NOMURA

Malaysia construction

EQUITY: ENGINEERING & CONSTRUCTION

Foundations #3: Earnings-cashflow matrix

Implications of the law of diminishing marginal returns: Buy SunCon; Neutral on IJM and Gamuda

Introducing earnings-cashflow matrix and the law of diminishing returns

We revisit our investment thesis for the Malaysian construction sector after analysing two factors: **1)** while net profit remains the best long-term predictor of stock price returns, we think that cash conversion of reported earnings is becoming equally important due to rising gearing in a weak property market, and we evaluate companies based on our earnings-cashflow matrix; and **2)** with most construction companies now sitting on record orderbooks, the law of diminishing marginal returns will likely apply to future projects. In a nutshell, due to the high base, small- and medium-sized project awards will have very little incremental impact on companies' future earnings and share prices.

Pure plays might still outperform diversified on property, valuations

We also review our proprietary indices for pure-play (eg, SunCon) and diversified contractors (eg, IJM and Gamuda). We see that, for the last two years, pure plays (+66% since Jan-2015), have outperformed the diversified contractors (+9%). This is due mainly to: 1) a drag from the property segment for the diversified companies; 2) constant earnings downgrades imply valuations for the diversified companies are still fairly expensive, vs. pure plays. As a result, we think the pure plays are likely to continue outperforming the diversified companies as long as they deliver earnings growth in 2017.

Upgrade SunCon to Buy, Gamuda to Neutral; downgrade IJM to Neutral

Based on the above, we review our stock pecking order. We upgrade **SunCon** to Buy due to it being a pure-play contractor, with healthy earnings and cashflow generation, good earnings visibility, and potential inclusion in the Shariah-compliant list. Whilst 2018F P/E looks high at 15x, cash-adjusted P/E is still reasonable at 12x. For diversified contractors, we downgrade **IJM** to Neutral, as even though cash generation remains healthy, its earnings performance has been disappointing due to weakness in property and ports segments with no turnaround or catalyst in the near term. We also upgrade **Gamuda** to Neutral as the period of earnings dip in FY16 is over, but we think that weak cashflow generation and high gearing means the stock should continue to trade sideways (GAM +0.2% since Jan-2015). We keep **WCT** at Reduce as its earnings and cashflow situation remain challenging, gearing is still stretched, and there is no clarity on whether the new management's restructuring plans will be value-accretive to minority shareholders. For diversified contractors (such as IJM, Gamuda and WCT), two potential upside risks are a revival in the property market, or mega-project awards, which could make a meaningful difference in future earnings expectations.

Fig. 1: Stocks for action

Stock	Ticker	Rating		M cap (USD mn)	3M ADTV (USDmn)	TP (MYR)		Price (MYR)	Upside (%)
SunCon	SCGB MK	Buy	↑	496	0.6	2.00	↑	1.71	17.0%
IJM	IJM MK	Neutral	↓	2,762	3.4	3.70	↓	3.41	8.5%
Gamuda	GAM MK	Neutral	↑	2,733	4.2	5.20	↑	5.02	3.6%
WCT	WCTHG MK	Reduce		529	0.9	1.40		1.88	(25.5%)

Source: Bloomberg, Nomura estimates. Note: prices as of 8 March 2017 close; ↑ upgrading; ↓ downgrading

Global Markets Research

10 March 2017

Anchor themes

We expect pure-play Malaysian contractors to continue to outperform diversified companies in 2017, due to the latter's property exposure. We like stocks where management is looking beyond short-term project awards and generating earnings growth and healthy cashflows, which in our view are the best indicators of long-term outperformance.

Nomura vs consensus

Unlike the street, our thesis is based on business mix and CF generation.

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See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

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Introducing the earnings-cashflow matrix

We revisit our investment thesis for the Malaysia construction sector after analysing two factors:

1) While net profit remains the best long-term predictor of stock price returns, we think that cash conversion of reported earnings is becoming equally important due to rising gearing in a weak property market.

2) With most construction companies now sitting on record orderbooks, the law of diminishing marginal returns will likely apply to future projects. In a nutshell, due to the high base, small- and medium-sized project awards will have very little incremental impact on companies' future earnings and share prices.

Description of the earnings-cashflow matrix

We observe that the Street's obsession with earnings numbers is potentially overlooking companies on two ends of the spectrum: a) companies which generate good earnings on paper, but conversion of that earnings number into operating cashflow has been subpar, due to various reasons (non-cash earnings streams, growing working capital) , leading to increasing gearing; and b) on the other end of the spectrum are companies, for which OCF generation remains healthy, but reported earnings figures are weak due to various reasons (non-cash charges, FX losses). For these companies, gearing is still under control.

In an environment where property development businesses of the diversified contractors remain weak, cash generation is getting even more important to manage balance sheet risks. As a result, we introduce our earnings-cashflow matrix to evaluate construction companies.

We draw a scatter plot where we plot the large Malaysian construction companies into two axes:

On the x-axis, we plot the average OCF yield (operating cashflow over the last 3 years as a percentage of the companies' market capitalisation). This approach evaluates how much the companies have been successful in generating OCF in recent history, and a 3-year average irons out volatility over time. The higher the value, the better.

On the y-axis, we plot the forward P/E for the stock, which is essentially the inverse of the earnings yield. This factor which gauges whether the companies are expensive or not based on expected earnings growth. The lower the P/E value, the better.

Key findings

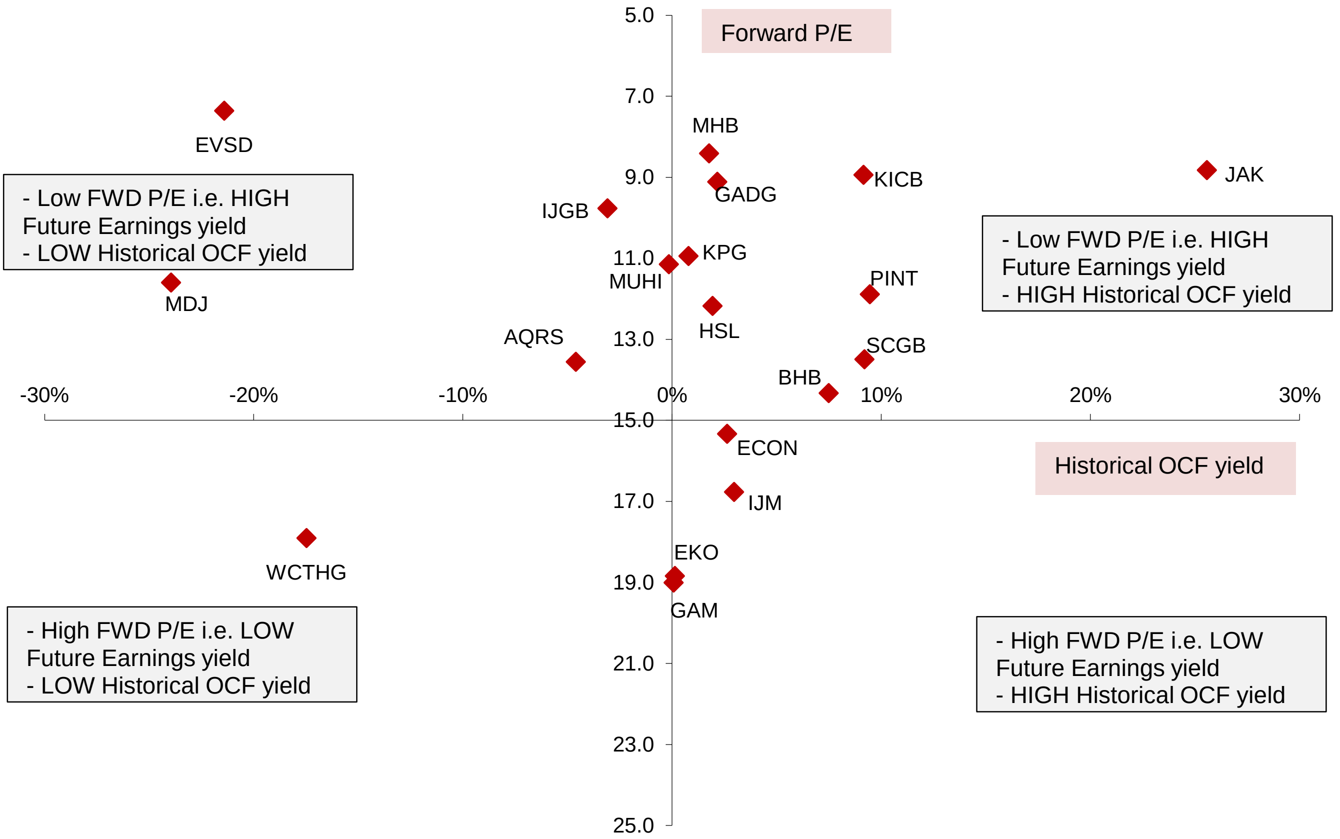
We observe that several small-mid cap Malaysian contractors are in the top right quadrant, which has P/E < 15x, and avg. OCF yield > 0%. This includes our top pick and only Buy idea, Sunway Construction, with cash-adjusted P/E of 13.5x on FY17F earnings and 12x on FY18F earnings.

We note that IJM has strong average OCF yield of 3%, but valuations are expensive at 17x due to earnings downgrades.

Gamuda has relatively cheaper valuations as earnings performance has been steady, but OCF yield is 0%, as past earnings has been accompanied by cash burn also, and SPLASH earnings is non-cash.

WCT is in the bottom left quadrant, where valuations are expensive (18x) and OCF yield has been a negative -17%, due to high cash use in working capital and low margins.

Fig. 2: Forward P/E vs. historical OCF yield



Note: We use cash adjusted forward P/E for SunCon (SCGB); Our estimates of forward P/E for rated stocks, Bloomberg estimates for others.
Source: Bloomberg, Company data, Nomura estimates

Law of diminishing marginal returns, and why pure-play companies should outperform in 2017…

One of the key reasons why the Street is positive on Malaysian contractors is the high number of potential projects which might be awarded in the next 2-3 years. However, we think that with most construction companies now sitting on record orderbooks, the law of diminishing marginal returns will likely apply to future projects. In a nutshell, due to the high base, small-to medium-sized project awards will have very little incremental impact on companies' future earnings and share prices. Only small-mid cap companies, which also fall under our pure-play index, are likely to benefit as they are coming from a low base and so orderbook accretion is still meaningful to them.

Our proprietary indices for pure-play (eg, SunCon) and diversified contractors (eg, IJM and Gamuda) show that, for the last two years, pure-play contractors (+66% since Jan-2015) have outperformed the big-cap diversified contractors (+9% since Jan-2015). This is due mainly to: **1)** a drag from the property segment for the diversified companies; **2)** constant earnings downgrades imply that valuations for the diversified companies are still fairly expensive, vs. pure-play contractors. As a result, we think pure-play companies are likely to continue outperforming diversified ones as long as they deliver earnings growth in 2017.

Stock calls:

Buy SunCon, Neutral on IJM and Gamuda, Reduce WCT

Fig. 3: Malaysia construction: Our stock picks and investment case

	Rating	TP (MYR)	Upside (%)	Investment case	Risks to our view
SunCon	Buy	2.00	17.0%	1. Pure-play construction companies likely to outperform diversified companies, in our view. 2. Steady earnings with decent cashflows 3. Healthy balance sheet, net cash position. Cash can be used for investment in integrated precast hub in Singapore or for paying out higher dividends. 4. Healthy order-book replenishment, parentco support 5. Likely upgrade to Shariah compliant list in May 2017	1. Delay-in/ lower project awards; 2. lower precast demand from Singapore and further fall in precast selling prices; 3. lower than expected margins
WCT	Reduce	1.40	(25.5%)	1. Diversified construction companies likely to underperform pure-play companies. 2. Weak earnings and cashflows resulting in elevated gearing due to weak construction margins; 3. De-gearing steps announced will be welcomed but will come with loss of earnings from the malls 4. Not clear on whether restructuring by new management will be accretive to minority shareholders.	1. Revival in the property sector 2. progress on arbitration payment from Meydan; 3. mega-project awards 4. special dividend on asset disposal or entry of strong strategic partners
				Why Neutral	**Upside risks**
IJM	Neutral	3.70	8.5%	1. Diversified construction companies likely to underperform pure-play companies. 2. Weak earnings and but decent cashflows - generates healthy cashflows, but is likely to disappoint on earnings as there is no recovery in the property segment or resumption of bauxite exports. 3. lack of positive catalysts – the law of diminishing marginal returns applies to future project awards as IJM is now sitting on record orderbook of MYR 9bn+ 4. Growth in Plantation earnings (on higher CPO prices) will not be able to offset the drag from infrastructure & property businesses	1. Revival in the property sector 2. Revival of bauxite exports through Kuantan port 3. Potentially value accretive corporate exercises like disposal of non-core assets (eg highways), and any potentially game–changing projects like mega-infrastructure awards
Gamuda	Neutral	5.20	3.6%	1. Diversified construction companies likely to underperform pure-play companies. 2. Generates healthy net income, but is likely to disappoint on cash flow in the future as overhang on SPLASH remains. 3. lack of positive catalysts – the law of diminishing marginal returns applies to future project awards as Gamuda is now sitting on record orderbook of MYR 8.7bn and additional small projects don't improve earnings outlook meaningfully.	1. Revival in the property sector 2. Potentially value accretive corporate exercises like disposal of non-core assets like SPLASH along with special dividends, and any potentially game–changing projects like mega-infrastructure awards

Source: Bloomberg, Nomura estimates, prices as of 8 March 2017 close

Fig. 4: Regional valuation table

		Nomura Rating	Last Close 8/Mar	Syariah?	Mcap (US$m)	P/E		P/B		EV/EBITDA		ROE		Div Yld	
						CY17F	CY18F	CY17F	CY18F	CY17F	CY18F	CY17F	CY18F	CY17F	CY18F
MALAYSIA CONSTRUCTION															
IJM Corp Bhd	IJM MK	Neutral	3.41	Y	2,763	17.9	15.7	1.3	1.2	13.0	11.9	7.4	8.0	2.8	3.2
Gamuda Bhd	GAM MK	Neutral	5.02	Y	2,734	19.2	17.3	1.6	1.6	15.3	14.3	9.1	9.7	2.5	2.8
Ekovest BHD	EKO MK	NR	1.31	Y	629	20.2	16.7			15.2	12.5	10.1	11.5	2.9	1.3
WCT Holdings Bhd	WCTHG MK	Reduce	1.88	Y	530	17.9	18.3	0.8	0.8	20.9	21.8	4.7	4.5	2.2	2.2
Sunway Construction Group B	SCGB MK	Buy	1.71	N	496	15.3	14.8	3.9	3.4	9.0	8.2	27.3	24.6	3.4	3.5
Kerjaya Prospek Group Bhd	KPG MK	NR	2.46	Y	283	11.2	9.6	1.7	1.5	6.1	4.9	15.3	15.9	2.8	3.3
Muhibbah Engineering M Bhd	MUHI MK	NR	2.6	Y	280	11.2	10.5	1.2	1.1	10.3	8.5	11.0	11.5	2.0	2.0
Econpile Holdings Bhd	ECON MK	NR	2.14	Y	257	15.1	14.4	3.4	2.9	8.0	7.3	28.5	26.8	2.1	2.2
Hock Seng LEE BHD	HSL MK	NR	1.71	Y	211	12.7	10.2	1.2	1.1	8.2	6.8	10.3	11.9	1.9	2.1
Mitrajaya Holdings Bhd	MHB MK	NR	1.27	Y	191	8.5	8.2	1.4	1.3	6.2	5.6	17.1	17.7	4.3	4.4
Gadang Holdings BHD	GADG MK	NR	1.23	Y	179	9.4	8.4	1.4	1.1	4.9	4.4	14.8	14.1	3.2	2.7
Kimlun Corp Bhd	KICB MK	NR	2.36	Y	164	9.1	8.7	1.2	1.1	6.0	5.9	14.3	12.8	2.6	2.7
Pintaras Jaya BHD	PINT MK	NR	3.52	Y	129	12.4								5.7	
Mudajaya Group Bhd	MDJ MK	NR	0.905	Y	109	12.4	9.5	0.4	0.4	12.6	12.5	3.4	4.4	2.8	2.8
Eversendai Corp Bhd	EVSD MK	NR	0.61	Y	106	7.3	7.1	0.4	0.4	6.7	6.5	6.4	6.9	1.5	1.5
Median						**12.4**	**10.3**	**1.3**	**1.1**	**8.6**	**7.8**	**10.7**	**11.7**	**2.8**	**2.7**

Source: Nomura estimates for rated stocks, Bloomberg consensus for others, prices as of 8 March 2017 close

Revising publication schedule of our Malaysia Construction Foundations series:

This issue of Malaysia Construction Foundations reports has been published a month early, ie, in March vs. the scheduled April release date. Our previous issues were in October and January. Note that, going forward, we will publish our Foundations reports in March, June, September and December to bring them more in line with industry data releases and earnings announcements.

Our previous issues can be found at the following links:

Foundations #2: China-led construction boom (Jan-2017)

Foundations #1: New threats to contractors (Oct 2016).

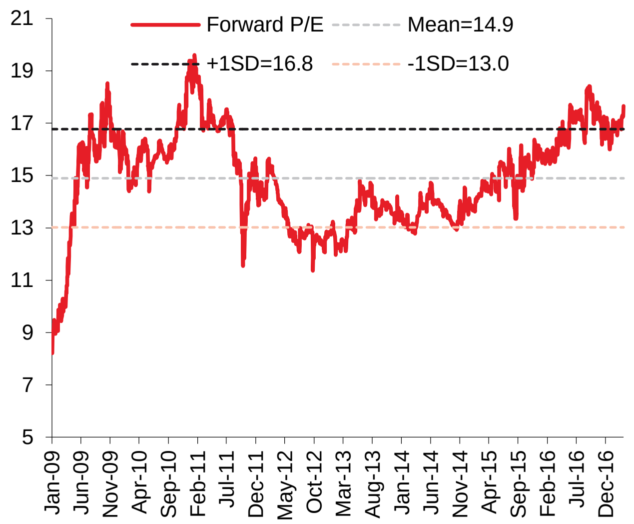
Analysing earnings and cashflow outlook…

Investors have only been focussed on earnings for contractors…

The investment community (including us) has historically focussed primarily on the earnings delivery of Malaysian contractors – this is reflected in the long-term stock returns being highly correlated (coefficients of 0.6-0.9) to EPS growth. As noted in our anchor report, Malaysia construction: Deep foundations for the long haul, dated 26 October 2015, news flow on project awards usually only provides a short-term boost to the share prices of contractors as most project awards do little else than to replenish depleting orderbooks, and result in fairly limited earnings growth, if any. We also believe that, notwithstanding the various RNAV/SOTP valuation methodologies for the construction sector used by consensus, construction stocks usually trade within a narrow range of P/Es (IJM: 12x-17x forward EPS; GAM: 12x-18x forward EPS), and any deviations from these multiples during times of project awards are usually short-lived.

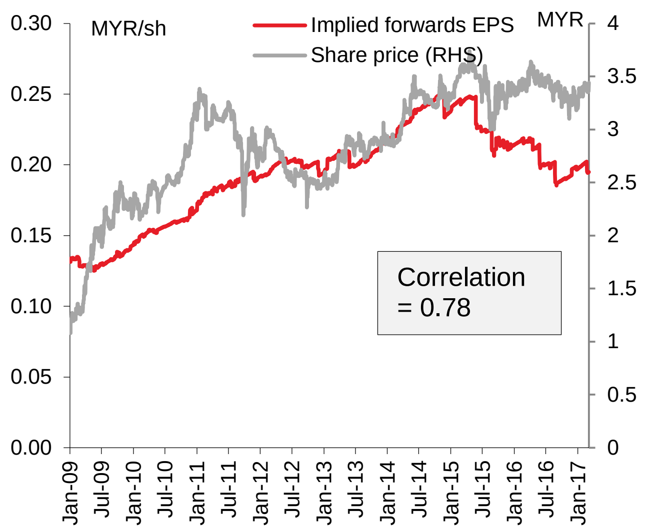
If we back out the consensus-implied N12M EPS figure from the share prices and the forward P/E, we note that stocks which demonstrate an ability to consistently grow EPS are rewarded by sustained share price outperformance. The correlation between share prices and implied 12M EPS is very high (0.6-0.9) for construction stocks. We conclude that, for a sustained stock price re-rating, the single-biggest predictor is the EPS growth potential over the long run (see Fig. 5-Fig. 12).

Fig. 5: IJM: Forward P/E (consensus)



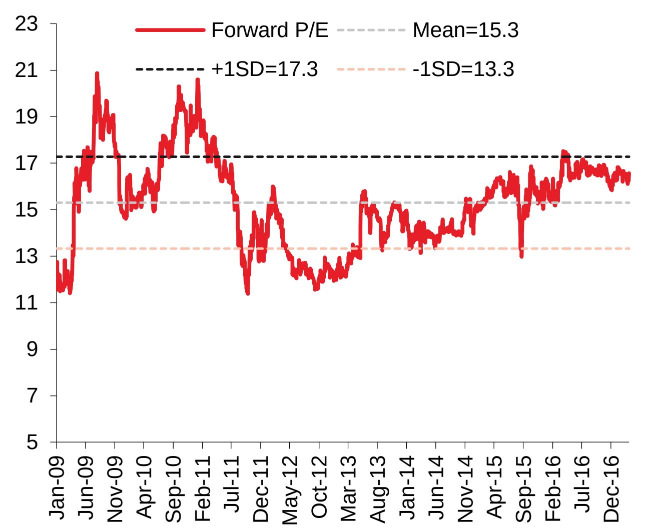
Source: Bloomberg consensus, Nomura research

Fig. 6: IJM: Implied N12M EPS vs. share price



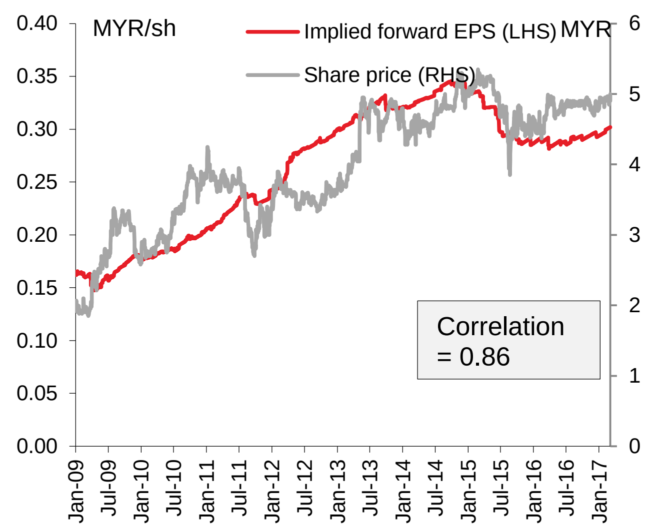
Source: Bloomberg, Nomura research

Fig. 7: Gamuda: Forward P/E (consensus)



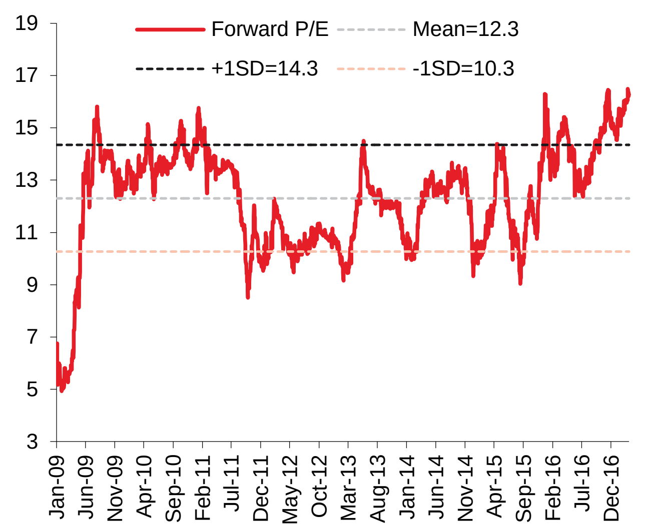
Source: Bloomberg consensus, Nomura research

Fig. 8: Gamuda: Implied N12M EPS vs. share price



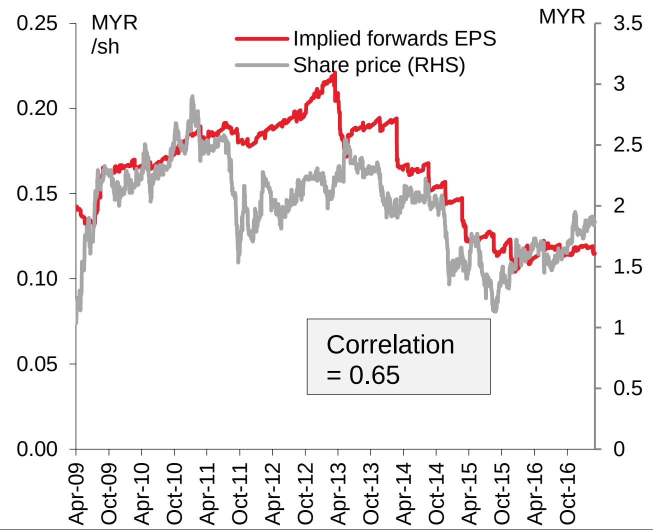
Source: Bloomberg, Nomura research

Fig. 9: WCT: Forward P/E (consensus)



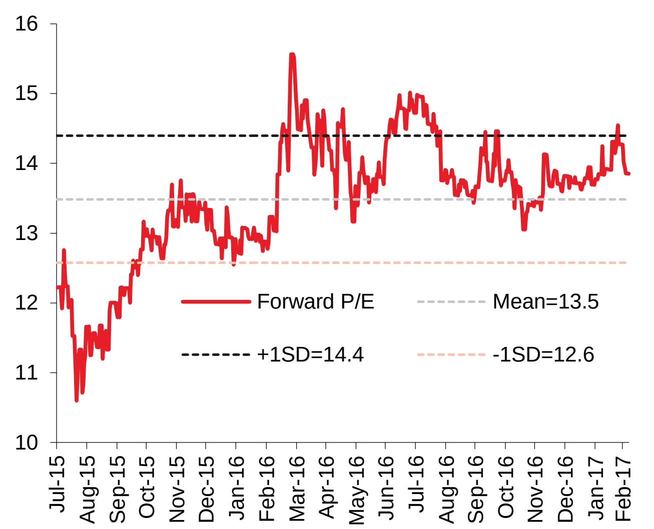
Source: Bloomberg consensus, Nomura research

Fig. 10: WCT: Implied N12M EPS vs. share price



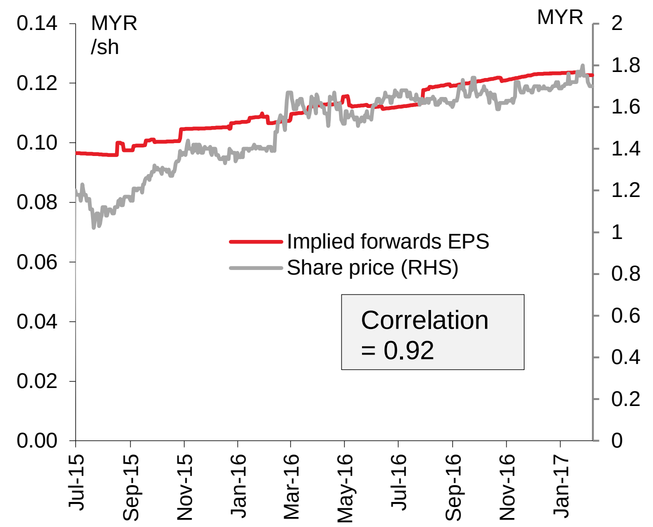
Source: Bloomberg, Nomura research

Fig. 11: SunCon: Forward P/E (consensus)



Source: Bloomberg consensus, Nomura research

Fig. 12: SunCon: Implied N12M EPS vs. share price

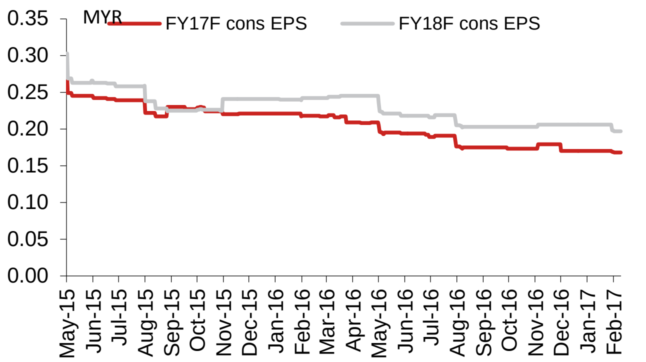


Source: Bloomberg, Nomura research

How are the earnings revision trends for contractors?

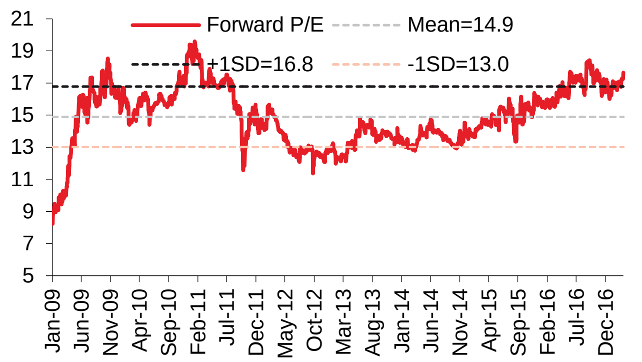
Consensus earnings for Gamuda seem to have stabilised, but those for IJM continue to be downgraded; for WCT, as well, FY17F-18F consensus earnings continue to be cut. Consensus earnings revisions for SunCon for FY17F have been flat-to-negative recently.

Fig. 13: IJM: Consensus EPS trends



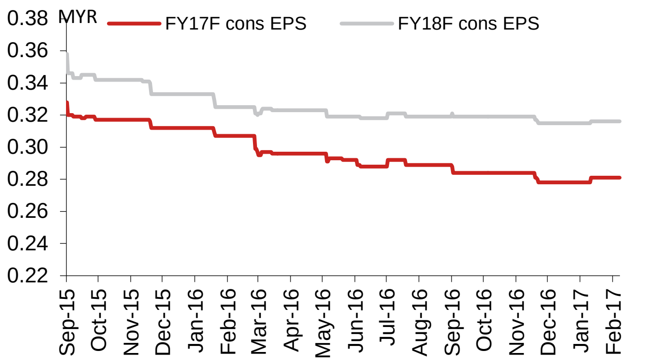
Source: Bloomberg, Nomura research

Fig. 14: IJM: Forward P/E



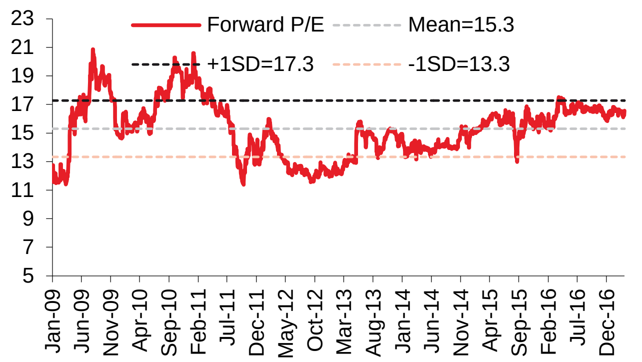
Source: Bloomberg, Nomura research

Fig. 15: Gamuda: Consensus EPS trends



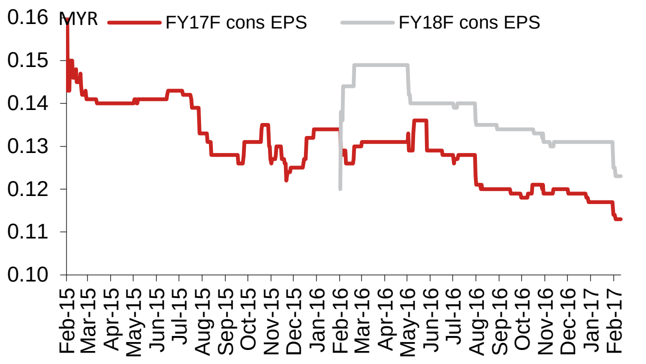
Source: Bloomberg, Nomura research

Fig. 16: Gamuda: Forward P/E



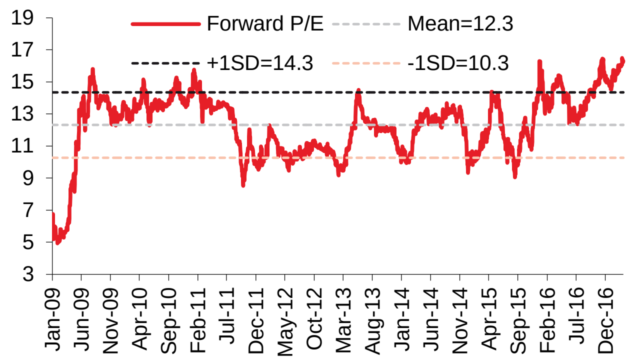
Source: Bloomberg, Nomura research

Fig. 17: WCT: Consensus EPS trends



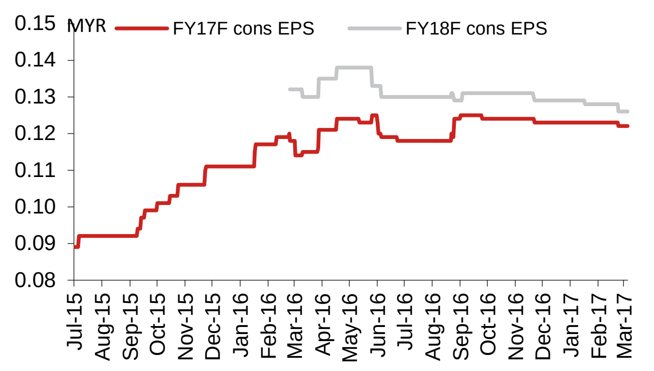
Source: Bloomberg, Nomura research

Fig. 18: WCT: Forward P/E



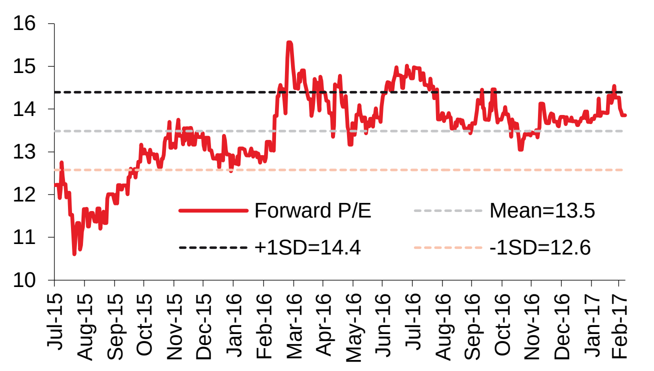
Source: Bloomberg, Nomura research

Fig. 19: SunCon: Consensus EPS trends



Source: Bloomberg, Nomura research

Fig. 20: SunCon: Forward P/E



Source: Bloomberg, Nomura research

… but cashflow becoming increasingly important due to property business being a drag

However, as a result of the Street's (including us) over-reliance on net income figures, we find that an important aspect of the business is often overlooked – the conversion of earnings to cashflows. In the last two years, we have seen that companies with weak headline earnings have generated strong cashflows (eg, IJM), whereas there are companies with strong headline earnings, which have generated weak cashflow (eg Gamuda).

The reason why the cashflow aspect is becoming even more important is that most big-cap construction companies such as IJM and Gamuda have now sizeable property businesses, which by their very nature are a strain on the balance sheet as upfront spending is needed on landbanking and construction of houses, whereas money comes in progressively later. As a result, what we are seeing is that for the diversified construction companies, net gearing is on an upward trajectory which puts strain on future spending and dividends. Moreover, headline net income does not always give an accurate picture of cash generation as there might be non-cash earnings streams for a company.

Assessing cashflow strengths…

We would like to update the views in our report Malaysia Construction - Focussing on cashflows, published 1 February 2016, as we think cashflows have become more important for contractors as the property slowdown has continued.

Specifically, we believe two questions need to be answered:

• Are there instances where higher earnings do not translate to higher operating cash?

• Are there instances where cashflows are materially lower than earnings?

If the answer to either of the questions above is yes, it is reflective of the weaker earnings to cash conversion, on which we remain cautious.

For construction companies under our coverage, we use data from the past 3-7 years. Based on the relationship between operating cashflows and net income (CFO = net income + non-cash charges – working capital investments), in an ideal scenario, we reckon that adjusted net income + depreciation/amortisation (hereafter referred to as cash earnings) should be relatively close to the operating cash generation, pre-working capital investments. Moreover, we also look at net operating cashflow numbers to check if working capital investments are eroding chunks of the cashflows.

We also make following adjustments: **1)** we add dividend income from associates and JVs to OCF because this reflects the cash generation from operating assets (eg, in the case of Gamuda, dividends come from Kesas, LITRAK, etc, which is a part of its core business); **2)** we use adjusted net income figures to remove gains on the revaluation of assets, which is usually non-cash; and **3)** we make the treatment of interest income and interest expense consistent across all companies (for example, GAM reports interest income as investing cash flow, whereas WCT reports it as operating cash flow; we treat both as operating cash flow).

IJM: Consistent superior OCF generation

- Within the Malaysian construction coverage, we find that IJM has the most consistent operating cash generation.
- IJM's OCF has consistently been higher than its cash earnings, except in FY14 and FY15. In our view, FY14, FY15 and FY16 numbers were distorted by two factors: 1) the merger of IJM Land in FY14; and 2) working capital investments in property development costs (mainly in its London project). The London project for IJM in particular is causing a drag on cashflows as IJM can only recognise cash on handover of the project in FY18F, whereas property development costs are being sunk in now.
- Pre-working capital investments, IJM's OCF is consistently much higher than its reported cash earnings (except FY16). This is in line with our positive view on IJM and is indicative of the superior cash generation. IJM's net debt to equity has also remained stable, coming down from 58% in FY13 to ~47% as of 3Q17. (Note that IJM's OCF is computed based on the direct method, and we estimate working capital investments based on our own reading of the balance sheet.)

Fig. 21: IJM: Earnings vs. operating cash flows

Financial year ending March

MYR mn	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	9M17
Income statement items									
Adjusted net income	290	333	242	447	394	570	474	492	418
Reported net income	290	333	304	409	421	830	481	794	418
Cash flow items									
OCF before WC changes	862	851	737	989	1,196	2,960	2,774	1,225	1,006
Changes in WC	(93)	(136)	109	57	(234)	(2,325)	(1,803)	(117)	57
OCF after WC changes	769	714	846	1,046	962	635	971	1,108	1,063
Net OCF after WC, interest, taxes	430	440	564	677	594	169	357	573	765
Dividend received from associates and JV	5	5	12	16	17	17	11	9	23
Depreciation & Amortisation (D&A)	147	150	141	158	166	201	255	255	191
Net debt to Equity									
Net debt	2,783	2,591	2,287	2,823	3,270	3,598	4,329	4,132	4,288
Total Equity	4,770	5,096	4,997	5,348	5,607	6,739	8,430	9,028	9,145
Net debt to equity	58%	51%	46%	53%	58%	53%	51%	46%	47%
Comparison									
1 Adjusted net income + D&A	437	482	382	605	561	770	728	747	609
Net OCF	430	440	564	677	594	169	357	573	765
2 Adjusted net income + D&A	437	482	382	605	561	770	728	747	609
Net OCF pre WC investments + Div from assoc and JV	528	581	467	635	845	2,511	2,172	700	731

Source: Company data, Nomura research. Note: Working capital computed based on Nomura estimates

Gamuda: Cashflows remain low due to the overhang from SPLASH

- For Gamuda, we find that operating cash generation consistently falls short of cash earnings. In fact, OCF generation has also been negative in three out of the past seven years (i.e. in FY11, FY13 and FY14).
- Even if we exclude working capital investments, and take into account the reclassification of Kesas from associate to subsidiary in FY14, we find that GAM's OCF generally remains lower than what its earnings would suggest. The main factor causing this, in our view, is its investment in the water assets (SPLASH and Gamuda Water), which although contributing a big chunk to reported earnings, do not result in any cashflow (except for a small dividend in some years) and instead GAM's receivables balance increases.
- This is in line with our view that GAM's disposal of SPLASH at 1x book value will help in monetising what has been already booked as earnings in the past.
- The gearing has increased due to the investments in land banking from 32% in FY14 to 59% as at the end of 1Q17.

Fig. 22: Gamuda: Earnings vs. operating cash flows

Financial year ending July

MYR mn	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	1Q17
Income statement items									
Adjusted net income	192	376	457	524	663	708	682	626	162
Reported net income	194	323	425	547	541	719	682	626	162
Cash flow items									
OCF before WC changes	209	340	438	581	383	464	648	611	162
Changes in WC	410	241	(475)	(169)	(335)	(527)	(179)	(256)	(430)
OCF after WC changes	619	581	(37)	412	48	(63)	469	355	(268)
Net OCF after WC, interest, taxes	461	438	(200)	176	(147)	(256)	246	94	(333)
Dividend received from associates and JV	172	106	78	97	78	123	84	189	169
Depreciation & Amortisation (D&A)	18	20	19	24	22	27	103	122	36
Net debt to Equity									
Net debt	385	624	901	1,169	1,096	1,731	3,207	3,980	4,210
Total Equity	3,301	3,440	3,687	4,048	4,878	5,474	6,337	6,878	7,156
Net debt to equity	12%	18%	24%	29%	22%	32%	51%	58%	59%
Comparison									
1 Adjusted net income + D&A	210	396	476	548	685	735	785	748	199
Net OCF	461	438	(200)	176	(147)	(256)	246	94	(333)
2 Adjusted net income + D&A	210	396	476	548	685	735	785	748	199
Net OCF pre WC investments + Div from assoc and JV	223	303	353	441	265	395	508	538	266

Source: Company data, Nomura research

WCT: OCF generation weak

- For WCT Holdings, we find that the operating cash flow has been negative in the past 4 years (cumulative OCF drain –MYR1.8bn), and consistently lower than reported cash earnings.
- This is due to an increase in working capital investments, as the investment in development properties and investment properties has been increasing for the property and malls business. Accordingly, the gearing has also been rising from a low of 23% in FY09 to 91% currently.
- However, even pre-working capital investments, WCT's OCF generation has remained materially lower than that suggested by the earnings since FY11.

Fig. 23: WCT: Earnings vs. operating cash flows

Financial year ending December

MYR mn	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16
Income statement items									
Adjusted net income	88	167	116	122	155	127	111	47	100
Reported net income	101	146	150	166	359	198	123	209	68
Cash flow items									
OCF before WC changes	130	294	294	190	242	189	159	105	155
Changes in WC	(131)	(3)	(248)	(126)	(60)	(634)	(490)	(531)	(274)
OCF after WC changes	(2)	290	46	65	182	(444)	(331)	(426)	(119)
Net OCF after WC, interest, taxes	(69)	247	1	4	90	(548)	(430)	(554)	(258)
Dividend received from associates and JV	0	0	0	0	1	7	2	5	0
Depreciation & Amortisation (D&A)	5	25	16	9	7	10	8	8	15
Net debt to Equity									
Net debt	414	285	470	594	746	949	1,480	2,069	2,527
Total Equity	1,165	1,254	1,256	1,476	1,810	2,204	2,234	2,610	2,763
Net debt to equity	35%	23%	37%	40%	41%	43%	66%	79%	91%
Comparison									
1 Adjusted net income + D&A	93	192	133	132	162	137	119	55	115
Net OCF	(69)	247	1	4	90	(548)	(430)	(554)	(258)
2 Adjusted net income + D&A	93	192	133	132	162	137	119	55	115
Net OCF pre WC investments + Div from assoc and JV	63	251	249	129	151	92	61	(18)	16

Source: Company data, Nomura research

SunCon: Stable OCF delivery

- For SunCon, we find that OCF pre-working capital is tracked fairly well by reported cash earnings.
- This, in our view, is reflective of its healthy margins, timely cash collection from customers, and relatively straightforward balance sheet.
- Gearing is in net cash post-IPO.

Fig. 24: SunCon: Earnings vs. operating cash flows

Financial year ending December

MYR mn	FY12	FY13	FY14	FY15	FY16
Income statement items					
Adjusted net income	67	104	122	124	125
Reported net income	55	67	163	127	124
Cash flow items					
OCF before WC changes	85	122	172	175	167
Changes in WC	(17)	(68)	49	65	(59)
OCF after WC changes	68	54	221	240	108
Net OCF after WC, interest, taxes	51	36	194	215	80
Dividend received from associates and JV	0	47	97	25	0
Depreciation & Amortisation (D&A)	28	43	45	42	39
Net debt to Equity					
Net debt	(91)	(66)	(156)	(332)	(329)
Total Equity	560	614	380	451	493
Net debt to equity	-16%	-11%	-41%	-74%	-67%
Comparison					
1 Adjusted net income + D&A	95	146	166	166	164
Net OCF	51	36	194	215	80
2 Adjusted net income + D&A	95	146	166	166	164
Net OCF pre WC investments + Div from assoc and JV	68	151	242	175	139

Source: Company data, Nomura research

Conclusion: IJM, SunCon strong in cash generation versus GAM and WCT

- **SunCon's** (SCGB MK, Buy) earnings fairly accurately track its actual cashflows, reflective of its healthy margins and timely collections from customers, in our view.
- We find that **IJM's** (IJM MK, Neutral) operating cash flow (OCF) generation is consistently better than that predicted by its reported earnings, and should get a further boost on the completion of its London property project, for which cash will only be realised on handover in FY18F, in our view.
- **Gamuda** (GAM MK, Neutral), in contrast, generates lower cashflows, which in our view, are mainly due to the SPLASH overhang – this asset contributes ~ MYR150mn annually to GAM's PBT, but very little to cash flows (as receivables build up). This is in line with our view that a disposal of SPLASH at close to 1x P/B is the only way to monetise earnings already recognised on the books.
- **WCT** (WCTHG MK, Reduce) also generates lower cashflows, which has led to the gearing rising to 91% in FY16, and is mainly due to investments in property ventures and lower construction margins, in our view.

Pure-play contractors might still continue to outperform on valuations

In the following section, we recap our pure-play and diversified contractors' index and discuss their performance.

Important to look at pure-play and diversified contractors separately

- As highlighted in the first issue of our Malaysia Construction foundation series, many big-cap construction companies in Malaysia have ventured into other segments to diversify their businesses and shield themselves from the volatility in the construction earnings, as it is hard to have continuous orderbook replenishment every year, eg, IJM has a diversified business model with only 28% of its revenue coming from construction in FY16 (FY-end July), while its other businesses like property development, concessions, manufacturing and plantations accounted for 23%/19%/19%/11% of revenues, respectively.
- Although construction companies in Malaysia are moving towards diversification, we believe the construction segment still remains the major driver of earnings for a majority of the smaller KLCON constituents.
- **We think it is becoming more important to distinguish the performance of diversified contractors vs. those which are still primarily construction-focused**, **for two reasons**: 1) our analysis below reveals that diversified players' performance has been lagging that of the pure-play stocks, suggesting pure-play names have generated more alpha of late; 2) with property development being the business of choice into which to diversify for most large contractors, it has remained a drag on their earnings performance in recent years due to the slowdown in the property sector.

Recap of our indices: we had constructed proprietary indices for pure-play contractors and diversified contractors

- We looked at the top 20 members (by market cap) of the KL construction (KLCON) index (ex WCE Holdings and Protasco which have limited analyst coverage) and by analysing their revenue breakdown by businesses, we identified and segregated companies into those which have a diversified business model or those which can be considered as pure-play construction players.
- We then created two indices (market cap weighted): the KL Diversified Construction Index (KLCONDIVERSE) and the KL Pureplay Construction Index (KLCONPURE) and looked at the performance of these two indices vs. KLCON and Bursa Malaysia KLCI-30 (KLCI) Index. Of the 20 stocks we considered, six stocks are included in the diversified index and the remaining 14 stocks fall into the pure play category (revenues from construction >70-80%).
- Our construction diversified index – KLCONDIVERSE – includes IJM, Gamuda, WCT, Muhibbah Engg, Puncak Niaga and Jaks Resources, and the pure play index – KLCONPURE – includes 14 stocks, namely SunCon, Ekovest, Kerjaya Prospek, Hock Seng Lee, Mitrajaya, Econpile, Gadang, Kimlun Corp, Mudajaya, Pintaras Jaya, Eversendai, Gabungan Aqrs, Ikhmas Jaya and Benalec. The index weights and methodology are highlighted in Fig. 25:

Fig. 25: Index weights and methodology

Methodology

- We took top 20 members (by market cap) of the KL construction (KLCON) index (ex WCE Holdings and Protasco which have no analyst coverage)

- By analysing their revenue breakdown by segment, we identified and segregate companies into those which have a diversified business model or those which can be considered as pure-play construction players

- We then created 2 separate indices - one for pure play names and the other for diversified companies

- For each index, we set the value at 100 on 1 Jan 2011

- To get the index value on each day, we calculate the index performance from its constituents' daily performance

- Index daily performance = sum of (weight of the stock in the index * day's performance of the stock)
where weight in the index = market cap of the stock divided by the sum of market caps of all the constituents on that day

- To get the index P/E, we take sum(weight * market cap of the stock)/ sum(weight * Last 12M net income of the company)

KL Pure play Construction Index (KLCONPURE)

Name	Ticker	Mcap (USD mn)	3M ADTV (USD mn)	Weight (%)	Revenue from construction (%)
SunCon	SCGB MK	497	0.6	16.6%	87%
Ekovest	EKO MK	611	2.0	20.4%	78%
Kerjaya Prospek	KPG MK	285	0.2	9.6%	69%
Hock Seng Lee	HSL MK	213	0.1	7.1%	95%
Mitrajaya	MHB MK	190	0.3	6.3%	86%
Econpile	ECON MK	257	0.5	8.6%	100%
Gadang	GADG MK	171	2.3	5.7%	71%
Kimlun	KICB MK	162	0.2	5.4%	81%
Mudajaya	MDJ MK	111	0.1	3.7%	83%
Pintaras Jaya	PINT MK	130	0.0	4.3%	75%
Eversendai	EVSD MK	110	0.7	3.7%	100%
Gabungan Aqrs	AQRS MK	103	0.2	3.4%	78%
Ikhmas Jaya	IJGB MK	67	0.1	2.2%	100%
Benalec	BHB MK	82	0.2	2.7%	98%

KL Diversified COnstruction Index (KLCONDIVERSE)

Name	Ticker	Mcap (USD mn)	3M ADTV (USD mn)	Weight (%)	Revenue from construction (%)
IJM	IJM MK	2,775	3.2	42.4%	28%
Gamuda	GAM MK	2,743	3.9	41.9%	67%
WCT	WCTHG MK	530	1.6	8.1%	77%
Muhibbah	MUHI MK	276	0.4	4.2%	48%
Puncak Niaga	PNH MK	97	0.2	1.5%	67%
Jaks Resources	JAK MK	122	1.0	1.9%	55%

Note: we assign the stocks subjectively to the two groups

Source: Bloomberg, Nomura estimates, Market cap as of 7 March 2017 close

Pure-play names have performed better than diversified companies over the last three years

- In 2014, the KLCONDIVERSE index returned 6% and has performed better than KLCON (flat), KLCI (-6%), as well as our pure-play construction index, the KLCONPURE (-4%).
- But in 2015, although our diversified index (+2%) performed better than the KLCON (-1%) and KLCI (-4%) index, the return was much higher for the pure-play construction companies' index (+24%).
- The trend continued in 2016 as well where our diversified index (flat) performed better that KLCI (-3%) but the performance was behind KLCON (+3%) and our pure-play construction companies' index (+28%).
- YTD 2017, our pure-play construction companies' index (+14%) performed better that the diversified index (+7%) as well as KLCON (+10%) and KLCI (+5%).
- We believe the relative underperformance of diversified companies index vs. pure play was the slowdown in property sales (property earnings were a source of diversification for four of six companies in the diversified index) after the cooling measures were announced by the government at end-2013, and the implementation of GST from 1 April 2015.
- Note that, in 2016, SunCon, Kerjaya Prospek, Ekovest, Econpile, Gadang and Kimlun were the best performers in the construction space.

Fig. 26: KL pure-play construction companies' index performance vs. KLCON and KLCI

	KLCONPURE	KLCON	FBMKLCI
2014	(4%)	0%	(6%)
2015	24%	(1%)	(4%)
2016	28%	3%	(3%)
YTD 2017	14%	10%	5%

Source: Bloomberg, Nomura estimates

Fig. 27: KL diversified construction companies' index performance vs. KLCON and KLCI

	KLCONDIVERSE	KLCON	FBMKLCI
2014	6%	0%	(6%)
2015	2%	(1%)	(4%)
2016	0%	3%	(3%)
YTD 2017	7%	10%	5%

Source: Bloomberg, Nomura estimates

Fig. 28: Stock price performance

		2014	2015	2016	YTD 2017
Diversified construction companies					
IJM	IJM MK	12%	3%	(5%)	7%
Gamuda	GAM MK	4%	(7%)	3%	5%
WCT	WCTHG MK	(22%)	6%	7%	9%
Muhibbah	MUHI MK	(18%)	18%	1%	15%
Puncak Niaga	PNH MK	(9%)	(51%)	(39%)	7%
Jaks Resources	JAK MK	(13%)	182%	(18%)	22%
Pure-play construction companies					
SunCon	SCGB MK			21%	1%
Ekovest	EKO MK	(11%)	0%	122%	33%
Kerjaya Prospek	KPG MK	34%	65%	33%	14%
Econpile	ECON MK		29%	68%	17%
Hock Seng Lee	HSL MK	(9%)	11%	(15%)	8%
Mitrajaya	MHB MK	94%	84%	5%	0%
Gadang	GADG MK	29%	57%	24%	11%
Kimlun	KICB MK	(29%)	16%	51%	12%
Pintaras Jaya	PINT MK	30%	(12%)	7%	0%
Mudajaya	MDJ MK	(50%)	(19%)	(23%)	1%
Eversendai	EVSD MK	(25%)	(2%)	(25%)	10%
Gabungan Aqrs	AQRS MK	18%	(33%)	9%	29%
Benalec	BHB MK	(34%)	(2%)	(32%)	21%
Ikhmas Jaya	IJGB MK			(16%)	1%

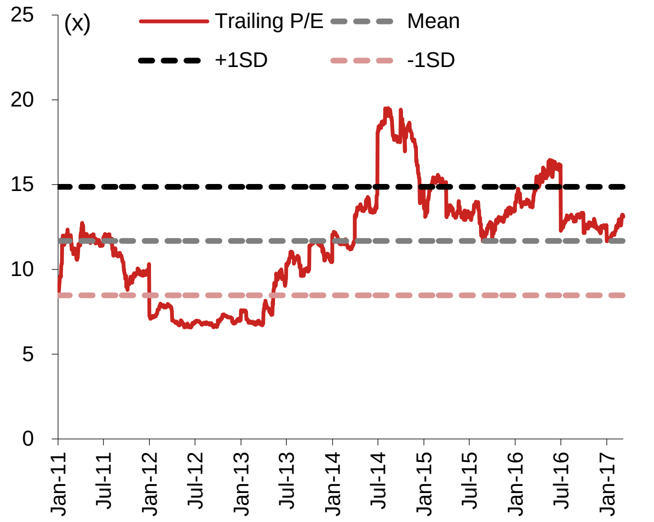
Source: Bloomberg, Nomura research

Reason for lacklustre performance of diversified contractors: high valuations due to earnings downgrades; pure-play contractors might continue relative outperformance

- In terms of valuation, the diversified contractors are trading at ~21x trailing P/E, which is +2SD above the historical mean valuation. The pure-play contractors valuation is relatively lower at ~13x, and which is between mean and +1SD levels.
- In our view, this explains the relatively lacklustre trading performance of stocks like IJM, GAM and WCT. We believe the valuation of the diversified contractors is still fairly expensive, due mainly to constant earnings downgrades from their property earnings division, and rich valuations have resulted in an overhang on the stocks, leading them to underperform.
- On the other hand, in spite of the outperformance of pure play contractors, their current trailing valuations at 13x P/E are still between their mean and +1SD levels. **In our view**, **this implies that these stocks might continue to relatively beat returns of diversified contractors over the next 12 months.** This is also helped by the fact that after the spate of infrastructure contract awards in the last 12 months, most pure-play contractors (and indeed even diversified contractors) are now sitting on record orderbooks with multi-year visibility. We note, however, that due to the threats on construction margins as highlighted above, this outperformance will only continue as long as earnings downgrades do not happen on an individual stock basis, and so margin momentum should be tracked closely by investors, in our view.

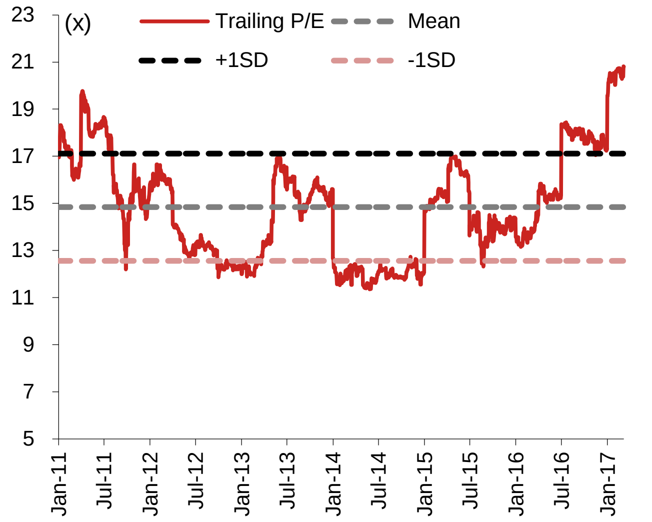
Note that we use trailing P/E as analyst coverage for some pure-play contractors is relatively light, and so reliable forward estimates might be hard to come by. We do not formally cover any pure-play contractors except Sunway Construction (SCGB MK, Buy).

Fig. 29: KL pure-play construction companies' index trailing P/E



Source: Bloomberg, Nomura estimates

Fig. 30: KL diversified construction companies' index trailing P/E



Source: Bloomberg, Nomura estimates

Stocks under our coverage sitting on record orderbooks

Increased competition from local unlisted contractors and foreign players will mean that the share of construction jobs will be lower for contractors in Malaysia coupled with lower operating margins. But for stocks under our coverage – IJM, Gamuda, WCT and SunCon – we see limited risk in the short term, as they are already sitting on record orderbooks which provide earnings visibility for 2-4 years from the construction business.

Fig. 31: Current outstanding orderbooks for construction stocks in Malaysia

	Outstanding orderbook (MYR bn)	Earnings visibility (years)
IJM	**9.0**	**4.0**
Gamuda	**8.7**	**3.5**
WCT	**5.1**	**3.2**
SunCon	**4.8**	**2.1**
Ekovest	11.8	14.8
Kerjaya Prospek	2.9	4.0
Muhibbah Engg	2.1	2.8
Hock Seng Lee	2.2	3.5
Mitrajaya	1.7	2.2
Econpile	1.0	2.3
Gadang	0.7	1.5
Kimlun Corp	2.1	2.0
Mudajaya	2.6	5.8
Pintaras Jaya	0.3	1.0
Protasco	0.9	3.6
Eversendai	2.7	1.5
Gabungan	1.1	3.4
Ikhmas Jaya	0.6	2.3
Benalec	0.2	1.1

Note: To calculate the visibility, we use last reported FY revenues from construction business except for: 1) EKovest - we use MYR0.8bn revenue from construction (80% of MYR1bn revenue forecast by the management); 2) IJM and SunCon internal + external revenue is used as the orderbook includes internal projects; 3) Kerjaya Prospek revenue rate for 9M16 is used to calculate visibility.

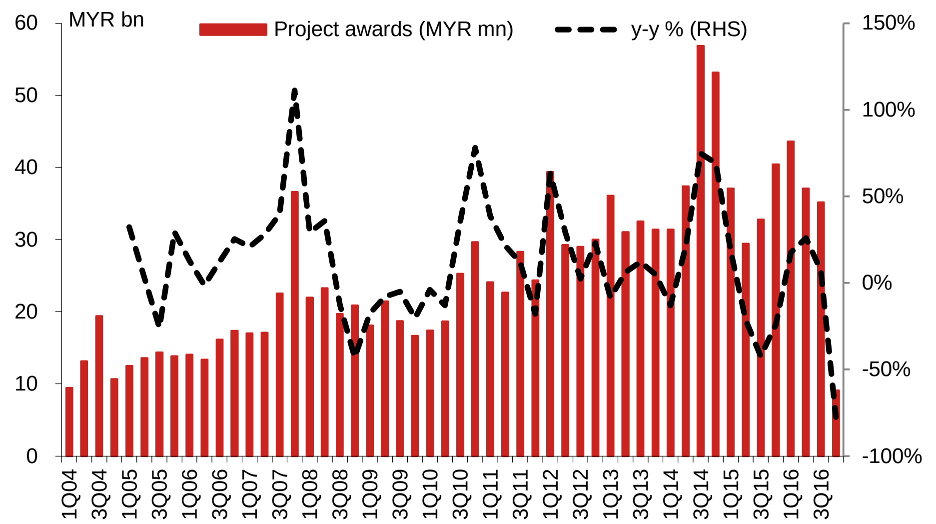
Source: Media articles (including in Edge Malaysia), company data, Nomura estimates

Sector outlook: project awards slow in 4Q16

Construction projects awards at MYR9bn in 4Q16

- In 4Q16, construction projects worth ~MYR9bn (-77% y-y, -74% q-q) were awarded in Malaysia, the lowest in the last 12 years. Note that the data for 3Q16 was restated from MYR23bn earlier to MYR35bn now. Therefore, there is a possibility that 4Q16 data might also be restated upwards due to late notifications of some awards.
- We believe the major reason for the drop in awards is the slowdown in the property sector which has led to lower awards in the residential as well as the non-residential segment. Residential property awards were rising since 2004 until they peaked in 1Q15. Since then, property construction contracts have been falling sequentially due to weak property sales in Malaysia after cooling measures were introduced by the government in 2013. Residential/ non-residential property project awards were down ~71% y-y/ 83% y-y in 4Q16. Awards in 4Q16 were also down due to lower infrastructure awards in the quarter.
- In comparison with 3Q16, contract awards were down 74% q-q, due to lower property and infrastructure contract awards.
- For full year 2016, construction contract awards were down 11% y-y mainly due to slowdown in the property sector. However, infrastructure contract awards almost doubled in 2016 due to major awards such as MRT2, Pan Borneo Highway, East Coast Rail link, DASH and SUKE highways.

Fig. 32: Construction project awards down 77% y-y in 4Q16

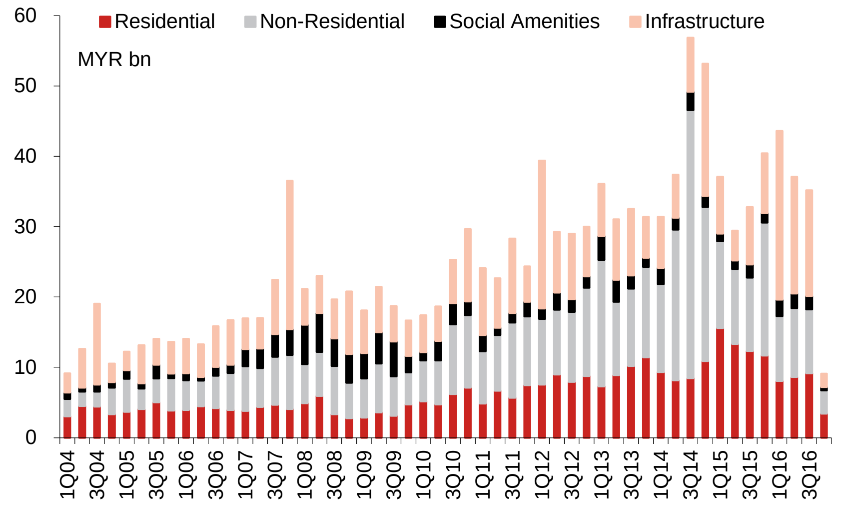


Source: Construction Industry Development Board, CEIC, Nomura research

Infrastructure the biggest contributor, amounting to ~46% of 2016 awards

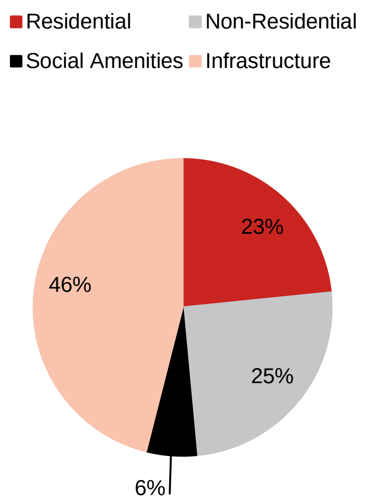
Over the last 5-6 years, contract awards from property projects (both residential and non-residential) formed ~60-75% of total awards. But in 2016, infrastructure contracts have been the biggest contributor, due mainly to MRT Line 2, the Pan Borneo Highway, DASH and SUKE awards this year and lower contribution from property projects, as mentioned above.

Fig. 33: Construction project awards by category



Source: Construction Industry Development Board, CEIC, Nomura research

Fig. 34: YTD 2016 construction awards



Source: Construction Industry Development Board, CEIC, Nomura research

Local contractors the overwhelming winners in 2016

In 2016, foreign contractors managed to secure only 12% of total contract awards (by value, vs. 19% in 2015) and almost all the awards were in the non-residential property construction and infrastructure segment. Historically, also, in the last 3-4 years the non-residential property segment has seen maximum awards to foreign contractors (although the share remains low at ~5-20% of total awards) followed by infrastructure contracts (0-5% of total awards). However, with the increasing Chinese presence, the share of revenues from foreign contractors is expected to increase again, in our view.

Fig. 35: Share of construction projects by contractor in various categories

	Total		Residential		Non-Residential		Social Amenities		Infrastructure	
	Local	Foreign	Local	Foreign	Local	Foreign	Local	Foreign	Local	Foreign
2007	94%	6%	18%	0%	26%	2%	13%	0%	36%	4%
2008	91%	9%	19%	1%	26%	2%	22%	1%	23%	6%
2009	96%	4%	19%	0%	29%	1%	20%	1%	28%	2%
2010	88%	12%	25%	1%	29%	7%	10%	0%	25%	4%
2011	81%	19%	24%	1%	28%	8%	7%	0%	23%	10%
2012	88%	12%	26%	0%	28%	5%	6%	0%	29%	7%
2013	88%	12%	29%	0%	31%	9%	7%	0%	22%	2%
2014	73%	27%	19%	1%	31%	21%	4%	1%	19%	4%
2015	81%	19%	32%	6%	27%	11%	4%	0%	19%	2%
2016	88%	12%	22%	1%	17%	8%	5%	0%	43%	3%

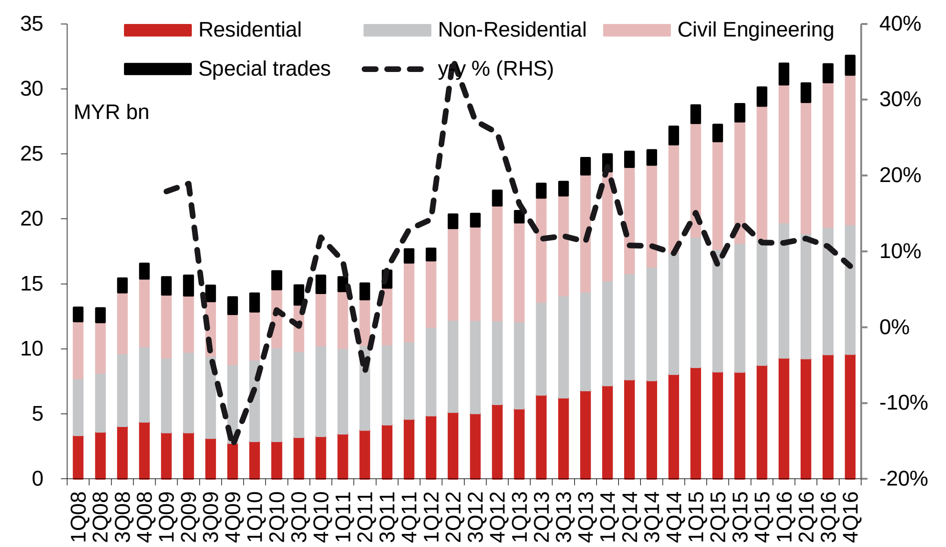
Source: Construction Industry Development Board, CEIC, Nomura research

Construction works done are steady, but a lagging indicator of future revenues

Construction works done during the quarter are ~MYR32.5bn and have remained in the range of ~MYR25-33bn since 2014. Residential, non-residential and civil works are the major categories, and works done in all three have remained steady in the last two years. The majority of the contribution (64% in 2016) of construction works in Malaysia comes from the private sector.

Note that construction works done is a co-incident indicator of contractors' revenues, and as such it is less relevant to extrapolate future revenue trends for listed contractors. A more relevant metric to forecast future revenues is project awards, discussed above, which serves as a leading indicator for future revenues.

Fig. 36: Construction works done



Source: CEIC, Nomura research

Fig. 37: Construction work done by project owner

% share of value of work done

Year	Private sector	Public sector			Total
		Govt	Public Corp	Total	
2008	56%	41%	3%	44%	100%
2009	50%	46%	4%	50%	100%
2010	50%	46%	4%	50%	100%
2011	63%	34%	4%	37%	100%
2012	66%	25%	9%	34%	100%
2013	70%	18%	13%	30%	100%
2014	71%	15%	15%	29%	100%
2015	67%	15%	18%	33%	100%
2016	64%	16%	21%	36%	100%

Source: CEIC, Nomura research

Fig. 38: Construction work done by type

% share of value of work done

Year	Residential	Non-residential	Civil Engineering	Special Trades	Total
2008	27%	35%	31%	8%	100%
2009	22%	41%	29%	9%	100%
2010	20%	45%	26%	9%	100%
2011	25%	39%	28%	7%	100%
2012	26%	34%	35%	5%	100%
2013	27%	32%	36%	5%	100%
2014	30%	33%	32%	5%	100%
2015	29%	34%	32%	5%	100%
2016	30%	31%	34%	5%	100%

Source: CEIC, Nomura research

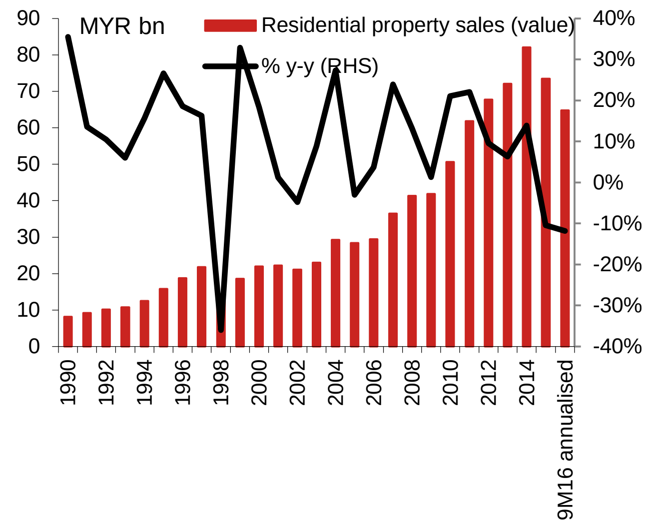
Residential/commercial property sales falling

Residential property sales value increased from MYR 42bn to MYR 82bn at a CAGR of 14% from 2009-2014, declined thereafter by 10% in 2015, and is annualising at a further 12% decline in 9M16. Residential sales volume has been declining since 2013, and is down to 202k transactions (annualised 9M16) vs. ~270k in 2012. We expect that with household debt to GDP remaining elevated, Bank Negara is unlikely to ease lending curbs to the property sector for fear of structural issues in asset quality in future, and as such residential property sales are not likely to stage a sharp turnaround in the near term.

Similarly, commercial property sales (by value) have been on a downtrend since 2014, falling 10%/ 17% in 2014/ 2015 and is annualising at a further 14% decline in 9M16.

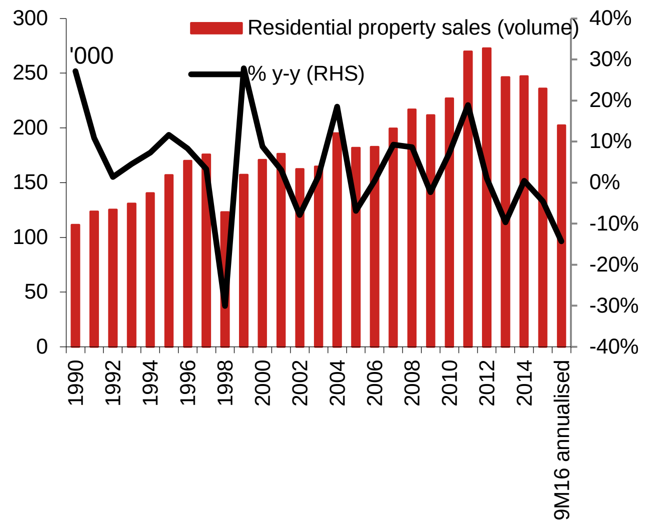
This implies that construction projects from property sector are also unlikely to stage a turnaround any time soon, and as such the bulk of revenue growth from the sector is likely to come from infrastructure projects, which are still strong.

Fig. 39: Malaysia: Residential property sales by value



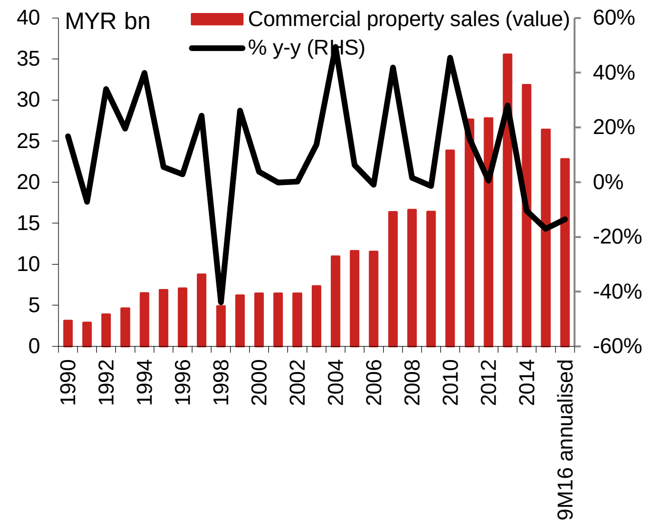
Source: CEIC, Nomura research

Fig. 40: Malaysia: Residential property sales volume



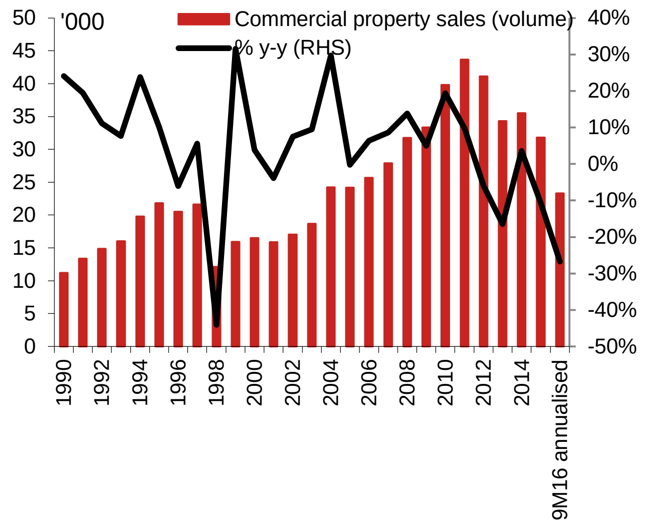
Source: CEIC, Nomura research

Fig. 41: Malaysia: Commercial property sales by value



Source: CEIC, Nomura research

Fig. 42: Malaysia: Commercial property sales volume



Source: CEIC, Nomura research

Fig. 43: List of China-driven projects in Malaysia

Date	Company	Value (MYR mn)	Value (USD mn)	Other comments	
Energy					
Jun-13	Comtec Solar Systems Group Ltd	1,200	366	Solar Ingots Manufacturing plant	
Aug-14	Sinopec	4,259	1,218	Oil refinery construction contract for RAPID project	KNM Group's subsidiary will be the sub-contractor
Oct-14	Shanghai Electric Group Co Ltd	1,500	429	2x300MW Balingian Coal-fired power plant	Construction
Sep-15	Zkenergy New Resources Science & Technology Co. Ltd	200	47	Malaysia-China Kuantan Industrial Park (MCKIP)	
Nov-15	China National Petroleum Corporation	2,063	480	EPC contract for 2 polypropylene units of RAPID project	JV with Maire Tecnimont Group of Italy (60%), CNPC 40%
Mar-16	Xi'an LONGi Silicon Materials Corp	1,066	238	Integrated solar plant in Sama Jaya Free Industrial Zone	
Jul-16	China National Complete Plant Import and Export Corporation (Complant), Sichuan Chemical Industry Holding (Group) Co. Ltd and China Chengda Engineering Co. Ltd	undisclosed	undisclosed	MoU signed with Sabah Oil & gas Development Corp Sdn Bhd to undertake feasibility studies for production of a petrochemical plant in Sipitang Oil & gas Industrial Park	
Aug-16	Hebel Xinwuan Steel Group & MCC Overseas Ltd	13,000	2,898	Develop steel plant in the Samalaju Industrial Park in Bintulu	In Cooperation with Sarawak Government
Sep-16	Powerchina International	30,000	6,687	Reclamation of 3 islands in Melaka	JV with KAJ Development Sdn Bhd
Sep-16	Sinopec	undisclosed	undisclosed	Warehouse for Pengerang Intergrated Complex (PIC) - awarded by Petronas	
Nov-16	China Nuclear Industry Huaxing Construction Co Ltd (HXCC)	2,000	446	Development of Green Tech park in Pekan, Pahang	Partnership with BHS Industries Bhd
Nov-16	Wuxi Suntech Power	4,000	892	Malaysia-China Kuantan Industrial Park (MCKIP)	
Nov-16	China National Petroleum Corporation	1,654	369	Package of Petronas' Intergrated complex (PIC)	JV with Maire tecnimont Group of Italy (65%), CNPC 35%
Nov-16	China Petroleum Pipeline Bureau（CPP)	-		EPCC of Trans Sabah Gas Pipeline and Multi-product Pipeline projects in Sabah	Partnership with Suria Strategic Energy resources Sdn Bhd
Materials					
Apr-15	China State Construction Engineering Corp	2,121	494	Malacca Xinyi Glass Industrial Park Project (to build two glass production lines)	
Sep-15	Guangxi Zhongli Enterprise Group Co. Ltd	2,000	466	Industrial park to manufacture clay porcelain @ Malaysia-China Kuantan Industrial Park (MCKIP)	
Metals and mining					
Aug-14	Guangxi Beibu Gulf Iron & Steel Investment Co Ltd	5,600	1,601	Steel mill at Malaysia-China Kuantan Industrial Park (MCKIP)	
Jun-16	Guangxi Investment Group Co Ltd	600	134	To build Aluminium processing plant at Malaysia-China Kuantan Industrial Park (MCKIP)	
Real estate					
Jul-12	Beijing Urban Construction Group	1,000	327	OSK's mixed development in Damansara Jaya, Petaling Jaya	GDV MYR1bn; BUCG is the main contractor
2013	Country Garden Holdings Ltd	137,579	42,000	Forest City development in Johor	Partnership with Esplanade Danga 88 Sdn Bhd
Jul-14	China Railway Construction Corporation	950	272	Four seasons Place	
Jan-15	China State Construction Engineering Corp	1,566	365	Princess Bay Project (Phase I) - fifteen 35-storey High rise buildings	
Jun-15	Beijing Urban Construction Group	675	157	Elite Pavilion Serviced Apartment project	
Jul-15	China State Construction Engineering Corp (Vietnam)	377	88	Tropicana Bora Project Phase 1A, a residential project	
Aug-15	Greenland Group	13,742	3,200	Property development project in Tebrau & Danga Bay, Iskandar	
Oct-15	China Communications Construction CO.	2,320	540	Land reclamation for the Seri Tanjung Pinang Phase 2 (STP2) project in Penang	
Transport					
Oct-13	Beijing Urban Construction Group/ China Railway Construction Corporation	6,300	1,923	Penang undersea tunnel	Consortium with Zenith (95%)-BUCG (1%)-Juteras (4%); note that BUCG later exited the consortium.
Feb-15	Beibu Gulf Holding	3,000	699	Kuantan Port expansion	60% IJM's stake
Dec-15	China Railway Construction Corp/ China Railway Group/ China Communications Construction Co	8,900	2,073	Southern Double tracking (Gemas-JB)	
Dec-15	China Railway Group Ltd	7,410	1,726	Bandar Malaysia	Iskandar waterfront Holdings and China Railway Engineering Corp (CREC) consortium bought 60% stake
Aug-16	China Communication Construction Co Ltd (CCCC)	1,010	225	MRT2 package SY204	CCCC- George Kent JV, 51% stake CCCC
Aug-16	China Harbour Engineering Co	940	210	Package in SUKE	JV with ML Sepakat
Aug-16	China Harbour Engineering Co	475	106	Package in DASH	JV with Pertama Makmur
Oct-16	China Communications Construction CO.	46,000	10,254	East coast rail link	China will build and finance
Nov-16	Powerchina International, Shenzhen Yantian Port and Rizhao Port	8,000	1,783	Melaka Gateway port	Partnership collaboration with KAJ Development
Dec-16	China communications construction CO.	389	87	Package in SUKE; subcontract from unlisted contractor (Gabungan Strategik Sdn Bhd)	JV with Econpile Holdings

Source: Company data, media reports (including in Edge Malaysia and The Star), Nomura research

Fig. 44: Malaysia: Major construction projects in the pipeline (1)

Infrastructure projects in the pipeline	Project owner	Estimated value	Status	Likelihood of going ahead soon
Highways				
West Coast Expressway (WCE)	IJM Corp Bhd	MYR 5 bn	Physical works expected to start in in 2H2016. IJM awarded MYR 2.8bn, remaining contracts to be awarded by public tender by year end (2016). On track for completion in 2019	High
Pan Borneo Highway	Government	MYR 30 bn	Lebuhraya Borneo Utara Sdn Bhd appointed PDP for Sarawak portion, all contracts for Sarawak portion awarded. Borneo Highway PDP (BHP) is the PDP of Sabah section and UEM Group-MMC-Warisan Tarang Construction also have a stake is the PDP.	Sarawak - already awarded, Sabah - yet to be awarded
Sungai Besi to Duta Ulu Klang Expressway (SUKE)	Prolintas	MYR 4.6 bn	Contracts awarded in Aug 2016; 6 of 9 contracts went to unlisted contractors	High
East Klang Valley Expressway (EKVE)	Ahmad Zaki Resources Bhd	MYR 1.55 bn	Works ongoing	High
Damansara-Shah Alam Highway (DASH)	Prolintas	MYR 3.25 bn	Contracts awarded in Aug 2016; All 8 contracts went to unlisted contractors	High
Datu-Ulu Kelang Expressway (DUKE) extension - Phase 2	Ekovest	MYR 1.12 bn	To be ready soon	High
Setiawangsa-Pantai Expressway (DUKE - Phase 3)	Ekovest	MYR 3.7 bn	Concession agreements signed in 2016	High
Expressway which inlcudes Kampung Baru link, Istana link and Kapar link expressway	Ekovest	MYR6.32bn	Project awarded in Jan-2017	High
Kinrara Damansara Expressway (Kidex)	Zabima Engineering and Construction-Emrail JV	MYR 2.42 bn	Facing opposition from residents in Cheras, Kota Damansara, Ampang and Petaling Jaya.	Cancelled
Public transport projects				
Klang Valley Mass Rapid Transit Line 2	Government	MYR 30-35 bn	Underground works and some viaduct contracts awarded	High
LRT 3	Government	MYR 9 bn	MRCB-George Kent appointed PDP	High
Kuala Lumpur - Singapore High Speed Rail	Government (Malaysia & Singapore)	MYR 50 bn+	Joint development partner already appointed; Both countries signed MoU in Jul-2016.	High
Kuantan Port Expansion	IJM Corp and Beibu Gulf Holding	MYR 1.5 bn	Ongoing	High
Gemas-JB double tracking and electrification	Government	MYR 8bn	Awarded to a Chinese consortium of China Railway Construction Corp Ltd (CRCC)/ China Railway Group and China Communications Construction Co in Dec-2015	High
East Coast Railway Line	Government	MYR 55 bn	Announced in Budget 2017; Awarded to China Communications Construction Co.	High
Penang Intergrated Transport Plan	Penang State Government	MYR 36 bn*	Gamuda, in a 60%-owned JV, awarded PDP; pending Federal govt. approval	
Bus Rapid Transit KL to Klang	Government	MYR 1bn	Not approved yet	

* based on our estimates

Source: Media articles (including in Edge Malaysia and The Star), Nomura research

Fig. 45: Malaysia: Major construction projects in the pipeline (2)

Infrastructure projects in the pipeline	Project owner	Estimated value	Status	Likelihood of going ahead soon
Utilities and Oil & Gas				
Refinery and Petrochemical Integrated Development (RAPID)	Petronas	MYR 61.2 bn	Targeted start in 2019	High
Langat 2 Water treatment Plant	Government	MYR 993 mn	Awarded to a consortium of Salcon-MMC-AZRB.	High
Langat Centralised Sewage Treatment Plant and Sewer conveyance system (langat CSTP)	Government	MYR 1.5 bn	Awarded to MMC Corp	High
Jimah East Power (Project 3B) - 2,000MW coal fired plant	Energy commission	MYR 12 bn	Awarded; being undertaken by Tenaga-Mitsui Co. Ltd consortium	High
Project 4A - 1,000MW-1,400MW combined cycle gas turbine plant	Energy commission	MYR 8 bn	Initially awarded to TNB, SIPP Energy and YTL Power but TNB and YTL have pulled out. Unclear whether SIPP Energy will be the sole owner or bring a partner	
Property developments		**Est. GDV**		
Kwasaland development	EPF	RM 50 bn	PDP for main infra awarded to MRCB; Other awards on-going	High
Tun Razak Exchange	1MDB	MYR 26 bn	WCT awarded MYR 825mn infrastructure works.	High
KL 118 (Warisan Merdeka)	PNB	MYR 5 bn	Major construction works (MYR3.4bn) awarded to UEM-Samsung JV	High
Bukit Jalil Stadium Refurbishment	Government	MYR 1 bn	Awarded to MRCB	High
Bandar Malaysia (Sungai Besi airbase)	Government (40%) and IWH-China Railway (60%)	MYR 160 bn		
Malaysia Vision valley (MVV)	Government (20%), consortium including Sime Darby and EPF (80%)	MYR 5 bn	Not awarded	

Source: Media articles (including in Edge Malaysia and The Star), Nomura research

NOMURA

Sunway Construction Group Bhd

SCOG.KL SCGB MK

EQUITY: ENGINEERING & CONSTRUCTION

Steady earnings with decent cashflows

Upgrade to Buy; pure-play model, healthy orderbook replenishment, net cash position

Upgrade to Buy

We expect SunCon's re-rating (+22% since Jan-2016, vs the KLCI's 2%) to continue, for the following reasons: **1)** at the sector level, pure-play contractors like SunCon are likely to continue to outperform diversified contractors like IJM and Gamuda, because of the latter's slow property business and expensive valuations; **2)** based on our earnings-cashflow matrix, SunCon generates steady earnings as well as healthy cashflows; and **3)** it has a very healthy balance sheet, and is currently sitting on net cash of MYR329mn, which could potentially be used for: i) investment in an integrated construction precast hub (ICPH) in Singapore and / or ii) paying higher dividends (payout has already increased to ~50% in FY16, vs its policy of 35%). By FY18F, we estimate SunCon's net cash will be ~20% of its present market cap. Finally, the stock looks likely to be re-added to the list of Shariah-compliant stocks in the next review (May 2017), which would also widen its potential investor base.

Valuation: New TP based on 15x cash adj FY18F P/E (EPS of MYR0.12)

SunCon's cash balance has tripled since 2012, and we think there is a good possibility of a dividend increase / high ROIC capex. Thus, we now believe that it is important for investors to look at SunCon's P/E multiples adjusted for its cash holdings (this is not applicable to other construction stocks in our coverage because of their net debt positions, and part of their cash sitting at their subsidiaries). We value SunCon at a cash-adjusted target P/E of 15x on CY18F EPS of MYR0.12, vs the current cash adj FY18F P/E of 12x, to arrive at our new TP of MYR2.00. Thus we upgrade SunCon to Buy, and it is now our only Buy in the Malaysia construction sector.

Catalysts: Shariah upgrade, investment in ICPH, higher dividend

Downside risks include: 1) delay in construction project awards; 2) lower-than-expected margins; 3) Singapore housing units not growing as expected; and 4) lower-than-expected orderbook inflows.

Year-end 31 Dec	FY16		FY17F		FY18F		FY19F
Currency (MYR)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	1,789	2,060	2,157	2,164	2,294		2,315
Reported net profit (mn)	124	139	145	144	149		154
Normalised net profit (mn)	125	139	145	144	149		154
FD normalised EPS	9.64c	10.76c	11.19c	11.15c	11.52c		11.93c
FD norm. EPS growth (%)	0.7	7.4	16.0	3.7	3.0		3.5
FD normalised P/E (x)	17.7	N/A	15.3	N/A	14.8	N/A	14.3
EV/EBITDA (x)	9.9	N/A	9.0	N/A	8.2	N/A	7.6
Price/book (x)	4.5	N/A	3.9	N/A	3.4	N/A	3.1
Dividend yield (%)	2.9	N/A	3.4	N/A	3.5	N/A	3.6
ROE (%)	26.2	27.0	27.3	24.1	24.6		22.7
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash		net cash

Source: Company data, Nomura estimates

Key company data: See next page for company data and detailed price/index chart.

Global Markets Research

10 March 2017

Rating Up from Neutral	**Buy**
Target Price Increased from 1.60	MYR 2.00
Closing price 8 March 2017	MYR 1.71
Potential upside	+17%

Anchor themes

In 2017, we expect pure-play Malaysian contractors to continue to outperform diversified companies, which have property exposure. We like stocks where management is looking beyond short-term project awards and generating both earnings growth and healthy cashflows, which in our view are the best indicators of long-term outperformance.

Nomura vs consensus

Our TP is 7% above consensus.

Research analysts

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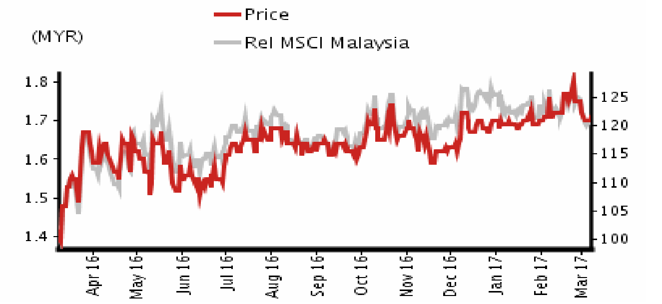
See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

Key data on Sunway Construction Group Bhd

Relative performance chart



Source: Thomson Reuters, Nomura research

Notes:

Performance

(%)	1M	3M	12M		
Absolute (MYR)	0.0	3.6	23.0	M cap (USDmn)	496.6
Absolute (USD)	-0.3	2.9	13.6	Free float (%)	37.9
Rel to MSCI Malaysia	-1.0	-0.8	21.5	3-mth ADT (USDmn)	0.7

Income statement (MYRmn)

Year-end 31 Dec	FY15	FY16	FY17F	FY18F	FY19F
Revenue	1,917	1,789	2,157	2,294	2,315
Cost of goods sold	-1,784	-1,638	-1,983	-2,113	-2,129
Gross profit	133	151	175	181	186
SG&A					
Employee share expense					
Operating profit	133	151	175	181	186
EBITDA	175	190	215	226	236
Depreciation	-42	-39	-40	-45	-50
Amortisation					
EBIT	133	151	175	181	186
Net interest expense	5	4	6	5	7
Associates & JCEs	0	0	0	0	0
Other income					
Earnings before tax	137	155	181	186	193
Income tax	-13	-30	-36	-37	-39
Net profit after tax	124	125	145	149	154
Minority interests	-1	0	0	0	0
Other items					
Preferred dividends					
Normalised NPAT	124	125	145	149	154
Extraordinary items	3	-1	0	0	0
Reported NPAT	127	124	145	149	154
Dividends	-52	-65	-75	-77	-80
Transfer to reserves	75	59	70	72	74
Valuations and ratios					
Reported P/E (x)	17.4	17.9	15.3	14.8	14.3
Normalised P/E (x)	17.9	17.7	15.3	14.8	14.3
FD normalised P/E (x)	17.9	17.7	15.3	14.8	14.3
Dividend yield (%)	2.3	2.9	3.4	3.5	3.6
Price/cashflow (x)	9.2	27.7	32.9	11.8	11.0
Price/book (x)	4.9	4.5	3.9	3.4	3.1
EV/EBITDA (x)	10.8	9.9	9.0	8.2	7.6
EV/EBIT (x)	14.1	12.5	11.0	10.3	9.6
Gross margin (%)	6.9	8.4	8.1	7.9	8.0
EBITDA margin (%)	9.1	10.6	10.0	9.8	10.2
EBIT margin (%)	6.9	8.4	8.1	7.9	8.0
Net margin (%)	6.6	6.9	6.7	6.5	6.7
Effective tax rate (%)	9.5	19.4	20.0	20.0	20.0
Dividend payout (%)	40.7	52.3	51.9	51.9	51.9
ROE (%)	30.6	26.2	27.3	24.6	22.7
ROA (pretax %)	13.5	14.8	14.6	13.7	13.6
Growth (%)					
Revenue	1.9	-6.7	20.6	6.3	0.9
EBITDA	2.5	8.5	13.3	5.1	4.3
Normalised EPS	1.8	0.7	16.0	3.0	3.5
Normalised FDEPS	1.8	0.7	16.0	3.0	3.5

Source: Company data, Nomura estimates

Cashflow statement (MYRmn)

Year-end 31 Dec	FY15	FY16	FY17F	FY18F	FY19F
EBITDA	175	190	215	226	236
Change in working capital	70	-72	-118	-6	-3
Other operating cashflow	-5	-38	-30	-32	-32
Cashflow from operations	240	80	67	188	201
Capital expenditure	-39	-19	-40	-45	-50
Free cashflow	201	61	27	143	151
Reduction in investments	24	0	0	0	0
Net acquisitions					
Dec in other LT assets	-7	2	0	0	0
Inc in other LT liabilities	0	-3	0	0	0
Adjustments	27	22	0	0	0
CF after investing acts	245	82	27	143	151
Cash dividends	-70	-84	-70	-76	-79
Equity issue					
Debt issue	2	0	0	0	0
Convertible debt issue					
Others	0	0	0	0	0
CF from financial acts	-68	-84	-70	-76	-79
Net cashflow	177	-3	-43	67	73
Beginning cash	292	468	466	423	489
Ending cash	468	466	423	489	562
Ending net debt	-332	-329	-286	-353	-426

Balance sheet (MYRmn)

As at 31 Dec	FY15	FY16	FY17F	FY18F	FY19F
Cash & equivalents	468	466	423	489	562
Marketable securities					
Accounts receivable	627	912	1,099	1,169	1,180
Inventories	17	24	26	28	28
Other current assets	105	16	16	16	16
Total current assets	1,217	1,418	1,564	1,702	1,785
LT investments	0	0	0	0	0
Fixed assets	162	134	134	134	134
Goodwill	4	4	4	4	4
Other intangible assets	1	0	0	0	0
Other LT assets	14	12	12	12	12
Total assets	1,397	1,567	1,714	1,852	1,935
Short-term debt	137	137	136	136	136
Accounts payable	742	925	997	1,062	1,070
Other current liabilities	63	11	11	11	11
Total current liabilities	942	1,073	1,144	1,210	1,217
Long-term debt	0	0	0	0	0
Convertible debt					
Other LT liabilities	4	1	1	1	1
Total liabilities	946	1,073	1,145	1,210	1,218
Minority interest	1	1	1	1	1
Preferred stock					
Common stock	259	259	259	259	259
Retained earnings	218	257	332	405	480
Proposed dividends					
Other equity and reserves	-25	-22	-22	-22	-22
Total shareholders' equity	451	493	568	641	716
Total equity & liabilities	1,397	1,567	1,714	1,852	1,935

Liquidity (x)					
Current ratio	1.29	1.32	1.37	1.41	1.47
Interest cover	na	na	na	na	na
Leverage					
Net debt/EBITDA (x)	net cash	net cash	net cash	net cash	net cash
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash

Per share					
Reported EPS (MYR)	9.84c	9.55c	11.19c	11.52c	11.93c
Norm EPS (MYR)	9.58c	9.64c	11.19c	11.52c	11.93c
FD norm EPS (MYR)	9.58c	9.64c	11.19c	11.52c	11.93c
BVPS (MYR)	0.35	0.38	0.44	0.50	0.55
DPS (MYR)	0.04	0.05	0.06	0.06	0.06
Activity (days)					
Days receivable	128.1	157.3	170.1	180.4	185.2
Days inventory	3.8	4.6	4.6	4.6	4.7
Days payable	154.3	186.2	176.9	177.9	182.8
Cash cycle	-22.3	-24.2	-2.2	7.2	7.1

Source: Company data, Nomura estimates

Upgrade to Buy

We upgrade SunCon to Buy from Neutral for three main reasons:

1) Pure-play contractors like Suncon should continue to outperform

We think it is becoming more important to distinguish the performance of diversified contractors vs those which are still primarily construction-focused, for two reasons: **1)** our analysis reveals that diversified players' performance has been lagging that of the pure-play stocks, suggesting pure-play names have generated more alpha of late; **2)** with property development being the business of choice into which to diversify for most large contractors, it has remained a drag on their earnings performance in recent years due to the slowdown in the property sector. In terms of valuation, the diversified contractors are trading at ~21x trailing P/E, which is +2SD above the historical mean valuation. The pure-play contractors' valuation is relatively lower at ~13x, between mean and +1SD levels. In our view, this implies that pure-play stocks might continue to relatively beat returns of diversified contractors over the next 12 months.

2) Steady earnings with decent cashflows

As noted earlier in our report, we prefer companies that deliver on both earnings momentum and cashflow generation. Although revenues from the construction division for SunCon were down 10% y-y in 2016 due to completion of certain projects in 2015, we expect construction revenues to be strong in 2017F as work progresses on the MRT2 viaduct and Putrajaya Parcel F contracts. SunCon managed to win ~MYR2.65bn worth of contracts (including internal projects worth ~MYR927mn) in 2016 and is targeting another ~MYR2bn in 2017. YTD it has already won MYR450mn of contracts from the parentco and is expecting to tender for projects such as the KL city traffic dispersal tunnel and a package in LRT3. An outstanding orderbook of MYR4.8bn (internal + external + precast) and continued orderbook replenishment, supported by its parentco, should continue to support SunCon's earnings.

Also for SunCon, we find that OCF pre-working capital is tracked fairly well by reported cash earnings. This, in our view, is reflective of its healthy margins, timely cash collection from customers, and relatively straightforward balance sheet.

3) Potential use of cash sitting on its balance sheet

SunCon is currently sitting on net cash of MYR329mn which can be potentially be used for: i) investment in an Integrated construction precast hub (ICPH) in Singapore and/ or ii) paying out higher dividends (payout was higher at ~52% in FY16, vs its policy of 35%). We forecast that by FY18F, SunCon's net cash will be ~20% of its present market cap.

i) Integrated precast hubs in Singapore to bring down operational costs in the long term: Singapore is moving towards multi-storey integrated construction precast hubs (ICPH) as opposed to open precast facilities currently, to meet the rising demand for precast concrete products and at the same time optimise the use of land in the country. As a result, Building and Construction Authority (BCA) in Singapore rolled out its first tender for 30-year land lease for the development of an ICPH in July-2013. Since then BCA has launched three more tenders and plans to have 10 ICPHs operational by 2020 (link).

SunCon also plans to participate in the ICPH development in Singapore, which should demand a capex of SGD40mn (~MYR125mn) spread over a three-year construction period. If SunCon manages to win any upcoming land lease tenders by the BCA, the plant will be operational by 2020 (at the earliest) and can bring down labour costs significantly as the ICPH requires ~50% less manpower than the traditional open precast plants (link).

ii) Possibility of higher dividends: There is a strong possibility that if SunCon is unsuccessful in its ICPH tender, it might increase the amount of dividends it pays to its shareholders with the excess cash it is holding, considering the payout in 2016 (at 52%) was higher than management's policy of a 35% payout.

Estimate revisions

We marginally raise our FY17F/18F earnings by 4%/3% as we increase our orderbook replenishment from the precast division from MYR250mn to MYR350mn in each year.

Fig. 46: SunCon: Changes in forecasts

MYR mn	*Old*		New		% change	
	FY17F	FY18F	FY17F	FY18F	FY17F	FY18F
Orderbook replenishment	*2,000*	2,000	2,100	2,100	5%	5%
External	*1,250*	1,250	1,250	1,250	0%	0%
Internal	*500*	500	500	500	0%	0%
Precast	*250*	250	350	350	40%	40%
Revenue	*2,060*	2,164	2,157	2,294	5%	6%
Adj PBT	*174*	180	181	186	4%	3%
PBT margins	*8.4%*	8.3%	8.4%	8.1%	(0.1 ppt)	(0.2 ppt)
Adj NPAT	*139*	144	145	149	4%	3%

Source: Nomura estimates

Valuing SunCon at 15x cash adjusted P/E; TP lifted to MYR2.00; upgrade to Buy

Since January 2016, SunCon has returned 22% (vs KLCI market's 2%) and currently trades at 14x forward P/E (consensus) as compared to 13x at the beginning of 2016. Its current valuation is above the average multiple of 12x for Malaysia mid-cap contractors but in line with large-cap contractors like IJM/ GAM.

However, SunCon has an outstanding cash balance of MYR466mn (end-2016) on its balance sheet (net cash of MYR329mn). The cash balance has tripled since 2012, and we think there is a good possibility of a dividend increase / high ROIC capex. By FY18F, we estimate that SunCon's net cash could be ~20% of its present market cap. Thus, we think it is important that investors consider SunCon's trading P/E, after adjusting for its cash holdings. This may not be true for other construction stocks in our coverage (eg, IJM, Gamuda and WCT) because they are in net debt positions and also, cash on their balance sheets is partly held at their subsidiaries.

Based on a cash-adjusted basis, SunCon now trades at 12x forward P/E, which is in line with the average multiple for Malaysian mid-cap contractors. Due to our bullish view on the company, we value SunCon at a cash-adjusted target P/E of 15x on FY18F earnings and value the cash sitting on its balance sheet separately to arrive at our new TP of MYR2.00. We believe the premium valuation for SunCon (vs other mid-cap contractors in Malaysia) is justified for its: 1) strong earnings and cashflow generation, and healthy balance sheet, 2) potential use of cash in ICPH and/ or higher dividend payouts; 3) exposure to Singapore's precast market, 4) support from the parentco for continued orderbook replenishment.

Using net income (less interest income) of MYR138mn for FY18F and a cash-adjusted P/E of 15x, we arrive at an equity value (ex-cash holdings) of MYR2.1bn. To this we add the cash balance in end-FY18F to arrive at our new TP of MYR2.00, which implies upside of 17%; thus we upgrade SunCon to Buy from Neutral.

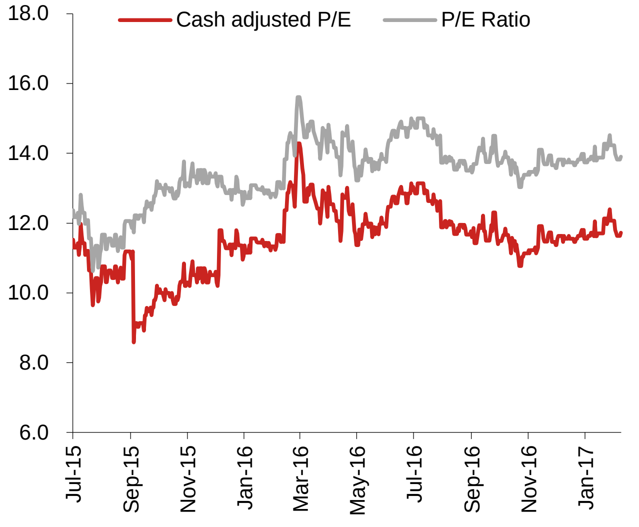
Note that cash-adjusted P/E = (Market cap – Cash balance) / (Net income – interest income).

Fig. 47: SunCon: Cash-adjusted P/E based valuation

	Dec-18
	FY18F
Normalised net profit (MYR mn)	149
Less: Interest income (MYR mn)	11
Net profit ex interest income (MYR mn)	138
Target FY18F cash adjusted P/E	15.0 x
Equity value ex cash holdings (MYR mn)	2,070
Add: Cash and Cash Equivalents (MYR mn)	489
Equity value (MYR mn)	**2,559**
FD number of shares outstanding (mn)	1,293
Price target (MYR/ sh)	**2.00**

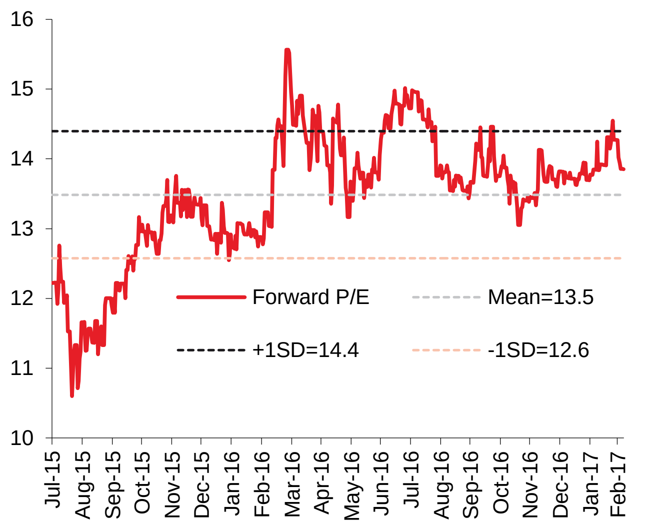
Source: Nomura estimates

Fig. 48: SunCon: Forward P/E vs Forward cash adjusted P/E



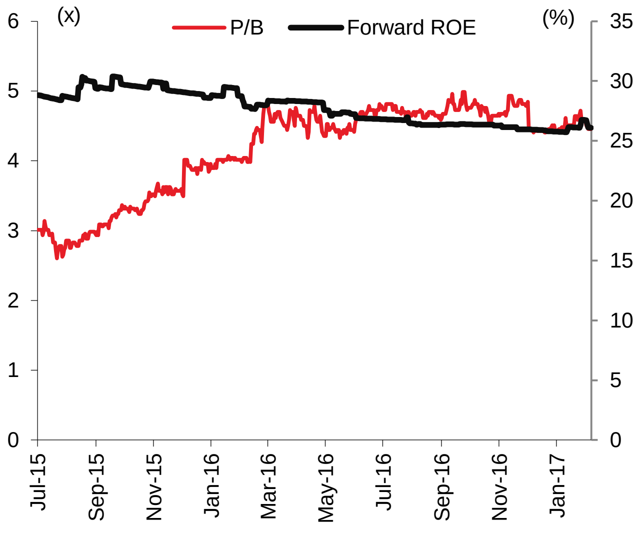
Source: Bloomberg, Company data, Nomura estimates

Fig. 49: SunCon: 1-year forward P/E chart



Source: Bloomberg, Nomura research

Fig. 50: SunCon: 1-year forward P/B vs ROE

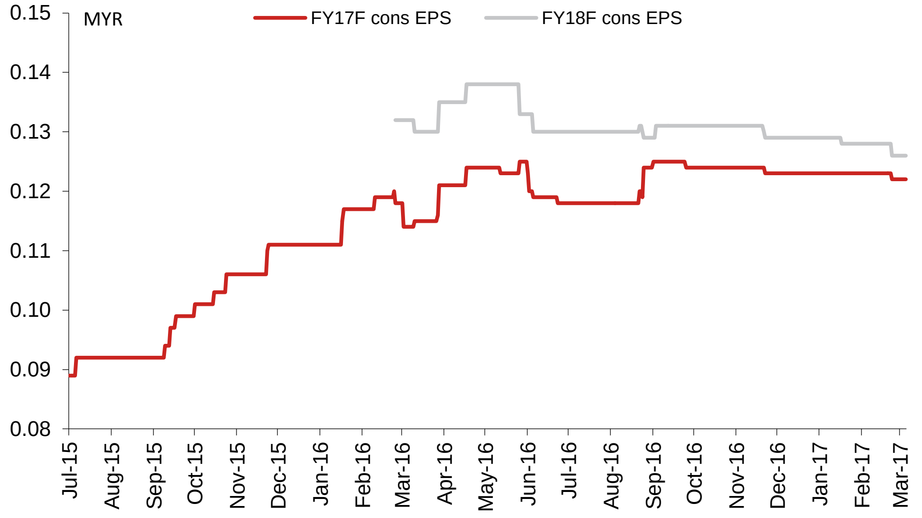


Source: Bloomberg, Nomura research

Risks to our view

Downside risks include: 1) delay in construction project awards; 2) lower-than-expected margins; 3) Singapore housing units not growing as expected; and 4) lower-than-expected orderbook inflows.

Fig. 51: SunCon: Consensus EPS forecasts



Source: Bloomberg, Nomura research

Fig. 52: SunCon: Earnings vs. operating cash flows

MYR mn	FY12	FY13	FY14	FY15	FY16
Income statement items					
Adjusted net income	67	104	122	124	125
Reported net income	55	67	163	127	124
Cash flow items					
OCF before WC changes	85	122	172	175	167
Changes in WC	(17)	(68)	49	65	(59)
OCF after WC changes	68	54	221	240	108
Net OCF after WC, interest, taxes	51	36	194	215	80
Dividend received from associates and JV	0	47	97	25	0
Depreciation & Amortisation (D&A)	28	43	45	42	39
Net debt to Equity					
Net debt	(91)	(66)	(156)	(332)	(329)
Total Equity	560	614	380	451	493
Net debt to equity	-16%	-11%	-41%	-74%	-67%
Comparison					
1 Adjusted net income + D&A	95	146	166	166	164
Net OCF	51	36	194	215	80
2 Adjusted net income + D&A	95	146	166	166	164
Net OCF pre WC investments + Div from assoc and JV	68	151	242	175	139

Source: Company data, Nomura research

NOMURA

IJM Corp IJMS.KL IJM MK

EQUITY: ENGINEERING & CONSTRUCTION

Weak earnings but decent cashflows

Property weakness, expensive valuations, lack of catalysts cap upside; downgrade to Neutral

Action: Downgrade to Neutral and cut TP to MYR3.70

We downgrade IJM to Neutral for three main reasons: **1)** at the sector level, we believe diversified contractors like IJM and Gamuda will continue to underperform pure-play contractors due to a slow property market and expensive valuations; **2)** based on our earnings-cashflow matrix, IJM generates healthy cashflows, but is likely to disappoint on earnings in the future as there is no recovery in the property segment or the resumption of bauxite mining; and **3)** lack of positive catalysts – the law of diminishing marginal returns applies to future project awards as IJM is now sitting on a record orderbook of MYR 9bn+. While there are near-term positives like higher CPO prices, we think the growth in plantation earnings will not be able to offset the drag from Infrastructure and property businesses, which leads us to cut our FY17F/18F earnings by 12%/15%. Our preferred stock in the sector is Suncon (SCGB MK, Buy).

Valuation: Expensive due to consensus earnings cuts

IJM, on our numbers, currently trades at 16x CY2018F EPS of 22sen, between the mean and +1SD to its historical average due to prolonged consensus earnings estimate cuts. We value the stock at 17x CY2018F P/E.

Catalysts: Limited visibility

We believe the main catalysts for diversified contractors such as IJM will have to be: **1)** a revival in the property sector (either through a relaxation in cooling measures, or through a relaxation in bank lending guidelines), or **2)** a revival of bauxite mining through the Kuantan port, both of which are not on the radar for now. IJM can also create shareholder value through potential value-accretive corporate exercises like the disposal of non-core assets (e.g. highways), and any potentially game-changing projects like mega-infrastructure awards can be positive catalysts for the stock. Over the long term, IJM still provides the best structural growth story due to its diversified model, cheap land bank and growing plantation estates.

Year-end 31 Mar	FY16	FY17F		FY18F		FY19F	
Currency (MYR)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	5,128	5,445	5,894	7,087	7,607	7,466	7,544
Reported net profit (mn)	794	646	571	864	731	975	799
Normalised net profit (mn)	492	646	571	864	731	975	799
FD normalised EPS	13.51c	18.01c	15.91c	24.11c	20.39c	27.19c	22.29c
FD norm. EPS growth (%)	-14.7	33.3	17.8	33.9	28.1	12.8	9.3
FD normalised P/E (x)	25.2	N/A	21.4	N/A	16.7	N/A	15.3
EV/EBITDA (x)	13.8	N/A	15.1	N/A	12.2	N/A	11.8
Price/book (x)	1.4	N/A	1.3	N/A	1.3	N/A	1.2
Dividend yield (%)	2.9	N/A	2.3	N/A	3.0	N/A	3.3
ROE (%)	9.1	7.1	6.3	9.1	7.8	9.7	8.1
Net debt/equity (%)	45.8	44.2	45.8	41.7	44.8	36.7	40.5

Source: Company data, Nomura estimates

Key company data: See next page for company data and detailed price/index chart.

Global Markets Research

10 March 2017

Rating Down from Buy	**Neutral**
Target Price Reduced from 4.05	MYR 3.70
Closing price 8 March 2017	MYR 3.41
Potential upside	+8.5%

Anchor themes

In 2017, we expect pure-play Malaysian contractors to continue to outperform diversified companies, which have property exposure. We like stocks where management is looking beyond short-term project awards and generating both earnings growth and healthy cashflows, which in our view are the best indicators of long-term outperformance.

Nomura vs consensus

Our TP is in line with consensus.

Research analysts

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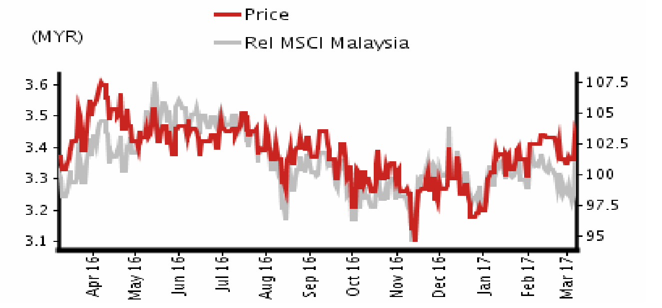
Key data on IJM Corp

Relative performance chart



Source: Thomson Reuters, Nomura research

Notes:

Performance

(%)	1M	3M	12M		
Absolute (MYR)	0.0	0.3	1.2	M cap (USDmn)	2,767.1
Absolute (USD)	-0.2	-0.3	-6.5	Free float (%)	80.4
Rel to MSCI Malaysia	-1.0	-4.1	-0.3	3-mth ADT (USDmn)	3.4

Income statement (MYRmn)

Year-end 31 Mar	FY15	FY16	FY17F	FY18F	FY19F
Revenue	5,448	5,128	5,894	7,607	7,544
Cost of goods sold	-4,163	-4,129	-4,856	-6,288	-6,193
Gross profit	1,285	999	1,039	1,319	1,351
SG&A					
Employee share expense					
Operating profit	1,285	999	1,039	1,319	1,351
EBITDA	1,540	1,254	1,185	1,472	1,511
Depreciation	-255	-255	-146	-153	-160
Amortisation					
EBIT	1,285	999	1,039	1,319	1,351
Net interest expense	-243	-169	-160	-160	-160
Associates & JCEs	-30	24	-9	2	14
Other income					
Earnings before tax	1,012	854	870	1,162	1,205
Income tax	-306	-274	-211	-301	-274
Net profit after tax	706	579	659	860	931
Minority interests	-232	-88	-88	-129	-132
Other items					
Preferred dividends					
Normalised NPAT	474	492	571	731	799
Extraordinary items	7	302	0	0	0
Reported NPAT	481	794	571	731	799
Dividends	-256	-357	-285	-366	-400
Transfer to reserves	225	436	285	366	400
Valuations and ratios					
Reported P/E (x)	20.9	15.3	21.4	16.7	15.3
Normalised P/E (x)	21.2	24.8	21.4	16.7	15.3
FD normalised P/E (x)	21.5	25.2	21.4	16.7	15.3
Dividend yield (%)	2.5	2.9	2.3	3.0	3.3
Price/cashflow (x)	28.5	21.6	16.3	17.9	11.4
Price/book (x)	1.2	1.4	1.3	1.3	1.2
EV/EBITDA (x)	11.8	13.8	15.1	12.2	11.8
EV/EBIT (x)	14.2	17.3	17.3	13.6	13.1
Gross margin (%)	23.6	19.5	17.6	17.3	17.9
EBITDA margin (%)	28.3	24.5	20.1	19.4	20.0
EBIT margin (%)	23.6	19.5	17.6	17.3	17.9
Net margin (%)	8.8	15.5	9.7	9.6	10.6
Effective tax rate (%)	30.3	32.1	24.2	25.9	22.7
Dividend payout (%)	53.2	45.0	50.0	50.0	50.0
ROE (%)	6.3	9.1	6.3	7.8	8.1
ROA (pretax %)	7.3	5.7	5.5	6.7	6.6
Growth (%)					
Revenue	-9.3	-5.9	14.9	29.1	-0.8
EBITDA	-7.1	-18.5	-5.5	24.3	2.6
Normalised EPS	-20.8	-14.3	15.6	28.1	9.3
Normalised FDEPS	-20.2	-14.7	17.8	28.1	9.3

Source: Company data, Nomura estimates

Cashflow statement (MYRmn)

Year-end 31 Mar	FY15	FY16	FY17F	FY18F	FY19F
EBITDA	1,540	1,254	1,185	1,472	1,511
Change in working capital	-1,958	-2	-64	-329	0
Other operating cashflow	776	-679	-371	-461	-434
Cashflow from operations	357	573	750	682	1,077
Capital expenditure	-832	-524	-440	-447	-454
Free cashflow	-474	49	310	235	623
Reduction in investments	259	-492	10	-1	-13
Net acquisitions					
Dec in other LT assets	408	324	-295	-295	-295
Inc in other LT liabilities	77	-202	0	0	0
Adjustments	-884	715	285	296	308
CF after investing acts	-615	394	310	235	623
Cash dividends	-367	-304	-393	-325	-383
Equity issue					
Debt issue	1,026	420	0	0	0
Convertible debt issue					
Others	-233	-650	0	0	0
CF from financial acts	426	-533	-393	-325	-383
Net cashflow	-189	-139	-83	-91	240
Beginning cash	2,008	1,819	1,679	1,597	1,506
Ending cash	1,819	1,679	1,597	1,506	1,747
Ending net debt	4,329	4,132	4,215	4,305	4,065

Balance sheet (MYRmn)

As at 31 Mar	FY15	FY16	FY17F	FY18F	FY19F
Cash & equivalents	1,819	1,679	1,597	1,506	1,747
Marketable securities	215	407	407	407	407
Accounts receivable	2,424	2,256	2,594	3,347	3,319
Inventories	784	1,092	1,348	1,746	1,720
Other current assets	5,941	5,785	5,785	5,785	5,785
Total current assets	11,183	11,220	11,731	12,791	12,978
LT investments	1,310	1,610	1,600	1,602	1,615
Fixed assets	1,727	1,813	1,813	1,813	1,813
Goodwill					
Other intangible assets	86	92	92	92	92
Other LT assets	5,425	5,101	5,395	5,690	5,985
Total assets	19,731	19,836	20,631	21,988	22,482
Short-term debt	1,989	1,477	1,477	1,477	1,477
Accounts payable	2,014	2,258	2,787	3,609	3,555
Other current liabilities	296	35	35	35	35
Total current liabilities	4,300	3,771	4,300	5,122	5,067
Long-term debt	4,158	4,334	4,334	4,334	4,334
Convertible debt					
Other LT liabilities	1,697	1,495	1,495	1,495	1,495
Total liabilities	10,155	9,599	10,128	10,950	10,896
Minority interest	1,146	1,208	1,296	1,426	1,558
Preferred stock					
Common stock	1,500	3,585	3,585	3,585	3,585
Retained earnings	2,542	3,042	3,220	3,626	4,042
Proposed dividends					
Other equity and reserves	4,388	2,401	2,401	2,401	2,401
Total shareholders' equity	8,430	9,028	9,206	9,612	10,028
Total equity & liabilities	19,731	19,836	20,631	21,988	22,482
Liquidity (x)					
Current ratio	2.60	2.98	2.73	2.50	2.56
Interest cover	5.3	5.9	6.5	8.2	8.4
Leverage					
Net debt/EBITDA (x)	2.81	3.29	3.56	2.92	2.69
Net debt/equity (%)	51.4	45.8	45.8	44.8	40.5
Per share					
Reported EPS (MYR)	16.32c	22.22c	15.91c	20.39c	22.29c
Norm EPS (MYR)	16.07c	13.76c	15.91c	20.39c	22.29c
FD norm EPS (MYR)	15.83c	13.51c	15.91c	20.39c	22.29c
BVPS (MYR)	2.81	2.52	2.57	2.68	2.80
DPS (MYR)	0.09	0.10	0.08	0.10	0.11
Activity (days)					
Days receivable	158.9	167.0	150.2	142.5	161.3
Days inventory	60.3	83.2	91.7	89.8	102.1
Days payable	177.6	189.4	189.6	185.7	211.1
Cash cycle	41.6	60.8	52.3	46.7	52.3

Source: Company data, Nomura estimates

Downgrade to Neutral

We downgrade IJM to Neutral for three main reasons:

1) Diversified contractors like IJM should continue to underperform
We think it is becoming more important to distinguish the performance of diversified contractors vs. those which are still primarily construction-focused, for two reasons: 1) according to our analysis, diversified players' performance has been lagging pure-play stocks, suggesting pure-play names have generated more alpha of late; 2) with property development being the business of choice to diversify into for most large contractors, it has remained a drag on their earnings performance in recent years due to the slowdown in the property sector. In terms of valuation, diversified contractors are trading at ~21x trailing P/E, which is +2SD above the historical mean valuation. Pure-play contractors' valuations are relatively lower at ~13x, and are between the mean and +1SD levels. We believe this implies that pure-play stocks might continue to relatively beat the returns of diversified contractors over the next 12 months.

2) Earnings performance not encouraging (cashflow still decent)
As noted earlier in our report, we prefer companies which deliver on both earnings momentum and cashflow generation. IJM's earnings performance has been disappointing since the moratorium on bauxite mining put in place by the Malaysian government to avoid environmental pollution as IJM has now lost the high port throughput at Kuantan. Moreover, property earnings continue to be a drag at the group level due to weaker pre-sales and lower margins. IJM's 3Q17 (financial year-ending March) net income of MYR138mn was down 16% q-q. The growth in earnings from construction (the ramp-up of the recently awarded projects) and the plantations (higher CPO prices) division was more than offset by the lower earnings from property development (a decline in property sales and lower PBT due to the higher focus on affordable housing) and infrastructure division (lower cargo throughput at Kuantan port due to bauxite moratorium). With Indonesia possibly resuming bauxite exports to China, and with Indonesian bauxite quality and price better than Malaysia's, we think the Kuantan port's throughput will now remain weak until the Chinese investments in the Kuantan Industrial Park (MCKIP) start production.

Cashflow generation remaining strong is a positive. The operating cash flow (OCF) in 9M17 was at MYR765mn vs. MYR555mn in 9M16. Free cash flow (FCF) in 9M17 was at MYR453mn compared with MYR520mn for 9M16. Net gearing remains low at 47%.

3) Lack of catalysts
IJM currently has a record orderbook of MYR9bn+, with a recent award of MYR1.2bn of construction works for a retail mall in the Bukit Bintang City Centre (BBCC). While the outlook for the construction business remains strong, we believe the law of diminishing returns is applicable to future project awards – new projects simply do not add enough incremental earnings to the group to enthuse the market. Construction only accounts for ~30% of earnings; hence, a MYR1bn project only adds ~3% earnings to the group on a proforma basis. Higher CPO prices on its plantations business are good, but have already likely been priced in as the stronger earnings from palm oil have started to flow through earnings.

We believe the main catalysts for diversified contractors such as IJM will have to be: **1)** a revival in the property sector (either through a relaxation in cooling measures, or through a relaxation in bank lending guidelines); or **2)** a revival of bauxite mining through the Kuantan port, both of which are not on the radar for now. IJM can also create shareholder value through potential value-accretive corporate exercises like the disposal of non-core assets (e.g. highways), and any potentially game-changing projects like mega-infrastructure awards can be positive catalysts for the stock. Over the long term, IJM still provides the best structural growth story due to its diversified model, cheap land bank and growing plantation estates.

Estimate revisions

We lower our earnings estimates for FY17F/18F/19F by 12%/15%/18% as we make the following changes to our assumptions –

- **Construction:** We built in the new projects awarded so far in FY17F and increase the pace of revenue recognition from the ongoing projects as work progresses but lower our PBT margin estimates. Therefore, we lower our earnings estimate for the construction business compared to our earlier estimates.
- **Property development:** We lower our new property sales estimate for FY17F-19F by 7-17% and lower our PBT margin estimates as well.
- **Manufacturing & quarrying:** we raise our revenue estimates by 10% each for FY17F-19F.
- **Plantation:** We raise our earnings estimate for the plantation business as we incorporate the higher CPO prices into our estimates.
- **Infrastructure:** We lower our earnings estimate for the infrastructure division as we cut our earnings estimate for the Kuantan port due to low cargo throughput.

As a result of the above changes, we cut our EPS estimates for FY17F/18F/19F by 12%/15%/18%.

Fig. 53: IJM: Changes in forecasts

MYR mn	*Old estimates*			New estimates			% change		
	FY17F	*FY18F*	*FY19F*	FY17F	FY18F	FY19F	FY17F	FY18F	FY19F
Orderbook replenishment	***2,820***	***1,800***	***1,800***	**2,806**	**1,800**	**1,800**	**(0%)**	**0%**	**0%**
New property sales	***1,200***	***1,740***	***1,800***	**1,120**	**1,480**	**1,500**	**(7%)**	**(15%)**	**(17%)**
Revenue	***5,445***	***7,087***	***7,466***	**5,894**	**7,607**	**7,544**	**8%**	**7%**	**1%**
Construction	*1,948*	*2,138*	*2,882*	2,220	2,521	3,201	14%	18%	11%
Property development	*980*	*2,276*	*1,756*	1,160	2,288	1,454	18%	1%	(17%)
Manufacturing & Quarrying	*1,029*	*1,080*	*1,134*	1,127	1,183	1,242	10%	10%	10%
Plantation	*685*	*762*	*828*	752	960	960	10%	26%	16%
Infrastructure	*803*	*831*	*866*	636	655	686	(21%)	(21%)	(21%)
PBT	***997***	***1,333***	***1,470***	**870**	**1,162**	**1,205**	**(13%)**	**(13%)**	**(18%)**
Construction	*234*	*257*	*346*	200	227	288	(15%)	(12%)	(17%)
Property development	*221*	*434*	*421*	139	261	204	(37%)	(40%)	(52%)
Manufacturing & Quarrying	*130*	*137*	*144*	141	148	155	8%	8%	8%
Plantation	*130*	*189*	*205*	193	310	310	49%	64%	51%
Infrastructure	*282*	*316*	*355*	196	216	248	(30%)	(32%)	(30%)
PBT margins	***18.3%***	***18.8%***	***19.7%***	**14.8%**	**15.3%**	**0**	**-3.6 ppt**	**-3.5 ppt**	**-3.7 ppt**
Construction	*12.0%*	*12.0%*	*12.0%*	9.0%	9.0%	0	-3.0 ppt	-3.0 ppt	-3.0 ppt
Property development	*22.6%*	*19.1%*	*24.0%*	12.0%	11.4%	0	-10.6 ppt	-7.7 ppt	-10.0 ppt
Manufacturing & Quarrying	*12.7%*	*12.7%*	*12.7%*	12.5%	12.5%	0	-0.2 ppt	-0.2 ppt	-0.2 ppt
Plantation	*19.0%*	*24.8%*	*24.8%*	25.7%	32.3%	0	6.8 ppt	7.5 ppt	7.5 ppt
Infrastructure	*35.1%*	*38.1%*	*40.9%*	30.9%	33.1%	0	-4.2 ppt	-5.0 ppt	-4.8 ppt
Adj Net income	***646***	***864***	***975***	**571**	**731**	**799**	**(12%)**	**(15%)**	**(18%)**
Adj EPS (sen)	***18***	***24***	***27***	**16**	**20**	**22**	**(12%)**	**(15%)**	**(18%)**

Source: Nomura estimates

Lower TP to MYR3.70; roll forward to CY18F; downgrade to Neutral

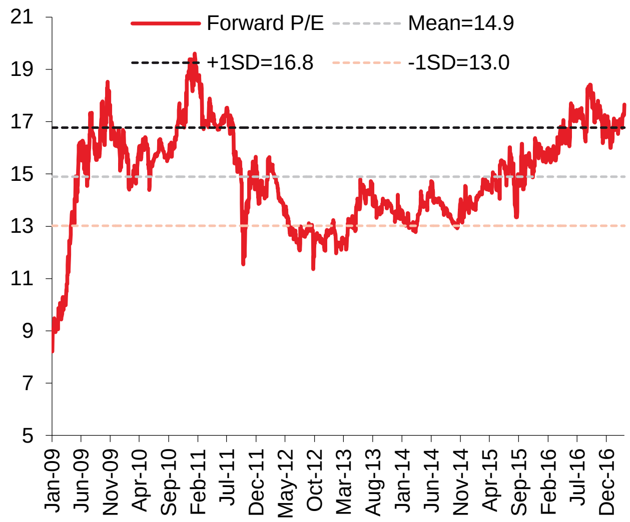
Our new TP of MYR3.70 is based on a target P/E of 17x (18x earlier) on CY18F (CY17F earlier) earnings. The target P/E of 17x is +1SD above its historical mean valuation. Using an EPS of 22sen for CY18F and target P/E of 17x, we arrive at our new TP of MYR3.70 for IJM which implies an upside of 8.5% at current levels. We, therefore, downgrade the stock to Neutral.

Fig. 54: IJM: P/E-based valuation

	Mar/18	Mar/19
	FY18F	FY19F
Normalised net income (MYR mn)	731	799
FD number of shares outstanding (mn)	3,585	3,585
FD EPS (MYR/sh)	0.20	0.22
	CY18F	
CY18F FD EPS (MYR/sh)	0.22	
Target CY18F P/E (x)	17.0 x	
Price target (MYR/sh)	**3.70**	

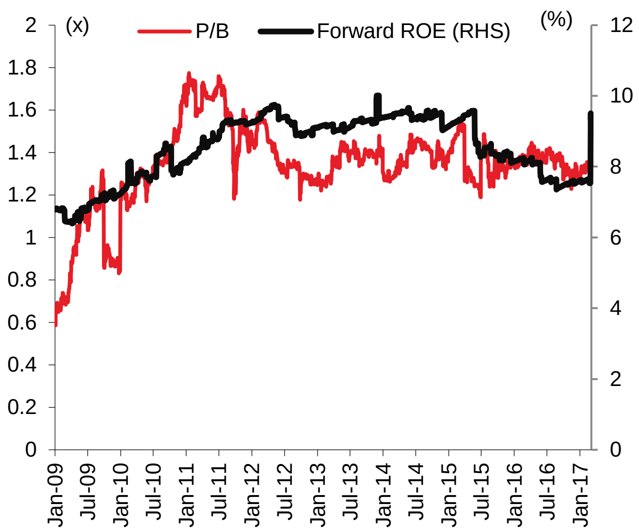
Source: Nomura estimates

Fig. 55: IJM: 1-year forward P/E



Source: Bloomberg, Nomura research

Fig. 56: IJM: 1-year forward P/B vs. ROE



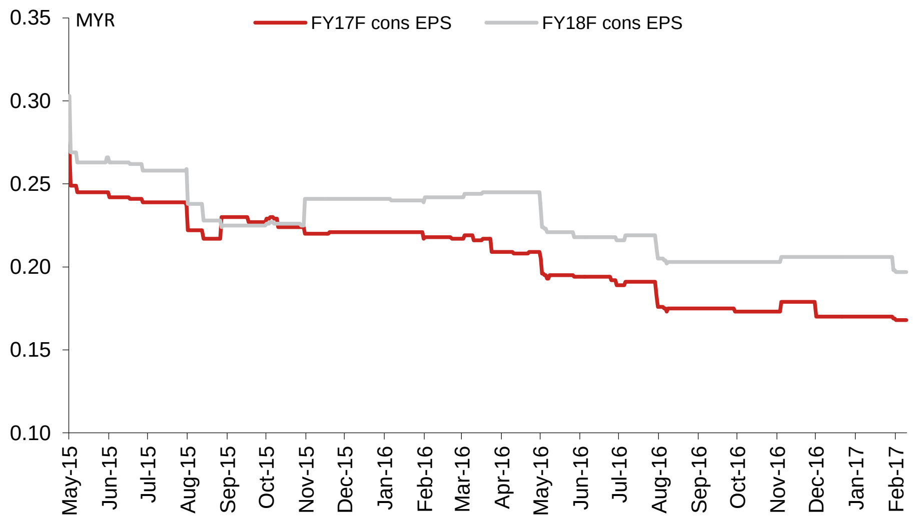
Source: Bloomberg, Nomura research

Risks to our view

Upside risks include: 1) a revival in the property sector (either through a relaxation in cooling measures or through a relaxation in bank lending guidelines); or 2) a revival of bauxite mining through Kuantan port.

Downside risks include: 1) lower than expected margins from construction and property development; 2) lower than expected orderbook inflows or property sales; 3) lower CPO or building material prices; and 4) an unexpected cancellation of projects, eg, the West Coast Expressway.

Fig. 57: IJM: Consensus EPS forecasts



Source: Bloomberg consensus, Nomura research

Fig. 58: IJM: Earnings vs. operating cash flows

MYR mn	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	9M17
Income statement items									
Adjusted net income	290	333	242	447	394	570	474	492	418
Reported net income	290	333	304	409	421	830	481	794	418
Cash flow items									
OCF before WC changes	862	851	737	989	1,196	2,960	2,774	1,225	1,006
Changes in WC	(93)	(136)	109	57	(234)	(2,325)	(1,803)	(117)	57
OCF after WC changes	769	714	846	1,046	962	635	971	1,108	1,063
Net OCF after WC, interest, taxes	430	440	564	677	594	169	357	573	765
Dividend received from associates and JV	5	5	12	16	17	17	11	9	23
Depreciation & Amortisation (D&A)	147	150	141	158	166	201	255	255	191
Net debt to Equity									
Net debt	2,783	2,591	2,287	2,823	3,270	3,598	4,329	4,132	4,288
Total Equity	4,770	5,096	4,997	5,348	5,607	6,739	8,430	9,028	9,145
Net debt to equity	58%	51%	46%	53%	58%	53%	51%	46%	47%
Comparison									
1 Adjusted net income + D&A	437	482	382	605	561	770	728	747	609
Net OCF	430	440	564	677	594	169	357	573	765
2 Adjusted net income + D&A	437	482	382	605	561	770	728	747	609
Net OCF pre WC investments + Div from assoc and JV	528	581	467	635	845	2,511	2,172	700	731

Source: Company data, Nomura research

NOMURA

Gamuda GAMU.KL GAM MK

EQUITY: ENGINEERING & CONSTRUCTION

Cash generation weak amidst decent earnings

Property weakness, expensive valuations, weak cashflow cap upside; up to Neutral

Global Markets Research

10 March 2017

Rating Up from Reduce	**Neutral**
Target Price Increased from 4.10	MYR 5.20
Closing price 8 March 2017	MYR 5.02
Potential upside	+3.6%

Action: Upgrade to Neutral; law of diminishing marginal returns applies

We upgrade Gamuda to Neutral. Our late 2015 Reduce call on Gamuda was premised on a de-rating in valuation multiples due to earnings dip from construction and property segments in FY16F. However, while FY16 net income did fall 8% y-y, the market was willing to look beyond the dip to focus on new project awards (MRT Line 2, Pan Borneo Highway) and, as a result, the stock price traded sideways, and has returned 0.2% since January 2015. With downside risks reduced, we upgrade Gamuda to Neutral. The key reasons why we think upside is still capped are: **1)** at the sector level, we believe diversified contractors such as IJM and Gamuda will continue to underperform pure-play contractors due to a slow property market and expensive valuations; **2)** based on our earnings-cashflow matrix, Gamuda generates healthy net income, but is likely to disappoint on cash flow in the future as overhang on SPLASH remains; and **3)** lack of positive catalysts – the law of diminishing marginal returns applies to future project awards as Gamuda is now sitting on a record orderbook of MYR8.7bn and additional small projects don't improve the earnings outlook meaningfully.

Valuation: Ex-SPLASH P/E even higher

Gamuda trades at 17x CY18F EPS of 29sen, between mean and +1SD to its historical average, which is fairly expensive. Moreover, if Gamuda disposes of SPLASH, its P/E will go up to 21x as SPLASH currently accounts for 18% of group earnings. Our revised TP of MYR5.20 is based on a target P/E of 17.5x on CY18F earnings, implying a potential upside of 4% at current levels.

Catalysts: Limited visibility

In our view, the main catalysts for diversified contractors like Gamuda will have to be: **1)** a revival in the property sector (either through a relaxation in cooling measures, or through a relaxation in bank lending guidelines); or **2)** potentially value-accretive corporate exercises such as disposal of non-core assets like SPLASH along with special dividends and any potentially game-changing projects such as mega-infrastructure awards.

Year-end 31 Jul	FY16		FY17F		FY18F		FY19F
Currency (MYR)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	4,171	4,623	3,946	3,960	3,849		6,529
Reported net profit (mn)	626	715	646	734	663		840
Normalised net profit (mn)	626	715	646	734	663		840
FD normalised EPS	25.25c	29.73c	25.81c	30.48c	26.47c		33.53c
FD norm. EPS growth (%)	-12.8	18.6	2.2	2.5	2.5		26.7
FD normalised P/E (x)	19.9	N/A	19.4	N/A	19.0	N/A	15.0
EV/EBITDA (x)	16.4	N/A	15.3	N/A	15.3	N/A	13.0
Price/book (x)	1.8	N/A	1.7	N/A	1.6	N/A	1.5
Dividend yield (%)	2.4	N/A	2.5	N/A	2.5	N/A	3.2
ROE (%)	9.5	10.3	9.2	10.0	9.0		10.8
Net debt/equity (%)	57.9	43.3	53.0	46.7	57.6		65.3

Source: Company data, Nomura estimates

Key company data: See next page for company data and detailed price/index chart.

Anchor themes

In 2017, we expect pure-play Malaysian contractors to continue to outperform diversified companies, which have property exposure. We like stocks where management is looking beyond short-term project awards and generating both earnings growth and healthy cashflows, which in our view are the best indicators of long-term outperformance.

Nomura vs consensus

Our TP is 4% below consensus.

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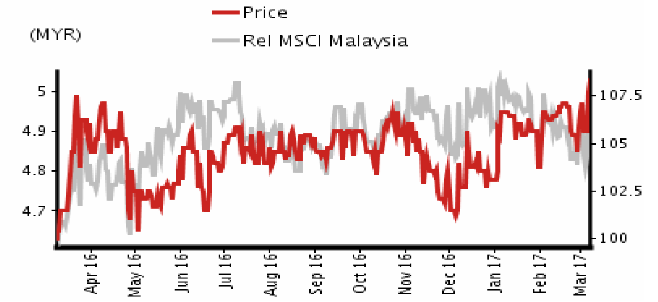
See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

Key data on Gamuda

Relative performance chart



Source: Thomson Reuters, Nomura research

Notes:

Performance

(%)	1M	3M	12M		
Absolute (MYR)	1.8	4.1	8.4	M cap (USDmn)	2,738.0
Absolute (USD)	1.6	3.5	0.2	Free float (%)	77.1
Rel to MSCI Malaysia	0.8	-0.3	7.0	3-mth ADT (USDmn)	4.2

Income statement (MYRmn)

Year-end 31 Jul	FY15	FY16	FY17F	FY18F	FY19F
Revenue	4,760	4,171	3,946	3,849	6,529
Cost of goods sold	-3,922	-3,404	-3,143	-3,014	-5,433
Gross profit	838	767	802	835	1,096
SG&A					
Employee share expense					
Operating profit	838	767	802	835	1,096
EBITDA	866	796	839	873	1,136
Depreciation	-27	-29	-36	-38	-40
Amortisation					
EBIT	838	767	802	835	1,096
Net interest expense	-124	-126	-147	-147	-162
Associates & JCEs	199	211	236	237	248
Other income					
Earnings before tax	914	852	891	926	1,182
Income tax	-188	-183	-187	-197	-267
Net profit after tax	725	669	704	729	915
Minority interests	-43	-43	-58	-66	-76
Other items					
Preferred dividends					
Normalised NPAT	682	626	646	663	840
Extraordinary items	0	0	0	0	0
Reported NPAT	682	626	646	663	840
Dividends	-285	-289	-299	-306	-388
Transfer to reserves	397	337	348	356	451

Valuations and ratios

Reported P/E (x)	17.3	19.3	18.8	18.3	14.5
Normalised P/E (x)	17.3	19.3	18.8	18.3	14.5
FD normalised P/E (x)	17.3	19.9	19.4	19.0	15.0
Dividend yield (%)	2.4	2.4	2.5	2.5	3.2
Price/cashflow (x)	51.8	173.0	14.1	na	na
Price/book (x)	1.9	1.8	1.7	1.6	1.5
EV/EBITDA (x)	14.8	16.4	15.3	15.3	13.0
EV/EBIT (x)	15.2	16.9	15.8	15.9	13.4
Gross margin (%)	17.6	18.4	20.3	21.7	16.8
EBITDA margin (%)	18.2	19.1	21.3	22.7	17.4
EBIT margin (%)	17.6	18.4	20.3	21.7	16.8
Net margin (%)	14.3	15.0	16.4	17.2	12.9
Effective tax rate (%)	20.6	21.5	21.0	21.2	22.6
Dividend payout (%)	41.8	46.2	46.2	46.2	46.2
ROE (%)	11.6	9.5	9.2	9.0	10.8
ROA (pretax %)	9.5	7.6	7.7	7.7	8.6

Growth (%)

Revenue	2.7	-12.4	-5.4	-2.5	69.6
EBITDA	12.4	-8.0	5.4	4.0	30.1
Normalised EPS	-6.1	-10.2	2.8	2.5	26.7
Normalised FDEPS	-4.6	-12.8	2.2	2.5	26.7

Source: Company data, Nomura estimates

Cashflow statement (MYRmn)

Year-end 31 Jul	FY15	FY16	FY17F	FY18F	FY19F
EBITDA	866	796	839	873	1,136
Change in working capital	1,669	-31	288	-681	-1,015
Other operating cashflow	-2,306	-694	-235	-243	-327
Cashflow from operations	228	72	891	-51	-206
Capital expenditure	-830	-730	-532	-234	-335
Free cashflow	-602	-658	359	-285	-542
Reduction in investments	-1,583	-336	-115	-154	-166
Net acquisitions					
Dec in other LT assets	-398	-289	71	73	74
Inc in other LT liabilities	162	-198	0	0	0
Adjustments	1,265	866	133	133	142
CF after investing acts	-1,157	-614	448	-233	-491
Cash dividends	-285	-289	-299	-306	-388
Equity issue	220	152	0	0	0
Debt issue	1,561	715	0	500	500
Convertible debt issue					
Others	-210	-63	0	0	0
CF from financial acts	1,286	514	-299	194	112
Net cashflow	129	-99	150	-39	-379
Beginning cash	799	928	829	978	939
Ending cash	928	829	978	939	560
Ending net debt	3,207	3,980	3,830	4,369	5,249

Balance sheet (MYRmn)

As at 31 Jul	FY15	FY16	FY17F	FY18F	FY19F
Cash & equivalents	928	829	978	939	560
Marketable securities	510	644	644	644	644
Accounts receivable	1,377	1,697	1,605	1,566	2,657
Inventories	186	117	108	104	187
Other current assets	2,234	1,860	1,562	2,232	3,098
Total current assets	5,234	5,147	4,898	5,484	7,146
LT investments	1,925	2,126	2,240	2,394	2,560
Fixed assets	3,024	3,464	3,964	4,164	4,464
Goodwill					
Other intangible assets					
Other LT assets	3,144	3,432	3,361	3,289	3,214
Total assets	13,326	14,169	14,464	15,331	17,385
Short-term debt	777	640	640	640	640
Accounts payable	1,355	1,444	1,333	1,278	2,304
Other current liabilities	327	86	86	86	86
Total current liabilities	2,459	2,169	2,058	2,003	3,030
Long-term debt	3,358	4,169	4,169	4,669	5,169
Convertible debt					
Other LT liabilities	815	617	617	617	617
Total liabilities	6,632	6,955	6,844	7,289	8,815
Minority interest	356	336	394	460	536
Preferred stock					
Common stock	2,406	2,419	2,419	2,419	2,419
Retained earnings	2,880	3,217	3,565	3,921	4,372
Proposed dividends					
Other equity and reserves	1,051	1,242	1,242	1,242	1,242
Total shareholders' equity	6,337	6,878	7,226	7,582	8,033
Total equity & liabilities	13,326	14,169	14,464	15,331	17,385

Liquidity (x)

Current ratio	2.13	2.37	2.38	2.74	2.36
Interest cover	6.8	6.1	5.5	5.7	6.8

Leverage

Net debt/EBITDA (x)	3.70	5.00	4.57	5.01	4.62
Net debt/equity (%)	50.6	57.9	53.0	57.6	65.3

Per share

Reported EPS (MYR)	28.94c	25.99c	26.72c	27.39c	34.70c
Norm EPS (MYR)	28.94c	25.99c	26.72c	27.39c	34.70c
FD norm EPS (MYR)	28.94c	25.25c	25.81c	26.47c	33.53c
BVPS (MYR)	2.63	2.84	2.99	3.13	3.32
DPS (MYR)	0.12	0.12	0.12	0.13	0.16

Activity (days)

Days receivable	118.6	134.9	152.8	150.4	118.0
Days inventory	22.4	16.3	13.1	12.8	9.8
Days payable	106.4	150.5	161.2	158.1	120.3
Cash cycle	34.6	0.7	4.6	5.1	7.5

Source: Company data, Nomura estimates

Upgrade to Neutral

We upgrade Gamuda to Neutral for three main reasons:

1) Diversified contractors like Gamuda should continue to underperform.
We think it is becoming more important to distinguish the performance of diversified contractors vs. those which are still primarily construction-focused, for two reasons: 1) our analysis reveals that diversified players' performance has been lagging the pure-play stocks, suggesting pure-play names have generated more alpha of late; 2) with property development being the business of choice into which to diversify for most large contractors, it has remained a drag on their earnings performance in recent years due to the slowdown in the property sector. In terms of valuation, the diversified contractors are trading at ~21x trailing P/E, which is +2SD above the historical mean valuation. The pure-play contractors' valuation is relatively lower at ~13x, and which is between mean and +1SD levels. In our view, this implies that pure-play stocks might continue to relatively beat returns of diversified contractors over the next 12 months.

2) Cashflow generation weak due to SPLASH (in spite of good earnings).
As noted earlier in our report, we prefer companies which deliver on both earnings momentum and cashflow generation. Gamuda has managed to generate earnings with low volatility, as MRT Line 2 earnings will start to contribute from FY17F/18F onwards just in time as MRT Line 1 is completed. Moreover, the dip in earnings from property segment, while sharp, was offset by profit growth from its concession segments (specifically, we note that Litrak earnings and SPLASH earnings have grown over the last year due to toll hikes in highways). However, even in spite of steady earnings delivery, we note that Gamuda's cashflow generation remains weaker than its peer IJM's, mainly due to two reasons: **1)** SPLASH and Gamuda Water, which collectively accounted for ~27% (~MYR230mn) of Gamuda's FY16A PBT, contribute very little in terms of actual cash, due to the water tariff hikes not being passed through to the consumers – as a result, SPLASH's earnings build up in the form of receivables on SPLASH's books, whereas Gamuda records it in the "investment in associate" line item; and **2)** Gamuda's property business has seen elevated spending on landbanking (eg, in Klang Valley, Singapore) which have pressured cashflow. As a result, we see Gamuda's net gearing having gone up from 32% to 59% over the last few years. Going forward, we expect property to remain a drag on group level due to weaker pre-sales and lower margins in overseas projects.

3) Law of diminishing marginal returns, lack of catalysts, elevated valuations
Our late 2015 anti-consensus Reduce call on Gamuda was premised on earnings dip from construction and property in FY16 leading to a de-rating in valuation multiples. However, having secured MRT Line 2 project (tunnelling value was above consensus MYR15.5bn, Gamuda's share 50%), and a MYR1bn Pan Borneo Highway package, the market overlooked the 8% y-y decline in FY16 earnings, in optimism of earnings growth resuming from FY17F onwards. As a result, the stock traded sideways for almost the whole of 2016, generating 0.2% return since January 2015. In our view, Gamuda now faces the law of diminishing marginal returns – with a record orderbook of ~MYR8.7bn, any new projects simply do not add enough incremental earnings to the group to excite the market. Construction only accounts for ~30% of earnings, and so a MYR1bn project only adds ~3% earnings to the group on a proforma basis.

Valuation for Gamuda is still fairly rich, at 17x CY18F EPS, and looks even more expensive at 21x if we exclude SPLASH earnings given Gamuda is looking to dispose of the asset.

In our view, the main catalysts for diversified contractors like Gamuda will have to be: 1) a revival in the property sector (either through a relaxation in cooling measures, or through a relaxation in bank lending guidelines), or 2) potentially value-accretive corporate exercises such as disposal of non-core assets like SPLASH. Note that this has to come with a special dividend so that the lower share price ex-dividend leads to a lower P/E. Finally, any potentially game–changing projects like mega-infrastructure awards can be positive catalysts for the stock.

Estimate revisions

We lower our earnings estimates for FY17F/18F by 10% each as we lower our construction PBT margins as well as margins from Gamuda's overseas property development projects.

Fig. 59: Gamuda: Changes in forecasts

	Old est.		New est.		% change	
	FY17F	*FY18F*	FY17F	FY18F	FY17F	FY18F
MRT completion %						
MRT Line 1 Tunneling	*100%*	*100%*	100%	100%	0 ppt	0 ppt
MRT Line 1 PDP	*100%*	*100%*	100%	100%	0 ppt	0 ppt
MRT Line 2 Tunneling	*5%*	*20%*	7%	20%	2 ppt	0 ppt
MRT Line 2 PDP	*5%*	*20%*	10%	20%	5 ppt	0 ppt
PDP fee						
MRT 2	*6%*	*6%*	6%	6%	0 ppt	0 ppt
MRT 3	*6%*	*6%*	6%	6%	0 ppt	0 ppt
New property sales (MYR mn)	***1,580***	***1,700***	**2,120**	**1,700**	**34%**	**0%**
PBT (MYR mn)	***949***	***976***	**891**	**926**	**(6%)**	**(5%)**
… Engineering and construction	*256*	*207*	222	206	(13%)	(0%)
… Property development & club operations	*242*	*264*	156	163	(36%)	(38%)
… Water and expressway concessions	*451*	*505*	513	557	14%	10%
Adj. Net income (MYR mn)	***715***	***734***	**646**	**663**	**(10%)**	**(10%)**

Source: Nomura estimates

Raise to Neutral with a higher TP of MYR5.20

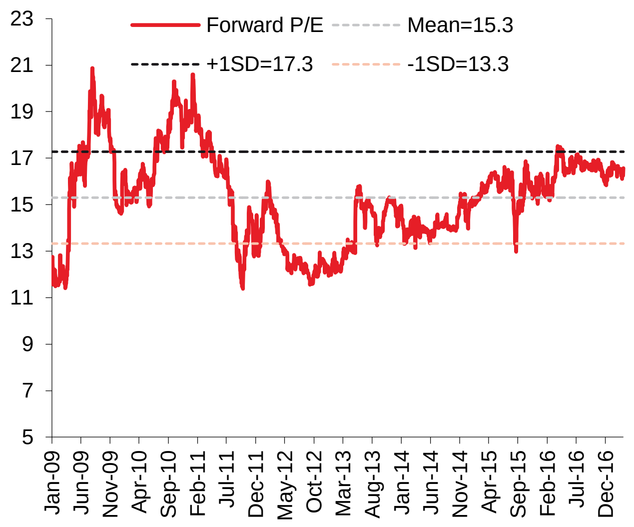
Our revised TP is based on target P/E of 17.5x (15x previously) on CY18F earnings. The target P/E of 17.5x is close to +1SD of its historical valuations. Using an EPS of 22sen for CY18F and target P/E of 17.5x, we arrive at our new TP of MYR5.20 for Gamuda which implies a potential upside of 4% at current levels. We therefore raise the stock to Neutral.

Fig. 60: Gamuda: P/E based valuation

	Jul/18	Jul/19
	FY18F	FY19F
Normalised net profit (MYR mn)	663	840
FD number of shares outstanding (mn)	2,504	2,504
FD EPS (MYR/ sh)	0.26	0.34
	CY18F	
CY18F FD EPS (MYR/ sh)	0.29	
Target CY18F P/E (x)	17.5 x	
Price target (MYR/ sh)	**5.20**	

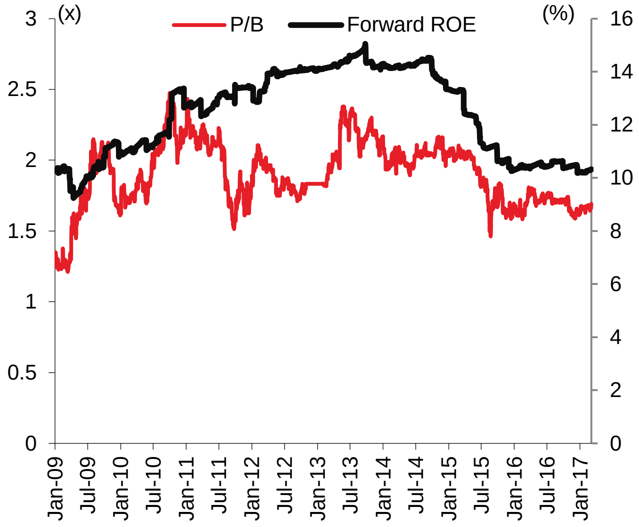
Source: Nomura estimates

Fig. 61: Gamuda: 1-year forward P/E chart



Source: Bloomberg, Nomura research

Fig. 62: Gamuda: 1-year forward P/B vs ROE



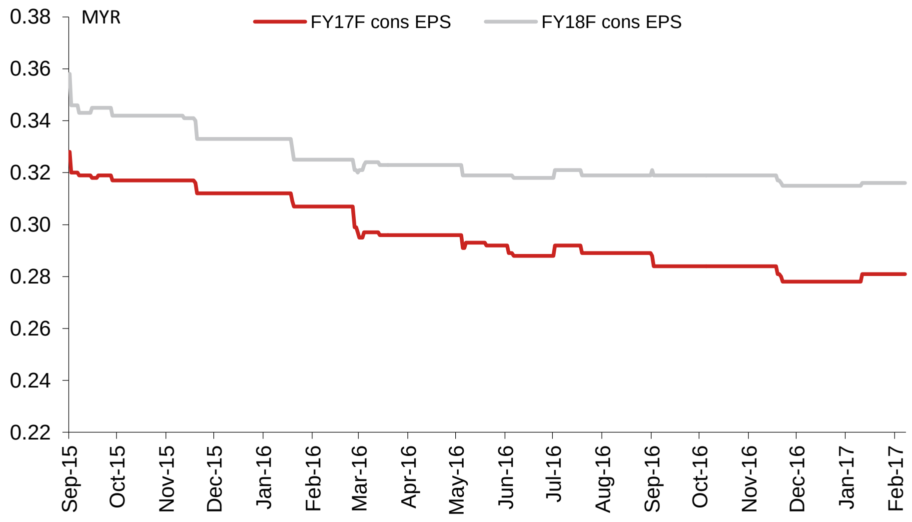
Source: Bloomberg, Nomura research

Risks to our view

Upside risks include: 1) revival in the property sector (either through a relaxation in cooling measures or through a relaxation in bank lending guidelines), or 2) potentially value-accretive corporate exercises such as disposal of non-core assets like SPLASH.

Downside risks include: 1) lower-than-expected margins from construction and property development; and 2) lower-than-expected orderbook inflows or property sales.

Fig. 63: Gamuda: Consensus EPS forecasts



Source: Bloomberg, Nomura research

Fig. 64: Gamuda: Earnings vs. operating cash flows

MYR mn	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	1Q17
Income statement items									
Adjusted net income	192	376	457	524	663	708	682	626	162
Reported net income	194	323	425	547	541	719	682	626	162
Cash flow items									
OCF before WC changes	209	340	438	581	383	464	648	611	162
Changes in WC	410	241	(475)	(169)	(335)	(527)	(179)	(256)	(430)
OCF after WC changes	619	581	(37)	412	48	(63)	469	355	(268)
Net OCF after WC, interest, taxes	461	438	(200)	176	(147)	(256)	246	94	(333)
Dividend received from associates and JV	172	106	78	97	78	123	84	189	169
Depreciation & Amortisation (D&A)	18	20	19	24	22	27	103	122	36
Net debt to Equity									
Net debt	385	624	901	1,169	1,096	1,731	3,207	3,980	4,210
Total Equity	3,301	3,440	3,687	4,048	4,878	5,474	6,337	6,878	7,156
Net debt to equity	12%	18%	24%	29%	22%	32%	51%	58%	59%
Comparison									
1 Adjusted net income + D&A	210	396	476	548	685	735	785	748	199
Net OCF	461	438	(200)	176	(147)	(256)	246	94	(333)
2 Adjusted net income + D&A	210	396	476	548	685	735	785	748	199
Net OCF pre WC investments + Div from assoc and JV	223	303	353	441	265	395	508	538	266

Source: Company data, Nomura research

NOMURA

WCT Holdings WCTE.KL WCTHG MK

EQUITY: ENGINEERING & CONSTRUCTION

Weak earnings and cashflows

Margin weakness, property slowdown and high gearing are reasons for our bearish stance

Action: Our call on WCT remains Reduce

WCT's share price has performed well since Jan-2016 (+18% vs KLCI up 2%), mainly because of investor expectations from new company management. However, we remain cautious on the stock for three reasons: **1)** at the sector level, we think diversified contractors such as WCT will continue to underperform pure-play contractors due to a slow property market and expensive valuations; **2)** based on our earnings-cashflow matrix, WCT might continue to miss expectations on those two measures, resulting in elevated gearing due to weak construction margins and slow property sales; and **3)** while we think that de-gearing steps announced by management will be welcomed by investors, they will also come with a loss of earnings streams from the malls. Moreover, we are unclear on the end-goal of the any future restructuring (whether WCT will become a property-focussed company) and how minority shareholders stand to benefit from these steps.

Valuation: Still expensive

We currently do not build in any de-gearing measures and asset disposals to get a comparable picture of group profitability, and raise our valuation multiple to 14x, +1SD above historical average to account for the optimism on new management. However, with a reduction in earnings forecasts, our TP is still MYR1.40, reflecting 25% potential downside. We maintain our Reduce rating on the shares. It is currently trading at 18x CY18F P/E (EPS: 10.3sen).

Catalysts: continued weak profitability

We expect the stock to de-rate on weak earnings momentum. Upside risks to our call include 1) a revival in the property sector, 2) receiving arbitration payment from the middle east, 3) mega-project awards 4) special dividend on asset disposals or entry of strong strategic partners.

Year-end 31 Dec	FY16		FY17F		FY18F		FY19F
Currency (MYR)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	1,934	2,050	2,165	1,927	2,013		2,167
Reported net profit (mn)	68	149	132	167	129		150
Normalised net profit (mn)	100	149	132	167	129		150
FD normalised EPS	8.04c	11.87c	10.50c	13.31c	10.30c		11.97c
FD norm. EPS growth (%)	95.6	15.3	30.7	12.1	-1.9		16.2
FD normalised P/E (x)	23.4	N/A	17.9	N/A	18.3	N/A	15.7
EV/EBITDA (x)	23.2	N/A	20.9	N/A	21.8	N/A	19.3
Price/book (x)	0.9	N/A	0.8	N/A	0.8	N/A	0.8
Dividend yield (%)	na	N/A	2.2	N/A	2.2	N/A	2.5
ROE (%)	2.5	5.4	4.7	5.8	4.5		5.1
Net debt/equity (%)	91.4	77.7	91.6	83.1	94.1		96.5

Source: Company data, Nomura estimates

Key company data: See next page for company data and detailed price/index chart.

Global Markets Research

10 March 2017

Rating Remains	**Reduce**
Target Price Remains	MYR 1.40
Closing price 8 March 2017	MYR 1.88
Potential downside	-25.5%

Anchor themes

In 2017, we expect pure-play Malaysian contractors to continue to outperform diversified companies, which have property exposure. We like stocks where management is looking beyond short-term project awards and generating both earnings growth and healthy cashflows, which in our view are the best indicators of long-term outperformance.

Nomura vs consensus

We have a non-consensus Reduce on WCT.

Research analysts

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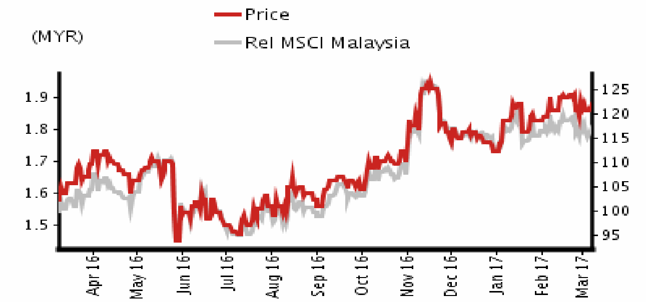
See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

Key data on WCT Holdings

Relative performance chart



Source: Thomson Reuters, Nomura research

Notes:

Performance

(%)	1M	3M	12M		
Absolute (MYR)	1.1	6.2	19.0	M cap (USDmn)	533.6
Absolute (USD)	0.7	5.5	9.8	Free float (%)	80.4
Rel to MSCI Malaysia	0.0	1.8	17.5	3-mth ADT (USDmn)	0.9

Income statement (MYRmn)

Year-end 31 Dec	FY15	FY16	FY17F	FY18F	FY19F
Revenue	1,668	1,934	2,165	2,013	2,167
Cost of goods sold	-1,448	-1,766	-1,971	-1,824	-1,941
Gross profit	220	167	194	189	226
SG&A					
Employee share expense					
Operating profit	220	167	194	189	226
EBITDA	228	182	201	195	233
Depreciation	-8	-15	-6	-6	-7
Amortisation					
EBIT	220	167	194	189	226
Net interest expense	-58	-31	-36	-38	-41
Associates & JCEs	30	30	39	41	42
Other income					
Earnings before tax	192	167	198	192	228
Income tax	-55	-57	-66	-63	-77
Net profit after tax	137	110	132	129	150
Minority interests	2	3	0	0	0
Other items	-93	-13	0	0	0
Preferred dividends	0	0	0	0	0
Normalised NPAT	47	100	132	129	150
Extraordinary items	162	-32	0	0	0
Reported NPAT	209	68	132	129	150
Dividends	-55	0	-53	-52	-60
Transfer to reserves	154	68	79	78	90
Valuations and ratios					
Reported P/E (x)	10.2	34.2	17.9	18.3	15.7
Normalised P/E (x)	45.7	23.3	17.9	18.3	15.7
FD normalised P/E (x)	45.8	23.4	17.9	18.3	15.7
Dividend yield (%)	2.4	na	2.2	2.2	2.5
Price/cashflow (x)	na	na	23.0	72.1	81.5
Price/book (x)	0.9	0.9	0.8	0.8	0.8
EV/EBITDA (x)	17.4	23.2	20.9	21.8	19.3
EV/EBIT (x)	17.9	25.0	21.5	22.4	19.8
Gross margin (%)	13.2	8.7	9.0	9.4	10.4
EBITDA margin (%)	13.6	9.4	9.3	9.7	10.7
EBIT margin (%)	13.2	8.7	9.0	9.4	10.4
Net margin (%)	12.6	3.5	6.1	6.4	6.9
Effective tax rate (%)	28.6	34.1	33.4	32.7	34.0
Dividend payout (%)	26.3	0.0	40.0	40.0	40.0
ROE (%)	8.6	2.5	4.7	4.5	5.1
ROA (pretax %)	4.3	3.0	3.3	3.2	3.6
Growth (%)					
Revenue	0.3	15.9	12.0	-7.0	7.7
EBITDA	9.0	-19.9	10.1	-2.6	19.1
Normalised EPS	-58.1	95.7	30.3	-1.9	16.2
Normalised FDEPS	-58.0	95.6	30.7	-1.9	16.2

Source: Company data, Nomura estimates

Cashflow statement (MYRmn)

Year-end 31 Dec	FY15	FY16	FY17F	FY18F	FY19F
EBITDA	228	182	201	195	233
Change in working capital	-492	39	-21	-87	-113
Other operating cashflow	-290	-479	-77	-75	-91
Cashflow from operations	-554	-258	102	33	29
Capital expenditure	-148	-277	-126	-126	-126
Free cashflow	-702	-535	-24	-93	-97
Reduction in investments	-162	-240	-60	-60	-60
Net acquisitions					
Dec in other LT assets	-355	-379	-79	-81	-82
Inc in other LT liabilities	113	13	0	0	0
Adjustments	475	625	139	141	142
CF after investing acts	-632	-516	-24	-93	-97
Cash dividends	-23	-25	-53	-52	-60
Equity issue	108	93	0	0	0
Debt issue	342	381	200	200	200
Convertible debt issue					
Others	-223	-1	0	0	0
CF from financial acts	205	447	147	148	140
Net cashflow	-427	-69	124	55	43
Beginning cash	951	524	455	579	634
Ending cash	524	455	579	634	676
Ending net debt	2,069	2,527	2,604	2,749	2,906

Balance sheet (MYRmn)

As at 31 Dec	FY15	FY16	FY17F	FY18F	FY19F
Cash & equivalents	524	455	579	634	676
Marketable securities					
Accounts receivable	920	827	925	860	925
Inventories	154	132	104	97	104
Other current assets	1,106	1,226	1,233	1,333	1,433
Total current assets	2,703	2,640	2,841	2,923	3,139
LT investments	1,033	1,273	1,333	1,393	1,454
Fixed assets	288	328	324	317	310
Goodwill					
Other intangible assets					
Other LT assets	2,728	3,107	3,186	3,268	3,350
Total assets	6,752	7,348	7,684	7,901	8,252
Short-term debt	520	823	823	823	823
Accounts payable	757	794	850	790	851
Other current liabilities	188	196	196	196	196
Total current liabilities	1,466	1,814	1,870	1,810	1,870
Long-term debt	2,073	2,159	2,359	2,559	2,759
Convertible debt					
Other LT liabilities	566	579	579	579	579
Total liabilities	4,105	4,551	4,807	4,948	5,208
Minority interest	37	34	34	34	34
Preferred stock	0	0	0	0	0
Common stock	600	631	631	631	631
Retained earnings	1,259	1,333	1,412	1,490	1,580
Proposed dividends					
Other equity and reserves	751	799	799	799	799
Total shareholders' equity	2,610	2,763	2,842	2,920	3,010
Total equity & liabilities	6,752	7,348	7,684	7,901	8,252

Liquidity (x)

	FY15	FY16	FY17F	FY18F	FY19F
Current ratio	1.84	1.46	1.52	1.62	1.68
Interest cover	3.8	5.4	5.4	5.0	5.6
Leverage					
Net debt/EBITDA (x)	9.09	13.87	12.98	14.08	12.50
Net debt/equity (%)	79.3	91.4	91.6	94.1	96.5

Per share

	FY15	FY16	FY17F	FY18F	FY19F
Reported EPS (MYR)	18.37c	5.50c	10.50c	10.30c	11.97c
Norm EPS (MYR)	4.12c	8.06c	10.50c	10.30c	11.97c
FD norm EPS (MYR)	4.11c	8.04c	10.50c	10.30c	11.97c
BVPS (MYR)	2.17	2.20	2.27	2.33	2.40
DPS (MYR)	0.05	0.00	0.04	0.04	0.05
Activity (days)					
Days receivable	196.5	165.3	147.7	161.8	150.3
Days inventory	30.8	29.6	21.9	20.1	18.9
Days payable	200.7	160.7	152.2	164.1	154.3
Cash cycle	26.6	34.2	17.3	17.8	15.0

Source: Company data, Nomura estimates

Maintain Reduce

We maintain our Reduce call on WCT for three main reasons:

1) Diversified contractors like WCT should continue to underperform
We think it is becoming more important to distinguish the performance of diversified contractors vs those which are still primarily construction-focused, for two reasons: 1) our analysis reveals that diversified players' performance has been lagging the pure-play stocks, suggesting pure-play names have generated more alpha of late; 2) with property development being the business of choice into which to diversify for most large contractors, it has remained a drag on their earnings performance in recent years due to the slowdown in the property sector. In terms of valuation, the diversified contractors are trading at ~21x trailing P/E, which is +2SD above the historical mean valuation. The pure-play contractors valuation is relatively lower at ~13x, which is between mean and +1SD levels. In our view, this implies that pure-play stocks might continue to relatively beat returns of diversified contractors over the next 12 months.

2) Weak earnings and weak cashflow generation
As noted earlier in this report, we prefer companies which deliver on both earnings momentum and cashflow generation. We note that WCT has missed consensus earnings several years in a row, despite a record MYR3bn in awards in 2015 and MYR1.4bn in 2016. This, in our view, is due to below-expectations margin realisation for the projects. More importantly, we expect that margins on the construction business might remain volatile and fall below expectations, as industry fragmentation means that the tender environment remains competitive in Malaysia, which might reduce the profitability of contractors who choose to sacrifice some margin to win projects. Note that WCT also has a project in its orderbook (the Tun Razak Exchange project worth MYR755mn), part of which is payable in land, which will also mean lower margins in the near term. In the property business, too, weak sales and capitalised interest costs could mean lower margins in the future.

On top of weak earnings, WCT's gearing remains stubbornly high, because cashflow for WCT has been under pressure due to property investments. The sale of Ascent@Paradigm for MYR347mn is unlikely to reduce gearing much, as proceeds will be used to pay down Associate-level debt rather than at the holdco first. After the change in management, WCT announced a private placement, worth ~MYR213mn, which should be the first concrete step in reducing gearing, in our view.

3) High expectations with new management
One of the main reasons investors have high expectations for WCT is the change in controlling shareholder to Pavilion REIT's Tan Sri Desmond Lim in Nov (report), which was reportedly transacted at MYR2.50/sh. While this price likely includes a control premium not available to minority shareholders, the new management is actively working to bring the gearing of WCT to a healthy level. To this end, they are planning a private placement, sale of Aeon Bukit Tinggi and Paradigm Mall to a REIT (worth MYR1.2bn together), and some land sales. While we think that these steps will be welcomed by investors, as they will reduce gearing, they will also come with a loss of an earnings stream (the two malls on our calculations, contribute ~15% to WCT's earnings), which will reduce the group's profitability further. Moreover, the final goal of the restructuring (whether WCT will be a construction-focussed company or a property-focussed one, and whether minority shareholders will benefit from these steps) remains unclear at this stage. So, we continue to forecast earnings and a target price for WCT on an as-is basis (ie assuming business as usual, not building in the placement and proposed disposals), as this approach still gives a comparable picture of the group's overall profitability. Finally, we ascribe a 14x multiple, +1SD above historical average, to come up with our TP of MYR1.40.

In our view, the main upside risks for our call are: 1) a revival in the property sector (either through a relaxation in cooling measures, or through a relaxation in bank lending guidelines); and 2) arbitration payments – any progress in receiving arbitration payments from Meydan (see our report) might be positive for the stock, as there is the potential for improving gearing substantially by using the proceeds. Other upside risks include: 3) new project awards larger than our estimates; 4) higher-than-expected margins for construction and property development: margins are affected due to cost and labour pressures in Malaysia and the Middle East; however, if these were to reverse, it could pose an upside risk; and 5) special dividend on asset disposals or entry of strong strategic partners.

Estimate revisions

We lower our earnings estimates for FY17F/18F by 12%/23%, as we make the following changes to our assumptions –

- We lower our operating margin assumptions for construction projects to 5%, which lowers our operating profit forecasts from the construction division.
- We lower our new property sales target for FY17F/18F by 43%/ 40%.

As a result of the above changes, we cut our net income estimates for FY17F/18F by 12%/23%.

Fig. 65: WCT: Changes in forecasts

MYR mn	*Old estimates*		New estimates		% change	
	FY17F	*FY18F*	FY17F	FY18F	FY17F	FY18F
Revenue	***2,050***	***1,927***	**2,165**	**2,013**	**6%**	**4%**
… Construction	*1,574*	*1,272*	1,757	1,595	12%	25%
… Property development	*370*	*520*	308	289	(17%)	(44%)
… Investment & Mgmt	*106*	*135*	100	130	(5%)	(4%)
Operating profit	***225***	***249***	**194**	**189**	**(13%)**	**(24%)**
… Construction	*110*	*102*	88	80	(20%)	(22%)
… Property development	*74*	*94*	68	58	(9%)	(38%)
… Investment & Mgmt	*41*	*54*	39	51	(4%)	(4%)
Associate and JCE	***38***	***40***	**39**	**41**	**2%**	**2%**
Operating margins	***11%***	***13%***	**9%**	**9%**	**(2.0) ppt**	**(3.5) ppt**
… Construction	*7%*	*8%*	5%	5%	(2.0) ppt	(3.0) ppt
… Property development	*20%*	*18%*	22%	20%	2.0 ppt	2.0 ppt
Adj. Net income	***149***	***167***	**132**	**129**	**(12%)**	**(23%)**
New project awards	***1,000***	***1,000***	**1,000**	**1,000**	**0%**	**0%**
New property pre-sales	***350***	***400***	**200**	**240**	**(43%)**	**(40%)**

Source: Nomura estimates

Maintain Reduce; TP at MYR1.40

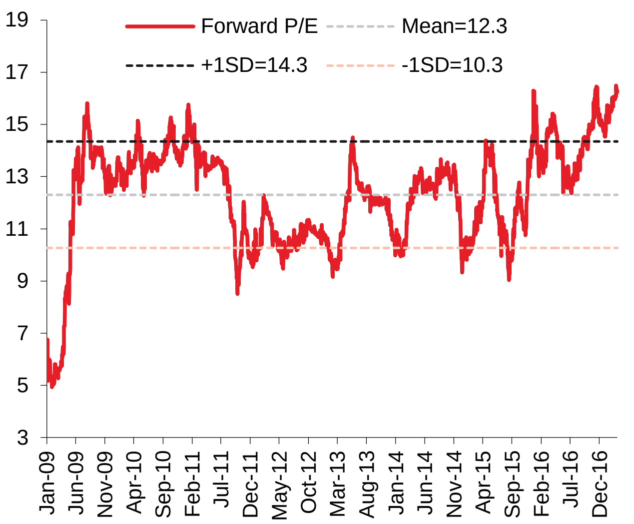
Our TP is unchanged but is now based on a target P/E of 14x (12x previously) on CY18F (CY17F previously) earnings. The target P/E of 14x is close to +1SD above its historical mean valuation. Using an EPS of 10sen for CY18F and target P/E of 14x, we arrive at our TP of MYR1.40 for WCT which implies downside of 25% at current levels. We therefore maintain our Reduce rating on the stock.

Fig. 66: WCT: P/E based valuation

	Dec/18
	FY18F
Normalised net profit (MYR mn)	129
FD number of shares outstanding (mn)	1,255
FD EPS (MYR/ sh)	0.10
Target CY18F P/E (x)	14.0 x
Price target (MYR/ sh)	1.40

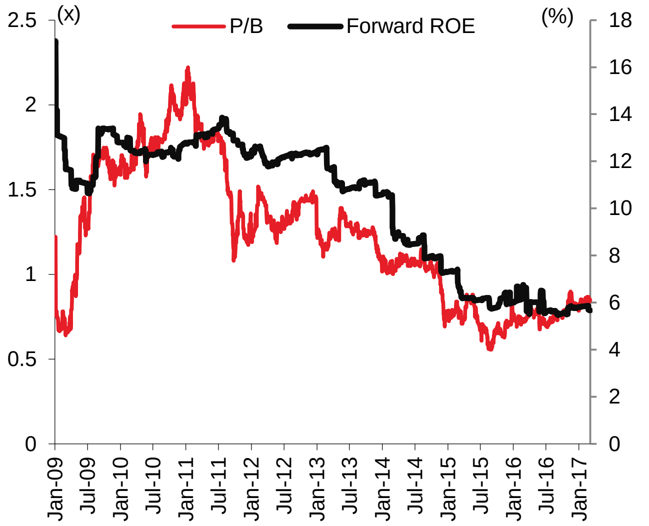
Source: Nomura estimates

Fig. 67: WCT: 1-year forward P/E chart



Source: Bloomberg, Nomura research

Fig. 68: WCT: 1-year forward P/B vs ROE

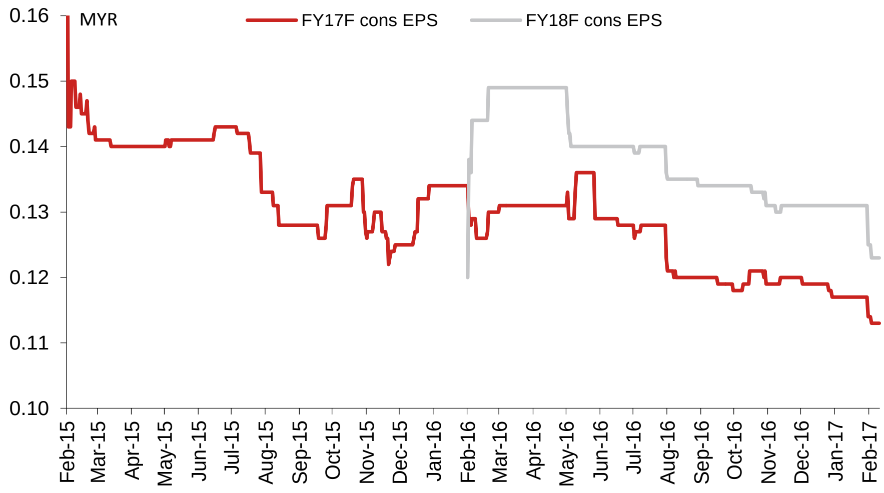


Source: Bloomberg, Nomura research

Upside risks to our view

In our view, the main upside risks to our call are: 1) a revival in the property sector (either through a relaxation in cooling measures, or through a relaxation in bank lending guidelines); and 2) arbitration payments – any progress in receiving arbitration payments from Meydan might be positive for the stock, as there is the potential for improving gearing substantially by using the proceeds. Other upside risks include: 3) new project awards larger than our estimates; 4) higher-than-expected margins for construction and property development: margins are affected due to cost and labour pressures in Malaysia and the Middle East; however, if these were to reverse, it could pose an upside risk; and 5) special dividend on asset disposals or entry of strong strategic partners.

Fig. 69: WCT: Consensus EPS forecasts



Source: Bloomberg, Nomura research

Fig. 70: WCT: Earnings vs. operating cash flows

MYR mn	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16
Income statement items									
Adjusted net income	88	167	116	122	155	127	111	47	100
Reported net income	101	146	150	166	359	198	123	209	68
Cash flow items									
OCF before WC changes	130	294	294	190	242	189	159	105	155
Changes in WC	(131)	(3)	(248)	(126)	(60)	(634)	(490)	(531)	(274)
OCF after WC changes	(2)	290	46	65	182	(444)	(331)	(426)	(119)
Net OCF after WC, interest, taxes	(69)	247	1	4	90	(548)	(430)	(554)	(258)
Dividend received from associates and JV	0	0	0	0	1	7	2	5	0
Depreciation & Amortisation (D&A)	5	25	16	9	7	10	8	8	15
Net debt to Equity									
Net debt	414	285	470	594	746	949	1,480	2,069	2,527
Total Equity	1,165	1,254	1,256	1,476	1,810	2,204	2,234	2,610	2,763
Net debt to equity	35%	23%	37%	40%	41%	43%	66%	79%	91%
Comparison									
1 Adjusted net income + D&A	93	192	133	132	162	137	119	55	115
Net OCF	(69)	247	1	4	90	(548)	(430)	(554)	(258)
2 Adjusted net income + D&A	93	192	133	132	162	137	119	55	115
Net OCF pre WC investments + Div from assoc and JV	63	251	249	129	151	92	61	(18)	16

Source: Company data, Nomura research

Appendix A-1

Analyst Certification

I, Tushar Mohata, hereby certify (1) that the views expressed in this Research report accurately reflect my personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of my compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

Issuer Specific Regulatory Disclosures

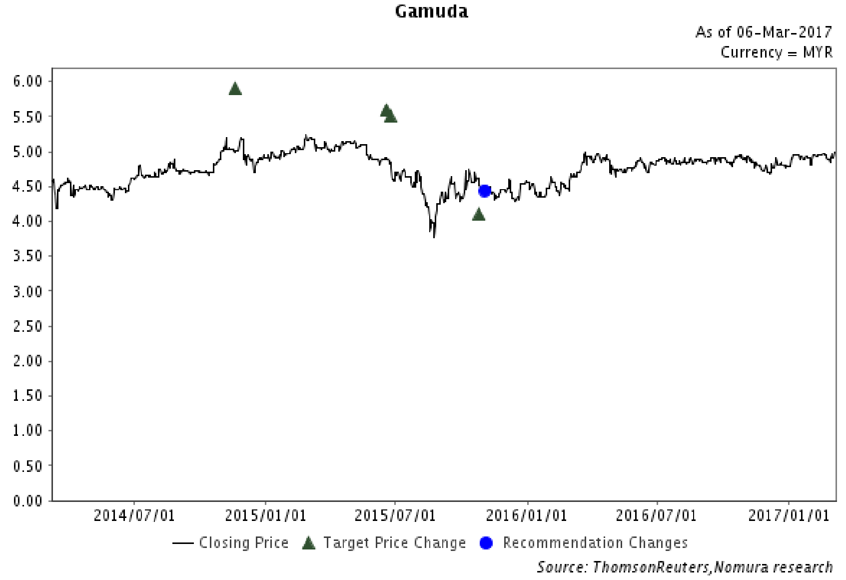
The terms "Nomura" and "Nomura Group" used herein refers to Nomura Holdings, Inc. and its affiliates and subsidiaries, including Nomura Securities International, Inc. ('NSI') and Instinet, LLC('ILLC'), U. S. registered broker dealers and members of SIPC.

Materially mentioned issuers

Issuer	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Gamuda	GAM MK	MYR 5.01	08-Mar-2017	Neutral	N/A	
IJM Corp	IJM MK	MYR 3.41	08-Mar-2017	Neutral	N/A	
Sunway Construction Group Bhd	SCGB MK	MYR 1.71	08-Mar-2017	Buy	N/A	
WCT Holdings	WCTHG MK	MYR 1.88	08-Mar-2017	Reduce	N/A	

Gamuda (GAM MK) **MYR 5.01 (08-Mar-2017)** Neutral (Sector rating: N/A)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
26-Oct-15	Reduce		4.523
26-Oct-15		4.10	4.523
24-Jun-15		5.50	4.856
18-Jun-15		5.60	4.914
19-Nov-14		5.90	5.022

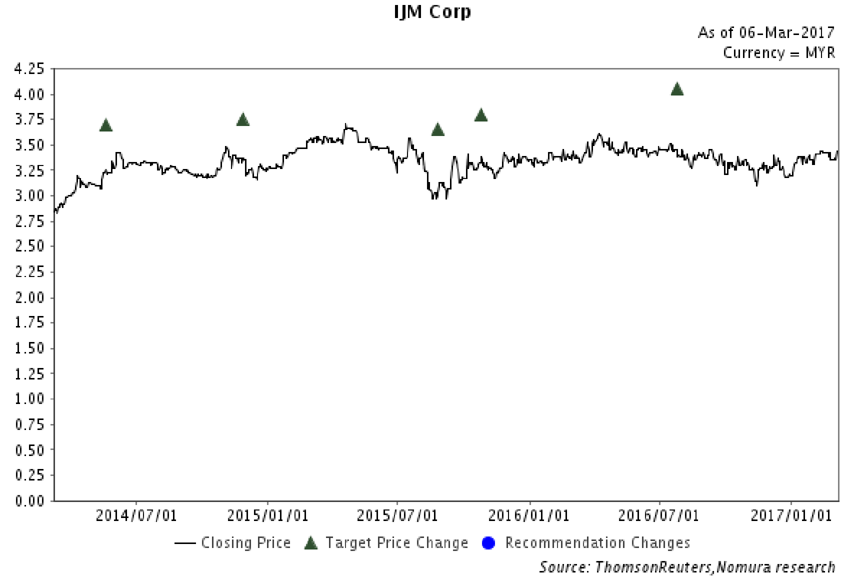
For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology In valuing Gamuda, we ascribe a target P/E of 17.5x which is close to +1SD of its historical valuation. Using our fully diluted EPS forecast of 29sen for CY18F, we arrive at our target price of MYR5.20. The benchmark index for the stock is the MSCI Malaysia.

Risks that may impede the achievement of the target price Upside risks include: 1) revival in the property sector (either through a relaxation in cooling measures or through a relaxation in bank lending guidelines), or 2) potentially value-accretive corporate exercises such as disposal of non-core assets like SPLASH. Downside risks include: 1) lower-than-expected margins from construction and property development; and 2) lower-than-expected orderbook inflows or property sales.

IJM Corp (IJM MK) **MYR 3.41 (08-Mar-2017)** Neutral (Sector rating: N/A)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
25-Jul-16		4.05	3.46
26-Oct-15		3.80	3.39
26-Aug-15		3.65	3.023
26-Nov-14		3.75	3.375
19-May-14		3.70	3.254

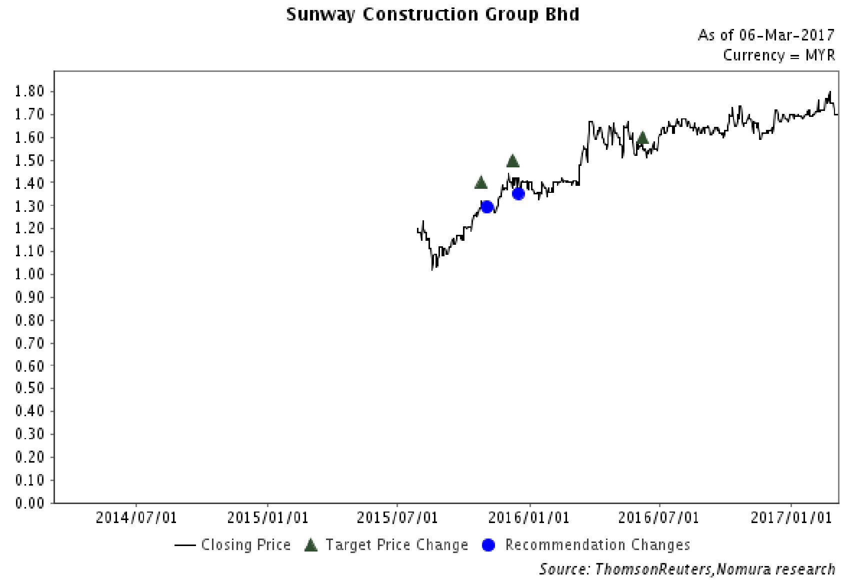
For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We value IJM based on a CY18F target P/E of 17x which is close to +1SD of its historical valuation. Using our fully diluted EPS forecast of 22sen for CY18F and target multiple of 17x, we arrive at our target price of MYR3.70. The benchmark index for the stock is the MSCI Malaysia.

Risks that may impede the achievement of the target price Upside risks include: 1) revival in the property sector (either through a relaxation in cooling measures or through a relaxation in bank lending guidelines); or 2) a revival of bauxite mining through Kuantan port. Downside risks include: 1) lower-than-expected margins from construction and property development; 2) lower-than-expected orderbook inflows or property sales; 3) lower CPO or building material prices; and 4) an unexpected cancellation of projects, eg, the West Coast Expressway.

Sunway Construction Group Bhd (SCGB MK) **MYR 1.71 (08-Mar-2017)** Buy (Sector rating: N/A)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
07-Jun-16		1.60	1.56
08-Dec-15	Neutral		1.38
08-Dec-15		1.50	1.38
26-Oct-15	Buy		1.32
26-Oct-15		1.40	1.32

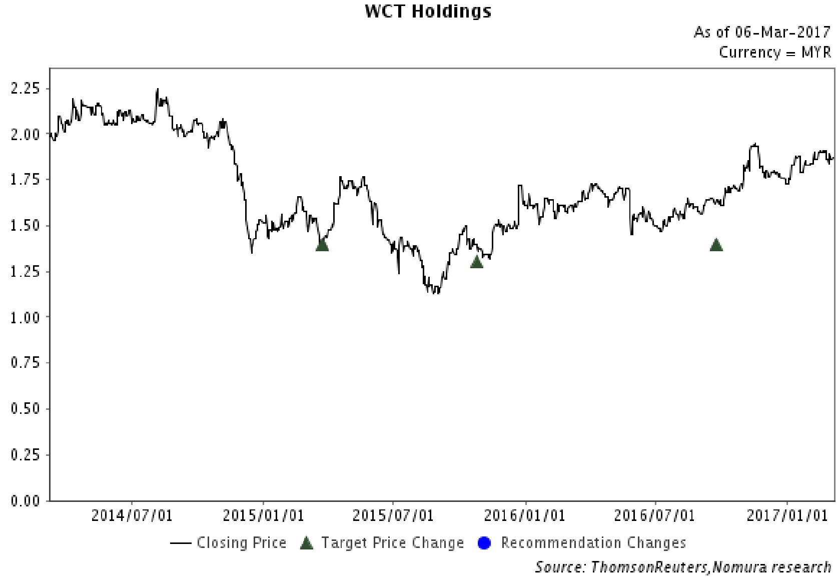
For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We value SunCon at a cash adjusted target P/E of 15x on FY18F earnings and value the cash sitting on its balance sheet separately. Using net income, less of interest income, of MYR138mn for FY18F and a cash-adjusted P/E of 15x, we arrive at an equity value, ex-cash holdings, of MYR2.1bn. To this we add the cash balance in end-FY18F to arrive at our new TP of MYR2.00. The benchmark index for the stock is MSCI Malaysia.

Risks that may impede the achievement of the target price Downside risks include: 1) delay in construction project awards, 2) lower-than-expected margins, 3) Singapore housing units not growing as expected; and 4) lower-than-expected orderbook inflows

WCT Holdings (WCTHG MK) **MYR 1.88 (08-Mar-2017)** Reduce (Sector rating: N/A)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
23-Sep-16		1.40	1.64
26-Oct-15		1.30	1.38
24-Mar-15		1.40	1.428

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We value WCT based on CY18F target P/E of 14x which is +1SD above its historical average valuation. Using our fully diluted EPS forecast of 10sen for CY18F and target multiple of 14x, we arrive at our target price of MYR1.40. The benchmark index for the stock is the MSCI Malaysia.

Risks that may impede the achievement of the target price In our view, the main upside risks for our call will be 1) a revival in the property sector (either through a relaxation in cooling measures, or through a relaxation in bank lending guidelines), or 2) Arbitration payment: Any progress in receiving arbitration payments from Meydan (see our report) might be positive for the stock, as there is the potential for improving gearing substantially by using the proceeds. Other upside risks include: 3) new project awards larger than our estimates; 4) higher-than-expected margins for construction and property development: margins are affected due to cost and labour pressures in Malaysia and the Middle East. However, if these were to reverse, it could pose an upside risk; 5) special dividend on asset disposals or entry of strong strategic partners.

Rating and target price changes

Issuer	Ticker	Old stock rating	New stock rating	Old target price	New target price
Gamuda	GAM MK	Reduce	Neutral	MYR 4.10	MYR 5.20
IJM Corp	IJM MK	Buy	Neutral	MYR 4.05	MYR 3.70
Sunway Construction Group Bhd	SCGB MK	Neutral	Buy	MYR 1.60	MYR 2.00

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