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20 April 2020 Malaysia

EQUITIES

# Malaysia Construction
## The cure is worse than the disease

### Key points

- We revised the sector EPS by -26% and -18%, respectively, in reflecting the impact of Covid-19 to the construction sector.
- We expect a stimulus package aimed at the construction sector to be announced next with the revival of MRT3, PBH Sabah and HSR projects.
- Top picks in Malaysia Construction are Gamuda, SunCon and Econpile.

**Malaysia Construction coverage summary**

| Ticker | Rating | Mkt. Cap (USm) | Px (RM) | TP (RM) | TSR (%) | 3yr EPS growth |
|---|---|---|---|---|---|---|
| AQRS MK | OP | 99 | 0.82 | 1.20 | 49% | 16% |
| ECON MK | OP | 171 | 0.52 | 0.75 | 46% | -3% |
| GAM MK | N | 1,997 | 3.24 | 3.50 | 9% | 1% |
| HSS MK | OP | 54 | 0.44 | 0.60 | 38% | 134% |
| IJM MK | N | 1,419 | 1.75 | 1.60 | -8% | -15% |
| KPG MK | OP | 326 | 1.07 | 1.40 | 34% | 5% |
| MRC MK | OP | 546 | 0.51 | 0.50 | 3% | 60% |
| SCGB MK | N | 564 | 1.78 | 2.00 | 15% | 6% |
| **Market Cap Wtd. Average** | | | | | **8.3%** | **5.0%** |

Note: Share prices as at 17 April 2020 close

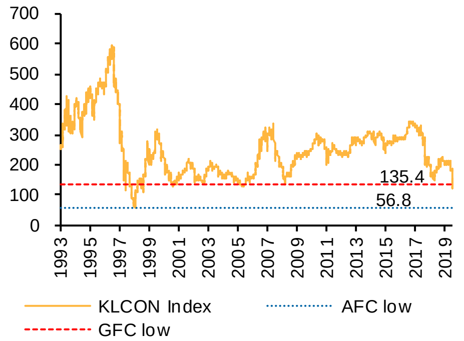
Source: Bloomberg, Macquarie Research, April 2020

**Malaysia Construction EPS revision**

| Company | FY20E | FY21E |
|---|---|---|
| AQRS MK | -25% | -34% |
| ECON MK | -55% | -19% |
| GAM MK | -11% | 0% |
| HSS MK | -46% | -32% |
| IJM MK | -30% | -30% |
| KPG MK | -16% | -15% |
| MRC MK | -65% | -65% |
| SCGB MK | -28% | -3% |
| **Mkt Cap Wtd EPS revision** | **-26%** | **-18%** |
| **Mkt. Cap Wtd PER (CP)** | **17.5x** | **16.3x** |
| **Mkt Cap WTD PER (TP)** | **19.8x** | **17.0x** |

Source: Bloomberg, Macquarie Research, April 2020

**KLCON Index recently tested the GFC levels**




Source: Bloomberg, Macquarie Research, April 2020

Inside



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### Is the cure worse than the disease?

The sector took a massive beating, -25% YTD (underperforming KLCI by -12%), after the start of Covid-19 pandemic. Further, virus containment measures taken by the government such as the movement control order (MCO) brought all construction activities to a grinding halt. While there are potential exemptions to the MCO for the construction sector, we believe the sector is not able to operate in full capacity until the government lifts the MCO on the sector and its entire supply chain – until then volatility shall remain. We revised the sector's FY20-21E EPS by -26% and -18% respectively to reflect the impact of Covid-19 pandemic. We upgrade the Malaysia Construction sector rating to Overweight with top picks being Gamuda, Sunway Construction and Econpile, in order of preference.

### Construction focused stimulus package may be on the cards

Government has announced over RM260bn in stimulus packages since the start of Covid-19 pandemic. We understand that once the situation is contained, government will likely announce a stimulus package aimed at achieving the highest multiplier effect in its bid to jump-start the economy – rollouts of infrastructure projects. Since the fall of Barisan Nasional government in 2018, key projects such as MRT3, KL-Singapore High Speed Rail (HSR) and Pan Borneo Highway (PBH) Sabah have been stalled with little indication that they will resume. The projects above carry a combined project value of at least RM100bn – thus rolling out these projects could spur a strong sector rerating.

### Do it the Petronas way; opportune time to raise pump-priming debt

We believe now could be the opportune time for the government of Malaysia (GoM) to raise funds for future infrastructure projects. After seeing Petronas opportunistically tapping on the low interest rate environment by issuing a series of long-term bonds totalling USD6bn, we believe the government owned infrastructure financing company – DanaInfra Nasional Berhad should also follow suit, raising funds for MRT3 and PBH Sabah projects. Note that HSR was previously under a build-operate-transfer (BOT) model and ECRL has its own funding program between GoM and EXIM Bank of China.

### Granted stocks are cheap, but when to buy?

Buy now. Our top picks Gamuda, SunCon and Econpile are all trading at around 11-13x fwd-PE, deep discounts to their 5-yr peak at 17-21x. We believe, once any indication of stimulus or infra bond issuance anecdotes begin to make headlines, the sector would have rerated fast, by then. In order to eliminate the "fear of missing out" panic buying, collecting the construction names now could be the right timing given– 1) the flattening of the Covid-19 curve; and 2) the reduction of red zone districts in Malaysia. The strongest leading indicator of all that has yet to happen would be lifting of MCO on building material sector.

**Please refer to page 16 for important disclosures and analyst certification, or on our website www.macquarie.com/research/disclosures.**

# The cure is worse than the disease

### We cut FY20-21E earnings by -26% and -18%, respectively to reflect the Covid-19 impact on the sector

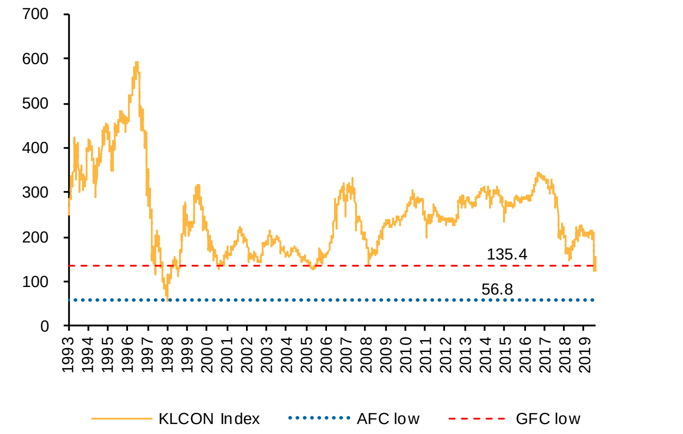
Due to the Covid-19 pandemic, we revised all the earnings estimates under our Malaysia Construction coverage which had resulted in earnings revision of -26% and -18% (refer Fig 17) in FY20-21E, respectively. The revised estimates imply a 17.5x and 16.3x PE to FY20-21E EPS (market cap weighted) respectively, backed by an average 5.0% 3-yr EPS CAGR. We upgrade the sector to Overweight from Neutral previously – our top picks in Malaysia Construction are Gamuda, Econpile and Sunway Construction (SunCon), in order of preference.

### Valuation is cheap, sector has bottomed – but how to avoid false starts

Since the start of the Covid-19 pandemic, the Malaysia Construction sector came to a grinding halt with the nationwide MCO starting from 17 March 2020. Recently, government has lifted some of the job scopes under the construction sector granting them the exemption to work during the MCO; but we strongly believe the sector will remain idle until government lifts the MCO on the entire construction supply chain i.e. building material producers, precast plants and machinery rental companies.

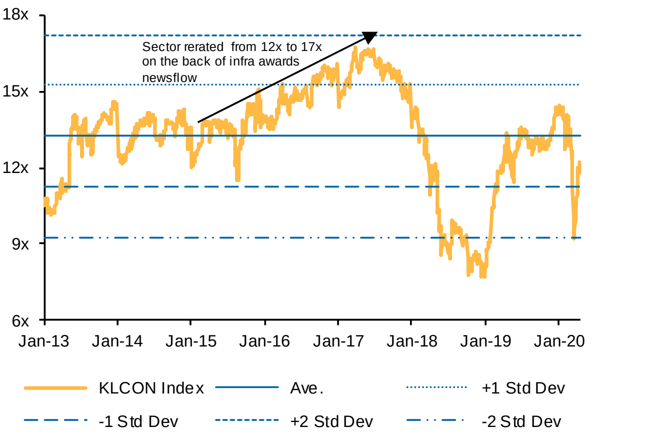
YTD the construction sector has seen a 25% correction (underperforming KLCI Index by -12%) – with the KLCON Index dropped from YTD high of 213 points to 122 points, breaking lower than the GFC period low of 135 points. While the sector has recovered with current levels sitting at c.30% above the YTD low, we believe there will be volatilities over the next two to three months before we can see a meaningful rally. Currently, KLCON Index is trading at 12x fwd-PE and it could potentially rerate to 17x, which was the peak we saw during CY15-17 construction boom.

**Fig 1 KLCON Index has recovered by c.30% from the YTD low after the start of COvid-19 pandemic**




Source: Bloomberg, Macquarie Research, April 2020

**Fig 2 Sector is now trading at 12x fwd-PE; peak during CY15-17 construction boom was at 17x fwd-PE**




Source: Bloomberg, Macquarie Research, April 2020

### What could spur the rally?

Government has announced multiple stimulus package in combating the Covid-19 pandemic. In total more than RM260bn was allocated towards this motion. Given the high multiplier effect of the construction sector, we believe once the pandemic is contained the next stimulus package should be channelled to the construction sector with the awards of MRT3, KL-Singapore High Speed Rail (HSR) and Pan Borneo Highway Sabah (PBH Sabah) projects. We estimate the projects above carry a cumulative project value of at least RM100bn and could bring meaningful impact to the economy for the next four to seven years.

Further, we think now is the opportune time for the government of Malaysia (GoM) to raise funds for future infrastructure projects. After seeing Petronas opportunistically tapping on the low interest rate environment by issuing a series of long-term bonds totalling USD6bn, we believe the government owned infrastructure financing company – DanaInfra Nasional Berhad should also follow suit. Note that the key infrastructure projects above have not had a funding program in place. Note that the East Coast Railway Link (ECRL) project is under a different program between GoM and EXIM Bank of China.

Hypothetically, if talks of DanaInfra issuing bonds/sukuks for future infra projects had started to make headlines, the sector would have rerated by then. In order to catch the rally we believe investors should buy now given: 1) the flattening of the Covid-19 curve; and 2) the reduction of red zone districts in Malaysia. Another leading indicator that has yet to happen would be the lifting of movement control order (MCO) on building material sector.

### Why do we have Gamuda, SunCon and Econpile as our top picks?

- **Gamuda – liquid, multi-geographical earnings source, HSR not in valuation yet**
  - ⇒ Valuation: It is now trading at 13x fwd-PE, still well below the 5-year peak of c.17x.
  - ⇒ Potential upside: our current valuation only factored in MRT3 project. If the HSR project is back and contributes another RM10bn order win to Gamuda, there could be another 38% upside – every RM100mn order win (from base case) increases our valuation by 0.38%.
  - ⇒ Downside risk: Limited downside risk as 100% of Gamuda's current order book consist of government projects which carry limited payment risk. Multiple geographical presence will also minimise earnings risk. Biggest potential EPS downside is if government goes ahead with acquiring Gamuda's toll roads – this will bring significant earnings downside
- **SunCon – limited payment risk, overseas expansion, solid balance sheet**
  - ⇒ Valuation: It is now trading at 17x fwd-PE, still well below the 5-year peak of c.21x.
  - ⇒ Potential upside: had already secured an RM500mn contract for a tollroad project in India and is now looking to expand into other toll road projects and MRT projects there. In talks to secure general hospital civil works projects in Myanmar, given its expertise in building hospitals including the M&E works, SunCon stands a good chance to secure the projects in Myanmar. Order win support from the parent company – Sunway Berhad could amount to RM1bn p.a. in FY20-21E.
  - ⇒ Downside risk: Limited payment risks as 90% of current order book consist of in-house and government projects. With a net cash position of >60%, SunCon could use it for overseas expansions and could sustain its operations during the current downtime.
- **Econpile – risk-reward play, high order win to valuation sensitivity, niche sector leader**
  - ⇒ Valuation: It is now trading at 11x fwd-PE, still well below the 5-year peak of c.20x.
  - ⇒ Potential upside: could secure a casino resort project in Cambodia worth USD200mn. Still holds the largest market share of substructure sector in Malaysia. Potential beneficiary of all future infrastructure projects including MRT3, HSR and ECRL.
  - ⇒ Downside risk: second highest receivables-to-revenue ratio in our coverage, the lowest orderbook-to-revenue cover in our coverage (higher = better), without significant order wins of at least RM600mn p.a. mid-term earnings may be affected as substructure works carry an average project duration of only 15 months.

# Sector valuation

## Looking past PE multiples – Malaysia Construction scorecard

In 2019, we introduced the scorecard for our Malaysia Construction coverage. In the scorecard, the companies are assessed based on 10 criteria and each company is ranked between 1 and 8 for every criterion, with 1 being the best. Based on this scorecard, the perfect score is 10 and the worst possible score is 80. In the CY20 scorecard we replaced 2 criteria from CY19 – earnings diversity and dividend upside with liquidity and orderbook-to-revenue cover as we find these criteria to be more relevant.

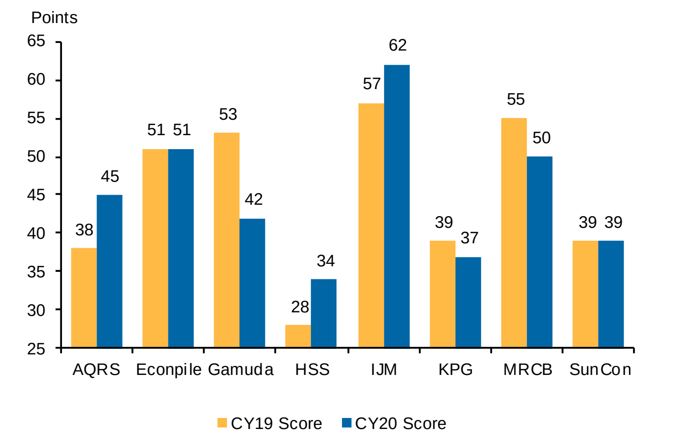
Our top picks – Gamuda, Econpile and SunCon ranked fourth, seventh and third, respectively. While we have an Outperform rating on HSS and KPG – ranked first and second respectively, we note that these stocks are not as liquid as our top picks above.

**Fig 3 Malaysia Construction scorecard (lower = better)**

| Criteria | AQRS | Econpile | Gamuda | HSS | IJM | KPG | MRCB | SunCon |
|---|---|---|---|---|---|---|---|---|
| Earnings growth | 3 | 7 | 6 | 1 | 8 | 5 | 2 | 4 |
| Margins growth | 6 | 3 | 4 | 1 | 8 | 5 | 2 | 7 |
| ROE | 4 | 2 | 5 | 6 | 7 | 3 | 8 | 1 |
| Orderbook-to-revenue cover | 5 | 8 | 2 | 3 | 7 | 4 | 1 | 6 |
| Lowest risks on receivables | 4 | 8 | 5 | 1 | 3 | 2 | 7 | 6 |
| Least potential to gear up | 4 | 7 | 5 | 2 | 6 | 1 | 8 | 3 |
| Net debt-to-EBITDA | 5 | 3 | 6 | 4 | 7 | 2 | 8 | 1 |
| Dividend yield | 5 | 7 | 2 | 8 | 6 | 3 | 4 | 1 |
| Liquidity | 6 | 4 | 1 | 7 | 3 | 8 | 2 | 5 |
| Order win to valuation sensitivity | 3 | 2 | 6 | 1 | 7 | 4 | 8 | 5 |
| **Total** | **45** | **51** | **42** | **34** | **62** | **37** | **50** | **39** |

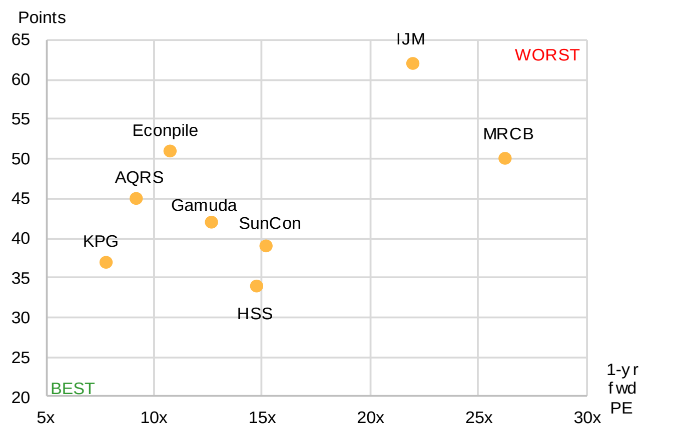
Source: Company data, Macquarie Research, April 2020

**Fig 4 HSS, KPG and SunCon retained the top four best scoring companies throughout CY19-20, with Gamuda showing the strongest improvement**




Source: Macquarie Research, April 2020

**Fig 5 If we plot the scores against the respective fwd-PE multiple of each company, the best 4 scoring companies still emerge as the best 4 in the chart below**




Source: Macquarie Research, April 2020

### PE multiples – how do the companies differ from one another?

We believe the best timeframe to evaluate the sector is starting from the year 2010 onwards. During this period Malaysia went on an infrastructure boom for at least 5 years. Malaysia Construction had a lost decade between the year 2000 and 2010, until the government then launched the MRT and LRT projects. Based on our observation, any PE of >15x is considered a premium (Gamuda and IJM historically fall within this range), 12x-15x is considered an average (most small mid cap construction companies are valued within this range) and <12x is considered a discount (self-explanatory).

In our valuation framework we assess the areas below to arrive at our target-PE for every company.

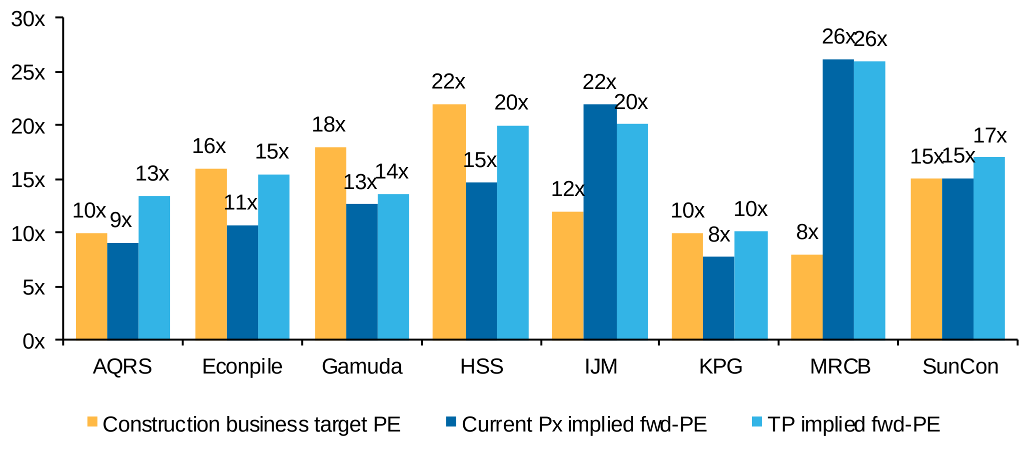
- Higher target PE companies generally have:
  - ⇒ high percentage of government projects in the orderbook
  - ⇒ high earnings visibility (high orderbook cover)
  - ⇒ its own niche in the respective engineering field
  - ⇒ high order win prospects
- Lower target PE companies generally have:
  - ⇒ large exposure in clients that are private property developers
  - ⇒ high percentage of idle projects in the order book
  - ⇒ shown lack of ability to secure new projects in the past 12-15 months
  - ⇒ high receivables-to-revenue ratio

**Fig 6 By looking at the historical fwd-PE band of the respective companies, we picked the target PE levels**

| Company | Construction business target PE | Comments |
|---|---|---|
| AQRS | 10x | AQRS did not manage to secure a single order win in FY19, 36% of orderbook consist of idle projects. |
| Econpile | 16x | Econpile cast the widest net in terms of potential projects, in the running to secure an overseas project the size of its market cap. It holds the highest market share (>25%) of the piling and foundation subsector in Malaysia. |
| Gamuda | 18x | Leading contender for MRT3 main contractor package, ample earnings support from projects overseas on top of the unaffected (by MCO) MRT2 construction works. No risk of dividend downgrade as 100% of orderbook are government contracts locally and abroad. |
| HSS | 22x | In general, consultants trade at a premium to civil work contractors. Likely to qualify for all MCO exemptions, key role in ECRL and MRT projects. Largest engineering consultant in Malaysia with over 30 years of establishment |
| IJM | 12x | Significant downgrade from >15x PE target in the past - IJM has lost its ability to secure projects in Malaysia evidently with this weak orderbook replenishments in the past. |
| KPG | 10x | Well run company but the lower-than-peer PE target is due to its 100% exposure to private property developers which may have a higher risk in terms of payments. Low free float % also contributed to the discounted PE. |
| MRCB | 8x | High orderbook balance but only less than 30% contributing to earnings. Contender for major infra projects but margins could still be weak. |
| SunCon | 15x | Minimal risks on payments as 90% of orderbook are government and in-house projects. Strong balance sheet to take on bigger projects going ahead. No risk of dividend downgrade. |

Source: Macquarie Research, April 2020

**Fig 7 Higher target PE is assigned to companies with strong track record, a niche in the sector and lower payment risk relative to peers**

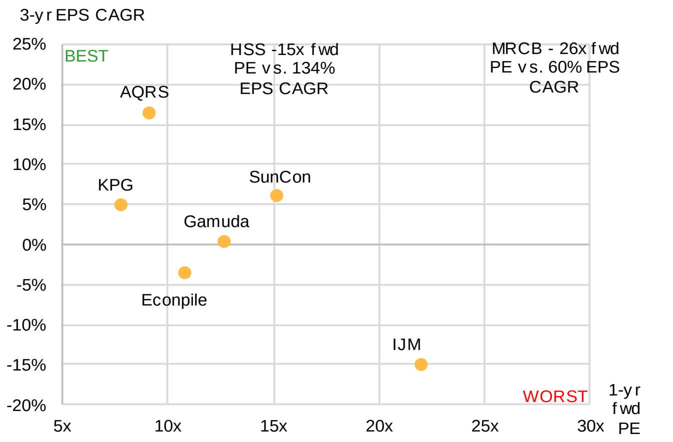



Source: Bloomberg, Macquarie Research, April 2020

## Earnings growth and ROE vs. fwd-PE

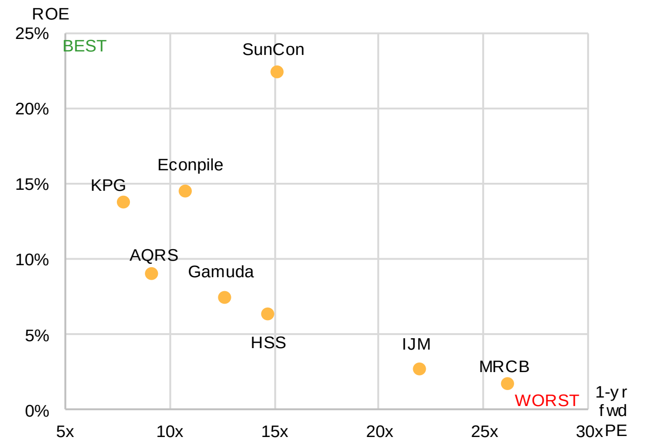
Earnings growth among the companies could be distorted especially those that reported significantly weaker-than-expected earnings in FY19. HSS and MRCB both have the highest 3-yr EPS CAGR at 135% and 60% respectively, but they both come from low earnings base in FY19. Excluding the two companies above AQRS, KPG and SunCon have the best EPS growth prospects. In terms of ROE, SunCon, Econpile and KPG have the best ROE. This is mainly due to their asset light business model and stronger-than-peer profit margins.

**Fig 8 AQRS earnings growth is driven by new infra projects and property development earnings**




Source: Bloomberg, Company data, Macquarie Research, April 2020

**Fig 9 SunCon has managed to sustain its high ROE due to strong profit margin and high asset turnover**



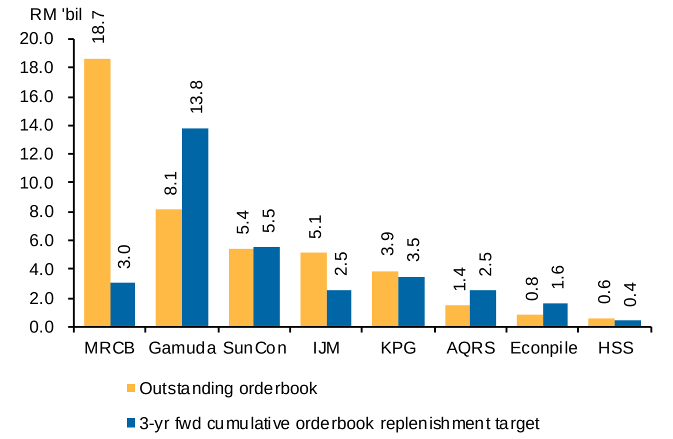

Source: Bloomberg, Company data, Macquarie Research, April 2020

### Orderbook replenishment

In our coverage, MRCB has the highest orderbook balance at c.RM19bn. However we note that only less than 30% of the balance are contributing to MRCB's earnings, while the rest are either idle or progressing at a very slow pace.

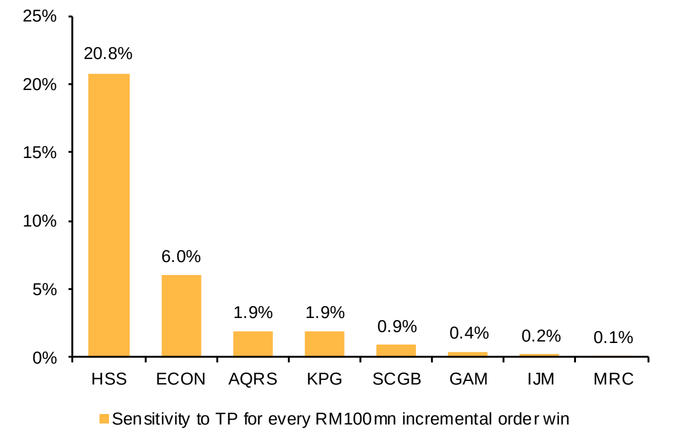
In our orderbook targets we have baked in potential order wins from the Pan Borneo Highway Sabah, MRT3 and ECRL. We have yet to include HSR in the order win estimates but we stress that newsflow on HSR may drive a rerating to the sector, even before the awards take place.

**Fig 10 Outstanding orderbook and 3-yr orderbook targets**



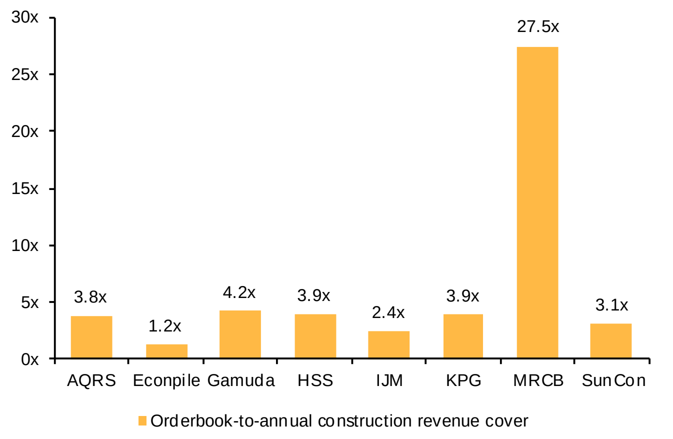

Source: Company data, Macquarie Research, April 2020

**Fig 11 HSS has the highest TP sensitivity to order wins**



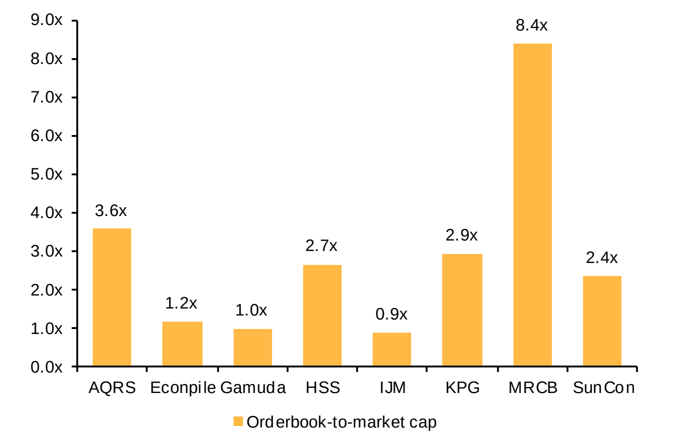

Source: Company data, Macquarie Research, April 2020

**Fig 12 All companies under our coverage have ample revenue support for more than a year**




Source: Company data, Macquarie Research, April 2020

**Fig 13 Excluding MRCB, AQRS is undervalued compared to peers based on orderbook-to-market cap ratio**




Source: Company data, Macquarie Research, April 2020

### Key risk to the sector and mitigating action

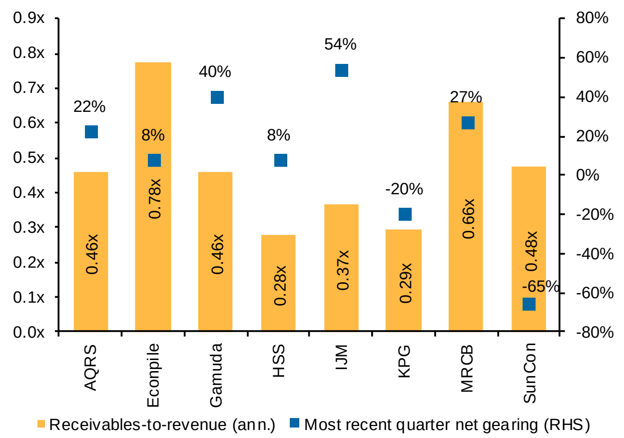
We believe post the Covid-19 pandemic, the key risk would be receivables. Project owners chiefly real estate developers are currently facing cashflow issues as property sales could not be generated the way they did before. This cashflow issue will trickle down to the contractors and we could see receivables piling up over the next two to three quarters.

Based on current standing, Econpile has the riskiest receivables balance – almost 80% of its annual revenue. Note that Econpile has had a major receivables issue with its main contractors which prompted management to impair the receivables in 2QFY19.

We also analysed the staff costs of each company under our coverage – judging from the most recent published cash balance – assuming no new payment is paid by clients, HSS is the only company that has less than a year to sustain its operations, before gearing up to cover for overhead costs and other working capital requirements.

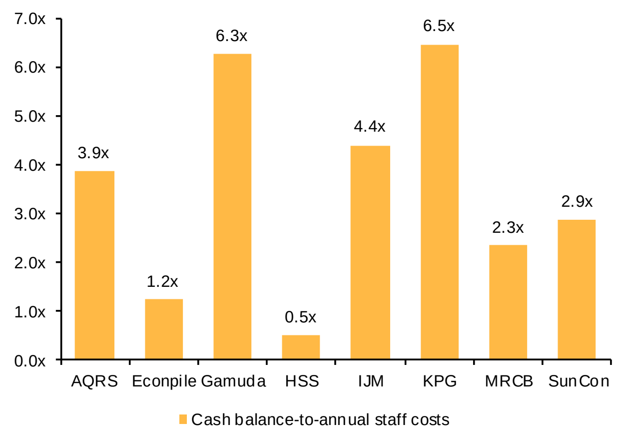
The key mitigating action during this pandemic is the government's initiative to introduce a moratorium on loan repayment for corporates and individual in order to dampen the financial impact of this pandemic. We understand corporates under our coverage are also taking advantage of the low interest rate environment to refinance their existing loans.

**Fig 14 Econpile and MRCB have higher-than-peer receivables-to-revenue ratio but both have strong balance sheet to take on further gearing**




Source: Company data, Macquarie Research, April 2020

**Fig 15 Assuming zero payment from clients, HSS has the shortest window compared to peers, before it utilises all its cash for staff's payroll**




Source: Company data, Macquarie Research, April 2020

**Fig 16 Malaysia Construction coverage valuation matrix**

| Company | Ticker | Rec. | Px (RM) | TP (RM) | Upside (%) | Mkt Cap (USDm) | 1m ADTV (USDm) | FY20E Yield (%) | FY20E Net gearing (%) | FY20E PER (x) | FY21E PER (x) | FY20E ROE (%) | FY21E ROE (%) | FY20E P/Bv (x) | FY21E P/Bv (x) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Malaysia** | | | | | | | | | | | | | | | |
| Gamuda | GAM MK | OP | 3.24 | 3.50 | 8% | 1,862 | 2.8 | 3.7 | 36.1 | 12.6 | 11.6 | 7.5 | 7.8 | 0.9 | 0.9 |
| IJM Corp | IJM MK | N | 1.75 | 1.60 | -9% | 1,456 | 1.6 | 1.1 | 33.5 | 22.0 | 22.3 | 2.7 | 2.6 | 0.6 | 0.6 |
| Sunway Construction | SCGB MK | OP | 1.78 | 2.00 | 12% | 526 | 0.3 | 3.9 | -70.5 | 19.9 | 15.1 | 18.2 | 22.5 | 3.5 | 3.3 |
| MRCB | MRC MK | N | 0.51 | 0.50 | -1% | 509 | 1.6 | 2.0 | 28.3 | 27.8 | 26.2 | 1.7 | 1.7 | 0.5 | 0.5 |
| Kerjaya Prospek | KPG MK | OP | 1.07 | 1.40 | 31% | 304 | 0.1 | 3.7 | -18.8 | 9.5 | 7.8 | 12.4 | 13.9 | 1.1 | 1.0 |
| Econpile | ECON MK | OP | 0.52 | 0.75 | 44% | 159 | 0.7 | 1.4 | -3.6 | 10.7 | 10.4 | 14.6 | 13.5 | 1.5 | 1.3 |
| AQRS | AQRS MK | OP | 0.82 | 1.20 | 47% | 92 | 0.2 | 1.2 | 16.6 | 9.3 | 9.1 | 9.8 | 9.1 | 0.9 | 0.8 |
| HSS Engineers | HSS MK | OP | 0.44 | 0.60 | 36% | 50 | 0.1 | 0.6 | 12.9 | 21.7 | 14.7 | 4.6 | 6.3 | 1.0 | 0.9 |
| | **Mkt. Cap. Weighted Average** | | | | | | | **2.7** | **18.0** | **17.5** | **16.3** | **7.2** | **7.8** | **1.1** | **1.0** |

Source: Bloomberg, Company data, Macquarie Research, April 2020; share prices as at 17 April 2020 close

**Fig 17 We revised sector's FY20-21E EPS by -26% and -18%, respectively on the back of Covid-19 pandemic**

| RM 'mil | New Estimates | | | Old Estimates | | | Difference | | |
|---|---|---|---|---|---|---|---|---|---|
| | FY20E | FY21E | FY22E | FY20E | FY21E | FY22E | FY20E | FY21E | FY22E |
| **Gamuda** | | | | | | | | | |
| Revenue | 4,232 | 4,616 | 5,129 | 4,842 | 4,709 | 5,446 | -13% | -2% | -6% |
| EBIT | 704 | 681 | 747 | 768 | 669 | 746 | -8% | 2% | 0% |
| PBT | 835 | 834 | 895 | 936 | 835 | 877 | -11% | 0% | 2% |
| PAT | 649 | 645 | 702 | 733 | 647 | 687 | -11% | 0% | 2% |
| Adj. EPS | 25.8 | 25.7 | 27.9 | 29.2 | 25.7 | 27.3 | -11% | 0% | 2% |
| **IJM Corp** | | | | | | | | | |
| Revenue | 5,768 | 5,816 | 5,775 | 6,344 | 6,487 | 6,788 | -9% | -10% | -15% |
| EBIT | 583 | 682 | 671 | 751 | 753 | 767 | -22% | -9% | -13% |
| PBT | 479 | 634 | 630 | 677 | 701 | 721 | -29% | -10% | -13% |
| PAT | 253 | 317 | 313 | 361 | 451 | 438 | -30% | -30% | -29% |
| Adj. EPS | 7.0 | 8.7 | 8.6 | 10.0 | 12.4 | 12.1 | -30% | -30% | -29% |
| **Sunway Construction** | | | | | | | | | |
| Revenue | 2,116 | 2,323 | 2,403 | 2,562 | 2,135 | na | -17% | 9% | na |
| EBIT | 132 | 168 | 164 | 194 | 183 | na | -32% | -8% | na |
| PBT | 148 | 194 | 194 | 203 | 198 | na | -27% | -2% | na |
| PAT | 116 | 152 | 155 | 161 | 156 | na | -28% | -3% | na |
| Adj. EPS | 9.0 | 11.8 | 12.0 | 12.4 | 12.1 | na | -28% | -3% | na |
| **MRCB** | | | | | | | | | |
| Revenue | 1,460 | 1,613 | 1,728 | 2,778 | 3,394 | na | -47% | -52% | na |
| EBIT | 146 | 156 | 167 | 330 | 364 | na | -56% | -57% | na |
| PBT | 114 | 131 | 147 | 324 | 364 | na | -65% | -64% | na |
| PAT | 80 | 85 | 97 | 227 | 241 | na | -65% | -65% | na |
| Adj. EPS | 1.8 | 1.9 | 2.2 | 5.2 | 5.5 | na | -65% | -65% | na |
| **Kerjaya Prospek** | | | | | | | | | |
| Revenue | 1,147 | 1,436 | 1,393 | 1,271 | 1,515 | 1,643 | -10% | -5% | -15% |
| EBIT | 182 | 223 | 209 | 213 | 255 | 258 | -14% | -12% | -19% |
| PBT | 183 | 225 | 214 | 219 | 264 | 271 | -16% | -15% | -21% |
| PAT | 139 | 171 | 162 | 166 | 201 | 206 | -16% | -15% | -21% |
| Adj. EPS | 11.2 | 13.8 | 13.1 | 13.4 | 16.2 | 16.6 | -16% | -15% | -21% |
| **Econpile** | | | | | | | | | |
| Revenue | 453 | 624 | 647 | 590 | 704 | 700 | -23% | -11% | -7% |
| EBIT | 40 | 85 | 91 | 86 | 107 | 118 | -53% | -21% | -23% |
| PBT | 38 | 83 | 88 | 83 | 105 | 115 | -55% | -21% | -23% |
| PAT | 29 | 65 | 67 | 65 | 80 | 87 | -55% | -19% | -23% |
| Adj. EPS | 2.2 | 4.8 | 5.0 | 4.8 | 6.0 | 6.5 | -55% | -19% | -23% |
| **AQRS** | | | | | | | | | |
| Revenue | 631 | 765 | 866 | 883 | 1,243 | na | -29% | -38% | na |
| EBIT | 73 | 74 | 96 | 98 | 112 | na | -26% | -34% | na |
| PBT | 72 | 73 | 95 | 95 | 110 | na | -25% | -33% | na |
| PAT | 53 | 55 | 71 | 71 | 83 | na | -25% | -34% | na |
| Adj. EPS | 8.7 | 8.9 | 11.7 | 11.7 | 13.6 | na | -25% | -34% | na |
| **HSS Engineers** | | | | | | | | | |
| Revenue | 168 | 181 | 190 | 214 | 213 | na | -22% | -15% | na |
| EBIT | 18 | 24 | 25 | 30 | 34 | na | -39% | -29% | na |
| PBT | 14 | 21 | 22 | 26 | 31 | na | -46% | -32% | na |
| PAT | 10 | 15 | 16 | 19 | 22 | na | -46% | -32% | na |
| Adj. EPS | 2.0 | 3.0 | 3.2 | 3.7 | 4.4 | na | -46% | -32% | na |

| | FY20E | FY21E |
|---|---|---|
| **Malaysia Construction martket cap weighted EPS revision** | **-26%** | **-18%** |
| **Market cap weighted PE ratio (current price)** | **17.5x** | **16.3x** |
| **Market cap weighted PE ratio (target price)** | **19.8x** | **17.0x** |

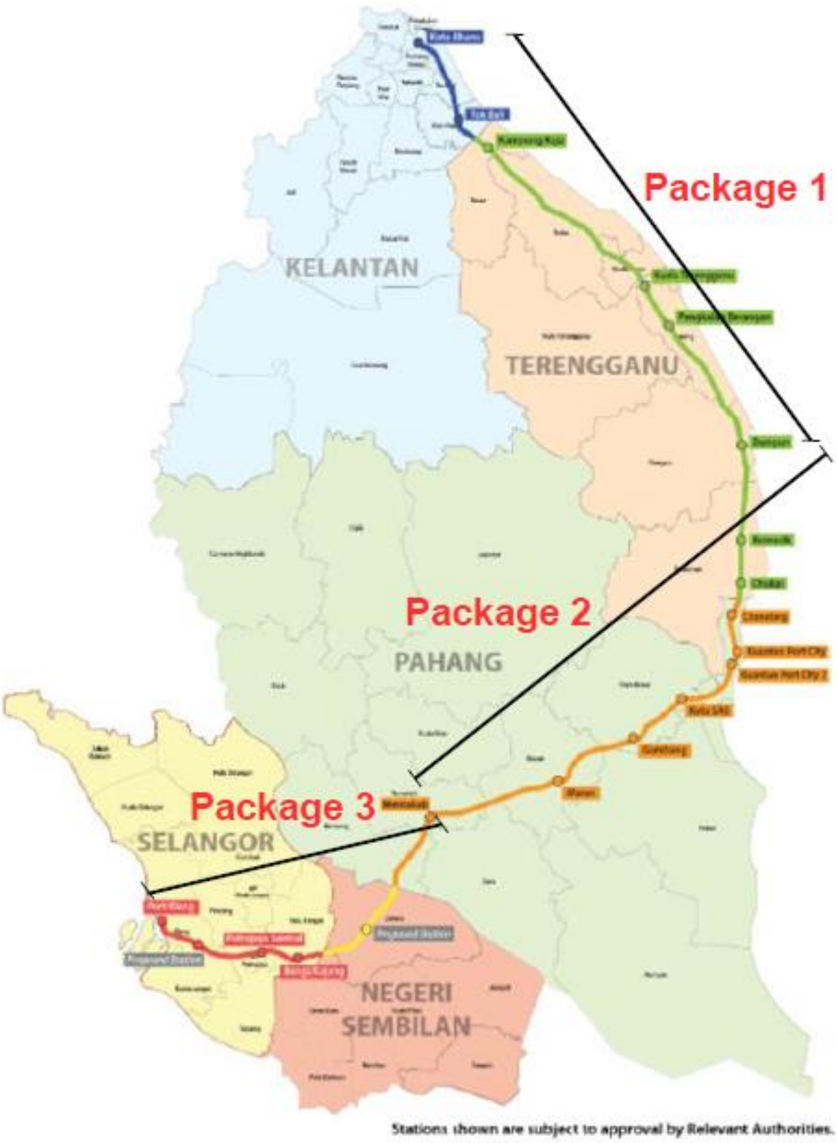
Source: Company data, April 2020

# Key catalytic projects

➢ **East Coast Railway Link (ECRL)**

- **Project value:** RM44bn.
- **Latest update**: Government is completing the land acquisition for Package 2, civil work contracts can be awarded once land reclamation is done (estimated 4Q20). Package 1 is currently undergoing the preliminary design process, once completed the final design package will be awarded. Package 3 alignment has yet to be finalised – once it has, we can expect awards for preliminary design to be awarded.
- **Funding plan**: 85% of the project cost will be funded via a soft loan from the EXIM Bank of China, with 7-year interest moratorium. The 15% balance will be funded by bond issuances by the Malaysian government.
- **Potential beneficiaries**: AQRS, HSS, IJM, Econpile and MRCB.

**Fig 18 ECRL alignment and available packages**




Source: Malaysia Rail Link, April 2020

### ➢ MRT3

- **Project value:** RM22bn
- **Latest update**: According to Gamuda, MRT3 project is already at the “shovel ready” stage. Pakatan Harapan planned to launch this project in 2H20 – but now with the change in government and Covid-19 pandemic, we still expect the project to be announced in the 2021 Budget presentation in 4Q20. In our view, MRT3 is the most viable project with the most immediate economic multiplier impact to the country as compared to ECRL, which may have a longer gestation period. We believe there could be a change in Gamuda’s partner for MRT3. Previously MMC Corp has been the Bumiputra partner for Gamuda in the previous MRT projects – but the new government may prefer a friendlier party for this role.
- **Funding plan**: Under the Barisan Nasional government, the tender for MRT3 was already opened, but those interested in the main contractor role must come up with their own financing and government will pay them on deferred payment scheme. This was introduced as the previous government planned to concurrently run the MRT2 and MRT3 project, hence there was a shortfall in funding. We believe the construction works of MRT3 will commence only after MRT2 is completed and therefore funding may come from DanaInfra per MRT1 and MRT2.
- **Potential beneficiaries**: Gamuda, MRCB, IJM, SunCon, MRCB, Econpile and HSS.

### ➢ KL-Singapore High Speed Rail

- **Project value**: TBA – government is reducing cost by making the train run at slower speeds.
- **Latest update**: The deadline for the bilateral agreement signing between Malaysia and Singapore was scheduled to take place on 31 May 2020. With the travel bans across the globe this date may be deferred. On the Malaysia side, the government has relaunched the HSR transport hub – Bandar Malaysia. This project was previously divided into two – Northern part and Southern part. The project delivery partner (PDP) of the project was already awarded, but the PDP for the southern part was terminated by the Pakatan Harapan government. Interestingly, the Northern part PDP – MRCB and Gamuda, have yet to be terminated from their role as the co-PDP. We expect the agreement to be achieved between both governments, but the signing may happen at a later date.
- **Funding plan**: Under the Barisan Nasional government, the project will be funded by the company that secures the role as the Asset Co. of the project (see details here). In return the Asset Co. will receive a long-term concession to build-operate-transfer the HSR project.
- **Potential beneficiaries**: AQRS, HSS, Gamuda, Econpile and MRCB.

### ➢ Pan Borneo Highway Sabah

- **Project value:** RM13bn.
- **Latest update**: Under the Pakatan Harapan, the project is divided into 35 packages and the then-government initially planned to open the tender of up to RM925mn from the total project cost in 1Q20. Despite Sabah being an opposition state, we believe the current government will carry out the project to garner support from Sabahan in the next general election. Expect awards to happen in early-2021.
- **Funding plan**: 100% funded via DanaInfra sukuk program.
- **Potential beneficiaries**: AQRS, Econpile and MRCB.

# Malaysia Construction coverage

## Gamuda (GAM MK, RM3.24, Outperform, TP: RM3.50)

**May have found the bottom (find report here)**

- **The good**
  - ⇒ Orderbook balance of RM8.1bn, enough to support 2-3 years of construction earnings
  - ⇒ Geographically diversified earnings source may weather the cashflow uncertainties
  - ⇒ It is a key contender for the MRT3 main contractor role – trading at 13x fwd-PE vs. the peak during pre-MRT2 awards of 17x.
- **The bad**
  - ⇒ Property sales in Malaysia and Singapore will be significantly impacted in CY20.
  - ⇒ Penetrating the Australian construction sector could be risky as there are large China-owned construction companies based in Australia with stronger track record than Gamuda.
  - ⇒ Even with the change of government, management seems very keen to divest its toll roads, although there is an impending threat of EPS void going ahead. If Gamuda, the most farsighted construction company in Malaysia, is keen to divest its toll roads, this opens to question as to why Gamuda is keen to dispose them.
- **The ugly**
  - ⇒ Gamuda may participate in the land reclamation works of the Penang Transport Master Plan project. However the contractor for this reclamation works is required to come up with its own financing. Payment will be deferred and largely dependent on the sales of the reclaimed land. If Gamuda participates in this role in a big way, this could bring unnecessary risk to its future earnings and operations.

## IJM Corporation (IJM MK, RM1.75, Neutral, TP: RM1.60)

**Feeling the pinch from all angles (find report here)**

- **The good**
  - ⇒ Still has an orderbook balance of RM5.1bn to support its construction earnings.
  - ⇒ Key contender for the spun pile supplier in the ECRL project – IJM has built the ICP plant within the vicinity of the ECRL project.
  - ⇒ Kuantan Port, despite it could potentially see a significant drop in throughput and revenue, could emerge as the key earnings support for the Group during this pandemic.
- **The bad**
  - ⇒ All key divisions are impacted by the Covid-19 pandemic, with loss-making operations in plantations and toll roads even before the Covid-19 started.
  - ⇒ For a company that lack earnings growth and its ability to competitively bid for new projects, paying a 22x PE for this company may not be the greatest risk-reward.
- **The ugly**
  - ⇒ IJM Construction’s key clients are property developers, mall owners and commercial property owners. If the clients went bust during this pandemic, this may bring a huge risk to IJM’s receivables.
  - ⇒ The LEKAS tollroad, which has been deeply loss making could see further drop in traffic as the government curbs crossing the state borders during the MCO. Without capital injection from the parent LEKAS could, in the worst-case scenario, default on its bonds and sukuk.

⇒ The plantations business may see another loss-making year due to the pandemic – which had caused demand shocks. Lower production volume will also curtail its opportunity to take advantage of the higher CPO price (vs. that of last year), as lower volume may offset the price gains. IJM Plantations was previously rumoured to be divested by the Group but the pricing could not be agreed by both parties. Push comes to shove, this deal may be back on the table, as additional cash may be useful to IJM in order to weather this pandemic.

### Sunway Construction Group (SCGB MK, RM1.78, Outperform, TP: RM2.00)

**Steady as she goes (find report here)**

- **The good**
  - ⇒ Has over RM5bn of order book balance with >90% of the outstanding value consist of government and in-house projects – therefore carry minimal payment risk.
  - ⇒ Has a 65% net cash position with a cash balance of c.RM700mn SunCon would have enough financial support to weather the sector downtime and could also utilise this cash for overseas expansion plans.
  - ⇒ Key contender for any MRT3 civil work packages and will continue to get order book support from parent company – Sunway Berhad amounting to RM1bn p.a.
- **The bad**
  - ⇒ Precast division may slump into losses again in FY20E after breaking even in FY19 due to plant shutdown and stalled construction works in Singapore and Malaysia.
  - ⇒ Expanding into India toll road projects, while this may be good for future earnings, we remain cautious on the payment risk and currency risk of this venture.
  - ⇒ LRT3 makes up c.40% of SunCon's orderbook. Further delays in the project could see another weak revenue delivery by SunCon.
- **The ugly**
  - ⇒ More of a long-term concern would be the sanctity of the contract between SunCon and the Indian government – a change of government could bring a premature termination to SunCon's contract.

### MRCB (MRC MK, RM0.51, Neutral, TP: RM0.50)

**Surprise me! (find report here)**

- **The good**
  - ⇒ One of the key contenders for ECRL (package 3) and MRT3 project.
  - ⇒ Rental income of at least RM50mn p.a. is there to support cashflows during this downtime.
  - ⇒ The delivery of its Australia property project in FY20E – Burwood may bring earnings support to MRCB.
- **The bad**
  - ⇒ We note 70% of the orderbook consist of idle or slow-moving projects – earnings recognition could be slower than expected.
  - ⇒ Construction margins have yet to improve despite guidance of margin expansion by management since FY17.
  - ⇒ Earnings delivery has not been MRCB's strongest suit, missing street estimates have become a norm rather than a surprise.
- **The ugly**
  - ⇒ High receivables to revenue ratio would be a concern, especially during downtime like this.

### Kerjaya Prospek (KPG MK, RM1.07, Outperform, TP: RM1.40)

**In the land of the poor, the cash-rich is king (find report here)**

- **The good**
  - ⇒ Strong orderbook replenishment outlook, already secured c.RM1bn in new orders FYTD, with at least another RM500mn to be secured throughout the year.
  - ⇒ High ROE due to high efficiency from its IBS method, KPG also manufactures the fit out and the interior furniture of the property projects it undertakes.
  - ⇒ High cash balance is utilised to pay subcontractors ahead, with discounts offered by subcontractors in return.
- **The bad**
  - ⇒ 100% of its orderbook comes from private property developers, which are a risky set of clients to have currently.
  - ⇒ Free float rate of less than 20% has been one of the reasons KPG trades at a discount to peers despite having much stronger fundamentals.
  - ⇒ Some clients have started to offer KPG property units as payment in-lieu for the outstanding payments – failing to monetise the property units during this period could be detrimental to KPG's cash balance.
- **The ugly**
  - ⇒ Impairment of receivables as a result of clients going bankrupt – a scenario that is not too foreign given how bad the overall property market is.

### Econpile Holdings (ECON MK, RM0.52, Outperform, TP: RM0.75)

**Prospects intact despite headwinds (find report here)**

- **The good**
  - ⇒ Key contender to secure up to USD200mn contract from a casino resort project in Cambodia.
  - ⇒ Still the market share leader in the piling and foundation industry in Malaysia with over 25% market share.
  - ⇒ In Malaysia Econpile casts a wider net in securing real estate, infra and bridge (marine) related works.
- **The bad**
  - ⇒ It has a high receivables-to-revenue ratio and given the impairment it took in 2QF19 investors remain cautious on the future payments.
  - ⇒ The orderbook is still largely concentrated on the Pavilion Damansara Town Centre project, investors are also cautious on the ability of Malton Group (the project owner) to honour its payment obligations.
  - ⇒ In order to secure more jobs, Econpile has widen the geographical concentration of the projects it undertakes – this will hamper its asset rotation between sites and affect its ROE.
- **The ugly**
  - ⇒ More impairments as a result of clients going bust – currently Maju Holdings has yet to settle the RM76mn due to Econpile after the arbitrator decided that Econpile has valid grounds to claim the amount from Maju Holdings.

### Gabungan AQRS (AQRS MK, RM0.82, Outperform, TP: RM1.20)

**Play to its strength (find report here)**

- **The good**
  - ⇒ Has established a strong working relationship with China Communications Construction Company (CCCC) to place it in good stead to secure packages from the ECRL project.
  - ⇒ Management is looking at reducing its OPEX by another 40% from RM50mn p.a. currently – this could help the company during the sector downtime.
  - ⇒ Still has a good relationship with the Sabah state government despite the state now being an opposition state. Prospects of securing the PBH Sabah project is still there, with meaningful progress in the One Jesselton Waterfront project expected over the next 2 FYs.
- **The bad**
  - ⇒ Two projects which makes up 36% of its RM1.4bn outstanding orderbook are currently idle, as such street's earnings forecast could be misrepresenting the inability of the project to generate revenue.
  - ⇒ Margin will begin to contract from FY21E onwards as its key high-margin job – Pusat Pentadbiran Sultan Ahmad Shah is due for completion this year. We estimate this project has been generating at least 30% EBIT margin to the construction division.
  - ⇒ Delayed cashflow from the slower than expected property sales from e'Island Lake Haven and The Peak in Selangor and Johor, respectively.
- **The ugly**
  - ⇒ AQRS had failed to secure new projects in FY19 as management concentrated its efforts in securing packages from the ECRL and PBH Sabah projects. If AQRS fails to secure any new orders this year, AQRS construction division will be left with only one running project – LRT3 package GS04.

### HSS Engineers (HSS MK, RM0.44, Outperform, TP: RM0.60)

**ECRL design works are key rerating catalysts (find report here)**

- **The good**
  - ⇒ It is the largest engineering consulting company in Malaysia and the only one listed.
  - ⇒ It is likely to be given a full exemption to work and operate per usual during the MCO based on the new exemption list by the government. HSS has applied for the exemption and will continue business as usual once approval is granted by the government.
  - ⇒ Key contender to secure the design packages from the ECRL project – there are at least 3 more major design works from the ECRL project that are yet to be awarded.
- **The bad**
  - ⇒ The acquisition of SMHB has yet to bear fruit with stagnant revenue pre- and post-acquisition. Whereas profit has been impacted from the impairment of SMHB's goodwill and the higher cost base it brought to the group.
  - ⇒ HSS tends to pro bono work (to the government) at the initial stage and will only get paid after the projects are live or launched. This would delay the revenue recognition process.
  - ⇒ We estimate 14% out of its RM581mn orderbook consist of idle projects, which have not been contributing to HSS' earnings over the past to three quarters.
- **The ugly**
  - ⇒ Further impairment of SMHB – however given the impairment amount HSS took in FY18, we believe the risk of this happening is quite remote.

## Important disclosures:

### Recommendation definitions

**Macquarie – Asia and USA**
Outperform – expected return >10%
Neutral – expected return from -10% to +10%
Underperform – expected return <-10%

**Macquarie – Australia/New Zealand**
Outperform – expected return >10%
Neutral – expected return from 0% to 10%
Underperform – expected return <0%

Note: expected return is reflective of a Medium Volatility stock and should be assumed to adjust proportionately with volatility risk

### Volatility index definition*

This is calculated from the volatility of historical price movements.

**Very high–highest risk** – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

**High** – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

**Medium** – stock should be expected to move up or down at least 30–40% in a year.

**Low–medium** – stock should be expected to move up or down at least 25–30% in a year.

**Low** – stock should be expected to move up or down at least 15–25% in a year.
* Applicable to select stocks in Asia/Australia/NZ

**Recommendations** – 12 months
**Note:** Quant recommendations may differ from Fundamental Analyst recommendations

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All "Adjusted" data items have had the following adjustments made:
Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense
Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

**EPS** = adjusted net profit / efpowa*
**ROA** = adjusted ebit / average total assets
**ROA Banks/Insurance** = adjusted net profit /average total assets
**ROE** = adjusted net profit / average shareholders funds
**Gross cashflow** = adjusted net profit + depreciation
*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

### Recommendation proportions – For quarter ending 31 March 2020

| | AU/NZ | Asia | USA | |
|---|---|---|---|---|
| Outperform | 53.43% | 61.07% | 67.03% | (for global coverage by Macquarie, 4.62% of stocks followed are investment banking clients) |
| Neutral | 34.30% | 26.77% | 31.87% | (for global coverage by Macquarie, 3.10% of stocks followed are investment banking clients) |
| Underperform | 12.27% | 12.17% | 1.10% | (for global coverage by Macquarie, 3.57% of stocks followed are investment banking clients) |

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