



AmInvestment Bank

Sector report  
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# CONSTRUCTION

*Pipeline, or just a pipe dream?*

**UNDERWEIGHT**

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(Maintained)

*Rationale for report: Sector update*

## Investment Highlights

- We maintain our **UNDERWEIGHT** recommendation for the construction sector. The trading sentiment on construction stocks has improved following the recent revival of East Coast Rail Link (ECRL) (at a reduced cost of RM44bil) and Bandar Malaysia (with an estimated GDV of RM140bil). However, we believe the market could have read too much into these, or could be ahead of itself as to what the construction sector can offer, if it assumes that these are tell-tale signs for the revival of more mega projects.

### Exhibit 1: Construction “Pipeline”

Project	Est. Value (RMbil)	Status
1 Klang Valley Double Track (Phase 2)	4-4.5	"Some processes to follow" before Government can call for tender
2 Johor Bahru-Singapore Rapid Transit System (JB-Singapore RTS)	4/5.3*	Suspended for another six months from Apr 2019
3 Pan Borneo Highway Sabah	12.8	60:20:20 JV of Warisan Tarang, MMC and UEM terminated as project delivery partner, completion reported at 12.4%
4 MRT3	45	Put on hold
5 Penang Transport Master Plan (PTMP)	46	Funding still not in place
6 Central Spine Road	10.7	16% completed, 16% under construction, 22% under procurement and 46% under planning
7 Coastal Road, Second Trunk Road and 11 bridges in Sarawak	11	Two bridges awarded: CMS consortium (RM467mil), HSL (RM299mil)
8 KL-Singapore High-Speed Rail (KL-Singapore HSR)	110	Deferred to May 2020, government to appoint technical advisory consultant (TAC) to review the technical aspects and cost reduction options

*\*Alternative alignment that "could better preserve Johor Bahru's skyline"*

*Source: AmInvestment Bank, various news reports*

- We are taking a look at the “pipeline” of the construction sector (Exhibit 1). We believe the projects can be placed under four broad categories as follows:
  - To proceed:** We believe **Klang Valley Double Track (Phase 2)** stands a very good chance of hitting the ground soon given a relatively affordable estimated price tag of RM4.0-4.5bil (vs. RM5.3bil previously awarded to Dhaya Maju LTAT but subsequently cancelled). After all, this is the single largest infrastructure project the Government has committed itself to carry out in the Budget 2019 announced in Nov 2018.
  - To proceed, but gradually:** We believe these will include **Central Spine Road, Pan Borneo Highway Sabah and various state-funded infrastructure projects in Sarawak**. Physical works at Central Spine Road and Pan Borneo Highway Sabah have actually started with completion reported at 16% and 12.4% respectively. We believe the government will not “rush” these projects but regard them as long-term infrastructure projects that will be funded with development expenditure annually. While Sarawak state government seems to be in a hurry to implement the Coastal Road, Second Trunk Road and 11 bridges in Sarawak, we believe the execution will take time given the lengthy planning, design and procurement processes.

3. **Facing various hurdles:** We believe these are **PTMP** and **JB-Singapore RTS**. While PTMP appears viable from a P&L standpoint, i.e. the three man-made islands under the Penang South Reclamation could be sold for RM70bil, more than enough to fund RM46bil reclamation cost and public infrastructure spending under PTMP, its implementation will be very challenging from a cashflow angle. PTMP will incur tremendous upfront cashflow to fund reclamation and the construction of public infrastructure, only to be recouped many years down the road via land sales from the three man-made islands. We believe this could only be possible with substantial soft loans either from the Federal Government or international development banks. On the other hand, while JB-Singapore RTS does not carry an exorbitant price tag, we see hurdles in more guarded Malaysia-Singapore relations post the 14<sup>th</sup> General Election.
4. **Out of reach:** Even if the costs of KL-Singapore HSR and MRT3 are to be cut by half from RM110bil and RM45bil to RM55bil and RM22.5bil respectively, we believe they are still beyond reach given the high national debt at present. We believe the government has little room for more debt service obligations following the revival of the RM44bil ECRL project coupled with its commitments towards the massive debt restructuring of two government agencies.
- We maintain our view that the market's recent reversion to high valuations for construction stocks as being unjustified and unsustainable. We acknowledge that the revival of the ECRL and Bandar Malaysia projects and the local participation requirements that come with the projects shall result in more jobs available in the market for local construction players.
  - However, in the heat of the euphoria, we believe the market has not priced in enough risk premium to reflect:
    1. The fact that unlike the previous ones (such as MRT1, MRT2, LRT3 and Pan Borneo Highway), the latest mega projects are driven by world-class Chinese contractors (and Chinese funding) which probably leaves the local contractors with only low-value/low-margin supporting roles in the projects (in order for the Chinese contractors to fulfill the local participation requirements); and
    2. The fact that given the still elevated national debt, the government has no choice but to remain steadfastly committed to fiscal prudence which means the revival of the ECRL project could be a "zero-sum game" as it impedes the government's ability to implement other public infrastructure projects.

#### EXHIBIT 2: VALUATION MATRIX

	Recomm.	Price	FV	Upside	Mkt Cap	FYE	EPS (sen)		EPS growth (%)		P/E (x)		P/B*	ROE*	NDPS*	Div Yield*
		(RM)	(RM)	(%)	(RMmil)		FY19F	FY20F	FY19F	FY20F	FY19F	FY20F	(x)	(%)	(sen)	(%)
Gamuda	UNDERWEIGHT	3.32	2.23	-32.8	8,065.7	Jul	21.5	23.4	-35.4	8.8	15.4	14.2	1.0	7.1	12.0	3.6
IJM Corp#	UNDERWEIGHT	2.16	1.18	-45.4	7,831.5	Mar	11.8	11.7	7.3	-0.8	18.3	18.5	0.8	4.2	6.0	2.8
SunCon	UNDERWEIGHT	2.04	1.11	-45.6	2,637.5	Dec	11.1	11.6	-0.9	4.5	18.4	17.6	4.3	23.7	7.0	3.4
Econpile	UNDERWEIGHT	0.69	0.22	-68.1	922.9	Jun	2.2	4.5	-62.7	104.5	31.4	15.3	2.4	5.7	1.6	2.3
HSL	UNDERWEIGHT	1.47	1.07	-27.2	856.6	Dec	11.1	11.9	20.7	7.2	13.2	12.4	1.0	8.0	2.4	1.6
Kimlun	UNDERWEIGHT	1.39	1.14	-18.0	445.6	Dec	14.2	14.2	-15.0	0.0	9.8	9.8	0.6	7.5	3.7	2.7
<b>Simple Average</b>									<b>-14.3</b>	<b>20.7</b>	<b>17.8</b>	<b>14.6</b>	<b>1.7</b>			
<b>Weighted Average</b>									<b>-13.4</b>	<b>8.6</b>	<b>17.4</b>	<b>16.1</b>	<b>1.4</b>			
*FY19	#FY19F and FY20F refer to FY20F and FY21F															

Source: AmInvestment Bank

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