CLSA

Malaysia Infrastructure

Sector outlook

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Malaysia

Infrastructure

SunCon	SCGB MK
Rec	BUY
Market cap	US$0.5bn
3M ADV	US$0.2m
Price	RM1.63
Target	RM1.92
Up/downside	+17.8%

IJM	IJM MK
Rec	O-PF
Market cap	US$1.3bn
3M ADV	US$0.6m
Price	RM1.59
Target	RM1.83
Up/downside	+15.1%

Gamuda	GAM MK
Rec	O-PF
Market cap	US$2.3bn
3M ADV	US$6.3m
Price	RM3.90
Target	RM3.95
Up/downside	+1.3%

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Gone full circle

Funding mode on MRT3 said to be reverting, per news from Edge

Citing sources, The Edge Weekly (20 Feb – 26 Feb print edition) in its article, *Government to Fund MRT3, Hybrid Financing Model Scrapped*, wrote the MRT3 is reverting full-circle to a government-funded model from hybrid funding. We await more clarity on this during the budget 2023 re-tabling this week. A move to government funding may be a slight loss in edge for contractors with deep balance sheets. The article also says the government is looking to reduce costs. We do not expect significant cost changes given alignment and design has undergone past optimisations.

Reportedly returning to a government-funded model

- **What changed?** Under the MRT3 main civil packages, hybrid funding is built into current tenders, ie. the main contractors are prepared to agree to two-year deferred payment. The Edge cites the government is moving away from this model and reverting to bonds via Danainfra Nasional SPV. As MRT3 was mentioned in previous Budget 2023 tabling, we hope for more clarity in the updates in the re-tabling this week (24 February).
- **We see a hybrid model a more suitable for the current climate.** Absent strong revenue levers (as the government said it would not introduce a consumption tax), this leaves the option of containing debt—this argues for a hybrid funding MRT3 model. The benefit would be to delay saddling an estimated RM3.3bn (in the first year) of the RM1.5tn load of debt (and liabilities), though we recognise there would be interest savings in the 1ppt difference between the government borrowing cost and by AA3-rated firms such as IJM and Gamuda.

Revisiting costs as well, though we do not expecting significant changes

- **Figures unconfirmed, but appear credible.** The article also divulged bidder names such as Gamuda, IJM and SunCon, as well non-rated companies, Malaysia Resources Corp Bhd (MRCB), YTL Corp and TRC Synergy, which we understand are keen on MRT3. While the Edge revealed the value of bids (Figure 5), firms unsurprisingly are largely unable to confirm commercial sensitivity. Based on alignment, and on an aggregate basis, the submitted bids reported by the paper are relatively close to our estimates (see Fig.6), going by MRT2 rates.
- **Not expecting significant changes but alignment tweaks.** We do not expect significant construction cost cuts as we believe the project has earlier undergone optimisation. On 7 Feb, the *Edge reported* that the MRT3 Corp will carry out a detailed and comprehensive study of alignment to reduce the social impact and land acquisition costs of RM8bn, or 17% of costs (excluding financing). Significant changes to alignment are not expected as the circle line has been planned to integrate and improve ridership for the earlier two lines, which will improve operational viability and are positive for the government in preventing ballooning debt. Operator Prasarana (for MRT1) showed an operating loss of RM2.0bn in 2021.
- Specifically, the article mentions reducing project management costs. In this area, firms such as HSS Engineers (N-R) has been made project management consultant (PMC) for a value of close to RM1bn. We think the government may be inclined to honour awarded contracts, unless the scope changes tied into the KPIs of PMC are significant.

Implications

- **Retender not seen.** Retender is not our base case as we do not assume material construction changes and we understand contractors submitted construction and financing solutions separately. However, on the potential alignment study, this could impact earnings assumptions if awards are delayed beyond mid-2023. Public display and land acquisitions are also needed before work starts.
- **Impact.** Changing the alignment may bring about some uncertainty over the aboveground/ underground mix (see map in Figure 2) which remains to be seen. Reverting to a government funded model appears a lesser concern. Some gloss would be taken away from firms perceived to have an advantage with strong balance sheets (Gamuda and IJM), though our view is unchanged. To this end, The Edge pointed out that MRT Corp will decide on the "*best evaluated tender*" and not necessarily the lowest price.
- We remain neutral on sector and our top pick remains laggard SunCon.

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Gone full circle

We examine some of the implications of the claims made in the The Edge Weekly article *Government to Fund MRT3, Hybrid Financing Model Scrapped*, who citing sources, shared information on the MRT3 roll-out as follows:

- Reverting to debt issuances by DanaInfra Nasional Bhd, instead of "hybrid financing" where the main contractors and system works contractors would have to fund the project for the first 2 years.
- The government will continue with the MRT3, but is looking ways to slash the cost. The article points out that the project management cost estimated at RM9bn will be slashed.

Expect more clarity when Budget is being re-tabled

We expect more clarity by the time of the Budget 2023 being re-tabled on 24 February, which may reduce one overhang. However, recently, MRT Corp has said it is also conducting a detailed and comprehensive study of the MRT Circle line. While MRT3 will press ahead, the risks seen primarily in timing.

Government was earlier open to funding the project but MRT Corp was pushing a hybrid financing model

To recap, as early as March 2022, there was already commitment by the then government that it was ready to commit RM50 bn over 8 years. Datuk Zarif, CEO of MRT Corp at the time was of the view that notwithstanding the government's commitment, MRT Corp would look to pursue a hybrid financing model. The hybrid financing model has flexibility that it could help plug a "shortfall" from the value the government would have been comfortable to fund.

Figure 1

Recent timeline of events for MRT3 (over the past 12 months)

March 2022	CEO of MRT Corp explains hybrid financing model will be adopted although the government stands ready on a RM50 bn commitment over 8 years
March 2022	Then Transport Minister Wee Ka Siong had said project will be opened for tender in May with awards in 4Q22, ie a 7 month process. It also revealed that the circle line will involve 5 packages - 3 packages for civil works, a systems works and a project management consultancy
April 2022	MRT Corp inviting prospective firms to participate in request for proposal for MRT3 circle line project consultancy services Work Package
August 2022	MRT Corp extended technical submission for CMC302 and CMC303 from 2 August to 30 September, while maintaining that for CMC301
Oct 2022	Government committed to MRT3 via the budget, and identifying that the budget for 2023 would amount to RM3.3 bn, with phase 1 completed by 2028 and phase 2 by 2030
Feb 2023	The Edge reports reverting to funding via Danainfra Nasional Berhad

Source: CLSA, news

We view the hybrid financing model to be suitable at this time

On policy choices by the finance minister, debt management would take center-stage

We see the hybrid financing model being more flexible for the government, as this will avoid adverse effects to national accounts for the initial 2 years. Our view considers the fact that Prime Minister Anwar who is also the Finance Minister has said that it won't reintroduce the Goods and Services Tax (*news*), and absent strong revenue levers, the area that country can best manage is the debt load. Thus we are less enamoured on putting the funding back to government's books for now.

Will look to reduce debt without affecting its development programme

In the previous Budget 2023 tabling (7 Oct 2022) by Tengku Zafrul, the then finance minister, it was unveiled that based on the medium term fiscal framework, that the Malaysia's deficit level from 2023 to 2025 was projected to reduce to an average of 4.4% of GDP, and a medium term target of 3.5%. Echoing such direction, Anwar

We do not think that the interest cost savings on the construction element will be substantial in the large scheme of things over the first two years

has recently stated that the government is looking to reduce its debts without affecting its development programme (*news*).

The amount to have been spent in 2023 alone was RM3.3 bn, per Tengku Zafrul, when initially unveiling the Budget 2023 (7 Oct 2022), this would be c0.3% of federal government borrowings. Assuming 2 years at this RM3.3 bn run rate, the interest differential between government or private funding is not large – cRM100 mn, calculated on a 1ppt difference in 3-year funding cost spread between Malaysian Government Securities and AA3-rated firms (such as Gamuda and IJM).

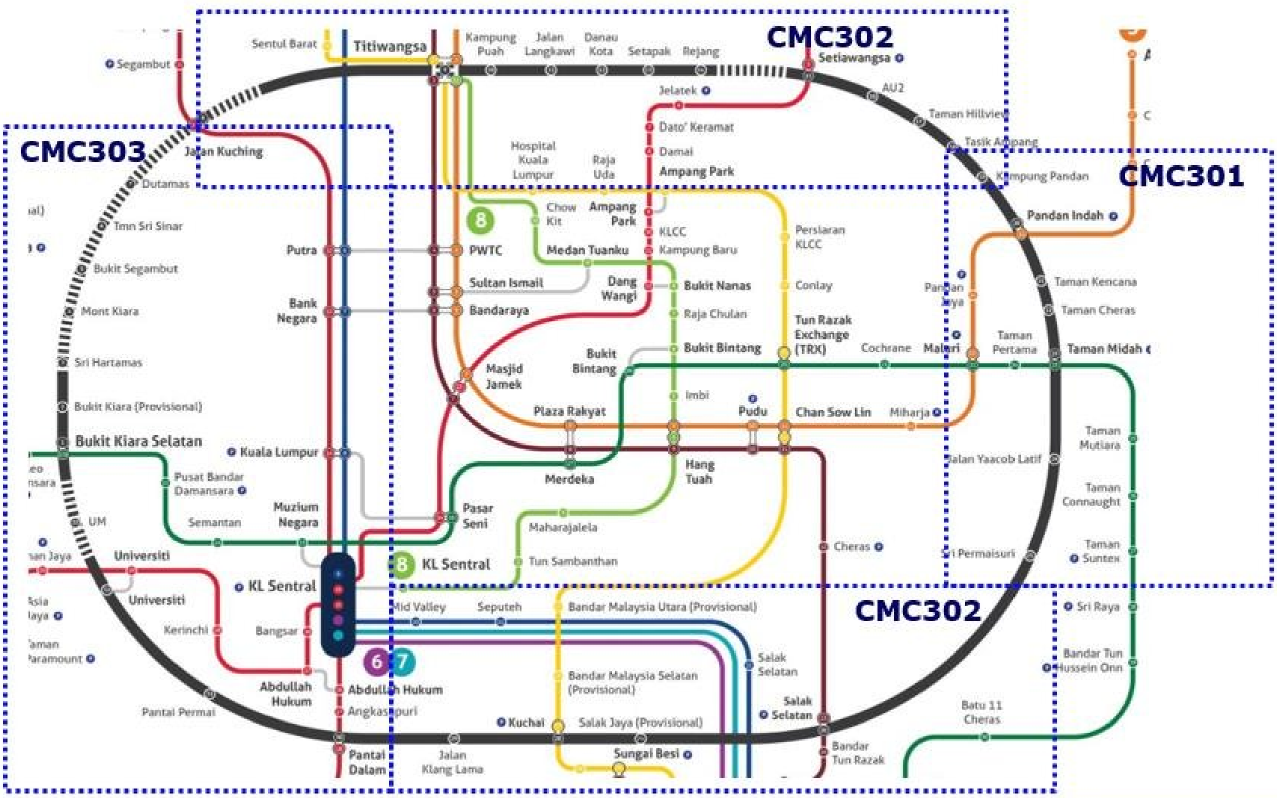
Not entirely surprising that the cost wil be reviewed following news that MRT Corp is conducting a detailed and comprehensive study

Relooking costs, including alignment and project management costs

The news that the government is revisiting costs, especially in project management, is not entirely surprising. This is because the Edge has about two weeks back *reported* that the MRT Corp is conducting a detailed and comprehensive study of the MRT Circle line's alignment. This is with the intention of minimizing the social impact of the project on the public especially land acquisition. The Edge reported that landowner and homeowners given notice by Land Department on possible acquisition had been in the dark. In the past, there have also been social media questions on whether the alignment served the "affluent areas".

Figure 2

MRT3 map cropped out from MRT Corp website. We have also superimposed our best guess of the three civil packages



CMC301: 6 km track with a depot
CMC302: 1.2 km of underground, and 27 km of elevated, with depot
CMC303: 10 km of underground, and 6 km of elevated

Source: MRT Corp, CLSA. According to MRT Corp, the CMC301 is for the design, construction and completion of viaduct guideway, elevated stations, depot and associated works from Pandan to Jalan Cheras. Meanwhile, that for CMC302 is for the section of Jalan Cheras to Pantai Dalam, and Jalan Kuching to Pandan. The alignment for CMC303 is from Pantai Dalam to Jalan Kuching.

Do not foresee significant changes to alignment

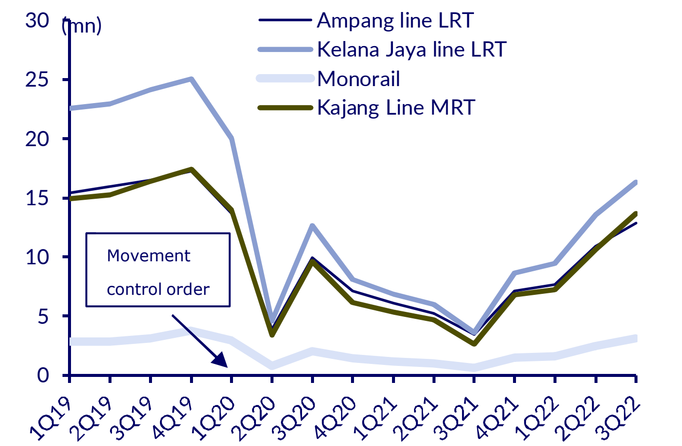
An alignment for MRT3 has been shared by MRT Corp (*link*), where we have cropped and highlighted our best estimation of where the 3 civil packages are. We think there won't be significant changes over the 50.8 kilometre alignment, including 10 interchanges, as MRT3 has undergone design optimisation, and a compromise in construction cost (RM34bn, Figure 3) at the expense of connectivity is unlikely. Where we think there could be some tweaks may be between the options for underground or elevated routes.

Lowering operational drain would be

The government expects that the MRT2 or Putrajaya line will attain 200,000 users in 2 years, and to also improve ridership in Line 1. Under line 1, the traffic in 3Q22 has only recovered to 86% of the quarterly average for 2019. Overall, we think that stronger connectivity between the various transport modes would be important to lower an operational drain. For example, Prasarana Malaysia Berhad, ie owner and operator of the light rail transit and operator for MRT, showed post-tax losses of RM3.4bn in 2021 (RM4.5bn in 2020). Loss from operations were RM2 bn.

Figure 3

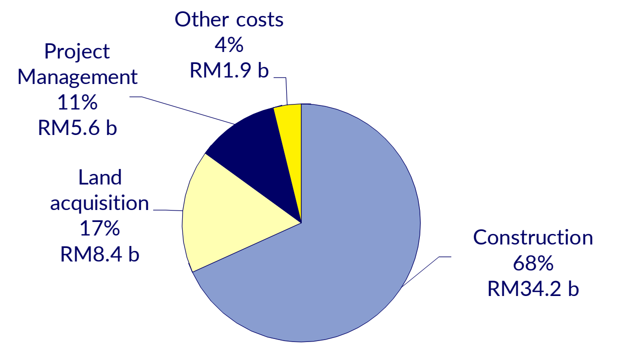
Usage of major urban rail transportation in Malaysia (quarterly passengers)



Source: CLSA, Ministry of Transport Malaysia

Figure 4

Breakdown of MRT3 cost according to Tengku Zafrul (August 2022)



Source: CLSA, Government of Malaysia

Some projects have already been awarded

The *Government to Fund MRT3, Hybrid Financing Model Scrapped* article pointed out that there is intention to slash costs on project management. Some awards have been underway here, including the award to a HSS Engineers joint venture as the project management consultant (PMC), for RM997.9m. The consortium beat out four others in a tender. To recap, the PMC has its own KPIs, and the challenges here are in integrating three civil work package contractors and 1 system work package to integrate. We believe that the government could be inclined to honour awarded contracts, unless scope and KPIs change significantly.

On an aggregate basis, the ranges provided by the companies for the three civil packages track close to our estimates

Figures unconfirmed, but appears credible on an aggregate basis

The Edge *Government to Fund MRT3, Hybrid Financing Model Scrapped* article also shared some details on bid values, as per Figure 3 below. Based on our channel checks, companies by and large cannot comment on sums tendered are as the values quoted in the article from the Edge—this is understandable given a competitive tender.

Figure 5

Details of bids by contractor as reported by the Edge

Package	Description of package	As reported by the Edge
CMC301	6km track with a depot	Lowest bid of RM2.9 bn by MRCB; and that TRC submitted a bid of RM3.1 bn
CMC302	1.2 km of underground, and 27 km of elevated structures	That YTL submitted a bid for RM10.8 bn and IJM the second lowest at RM11.8 bn. MRCB and SunCon have been named as well although the article did not divulge details
CMC303	10 km of underground works with stations, and 6 km of elevated sections	That IJM submitted a bid of RM13.8 bn and that MMC-Gamuda submitted theirs at RM13.3 bn. The article also points out that IJM is partnering China Railway Group Ltd

Source: CLSA, The Edge (*Government to Fund MRT3, Hybrid Financing Model Scrapped).*

On an aggregate basis, the ranges provided by the companies for the three civil packages track close to our estimates

Just based on the range of values quoted above for the CMC301, CMC302 and CMC303, we believe that in aggregate the range provided is quite similar to CLSA's estimation which is based on MRT2 costing for construction cost (Figure 5). We understand these values are for construction, as the companies submit a separate the value for construction and financing.

Figure 6

Estimations of construction contract value versus value quoted by the Edge

RM bn	CLSA estimated value based on MRT2 costing	MRT2 costing	Range of value quoted by the Edge
CMC301	2.7	RM350 mn for maintenance depot and RM390 mn per km for elevated	2.9-3.1
CMC302	11.7	RM390 mn per km for elevated and RM970 mn per km for underground	10.8-11.8
CMC303	12.0	RM390 mn per km for elevated and RM970 mn per km for underground	13.3-13.8

Source: CLSA, The Edge (*Government to Fund MRT3, Hybrid Financing Model Scrapped).*

Interest from the named parties across various packages

Having said that, the interest of the above named firms can be confirmed. For companies that we don't cover, we MRCB has submitted bids for CMC01, CMC02, and even CMC03, the latter helped by their expertise including in tunnelling for LRT3. MRCB would also be keen for the systems package, ie for signalling and train control, among others. According to the Edge (*news*), this is a four horse race, where the systems package is currently in pre-qualification stage (extended to 15 Feb this year). Likewise, TRC has also been interested in the MRT3, and has been the winner of the depot construction in the past 2 MRT packages. YTL, while not previously involved in the MRT lines, have also experience for elevated tracks given elevated section in its Gemas-Johor Bahru double tracking construction, in sections entering towns.

In our assumptions

We bake-in expectations for Gamuda and IJM

We already bake-in the expectation that MMC-Gamuda will clinch the CMC303, where it has been laser focused on one package; our estimate is for a smaller RM12bn (versus sum quoted by the Edge). Meanwhile, we also see IJM emerging as potential winner for CMC302, which counts on its strong balance sheet position. As there is not much clarity on its consortium make up and percentage share, we have at this juncture only given benefit in its RM3 bn order book guidance. At this juncture, if SunCon were to be successful in clinching one of the 2 civil packages (reportedly CMC01 and CMC02) as the main contractor, this would be a bonus to our expectations.

Figure 7

Peer comparison

Company	Stock code	Price	Mkt cap	ADT	PB		ROE		Yield	
					CY22	CY23	CY22	CY23	CY22	CY23
		(RM)	(US$m)	(US$m)	(x)	(x)	(%)	(%)	(%)	(%)
Ekovest	EKO MK	1.6	474.2	0.3	2.7	2.5	18.5	19.3	3.8	4.1
Gamuda	GAM MK	3.9	2306.4	6.2	1.0	1.0	7.5	7.5	6.9	8.7*
SunCon	SCGB MK	1.6	474.2	0.3	2.8	2.5	17.4	19.6	3.6	4.0
GDB	GDB MK	0.2	49.7	0.1	1.3	1.2	9.4	6.1	n.a	n.a
Kim Lun	KICB MK	0.8	61.0	0.0	0.4	0.3	3.4	6.2	2.0	3.3
Econpile	ECON MK	0.2	70.4	0.3	0.7	0.7	(0.6)	3.7	0.0	0.0
IJM	IJM MK	1.6	1260.3	0.6	0.5	0.5	3.2	3.3	5.0	3.5
Muhibbah	MUHI MK	0.7	116.5	0.3	0.4	0.4	0.5	1.8	1.8	2.1
Advancecon	ADVC MK	0.3	27.3	0.0	0.5	0.5	0.3	1.1	n.a	n.a
WCT	WCTHG MK	0.5	148.7	0.2	0.2	0.2	1.5	2.2	1.3	1.5
Gadang	GADG MK	0.3	52.6	0.1	n.a	n.a	3.9	4.8	1.7	0.6
Kerjaya Prospek	KPG MK	1.2	350.0	0.1	1.3	1.2	10.6	12.2	3.7	3.7
AQRS	AQRS MK Equity	0.3	39.2	0.2	0.3	0.3	7.3	8.8	3.1	2.8

Source: CLSA *High yield due to special dividends

Valuation details - Gamuda Bhd GAM MK

We value Gamuda's construction division based on 13.5x sustainable earnings and apply 12x sustainable earnings for its local property project, with a 40% discount. We use DCF to value expressway and water supply operations and maintenance concessions. Our target price for Gamuda is based on an estimated fully diluted RNAV/share.

Investment risks - Gamuda Bhd GAM MK

Execution risk on construction projects could lead to cost overruns while a slowdown of the Vietnam economy could dampen demand for property launches in Hanoi and Ho Chi Minh City. We are concerned about EPS dilution from a potential increase in the employee share option scheme and warrants; we include these concerns in our valuation. Given its job concentration in large projects, Gamuda is exposed to policy risk. The ability to replenish jobs before the MRT2 civil works are complete is also a concern. A prolonged Covid-19 outbreak could reduce work efficiency.

Valuation details - IJM Corp Bhd IJM MK

Our valuation reflects PE-based valuations for IJM's construction and industrial divisions and an RNAV-based valuation for its property segment, with an 8.8% WACC and DCF for its concessionaire stakes as well as a discount of 20%.

Investment risks - IJM Corp Bhd IJM MK

With a near-record-high order book, the key risk is execution of projects to ensure profitability and completion according to schedule. Slower property demand due to weaker consumer sentiment has affected IJM's property sales, and the risks are a sustained slowdown or further margin pressure. Rising labour costs could put pressure on construction profit margins. Regulatory risks related to toll-road and port concessions are not uncommon. Prolonged Covid-19 could also hinder operating efficiency.

Valuation details - Sunway Construction Group Bhd SCGB MK

Our target price is derived from 14.0x 24CL earnings, one standard deviation above the 10-year mean PE for the KL Construction index. We accord an above-sector average PE, given the company's flow of internal jobs and strong balance sheet.

Investment risks - Sunway Construction Group Bhd SCGB MK

The main concern is construction risk. Specific risks include lower-than-expected margins (below 5-8%) or if the amount of projects secured falls below our expectation, either due to an inability to secure projects or project rollout delays. Higher-than-expected steel price increases could cut into margins as SunCon hedges steel needs for a future six-month period. On the precast segment, another risk is margin recovery timing, currently in the doldrums due to competition. Prolonged Covid-19 could also reduce operating efficiency.

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Companies mentioned

Advancecon (N-R)
AQRS (AQRS MK - RM0.32 - O-PF)
Danainfra Nasional (N-R)
Danainfra Nasional Berhad (N-R)
Econpile (N-R)
Ekovest (N-R)
Gadang (N-R)
Gamuda (GAM MK - RM3.90 - O-PF)
GDB MK (N-R)
HSS (N-R)
IJM (IJM MK - RM1.59 - O-PF)
Kerjaya Propspek (N-R)
Kim Lun (N-R)
MRCB (N-R)
MRT Corp (N-R)
Muhibbah (N-R)
Prasarana Malaysia Berhad (N-R)
SunCon (SCGB MK - RM1.63 - BUY)
TRC Synergy (N-R)
WTC MK (N-R)
YTL (N-R)

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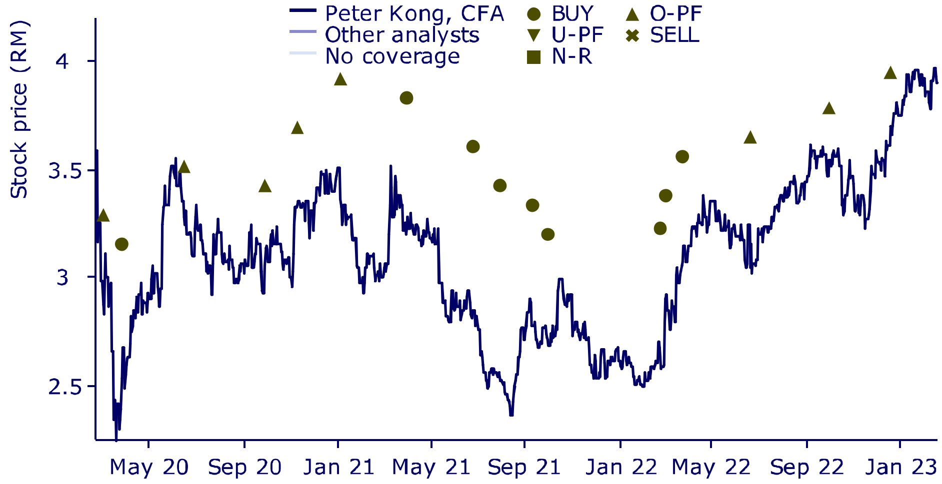
Important disclosures

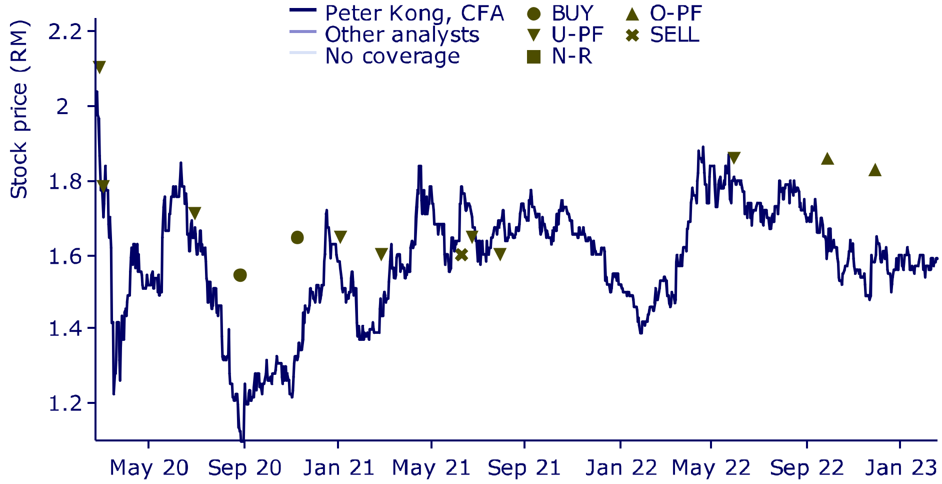
Recommendation history of Gamuda Bhd GAM MK



Date	Rec	Target	Date	Rec	Target
19 Dec 2022	O-PF	3.95	25 Jun 2021	BUY	3.61*
30 Sep 2022	O-PF	3.79*	31 Mar 2021	BUY	3.83*
20 Jun 2022	O-PF	3.65*	04 Jan 2021	O-PF	3.92*
24 Mar 2022	BUY	3.56*	09 Nov 2020	O-PF	3.70*
02 Mar 2022	BUY	3.38*	28 Sep 2020	O-PF	3.42*
23 Feb 2022	BUY	3.23*	15 Jun 2020	O-PF	3.52*
30 Sep 2021	BUY	3.20*	26 Mar 2020	BUY	3.15*
10 Sep 2021	BUY	3.33*	02 Mar 2020	O-PF	3.29*
30 Jul 2021	BUY	3.42*			

Source: CLSA; * Adjusted for corporate action

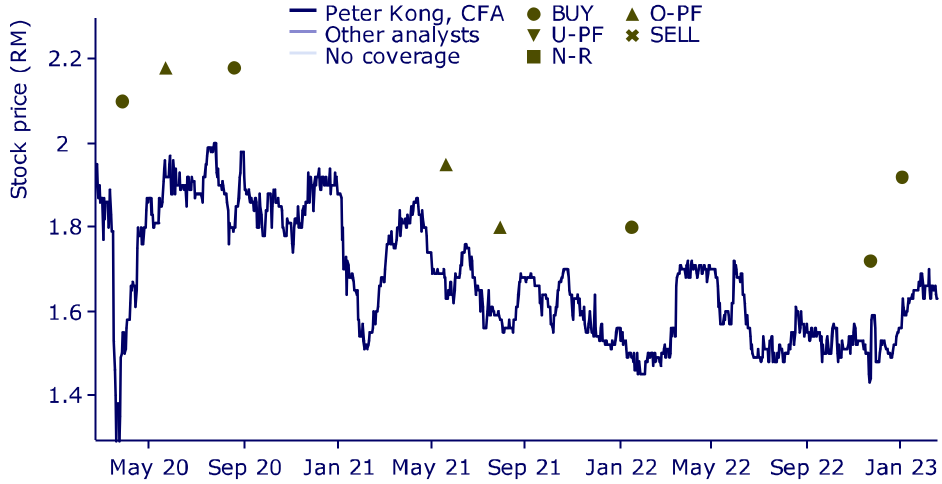
Recommendation history of IJM Corp Bhd IJM MK



Date	Rec	Target	Date	Rec	Target
29 Nov 2022	O-PF	1.83	04 Jan 2021	U-PF	1.65*
28 Sep 2022	O-PF	1.86	09 Nov 2020	BUY	1.65*
30 May 2022	U-PF	1.86	27 Aug 2020	BUY	1.55*
30 Jul 2021	U-PF	1.60*	29 Jun 2020	U-PF	1.71*
24 Jun 2021	U-PF	1.65*	02 Mar 2020	U-PF	1.78*
10 Jun 2021	SELL	1.60*	26 Feb 2020	U-PF	2.10*
26 Feb 2021	U-PF	1.60*			

Source: CLSA; * Adjusted for corporate action

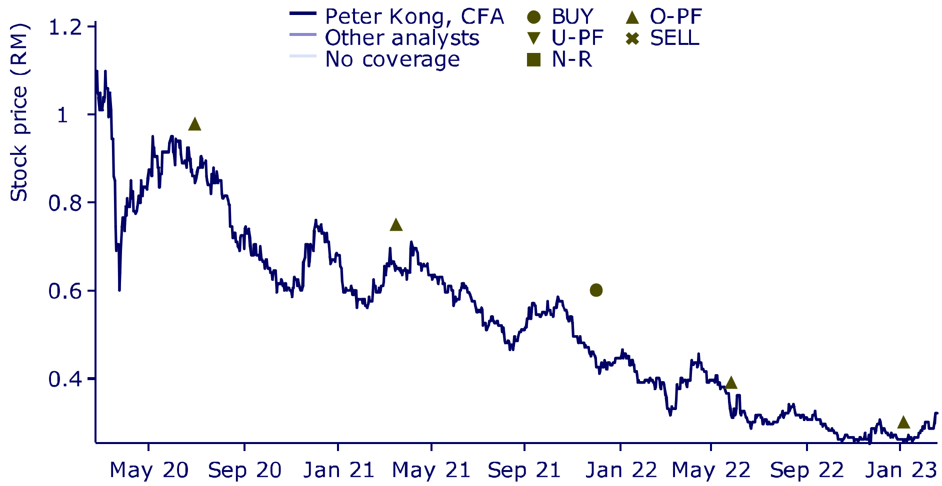
Recommendation history of Sunway Construction Group Bhd SCGB MK



Date	Rec	Target	Date	Rec	Target
03 Jan 2023	BUY	1.92	21 May 2021	O-PF	1.95
23 Nov 2022	BUY	1.72	19 Aug 2020	BUY	2.18
17 Jan 2022	BUY	1.80	22 May 2020	O-PF	2.18
30 Jul 2021	O-PF	1.80	27 Mar 2020	BUY	2.10

Source: CLSA

Recommendation history of Gabungan AQRS Berhad AQRS MK



Date	Rec	Target	Date	Rec	Target
05 Jan 2023	O-PF	0.30	17 Mar 2021	O-PF	0.75
26 May 2022	O-PF	0.39	29 Jun 2020	O-PF	0.98
02 Dec 2021	BUY	0.60			

Source: CLSA

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Overall rating distribution for CLSA (exclude CLST) only Universe: Overall rating distribution: BUY / Outperform - CLSA: 75.00%, Underperform / SELL - CLSA: 25.00%, Restricted - CLSA: 0.08%; Data as of 1 Jan 2023. Investment banking clients as a % of rating category: BUY / Outperform - CLSA: 21.92%, Underperform / SELL - CLSA: 5.08%; Restricted - CLSA: 0.08%. Data for 12-month period ending 1 Jan 2023.

Overall rating distribution for CLST only Universe: Overall rating distribution: BUY / Outperform - CLST: 59.65%, Underperform / SELL - CLST: 40.35%, Restricted - CLST: 0.00%. Data as of 1 Jan 2023. Investment banking clients as a % of rating category: BUY / Outperform - CLST: 0.00%, Underperform / SELL - CLST: 0.00%, Restricted - CLST: 0.00%. Data for 12-month period ending 1 Jan 2023.

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