

09 Jul 2019

Buy

Price  
RM0.97

Target Price  
RM1.08

Bloomberg code  
MRC MK

Equity | Malaysia | Property  
**Flashnote**

Analyst

Mak Hoy Ken  
(603) 2171 0508  
mak.hoyken@kaf.com.my

# MRCB

## Drops IJM from LRT 3 underground work

### Financial Highlights

FYE Dec	2017	2018	2019F	2020F	2021F
Revenue (RMm)	2,640.6	1,870.7	2,336.0	3,223.8	3,708.3
Core net profit (RMm)	95.6	38.7	68.8	106.7	165.0
Core EPS (Sen)	2.7	2.0	1.8	2.6	3.8
EPS growth (%)	(35.4)	(28.2)	(9.4)	44.1	47.1
DPS (Sen)	1.8	1.5	1.0	1.5	2.0
Core PE (x)	41.7	42.3	54.4	37.7	25.6
Div yield (%)	1.5	1.8	1.0	1.6	2.1
ROE (%)	4.2	2.1	1.4	2.2	3.3
Net Gearing (%)	55.2	19.6	27.4	31.1	30.0
PBV(x)	1.0	0.8	0.9	0.9	0.8

Source: Company, KAF

- We maintain our Buy rating on MRCB with an unchanged TP of RM1.08. This pegs the stock at a 10% discount to NAV.
- IJM Corp (IJM MK, RM2.43, Sell) announced that the group had on 8 July, received a notice of termination for its RM1.1b underground package under the LRT 3 project from Johan Setia to Bandar Utama.
- The notice was received from the MRCB-George Kent Holdings (GKENT MK, RM1.19, NC) JV, which is the turnkey contractor for LRT 3.
- Recall that LRT 3 construction works were halted after the Pakatan Harapan administration decided to review the project's cost.
- Following the review, MRCB-GK was reappointed as the turnkey contractor in November at a revised construction cost of RM11.9b (including reimbursables worth RM400m).
- For IJM, it had been awarded the RM1.1b underground package of LRT 3 on 13 March 2018 (construction period: 21 months), although minimal work has been carried out to-date.
- Under its original design, IJM's package would need tunnel boring machines (TBM's) to excavate a 2.1km long underground tunnel in Shah Alam that had an outer diameter of 6.35m.
- In February, MRCB-GK inked a novation agreement together with project owner Prasarana Malaysia and nine work package contractors (WPC's), which will continue as subcontractors under the renegotiated LRT 3 agreement.
- The nine were Mudajaya Corp (MDJ MK, RM0.30, NC), WCT Holdings (WCTHG MK, RM1.11, NC), Gabungan AQRS (AQRS MK, RM1.40, NC), Apex Communications, Rahimkon, Sunway Construction Group (SCGB MK, RM2.13, NC), Pembinaan Jaya Zira, SN Akmidia and TRC Resources (TRC MK, RM0.64, Buy).
- Interestingly, from the list, we observed that IJM was one of the few major WPC's that did not sign the novation agreement.
- Hence, apart from redesign issues, we believe that IJM's omission could have been triggered by uncertainties over its underground package after the government announced in July that part of the 47% reduction in the overall cost for LRT 3 (i.e. from RM31.7b to RM16.6b) was attributable to the cancellation of a 2km tunnel and underground station that may relate to the former's package.
- IJM's management had previously guided that it was looking at a potential cut of ~RM400m from its original contract value (*for more details, see our company update on IJM: LRT 3 contract terminated*).

- From our latest channel checks, the option to build the package underground remains viable, as its cost does not differ much from having it fully aboveground. Furthermore, the underground route is shorter and has a neater alignment.
- This, to us, could have held back the negotiation process between MRCB-GK and IJM.
- Ultimately, we postulate that the termination arose after both parties failed to agree on certain key parameters under the renegotiation process.
- We understand that IJM will seek a meeting with MRCB-GK soon to have more clarity on the situation although the group did disclose in its announcement that it has consulted its advisors to seek legal redress.
- From MRCB's standpoint, we expect the group to stand its ground. And regardless of the threat of a legal challenge, we do not anticipate MRCB-GK to initiate a re-tender exercise; rather the JV would likely have done some groundwork to seek potential candidates to take over the package.
- Most importantly, such a move would not materially impact the completion of LRT 3, in our view, as the project's extended delivery date (from 2020 to 2024) would provide some cushion against unexpected delays.
- We retain our earnings estimates for IJM pending more updates.

# Disclosure Appendix

## Recommendation structure

**Absolute performance, long term (fundamental) recommendation:** The recommendation is based on implied upside/downside for the stock from the target price and only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%.

**Performance parameters and horizon:** Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

**Market or sector view:** This view is the responsibility of the strategy team and a relative call on the performance of the market/sector relative to the region. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

**Target price:** The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

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Dato' Ahmad Bin Kadis  
Managing Director  
KAF-Seagroatt & Campbell Securities Sdn Bhd (134631-U)