19 April 2016 | Corporate Update

IJM Corporation Berhad

Crossing the Chasm with IBS

***Upgrade to* BUY**

***Revised* Target Price (TP): RM4.00**

(from RM3.56)

INVESTMENT HIGHLIGHTS

- **IBS accounts for 30-40% of IJM's construction projects**
- **IBS application in IJM's construction will potentially lift its PBT margin**
- **PBT is surmised to increase by 10%**
- **Altogether, we upgrade our recommendation to BUY with a TP of RM4.00 per share**

IBS accounts for 30-40% of IJM's construction projects. We revisit our PBT marginal assumptions on IJM due to the intensifying application of Industrialised Building System (IBS) (*Figure 1*) which currently accounts for 30-40% of its construction projects. Our assessments include (i) factoring the cost savings rates that IBS could potentially contribute to the bottom line of concrete manufacturing, property and construction segments, and (ii) illustrates the application of IBS in construction processes (*Figure 2*).

IBS application for IJM's could potentially improve its net margin. We reduced our total cost to revenue estimates from 72% to 69% to reflect the cost advantages of applying IBS. Furthermore, we expect revenue contribution from concrete manufacturing segment to rise from 17% to 25%. As a result, our overall construction PBT margin estimates for FYE17/FYE18 increased from 8.9% to 10%. Note that IJM's total cost to revenue has shown a decreasing trend for the past 5 years, except 2011 where the ETP was just launched (*Figure 3*). Evidentially, IBS has proven to reduce cost and positively impact the bottom line of the construction giants such as Skanska, Hochtief and Bechtel. Construction Industry Development Board, Malaysia (CIDB) has estimated that IBS reduces construction time by 50%, labour cost by 47.8% and construction cost by 15%.

Construction PBT could prospectively increase to 10%. We reckon IJM's PBT would increase through the reduction of costs and the increase of concrete manufacturing activities through IBS. Thus, we expect the content of IBS would expand due to diffusion of construction technology going forward. Segments such as construction (18.1% of PBT) would potentially increase its PBT margin by 1.1% and supported by an estimated revenue growth of 8% in concrete manufacturing (12.3% of PBT) in FYE17/FYE18. However, should there be any intermittent impact on the quarterly results, it will be due to temporary blips from gaps in project commencement and award. All in, we expect IJM's PBT margin would be lifted by 10%.

RETURN STATS	
Price (18 April 2015)	RM3.54
Target Price	RM4.00
Expected Share Price Return	+12.9%
Expected Dividend Yield	+2.2%
Expected Total Return	**+15.1%**

STOCK INFO	
KLCI	1,717
Bursa / Bloomberg	3336/ IJM MK
Board / Sector	Main / Construction
Syariah Compliant	Yes
Issued shares (mil)	3586.6
Par Value (RM)	1.00
Market cap. (RM'm)	12,696
Price over NA	1.41
52-wk price Range	RM2.87– RM3.75
Beta (against KLCI)	0.982x
3-mth Avg Daily Vol	5.62m
3-mth Avg Daily Value	RM19.4m
Major Shareholders (%)	
EPF	13.39
ASB	8.27
LTH	5.42
ASW	2.93

IBS application is not new to IJM. Historically, IJM through its joint venture consortium of IJM-Sunway-Zelan-LFE (ISZL) and PERI GmbH has applied IBS (known as modern construction methods) in their projects domestically and overseas. For example, the consortium was involved in the design, execution and completion of Phase 1, Plot 1 Zone C of residential towers CT1-5, luxury villas and podium in Al Reem Island, Abu Dhabi in 2009. Hence, the idea of applying the IBS is not new but a group-wide extension of their technical capabilities. Note that PERI, headquartered in Germany, is the largest formwork and scaffolding manufacturer in the world, and was instrumental in the construction of iconic buildings such as Marina Bay Sands (Singapore), Banyan Tree (Kuala Lumpur) and Al Hamra Tower (Kuwait City).

IBS increases control over risk factors through off-site component manufacturing. Comparatively, the processes (*Figure 3*) of IBS are largely off-site hence the control over quality, cost-overruns, key executions risk, change in construction delays can be avoided and mitigated. This is due to the fact that the construction process is automated through pre-fabricated or pre-casted components which are made in controlled manufacturing environment. For example, infrastructure projects such as tunnelling, railway track engineering and even public housing could be designed and cost-engineered through building information modelling (BIM) which is then manufactured offsite in factory and installed in site (*Figure 4*).

Our View. Premised on above, we remain sanguine on the prospect of IJM's application of IBS. We expect that MCM/IBS content of would impact its cost structure favourably hence positively influence its earnings. Whilst IJM's top-line growth would not be swayed significantly, the impact can be zeroed-in on to the bottom line as the average 5-year total cost of 72% can be trimmed to 69%. Currently, the application of IBS in Malaysia is still at its infancy due to (i) lower construction materials, and (ii) tender negotiations. However, we opine that by 'crossing the chasm' of using IBS in its construction processes and products (*Figure 5*), IJM could forge its competitive advantage in the long term for projects under its current orderbook of RM7.0bn or the upcoming infrastructure projects under GTP 3.0 and ETP 3.0. Hence, we believe that the impact of its application is significant to IJM's bottom line moving forward through the reduction of construction cost per square metre in its projects.

Valuation. As we have argued in our previous report (15.02.16), we hereby re-rate IJM predicating on the impact of its application of IBS that we estimate would expand from 30-40% currently to 50% in FYE17/FYE18 onwards. It is notable that IJM's potential internal cost structure improvement is a boon to its forward earnings potential.Thus, we raised our FYE17/FYE18 normalised earnings forecasts by 11-13% and revised our **TP** from RM3.56 to **RM4.00** per share which equates to an implied PER of 11x. Accordingly, we upgrade our recommendation from Neutral to **BUY.**

SOP VALUATION

Segments	Stake	Basis	Value (RM'm)	Per Share (RM)
Construction	100%	DCF@6.7%	4,125.4	1.16
Industrial	100%	FY16 PER of 14x	2,417.3	0.68
IJM Plantation	55%	MIDFR TP of RM3.57	1,735.0	0.49
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	24%	Market cap at 22sen	79.6	0.02
Total value			**18,728.8**	**5.25**
(Net debt) / net cash			-4,366.1	-1.22
SOP per share				**4.028**
No. of shares outstanding (mil)				3,565.6

Source: MIDFR

INVESTMENT STATISTICS

FYE March	FY14	FY15	FY16F	FY17F	FY18F
Revenue (RM'm)	6,006	5,448	6,277	7,102	6,146
EBIT (RM'm)	1,788	1,292	1,396	1,293	1,131
Pre-tax Profit (RM'm)	1,416	1,019	1,077	1,174	988
Normalised PATAMI (RM'm)	539	489	617	698	453
FD EPS (sen)	38	31	32	36	34
EPS growth (%)	25	-19	3	13	-4
PER (x)	10	11	22	20	11
Net Dividend (sen)	25	15	16	18	17
Net Dividend Yield (%)	2.4	2.5	2.2	2.5	2.7

Source: MIDFR

DAILY PRICE CHART



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Source: Bloomberg, MIDFR

APPENDIX

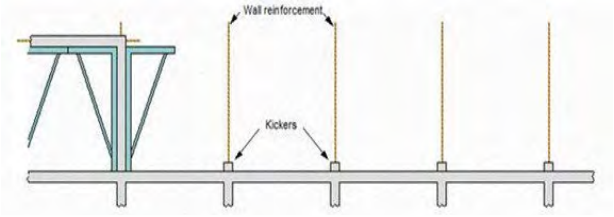
FIGURE 1: TYPES OF MODERN CONSTRUCTION METHODS/INDUSTRIALISED BUILDING SYSTEMS

Classification	Descriptions
Precast concrete framed buildings	The most common group of IBS products is the precast concrete elements; precast concrete columns, beams, slabs, walls, 3-D components (e.g. balconies, staircases, toilets, lift chambers, refuse chambers), lightweight precast concrete, as well as permanent concrete formworks.
Formwork System	Considered as one of the low-level or the least prefabricated IBS, as the system generally involves site casting and is therefore subject to structural quality control, the products offer high-quality finishes, and fast construction with less site labour and material requirement.
Steel Framing System	Commonly used with precast concrete slabs, steel columns and beams, steel framing systems have always been the popular choice and used extensively in the fast-track construction of skyscrapers. Recent developments in this type of IBS include the increased usage of light steel trusses consisting of cost-effective profiled cold-formed channels and steel portal frame systems as alternatives to the heavier traditional hot-rolled sections.
Prefabricated Timber Framing System	The system consists of timber building frames and timber roof trusses. While the latter are more popular, timber building frame systems also have their own niche market, offering interesting designs from simple dwelling units to buildings requiring high aesthetical values such as chalets for resorts.
Blockwork System	The construction method of using conventional bricks has been revolutionised by the development and usage of interlocking concrete masonry units (CMU) and lightweight concrete blocks. The tedious and time-consuming traditional brick-laying tasks are greatly simplified by the usage of these effective alternative solutions.

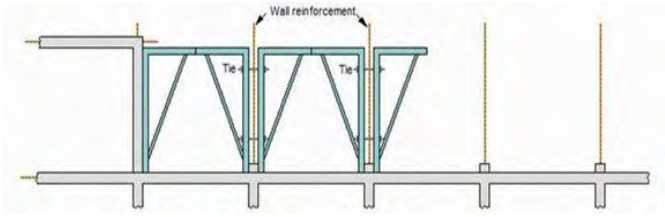
Source: CIDB, MIDFR

FIGURE 2: HOW IT WORKS (INFRASTRUCTURE TUNNELING WORK EXAMPLE)

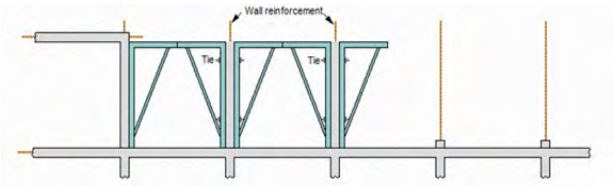
Stage 1: Prefabricated wall reinforcement is placed by cranes along the entire wing prior to casting the kickers (used to put formwork into place)



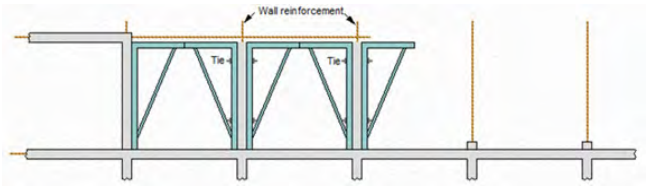
Stage 2: Two and a half tunnel is put into place by cranes, bolted together and ties are added



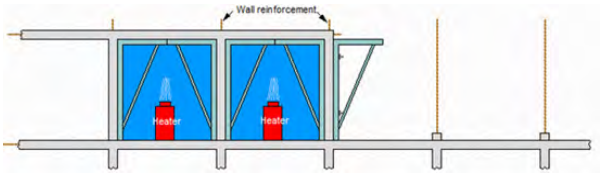
Stage 3: The wall concrete is poured



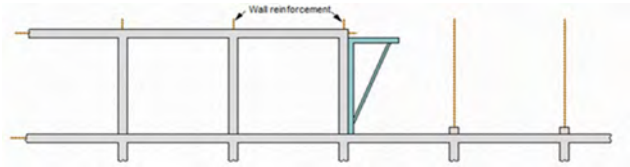
Stage 4: The slab reinforcements are fixed



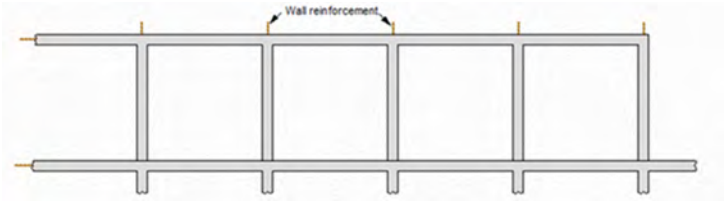
Stage 5: The slab concrete is placed. The formwork system provides for a pour to be wrapped in tarpaulins and for the use of butane heaters to maintain a sufficiently high temperature for the concrete to reach its strength overnight.



Stage 6: The tunnel-forms are removed following day.

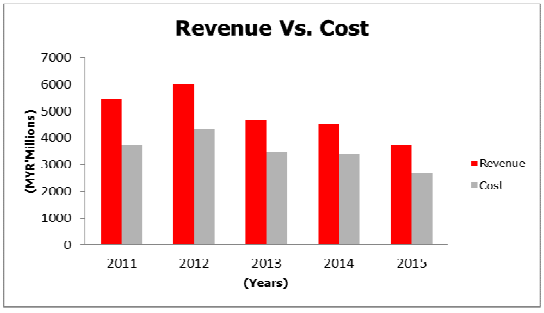


Stage 7: The process is repeated for the next two bays



Source: Ravishankar, R. & Et. Al, Academy of Architecture, Mumbai, MIDFR

FIGURE 3: REVENUE AGAINST COST



Source: Bloomberg, MIDFR

FIGURE 3: OFF-SITE PRE CAST MANUFACTURING



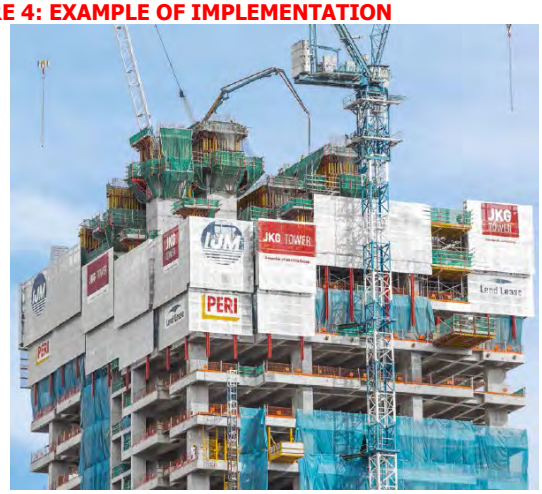
MANUFACTURED OFF-SITE



COMPONENTS ARE SENT TO SITE FOR ASSEMBLY

Source: PCE Ltd, UK, MIDFR

FIGURE 4: EXAMPLE OF IMPLEMENTATION



JKG TOWER JALAN RAJA LAUT (IJM)



KVMRT PACKAGE V3 (MUDAJAYA)



KVMRT PACKAGE V8, KAJANG (UEM CONSTRUCTION)



KVMRT COCHRANE STATION (CIVIL TECH S/B)

Source: PERI Formworks Malaysia Sdn. Bhd., MIDFR

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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 *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.