15 February 2016 | Corporate Update

IJM Corporation Berhad

West Coast Expressway Risk Factors

***Maintain* NEUTRAL**

***Unchanged* Target Price (TP): RM3.56**

INVESTMENT HIGHLIGHTS

- **WCE construction progress is fairly good judging from the timing of securing the financing packages and geotechnical works.**
- **The construction progress is influenced by two risk factors, i.e. geotechnics and pre financing cash flow.**
- **Altogether, we maintain our Neutral stance with an unchanged TP of RM3.56 per share.**

WCE's key project risks. West Coast Expressway (WCE) project spans 193 km over 21 interchanges from Banting to Changkat Jering with a Build-Operate-Transfer (BOT) concession model of 50 years. The project cost is RM6bn and slated to be operational by 1Q2018. We are revisiting the 2 key risks factor, namely (i) project finance, and (ii) geotechnical construction of WCE to obtain a clearer perspective on the progress of its construction phases.

Project financing risk. The vital cog for WCE project commencement was the financing package and the credit guarantee. The government has only budgeted c.RM980m for land acquisition cost. Hence, the remaining amount must be raised by IJM-Keuro. In so far, the project has raised up to RM4.74bn including RM1.0bn through the issuance of Sukuk Murabahah.

Guarantees obtained. Furthermore, the WCE concessionaire, i.e. West Coast Expressway Sdn. Bhd, requires additional capital through equity financing of c. RM1.6bn to service the debt as well as maintain and operate WCE in the initial years of operations. To alleviate the concern, Danajamin and Bank Pembangunan have guaranteed the proposed Sukuk for 21 years to reduce its credit risk. RAM Ratings has assigned an AAA (bg/fg)/Stable ratings to the sukuk programme.

Construction risk. Another pivotal factor is construction geotechnics. The total average rate of progress is currently at 15.2% (see *Figure 1*) which gives IJM ample time to award the remaining 5 packages for construction. Our assessment model in *Figure 2* imputes geotechnical risk as WCE is constructed on the West Peninsular Malaysia coastal alluvial plains.

The soil profile is of an estuarine, marine and deltaic soft soil deposit. Thus, construction cost and schedule will be closely influenced by ground works in *Figure 3* and the soil treatment procedures in *Figure 4*.

RETURN STATS	
Price (12 Feb 2015)	RM3.41
Target Price	RM3.56
Expected Share Price Return	4.3%
Expected Dividend Yield	+2.2%
Expected Total Return	**+6.5%**

STOCK INFO	
KLCI	1,643.74
Bursa / Bloomberg	3336/ IJM MK
Board / Sector	Main / Construction
Syariah Compliant	Yes
Issued shares (mil)	3580.6
Par Value (RM)	1.00
Market cap. (RM'm)	12,209
Price over NA	0.57
52-wk price Range	RM2.87– RM3.75
Beta (against KLCI)	0.99x
3-mth Avg Daily Vol	4.52m
3-mth Avg Daily Value	RM15.2m
Major Shareholders (%)	
EPF	13.8
ASB	7.55
LTH	5.51
ASW	2.93

Adequate pre-financing cash flow vital to project commencement. Firstly, moving forward, WCE needs to generate adequate pre-financing cash flow amounting to c.RM390m to balance its debt repayment obligation. While the credit guarantees from Danajamin and Bank Pembangunan assist in securing confidence in the project, but it does not negate the risk impact to the construction progress of WCE from cost overruns, changes in construction program and delays due to cash flow issues. Thus, the challenge would be raising funds through shareholders in current market situation. However, we believe that the fundraising efforts will be successful due to (i) potential steady stream of recurring income from tollway revenues, and (ii) strategy of transferring the financing to subcontractors to finance and build the sections.

Groundworks are critical in WCE to support high cyclic load and future maintenance. Secondly, in some stretches, the soil is unable to support high earth embankment which necessitate normal soft soil treatment as illustrated in *Figure 4*. For WCE's structural engineering, groundworks are the most critical because the abutments of structures such as piled gravels and sands will not settle fast on the road surface. Hence, ground treatment must be accelerated to avoid delays to the structures which are usually on the critical path in the construction progress rate. Any delays in the structure for groundworks will influence higher cost especially cost of construction thus eroding margins. We reckon that the risk is mitigated by employing earth fill and treatment using the Vibro Replacement method in *Figure 5* where large-sized columns of coarse backfill material are installed in the soil by means of special depth vibrators.

Soft soil condition not an uncommon phenomenon. Comparatively WCE's soft soil condition is not an uncommon phenomenon in Malaysia's highway construction. A case in point is the Jelutong Expressway, Penang Stage 1 construction from Sungai Pinang Interchange to Kampung Pokok Assam Interchange. The alignment of this expressway passes over a municipal waste dump and embankment construction was built between 4m and 7m in height. The subsoil consists of 6m rubbish dump and soft marine clay down to a depth of 10 m to 14 m. Therefore, ground improvement using Vibro Replacement in Jelutong Expressway (see *Figure 6 and 7*) was selected in order to compact the municipal waste dump as well as to improve soft clayey soils underlying the waste dump. It is also pertinent to note that Jelutong Expressway was designed and built by Jelutong Development Sdn. Bhd., a subsidiary of IJM, and completed in 2010. The expressway was completed without program delays and cost overruns despite its challenging soil profile.

Our View. We remain sanguine on the prospect of WCE progress rate and its potential completion dateline in 1Q2018. **Firstly**, we estimate that steady recurring income from WCE in which revenues can be registered as early as 2Q2019 is not far-fetched. Malaysian Automobile Association (MAA) data show that 55,000 new cars are added to Malaysian roads in every month and the number of cars in the Klang Valley is expected to increase to 7 million by 2020. Furthermore, there is a significant traffic fluxes from Klang Valley to North of Peninsular or vice versa on daily basis.

Secondly, Sub-contractor financing is another feasible strategy. Recently, WCT has been awarded the subcontracting role for the construction section 3,4,5,8 and 9 of WCE by IJM Construction Sdn. Bhd. for a sum of RM282.5m and for a period of 36 months. The scope was largely geotechnical, road base, pavements and earthworks. We consider that the subcontracting strategy would be beneficial to keep the construction progress rate rolling and avoid completion delays. We view the average cost per km of RM3.92m for phases aforementioned as fair and not excessive.

Thirdly, IJM past experience in the usage of Vibro Replacement method in Jelutong Expressway would be applied for WCE's construction, thus the risk of construction delay and change of program will be reduced and will not erode our conservative marginal assumption of c.8.5%. In sum, our earnings estimate for FYE16/FYE17 remains unchanged.

Valuation. Potential upward re-rating catalysts may include the award of the elevated viaducts for KVMRT2. Nonetheless, at this juncture, we remain cautious and take cognizant of the prevailing average low beta (c.1.01) market condition towards the big-cap construction companies in KL Construction Index. Thus, we reaffirm our **Neutral** recommendation with an unchanged **TP** of **RM3.56** per share which equates to an implied PER of 10x.

SOP VALUATION

Segments	Stake	Basis	Value (RM'm)	Per Share (RM)
Construction	100%	DCF@6.7%	2,841.8	0.80
Industrial	100%	FY16 PER of 14x	2,417.3	0.68
IJM Plantation	55%	MIDFR TP of RM3.65	1,433.7	0.40
Property				
Malaysia	Various	DCF@6.7%	5,252.0	1.47
JVs			899.2	0.25
Overseas			486.5	0.14
Concessions Assets				
Kuantan Port	60%	DCF@6.7%	1,200.2	0.34
Highways	Various	DCF@6.7%	1,638.2	0.46
GVK Gautami Power Limited	20%	Book value	336.0	0.09
Hexacon Construction	46%	Book value	305.8	0.09
Keuro	26%	Market Cap at RM0.98	253.6	0.07
Scomi Group	8%	Market cap at 22sen	26.2	0.01
Total value			**17,090.5**	**4.79**
(Net debt) / net cash			-4,366.1	-1.22
SOP per share				**3.569**
No. of shares outstanding (mil)				3,565.6

Source: MIDFR

INVESTMENT STATISTICS

FYE March	FY14	FY15	FY16F	FY17F
Revenue (RM'm)	6,006	5,448	6,277	7,102
EBIT (RM'm)	1,788	1,292	1,366	1,293
Pre-tax Profit (RM'm)	1,416	1,019	980	1,068
Normalised PATAMI (RM'm)	539	489	561	635
FD EPS (sen)	38	31	32	36
EPS growth (%)	25	-19	3	13
PER (x)	10	11	22	20
Net Dividend (sen)	25	15	16	18
Net Dividend Yield (%)	2.4	2.5	2.2	2.5

Source: MIDFR

DAILY PRICE CHART



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Source: Bloomberg, MIDFR

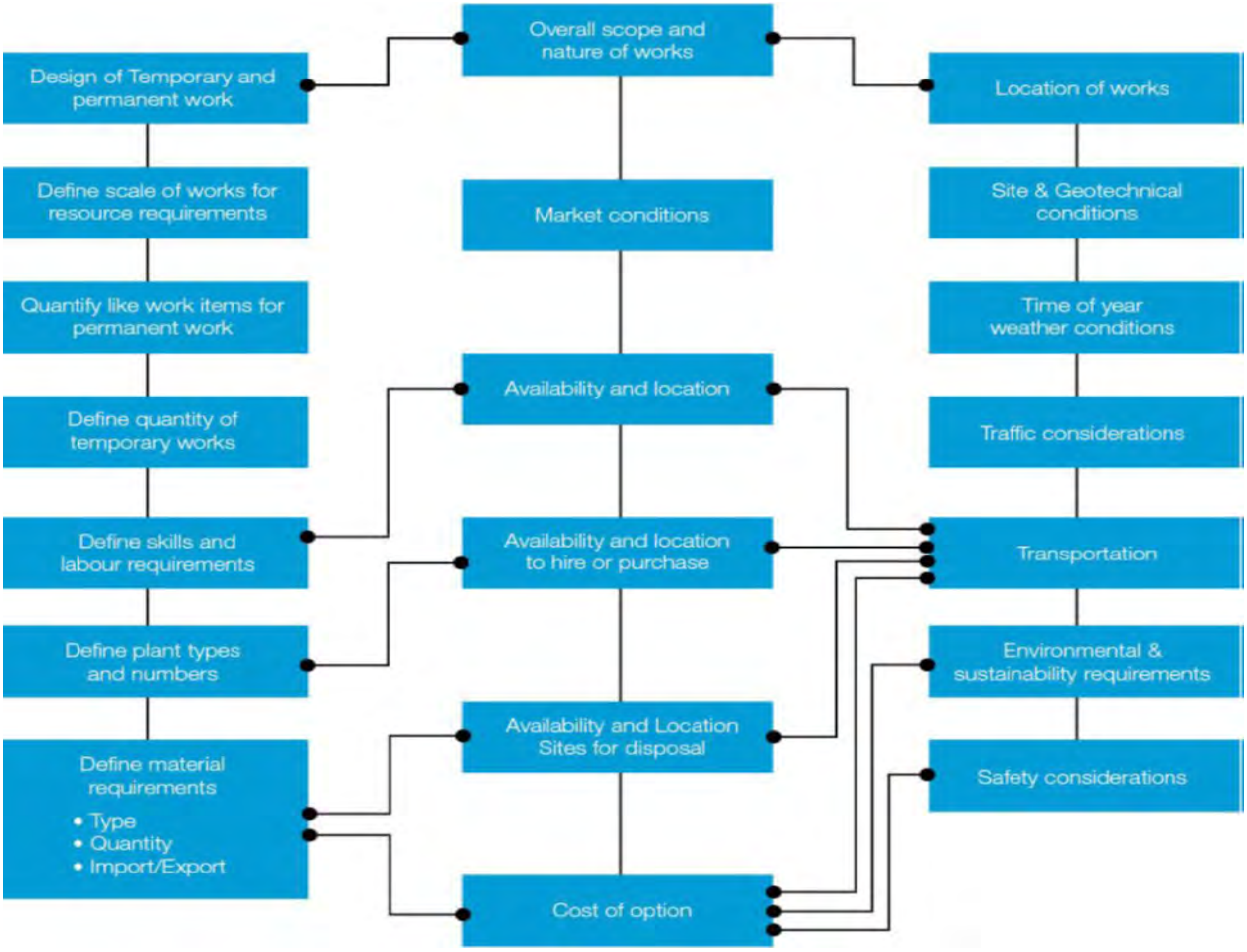
FIGURE 1: CURRENT PROGRESS RATE

Section	State	Route	Length (KM)	Current Progress (%)
1	Selangor	Banting Interchange to SKVE Interchange	11	14.99
2	Selangor	SKVE Interchange to SAE Interchange	7.2	13.46
3*	Selangor	SAE Interchange to NKVE/FHR2 Interchange	10.1	12.58
4*	Selangor	NKVE/FHR2 Interchange to NNKSB Interchange	4.5	32.08
5*	Selangor	NNKSB Interchange to Kapar Interchange	9.7	19.92
6	Selangor	Kapar Interchange to Assam Jawa Interchange	21.8	9.79
7	Selangor	Assam Jawa Interchange to Tg.Karang Interchange	29.5	4.13
8*	Perak	Hutan Melintang Interchange to Teluk Intan Interchange	19.1	22.05
9*	Perak	Kg Lekir Interchange to Changkat Chermin Interchange	28	15.2
10	Perak	Changkat Chermin Interchange to Beruas Interchange	16.6	12.29
11	Perak	Beruas Interchange to Taiping South Interchange	35.5	11.33

Source: WCE, MIDFR

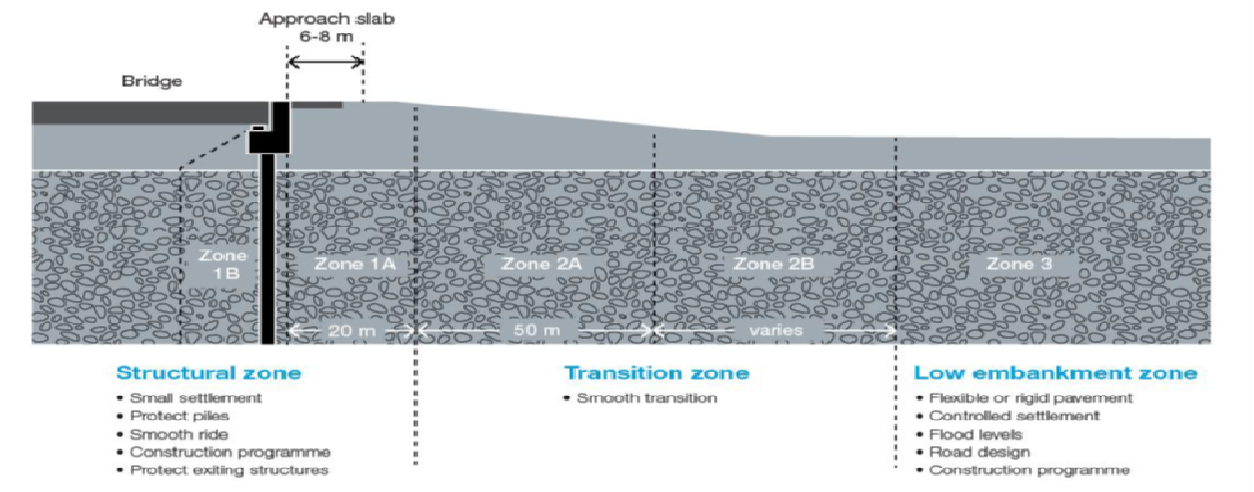
**Awarded to WCT Berhad for subcontracting role and announced on the 16th November 2015.*

FIGURE 2: GROUNDWORKS ENGINEERING ASSESMENT FACTORS



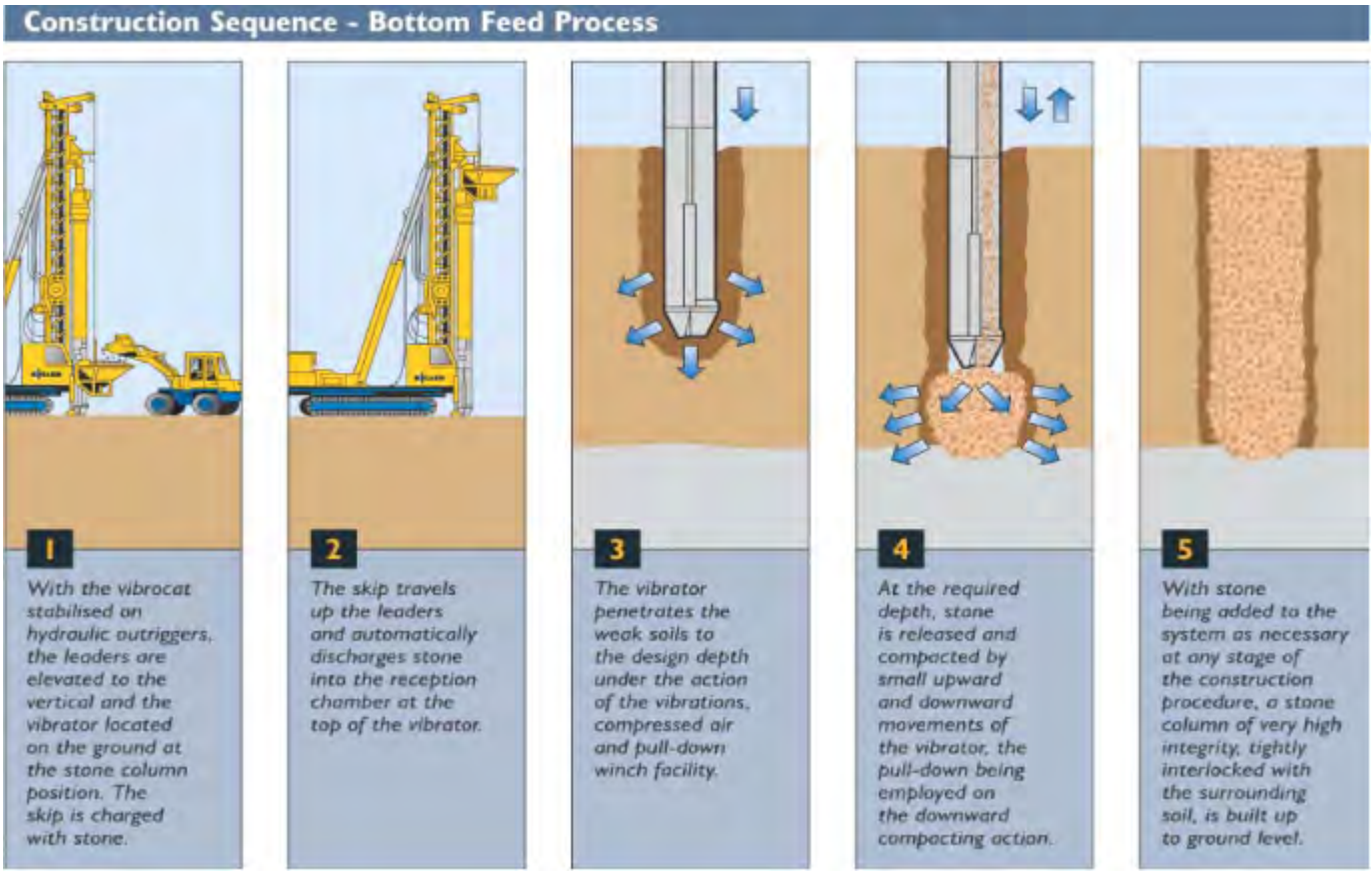
Source: Coffey, MIDFR

FIGURE 3: SOFT SOIL TREATMENT STRUCTURE



Source: Coffey, MIDF

FIGURE 4: SOFT SOIL TREATMENT



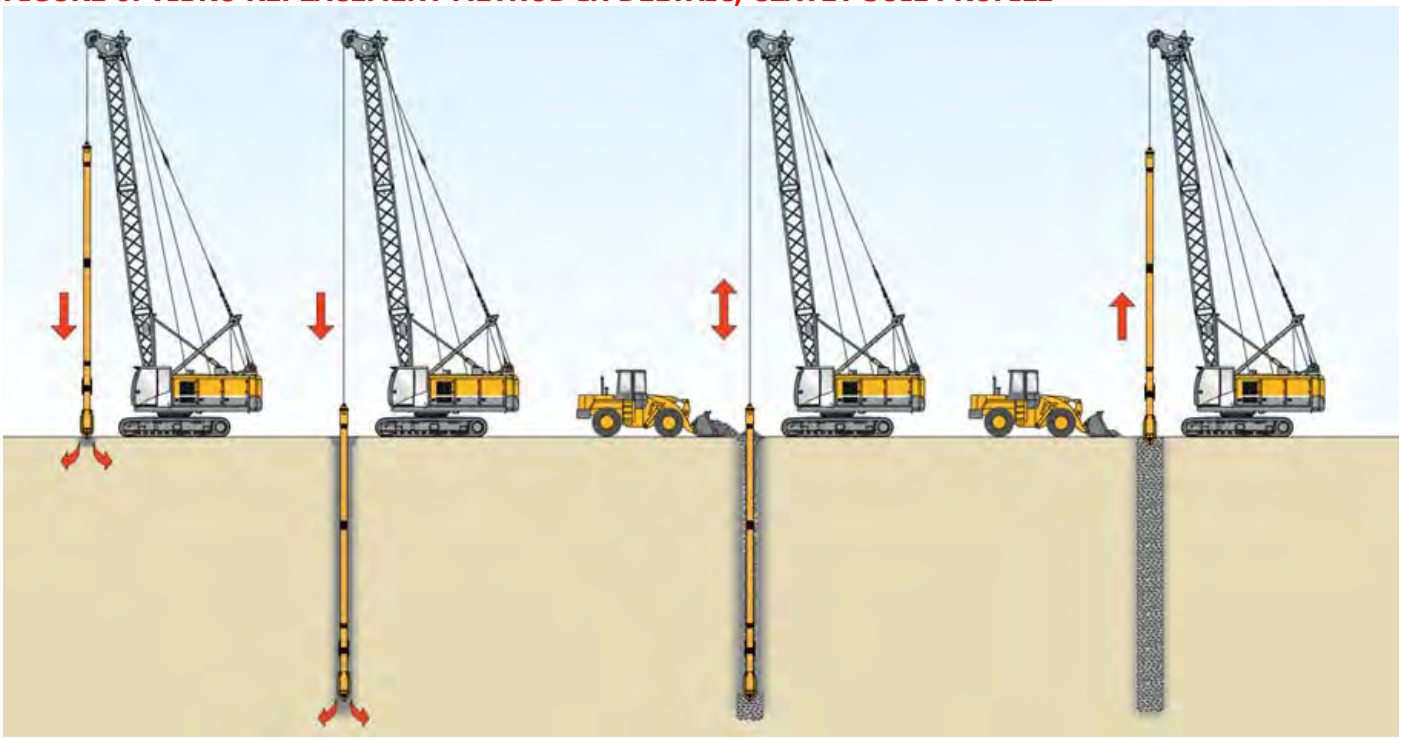
Source: McCabe, McNeil, Black, MIDFR.

FIGURE 5: SOFT SOIL TREATMENT PROCESSES

Category	Examples of ground treatment methods	Limitations
Removal	Excavate and replace, mud waving	• Only feasible where the depth of the soft soil is limited to about three metres. • Excavated acid sulfate soft soils also require treatment to avoid adverse impact on the environment.
Compaction	Dynamic compaction, impact rolling, explosive compaction and vibro-compaction	Limited to the treatment of loose granular soils, with experimental application of this method in soft clays with mixed success.
Consolidation	Preload or surcharge with or without wick drains, vacuum consolidation and electro-osmosis	Although consolidation is by far the most common and economical ground treatment method in soft cohesive soils, this process can be time consuming and may not be feasible where the soft soil has very low permeability, deep and the construction time program is limited.
Modification	Deep soil mixing, lime columns and grouting	Due to cost considerations, modification is limited to areas adjacent to structures such as bridge approaches and culverts. This enables accelerated construction to take place and control of post-construction differential settlement to acceptable limits.
Load transfer	Stone columns, dynamic replacement columns, controlled modulus columns and piled embankment	Due to cost considerations, load transfer is limited to areas adjacent to structures such as bridge approaches and culverts. This enables accelerated construction to take place and control of post-construction differential settlement

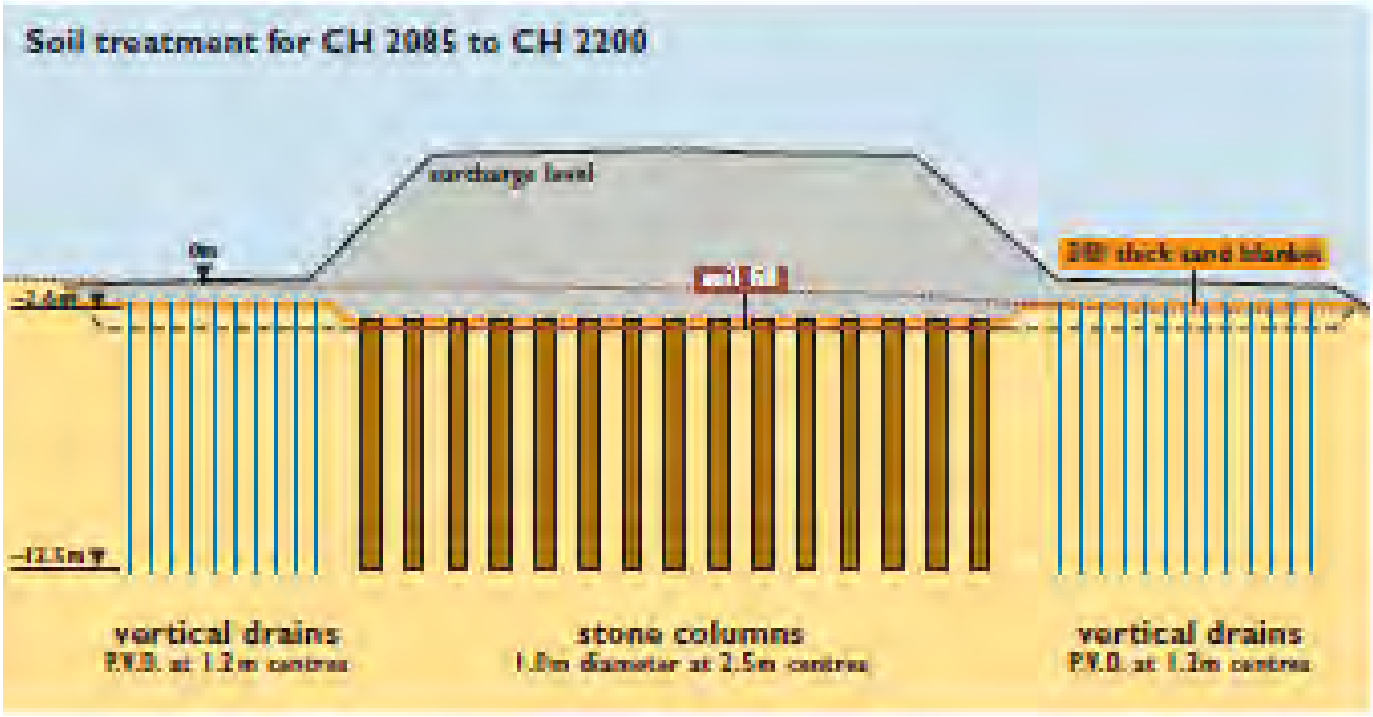
Source: Coffey, MIDFR

FIGURE 6: VIBRO REPLACEMENT METHOD IN DELTAIC, CLAYEY SOIL PROFILE



Source: Bauer, MIDFR

FIGURE 7: VIBRO REPLACEMENT METHOD APPLIED IN JELUTONG EXPRESSWAY



Source: Keller, 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 *rise* 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 *fall* 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.