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## Construction Sector

### *The Twin Injection of Strength*

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#### INVESTMENT HIGHLIGHTS

- **GLC Open Day 2015 helps to unveil the direction of the construction sector**
- **Infrastructure projects lead construction foray amounting to RM174bn for FY15**
- **Feeble crude oil price persisting against backdrop of potential hike in Iran's oil production**
- **The twin injection of strength:**
  - a) **Strong domestic government led projects, and**
  - b) **Lower construction material prices.**
- **We reiterate our POSITIVE stance on the sector.**

**Open day helps to unveil the direction of construction sector.** We visited the GLC Open Day 2015 on the 7<sup>th</sup> of August and participated in the GLC Transformation Story Forum led by Minister in the Prime Minister Department, Senator Dato' Sri Hj. Abdul Wahid Omar and moderated by Dr. Nungsari Ahmad Radhi from Prokhas Bhd. In gist, the Open Day showcased the achievements of GLC Transformation Program for government-linked companies (GLC) and government linked investment companies (GLIC) during the past decade. The objective of the event was to illustrate how GLCs and GLICs have executed and will continue to execute the development policies led by PEMANDU against the grim backdrop of falling crude oil prices and sliding value of Ringgit Malaysia.

**Infrastructure leads construction foray amounting to RM174bn for FY15.** Thus, we took the opportunity to add to our observations of government policies that will impact the domestic construction sector moving forward. Our observations are based on the premises of government's 2015 budget for infrastructure and infrastructure related spending of RM174bn. Moving ahead, the government-initiated projects will be strong catalysts for realizing Vision 2020 and arguably key for the incumbent to retain the mandate in the next election. Furthermore, infrastructure projects will lead the foray for construction sector giving strong focus on:

- (i) Transit-oriented Development (ToD),
- (ii) Transit-proximate Development (TpD),
- (iii) Transport Network-based Infrastructure (TNbI),
- (iv) Greenfield downstream oil and gas engineering, procurement and construction contract (EPC), and
- (v) Low cost housing.

**Feeble crude oil price persisting against backdrop of potential hike in Iran's oil production.** Meanwhile, we expect continued weakness in price of crude oil in view of Iran's announcement to boost oil production in a week after sanctions are lifted by late November. Its production can increase from 500,000 barrels a day to 1 million barrels a day and this would result in lower crude oil prices. Additionally, OPEC may not be able to regulate its members' output in the event that the sanctions for Iran are lifted. MIDFR expect crude oil prices to remain subdued in the near term with limited potential upside at between USD60-USD70 per barrel.

**The twin injection of strength.** During the next five years, the construction sector will be further strengthened by the injection of: (a) Strong domestic government led projects, coupled with (b) Lower crude oil price that could usher in the era of lower construction material prices:

**a) Strong Government led projects**

According to Department of Statistics, total value of projects awarded in Q1FY15 was higher by +6.1%QoQ (+15%,YoY) at RM28.7bn with 9,982 number of projects as compared to 10,000 projects in Q4FY14 with a lower total value of RM27bn. It was also an improvement from Q2FY14 with a total value of RM24.9bn and number of projects totalling 9,774. The number of projects illustrates the buoyancy of domestic construction sector propelled by government policies for (i) infrastructure projects, and (ii) transit oriented projects enumerated in various policies such as the Economic Transformation Agenda, Penang Transport Strategy Masterplan and National Land Public Transport Masterplan. Furthermore, ongoing and planned projects for the five series of Economic Corridor launched from 2006-2009 such as Northern Corridor Economic Region (NCER), Sarawak Corridor of Renewable Energy (SCORE), Iskandar Development Region (IDR) and East Coast Economic Region (ECER) are still in various development stages thus providing forward impetus for construction and infrastructure related projects.


**b) Lower crude oil price could usher in the era of lower construction material prices**

Construction projects have many uncertainties which include unexpected construction issues particularly due to adverse changes in raw material costs. The expected impact on construction companies will be on construction materials especially relating to civil, municipal, heavy and specialized steel, structural and fabrication related projects. Lower oil price (esp. Diesel and Bitumen) could mean that the companies will have favourable margins as construction materials remain flattish. Basic construction materials that require energy intensive manufacturing and primary processing such as steel, concrete and bricks should benefit from the fall in the price of crude oil. Thus, the companies can undertake construction projects with very competitive cost. CIDB has published the Building Material Cost Index for Peninsular Malaysia on annual basis for average construction materials price. It is found that the trend shows stabilizing price for the FY14 and is expected to remain the same for FY15. Building materials tracked in the CIDB research includes; (i) steel and metal section, (ii) aggregates, sand, (iii) bricks and wall, (iv) sanitary fittings (v) Glass (vi) Paints, (vi) floor and wall tiles. Therefore, the margin profile will be in a more favourable range without any unforeseeable volatility.

**Our View**

Accordingly, we are sanguine on the outlook for the sector due to; (i) lower cost – more stable margin rate, and (ii) buoyant domestic policy. Hence, we maintain **POSITIVE** for the sector whilst continuing to be additionally upbeat on smaller capitalized companies based on number of projects clinched and order-book replenishment rate.

Therefore, **Eversendai, KKB and Muhibbah** should remain attractive due to their wide exposures in EPC contracts of steel, structural and fabrication related to oil and gas. Additionally, **Sunway Construction, IJM, Gamuda, MRCB, Protasco** and **WCT** are potential beneficiaries of ToD, TpD and TNbI construction and development projects. **Naim** and **HSL** will also remain attractive and stands to benefit directly from Sarawak projects through SCORE, TpD and Lebuhraya Borneo Utara (LBU). We reckon that the tender process will start soon for LBU as the government has already appointed Lebuhraya Borneo Utara Sdn Bhd as a project delivery partner (PDP).

Apart from that, we continue to maintain Neutral for **LaFarge**. Eventhough it is seen to be a direct proxy of projects for cement and concrete supplies, but we are of the opinion that most of the infrastructure projects relies on in-house cement and concrete mix facilities and expertise due to cost and quality control. 

**Table 1: Our Universe.**

Companies	Market Cap	Target Price	Price (7/8/15) RM	Upside (%)	Call	EPS (Sen)		Current PER		PBV		Div.Yield (%)	
						FY15E	FY16E	FY15E	FY16E	FY15E	FY16E	FY15E	FY16E
<b>IJM</b>	12.59b	7.3	6.54	+5.6	Neutral	30.6	31.5	23.1	22.2	1.208	1.303	2.1	2.2
<b>Gamuda</b>	12.26b	4.83	4.48	-4.9	Neutral	2.3	-3.6	15.2	16.2	1.65	1.59	2.6	2.5
<b>WCT</b>	1.8b	1.84	1.32	+11.6	Neutral	13.7	15	12.6	11.5	0.8	0.7	2.1	2.6
<b>LaFarge</b>	8.8b	9.82	9.08	+1.1	Neutral	37.3	42.3	25.5	22.5	2.54	2.53	3.6	4.2
<b>KKB</b>	322.2m	1.8	1.61	+47.3	Buy	14.1	16	11.6	10.3	1.4	1.2	3.4	3.9
<b>NHB</b>	784.3m	4.42	2.29	+34.9	Buy	32.8	41.6	8.1	6.3	0.44	0.42	1.2	1.6
<b>Muhibbah</b>	1.05b	2.73	2.13	+24.3	Buy	22.5	23	10	9.8	1.4	1.3	2.2	2.2
<b>SunCon</b>	1.5b	1.38	1.18	+18	Neutral	9.3	10.3	12.9	11.7	3.1	2.7	2.7	3
<b>MRCB</b>	1.25b	2.24	1.04	+82.1	Buy	3.7	6.1	30.3	18.5	1.13	1.107	2.2	3.2
<b>Eversendai</b>	561.1m	0.78	0.93	+10.1	Neutral	11	11.7	8.1	7.7	0.7	0.7	2.5	2.6
<b>Protasco</b>	514.9m	2.45	1.66	+65.3	Buy	23.5	23.9	7.7	7.6	1.4	1.2	5.5	5.5
<b>HSL</b>	994.6m	2.06	1.83	+15.5	Buy	16	18	12.2	10.7	1.575	1.471	2	2.2

Source: MIDFR

**Table 2: Infrastructure Projects in National Budget 2015.**

Infrastructure and Infrastructure Related Projects in Federal Government 2015 Budget				
No	Projects	Units	Length (KM)	(RM'bn)
1	Sungai Besi-Ulu Klang Highway		59	5.3
2	West Coast Highway from Taiping to Banting		276	5
3	Damansara-Shah Alam Highway		47	4.2
4	Outer Ring Road Kuala Lumpur-East Coast Connection		36	1.6
5	Upgrading of East Bound Railway Track		-	0.15
6	MRT Line 2 dari Selayang ke Putrajaya		56	23
7	LRT3 from Bandar Utama-Shah Alam-Klang		36	9
8	Pengerang Refinery and Petrochemical Integrated Development		-	69
9	PR1MA Housing Programme	80,000	-	1.3
10	Low Cost Housing Programme	26,000	-	0.644
11	Constructing and Upgrading Rural Infrastructure in Sabah and Sarawak		-	4.5
12	Lebuh Raya Borneo Utara		1663	27
13	Construction of Dungun, Seri Iskandar Hospitals and 1Malaysia Clinics	32	-	23.3
	<b>Total</b>			<b>173.994</b>

Source: MIDFR



GLC OPEN DAY 2015 THEME



PUBLIC RESPONSE



MRCB BOOTH



GLC TRANSFORMATION FORUM

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#### 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.