. The robustness of the sector may propel construction companies' earnings growth prospect further and which in turn shall translate into higher market valuation. Hence we remain positive on the Construction sector. Our top picks for the sector are **Protasco (TP: RM2.45)** and **Gamuda (TP: RM5.28)**. We believe MRT line 2 will be a re-rating catalyst for Gamuda.



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
Gamuda	BUY**	5.30	5.28	33.5	32.6	16	16	12.0	12.0	2.3	2.3
IJM Corp	BUY	7.10	7.50	39.7	50.9	18	14	16.0	20.0	2.3	2.8
WCT Holdings	NEUTRAL**	1.60	1.84	13.7	15.0	12	11	4.0	4.5	2.5	2.8
Muhibbah Eng.	BUY	2.29	2.85	22.4	23.7	10	10	5.6	5.9	2.4	2.6
Eversendai	BUY	0.69	0.78	6.3	6.7	11	10	2.0	2.0	2.9	2.9
Hock Seng Lee	BUY	1.79	2.06	16.0	18.3	11	10	3.0	4.0	1.7	2.2
Protasco	BUY	1.60	2.45	23.5	23.9	7	7	10.0	10.0	6.3	6.3

Source: MIDFR

Table 2: Results Summary

Stock	Period under review	Expectation		Comment
		MIDFR	Consensus	
IJM Corp	9MFY15	Within	Below	
WCT Holdings	12MFY14	Below	Below	Normalised PATAMI of RM111.1m hampered by (1) persistent lower property progress billings, (2) thinner property and construction segments' margins and (3) higher deferred tax and amortizat from KLIA2 Gateway Mall
Muhibbah Eng.	12MFY14	Within	Below	
Eversendai	12MFY14	Above	Above	Normalised PATAMI was at RM33.4m due to higher local construction projects billings
Hock Seng Lee	12MFY14	Below	Below	Earnings of RM77m failed to keep pace with expectations dragged by lower construction margin
Protasco	12MFY14	Within	Within	

Source: MIDFR

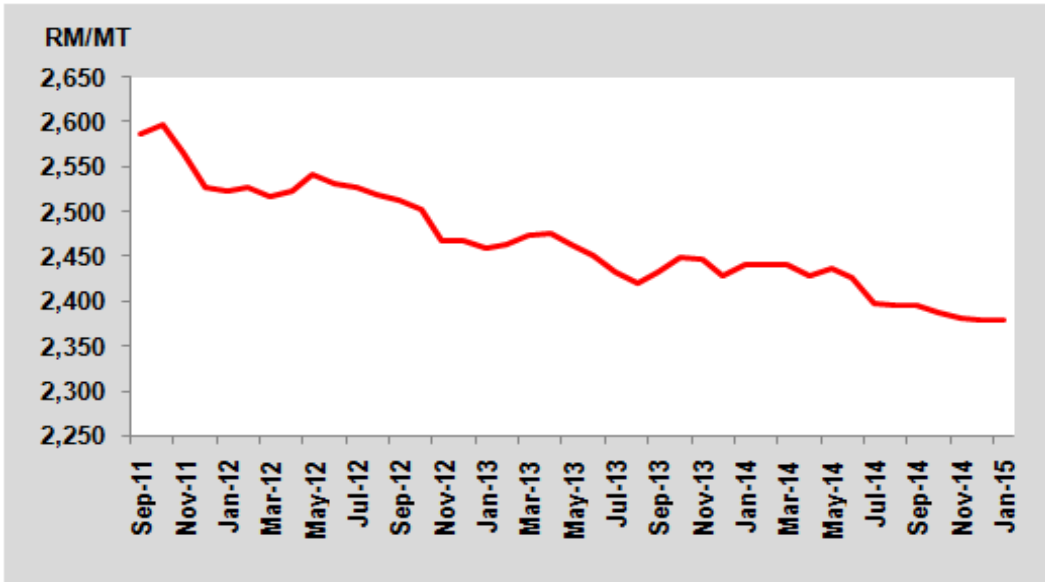
Table 3: Budget 2015 infrastructure projects

Projects	Estimated Value
Rail-lines	
1. KVMRT Line 2	RM23.0b
2. LRT 3	RM9.0b
Roads and Highways	
1. 1,663-km Pan-Borneo Highway	RM27.0b
2. 276-km West Coast Expressway	RM5.0b
3. 59-km Sungai Besi-UluKlang Expressway	RM5.3b
4. 47-km Damansara-Shah Alam Expressway	RM4.2b
5. 36-km Eastern Klang Valley Expressway	RM1.6b
6. 635-km of rural roads	RM943.0m

Source: Various, MIDFR

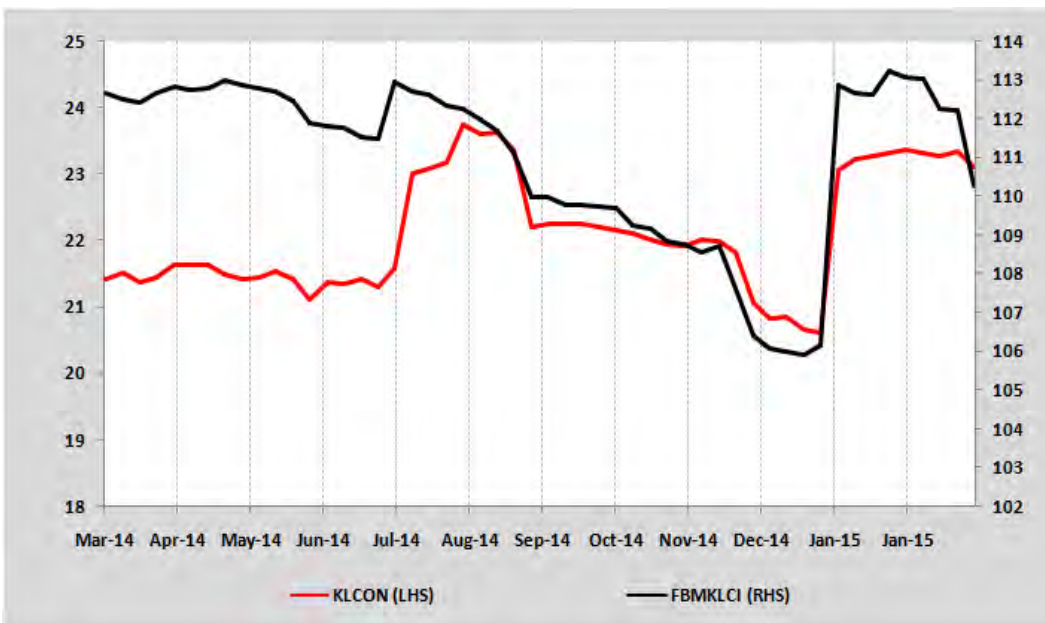
APPENDIX

Chart 1: Mild Steel Bar Prices



Source: CEIC, MIDFR

Chart 2: KLCON EPS vs. FBMKLCI EPS



Source: Bloomberg, 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.