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Construction Sector

Budgeting for infrastructure projects

Maintain POSITIVE

KLCON: 298.50 (+7.67%ytd)
FBMKLCI: 1,833.54 (-1.79%ytd)

INVESTMENT HIGHLIGHTS

- The total value of local and foreign jobs awarded to listed construction companies in 3Q14 was rather disappointing.
- However, earnings expectation and sector's GDP have seen encouraging numbers recently in view of better job replenishment and construction progress works.
- The pace of new contract awards is expected to recover in the months ahead.
- Although the KL Construction Index (KLCON) has outperformed the broader market so far this year, it is still trading below its 5-year quarterly average PER of 18x.
- At this juncture, we reaffirm our POSITIVE recommendation on the sector.

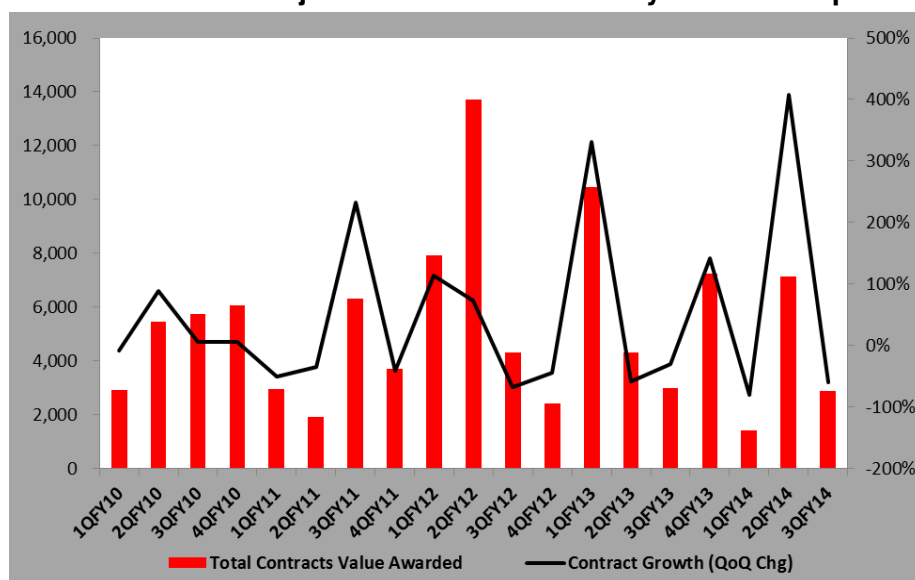
There are three key factors that solidify our POSITIVE rating on the construction sector, namely (i) potential contract awards, (ii) construction GDP growth, and (iii) PER valuation.

A. REVIEW OF CONTRACTS AWARDED IN 3Q14

A trickling of contract awards. The pace of contract awards was relatively sluggish in 3Q2014 with only RM2.9b total value of contracts awarded to listed construction companies. This was comparatively lower to the RM3b and RM7b worth of jobs given out in 3Q2013 and 2Q2014 respectively. The sluggishness was, in our opinion, associated with the dearth of additional awards from on-going big-ticket projects coupled with festival season factor.

Foreign jobs almost non-existent. The local contractors were awarded with 2 foreign contracts worth a marginal RM0.5b in 3Q2014. There were zero foreign contract awards in July and September this year.

Chart 1: Value of Projects Awarded For Locally-Listed Companies (RM'm)



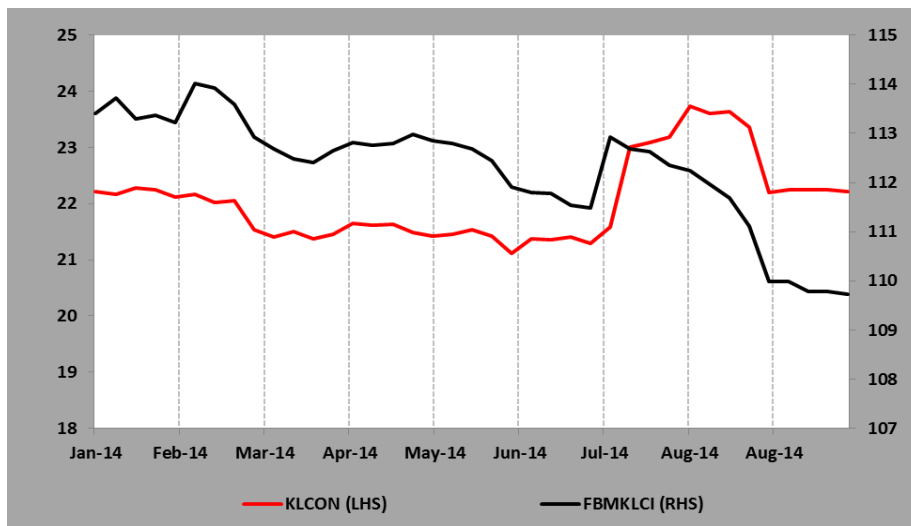
Source: Bursa
Malaysia, MIDFR

B. CORPORATE EARNINGS EXPECTATION

Earnings expectation regained momentum. The earnings outlook of KLCON greeted the second half of the year on an auspicious note. Its consensus earnings estimate was revised drastically upward in 3Q2014 (see chart 2), thanks to positive news flow on the status of large scale projects. The upward revision was suggesting that the market has regained its faith in the earnings growth prospect of construction stocks. Earlier on, the consensus EPS estimate was cut to 21.29sen in 2Q2014 from 22.21sen in 1Q2014 following the first quarter results which generally lagged expectations.

Looking ahead we expect the earnings estimate to stay stable at prevailing level on expectation of better construction job replenishments, as well as improvement in construction work progress.

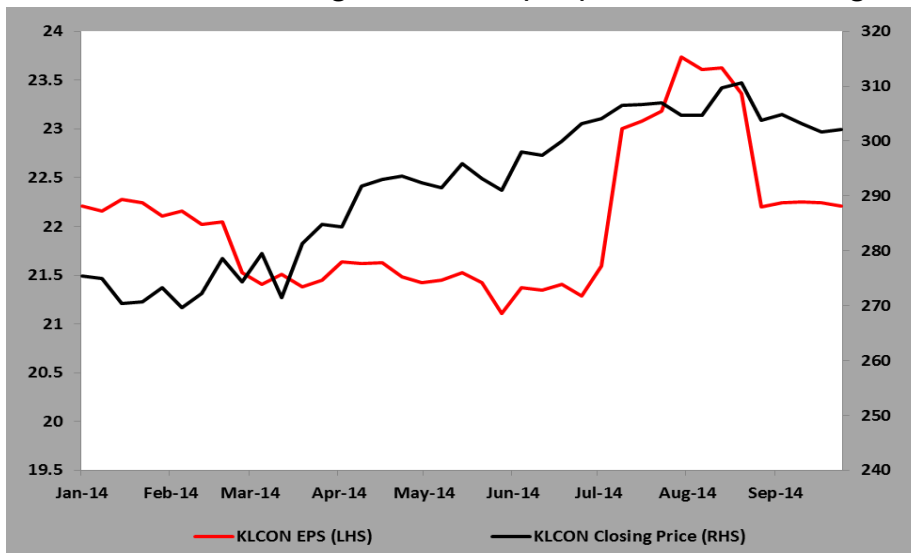
Chart 2: Revisions in Consensus Current Year Earnings Estimate (sen)



Source:
Bloomberg,
MIDFR

Despite the persistent downward earnings revisions during 1H2014, the KLCON Index has been steadily hovering above 300 points levels. We believe the underlying index trend will continue to be principally driven by the earnings prospect of its constituents (see chart 3).

Chart 3: KLCON Earnings Estimates (sen) vs. KLCON Closing Price (points)

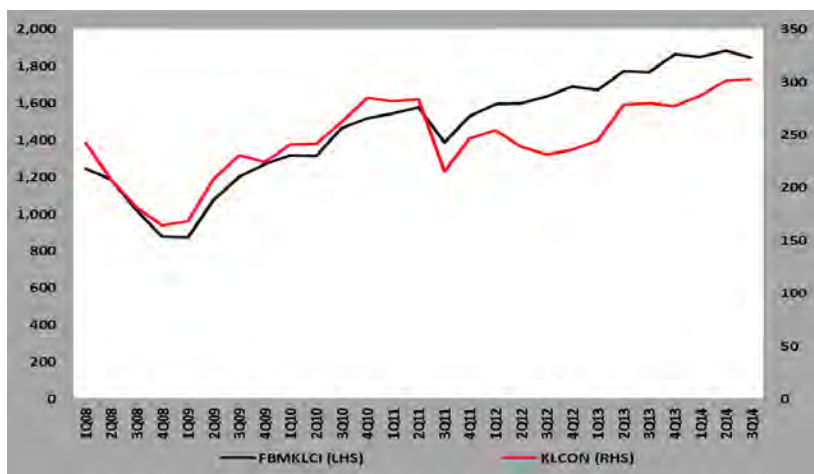


Source:
Bloomberg,
MIDFR

C. PERFORMANCE OF THE CONSTRUCTION SECTOR

Sector cycle still in upward trend. We view the recent slowdown in contract awards have resulted in some investors fearing a turning point in the sector's upward trend. Some financial cooling measures, country's tight fiscal budget, upcoming GST and interest rate hike could all be the attributing factors. However, even though there is a timing issue related to the roll-out of several pending multi-billion projects, we opine investors should look at this as a strategic opportunity to accumulate construction stocks before the sector cycle resumes its upward momentum.

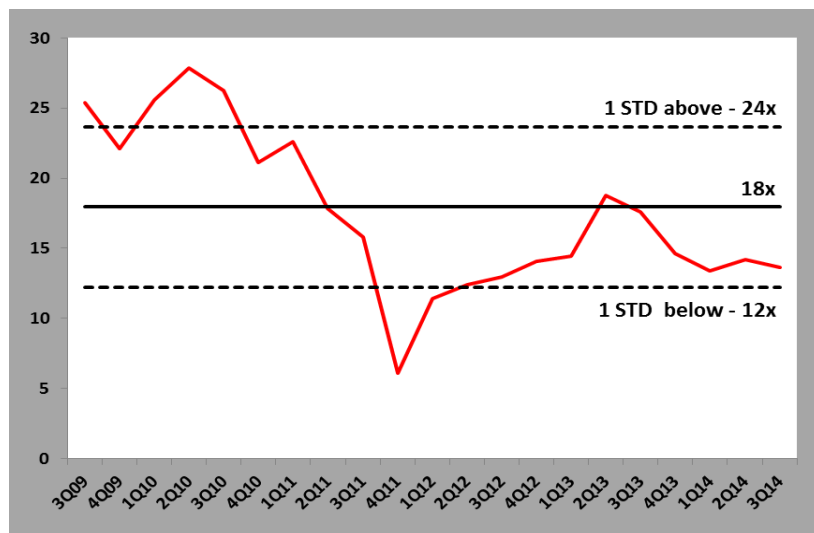
Chart 4: FBMKLCI vs. KLCON Index Performance



Source: Bloomberg, MIDFR

Limited valuation downside on construction stocks. It is noteworthy that, valuation-wise, KLCON Index is still relatively cheap as it is trading at a discount to its historical 5 years rolling 4-quarter PER of 18x (see chart 5). As at end 3Q2014, the KLCON Index's current and blended PER were trading at only 14x and 12x respectively. Hence we expect a limited valuation downside on construction stocks. Furthermore, in line with the recent upward-biased earnings estimate, investors' confidence in construction stocks should resurge going forward in anticipation of more multi-billion projects in coming year.

Chart 5: KLCON Index PER



Source: Bloomberg, MIDFR

Higher valuation will be propelled by earnings prospect. We note that some construction stocks have already gone up in price to reflect their current construction backlog. Nonetheless, we believe the much awaited multi-billion projects, such as KVMRT 2 & 3 and intra- and inter-urban highways, will propel construction companies' earnings growth prospect further hence translating into higher market valuation.

Construction GDP remains positive. The Construction GDP expanded at strongly at 14.4% in 1H2014 (vs. 12.1% in 1H2013) which outpaced the target of 9% set for 2014. Growth appeared to remain steady on the account of robust construction activities mainly from Klang Valley Mass Rapid Transit (KVMRT) Line 1 and various property developments.

D. SECTOR OUTLOOK

Budget 2015 expectations. We stand just a couple of days away from the country's Budget 2015. Our expectations are for the Government to continue to commit on priority infrastructure projects in 2015 as a measure to accelerate growth.

Among the key projects are:

- i. Highways i.e. West Coast Expressways, Kuala Lumpur Outer Ring Road, Damansara-Shah Alam Expressway, Sungai Besi-Ulu Klang Expressway and Pan Borneo Highway.
- ii. East Coast Economic Region including Kuantan Port expansion, SCORE development and other economic regional corridors.
- iii. Continuous effort on affordable or low cost housing programme.
- iv. Rehabilitation of abandoned housing projects.

Apart from projects abovementioned, we believe the sector will continue to excite investors with timely progress update on other large-scale projects such as the RM26b Tun Razak Exchange, RM5b PNB Warisan Merdeka Tower, RM6b Penang Third link projects, Penang Integrated Transport, RM25b KVMRT Line 2, RAPID projects and power plants going forward.


Maintain POSITIVE. At this juncture, we remain positive on the Construction sector. Our top picks for the sector are **Gamuda (TP: RM5.28)** and **Protasco (TP: RM2.57)**. Meanwhile, we believe Naim (TP: RM4.80), Hock Seng Lee (TP: RM2.01), Cahya Mata Sarawak (Non-rated) and KKB Engineering (TP: RM2.84) will continue to be key beneficiaries of robust East Malaysia economic corridor development. 

Table 1: Potential Multi-billion Projects in the Pipeline

Projects	Estimated Value
<u>Rail-infrastructure</u> 1. Klang Valley MRT Line 2 (KVMRT2) 2. Southern Electrified Double Tracking Railway 3. KL-Singapore High Speed Rail 4. LRT 3 5. KVMRT3 6. Penang LRT	RM25.0b RM8.0b RM40.0b RM9.0b - RM5.5b
<u>Roads and highways</u> 1. West Coast Expressway (WCE) 2. Sungai Besi to Duta Ulu Klang Expressway (SUKE) 3. Damansara-Shah Alam Highway (DASH) 4. Kinrara Damansara Expressway (KIDEX) 5. East Coast Expressway Phase 3 & 4 6. Pan-Borneo Highway 7. Penang Third Link projects 8. Penang highway infrastructure	RM5.0b RM4.8b RM4.2b RM2.5b RM21.0b - RM6.3b RM16.0b
<u>Property developments</u> 1. Kwasa Damansara 2. Tun Razak Exchange 3. Warisan Merdeka Tower 4. Bandar Malaysia 6. PR1MA Houses	RM50.0b RM26.0b RM5.0b RM20.0b RM17.6b
<u>Utilities</u> 1. RAPID 2. Power Plant Track 4 3. Baram and Balleh Hydroelectric Dams	RM60.0b RM8-10.0b RM7-8.0b

Source: Various, MIDFR

Table 2: Our Universe

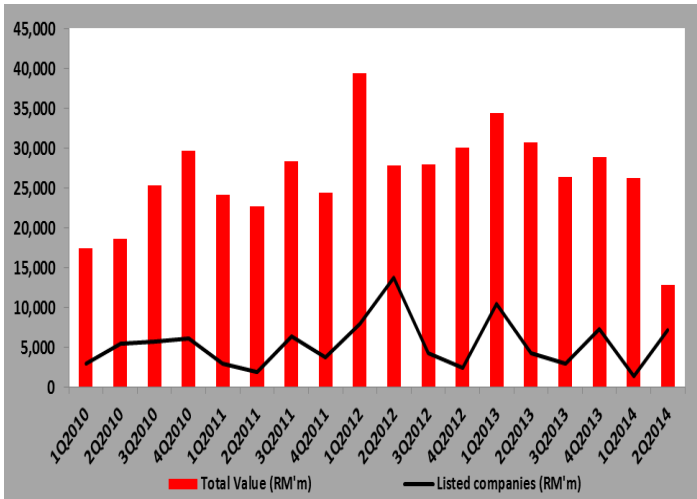
Company	Rating	Last Price (RM)*	TP (RM)	EPS (sen)		PER (x)		DPS (sen)		Yield (%)	
				FY14F	FY15F	FY14F	FY15F	FY14F	FY15F	FY14F	FY15F
Gamuda**	Buy	4.82	5.28	33.5	36.5	14	13	14.0	14.0	2.9	2.9
IJM Corp**	Neutral	6.47	6.98	37.7	45.0	17	14	12.5	19.2	1.9	3.0
WCT Holdings	Buy	2.16	2.59	17.2	20.3	13	11	8.9	10.0	4.1	4.6
Evesendai	Neutral	0.93	0.99	5.2	9.0	18	10	3.0	3.0	3.2	3.2
Hock Seng Lee	Buy	1.90	2.14	15.8	17.5	12	11	4.0	4.5	2.1	2.4
Protasco	Buy	1.67	2.57	17.7	28.1	9	6	12.0	14.0	7.2	8.4

*As at end of 3Q2014

**FY15 and FY16 forecasts

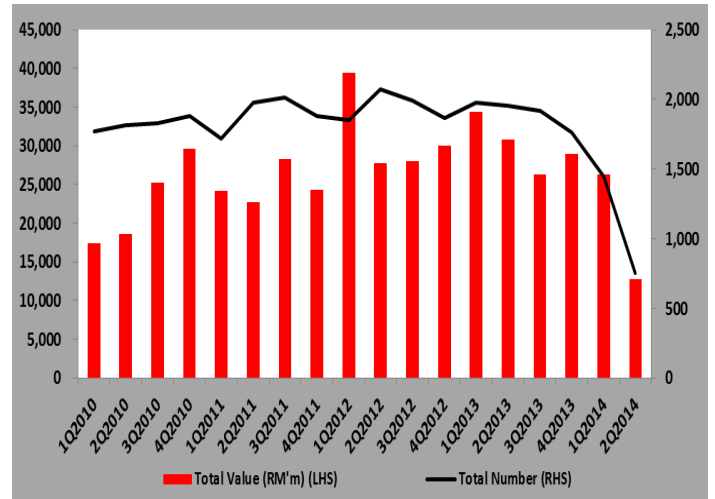
APPENDIX

Value of Contracts Awarded in the sector

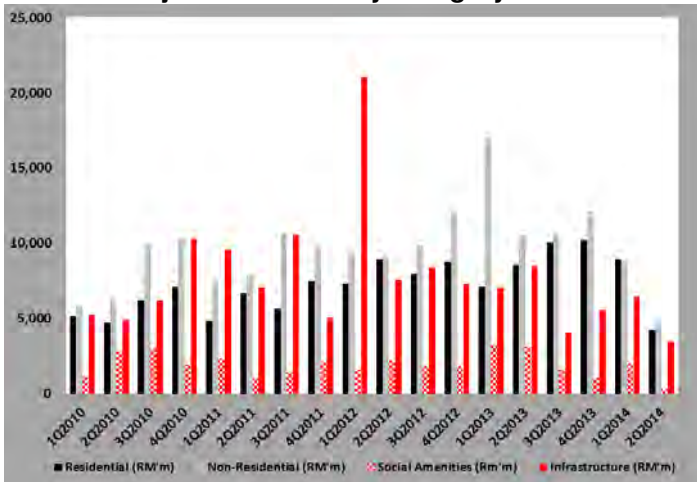


Source: CIDB, Bursa Malaysia, MIDFR

Number and value of Contracts Awarded

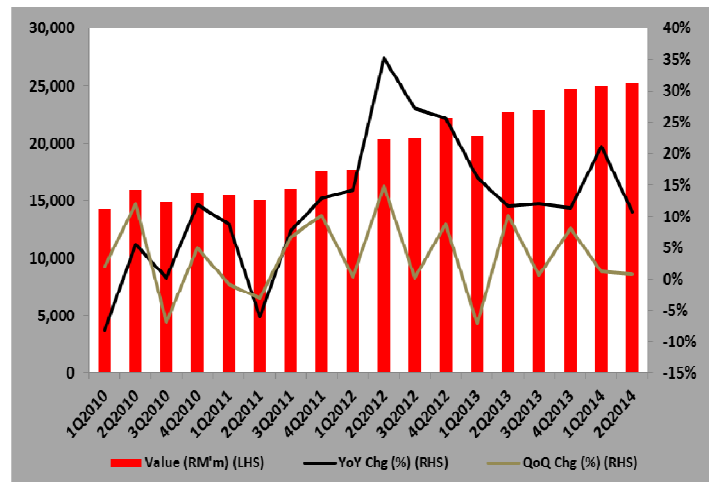


Value of Projects Awarded By Category



Source: Department of Statistics, CIDB, MIDFR

Value of Construction Work Done



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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.