

7 September 2018

Construction

Follow The Flow Of Contracts

Maintain NEUTRAL on the sector. Sunway Construction and Kerjaya are our Top Picks. The latest reporting season was broadly in line with estimates. Ongoing projects such as MRT2 and Pan Borneo Highway (Sarawak) are progressing smoothly, albeit, under review for cost reductions. Still, LRT3's development is less rosy, with progress stalled at 5%, which we believe is due to the facilitating of major design changes. As we see it, the private sector will present more opportunities for new jobs. As such, we favour our Top Picks. We will also be closely watching the PTMP project and Budget 2019 for the sector's potential rerating catalysts.

2Q18 results were broadly met. Half of the companies (six of 12) under our coverage reported earnings that met. Of the remaining six, the two that beat largely negated the other four that missed. In the big-cap space, IJM Corp's beat was aided by its property development business. In contrast, Sunway Construction's and Malaysian Resources Corp's results disappointed.

Ongoing projects progressing well for the most part. Based on channel checks with contractors, and our analysis of quarterly reports, we gather that the progress for Mass Rapid Transit 2 (MRT2) and Pan Borneo Highway (Sarawak) have seen few disruptions despite being under review as costs are scrutinised. Quite the opposite, progress for the Light Rail Transit 3 (LRT3) project has stalled, in our estimate, pending significant changes to the project scope.

Follow the contract flow. We prefer contractors that have not disappointed in terms of securing new contracts in 2018. Companies that meet this criteria are Sunway Construction and Kerjaya Prospek, which are our Top Buys. In 2018, these two companies have respectively secured new contracts amounting to MYR799m and MYR496m, receiving a steady flow of awards from external private developers and in-house units. Both companies appear to have weathered the drought in new jobs.

Private sector presents the most opportunities. We continue to favour companies that have significant exposure to private sector projects. Upcoming developments that could provide job flows, in our view, include Pavilion Damansara, Menara Dayabumi redevelopment, TRX, TNB Bangsar and other residential developments within the Klang Valley. From the public sector, projects that have received the Government's blessing such as Gemas-JB double tracking, the Penang Transport Masterplan and the JB-Singapore Rail Transit System (RTS) could be worth watching.

Maintain NEUTRAL on the broader sector, amid setbacks in the rollout of new projects, and a possible reduction of outstanding orderbook amid cost-cutting measures. We believe that most of the negative news have been reflected in share prices, with stocks declining 20-30% after the general elections, capping downside risk. Upside risk, meanwhile, is also limited in our view, due to a lack of clarity of future projects. For the near-term, we recommend investors adopt a trading approach based on company news flow such as contract awards. For the mid to long term, we prefer to wait for more clarity on the possible revival of mega projects.

Company Name	Rating	Price (MYR)	Target (MYR)	% Upside (Downside)	P/E (x) Dec-18F	P/B (x) Dec-18F	Yield (%) Dec-18F
Sunway	BUY	1.81	2.30	27.1	15.9	4.1	4.4
Kerjaya Prospek	BUY	1.41	1.64	16.3	11.5	1.8	2.7
MRCB	BUY	0.72	1.20	67.8	25.9	0.6	2.9
Gamuda	NEUTRAL	3.54	3.80	7.3	11.3	1.1	3.4
Gadang	NEUTRAL	0.70	0.82	17.1	4.3	0.6	4.7
GKent	NEUTRAL	1.27	1.66	30.7	5.7	1.3	6.1
Hock Seng Lee	NEUTRAL	1.38	1.50	8.7	12.8	1.0	1.2
IJM Corp	NEUTRAL	1.81	1.96	8.3	16.9	0.7	2.4
Kimlun	NEUTRAL	1.27	1.52	19.7	7.7	0.7	3.8
MGB	NEUTRAL	0.90	1.03	14.4	7.8	0.8	0.0
Pintaras	NEUTRAL	2.45	2.58	5.3	19.2	1.2	8.2
WCT	NEUTRAL	0.85	0.86	1.8	6.4	0.4	7.9

Source: Company data, RHB

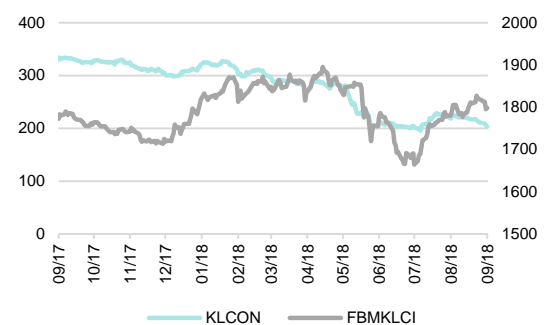
Construction & Engineering | Construction

Neutral (Maintained)

Stocks Covered: 12
Ratings (Buy/Neutral/Sell): 3 / 9 / 0
Last 12m Earnings Revision Trend: Negative

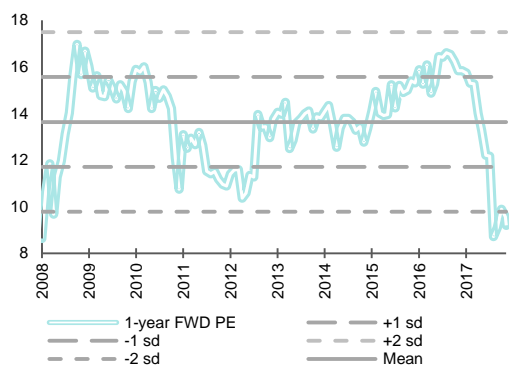
Top Picks **Target Price**
Sunway Construction (SCGB MK) – BUY **MYR 2.30**
Kerjaya Prospek (KPG MK) – BUY **MYR 1.64**
MRCB (MRC MK) – BUY **MYR 1.20**

Historical performance (KLCON & FBM KLCI)



Source: Bloomberg, RHB

10-year P/E band – KLCON



Source: Bloomberg, RHB

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2Q earnings were broadly in line

2Q18 results were broadly within expectations, with six (of 12) companies reporting numbers that were in line of estimates. The remaining six saw two which beat, and largely negated the four that missed the mark.

In the big-cap space, IJM reported earnings that were above expectations, aided by its property development business. In contrast, Sunway Construction and MRCB posted results that disappointed. The former's performance was a result of slower-than-expected progress for the LRT3 project, while the latter was due to weakness in its property development division.

For smaller-cap stocks, Gadang's results exceeded estimates, driven by better-than-expected performance by its construction division. Meanwhile, earnings for Kimlun and Pintaras Jaya were below estimates due to lower-than-anticipated recognition of progress billings for ongoing projects.

Figure 1: 2Q earnings vs our estimates

Company	Actual vs estimates	Recommendation
Gadang (4QFY18 (May))	Above	Neutral
IJM Corp (1QFY19(Mar))	Above	Neutral
Gamuda (3QFY18(July))	In line	Neutral
George Kent (1QFY19(Jan))	In line	Buy
Hock Seng Lee	In line	Neutral
Kerjaya Prospek	In line	Neutral
MGB	In line	Neutral
MRCB	In line	Neutral
WCT	Below	Buy
Kimlun	Below	Neutral
Suncon	Below	Buy
Pintaras Jaya (4QFY18(Jun))	Below	Neutral

Source: Company data, RHB

Figure 2: RHB's construction stock universe

	Price*	DY (%)		EPS Growth (%)		P/E (x)		P/BV (x)	ROE (x)
	(MYR/s)	FY18F	FY19F	FY18F	FY19F	FY18F	FY19F	FY19F	FY19F
Gadang^	0.69	4.7	5.0	8.1	8.7	4.3	3.9	0.5	13.8
Gamuda	3.57	3.4	3.4	26.5	4.4	11.3	10.9	1.0	9.8
George Kent^	1.29	6.1	6.7	2.3	8.9	5.7	5.2	1.1	22.8
Hock Seng Lee	1.39	1.2	1.3	34.3	10.1	12.8	11.6	0.9	8.0
IJM Corp^	1.89	2.4	3.2	16.0	33.6	16.9	12.7	0.7	5.5
Kerjaya Prospek	1.40	2.7	3.4	22.5	27.5	11.5	9.0	1.6	18.8
Kimlun	1.30	3.8	4.2	(18.6)	17.5	7.7	6.6	0.6	9.2
MGB	0.92	0.0	0.0	15.8	48.1	7.8	5.3	0.7	14.3
MRCB	0.73	2.7	3.0	(46.0)	29.1	26.0	20.2	0.6	3.2
Pintaras	2.45	8.2	8.6	(42.3)	19.6	19.2	16.0	1.3	7.9
Suncon	1.81	4.4	4.7	6.7	14.5	15.9	13.9	3.7	27.8
WCT	0.85	7.9	8.1	44.6	2.5	6.4	6.2	0.4	5.8

Note: ^FY18-19 valuations refer to those of FY19-20

Note 2: *Prices as at 5 Sep 2018

Source: Company data, RHB

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Construction sector book-to-bill ratio has fallen below 1x

As at Jun 2018, construction companies under our coverage maintained an aggregate outstanding orderbook valued at MYR48.7bn, down from MYR50.7bn as at Mar 2018. We believe that the fall in unbilled orderbook value could be due to book-to-bill ratios falling below 1x, as companies drawdown on outstanding orders at a faster pace compared to securing new jobs. In our estimate, average outstanding orderbook to construction revenue (previous FY) tapered to an average of 4.1x vs 4.3x last quarter.

At over 4x, outstanding orderbook provides revenue visibility for contractors over the next 3-4 years. However, the possibility of cost-cutting measures implemented on the MRT2 and LRT3 could reduce the value of outstanding orders for contractors, exerting downward pressure to this ratio. In addition, the scarcity in new large-scale public infrastructure projects provides fewer sizable new contract replenishment opportunities, in our view.

Figure 3: Outstanding construction orderbook for RHB Universe

Company	Outstanding orderbook (June)	Construction revenue (Last FY)	Orderbook/revenue (x)
Gadang	1,510	365.0	4.1
Gamuda	6,400	1,910.0	3.4
George Kent	5,300	471.5	11.2
Hock Seng Lee	2,500	429.8	5.8
IJM Corp	8,800	2,151.5	4.1
Kerjaya Prospek	2,880	874.6	3.3
Kimlun	2,100	871.1	2.4
MGB	2,000	632.8	3.2
MRCB	5,900	1,795.2	3.3
Pintaras Jaya	110	56.8	1.9
Suncon	5,800	1,931.4	3.0
WCT	5,400	1,391.8	3.9
Total	48,680	Average	4.1

Source: Company data, RHB

Contract flow in 2018 has been less exciting

According to our compilation of Bursa Malaysia announcements, a total of MYR4bn worth of jobs have been awarded to contractors under our coverage as at Sep 2018. This, in our estimate, is below the rate of awards over same period in 2016 and 2017, where large-scale projects such as the MRT2 and LRT3 had commenced. In 2018, there has been a clear absence of work package contracts for large-scale projects due to project deferrals.

In fact, the sole contract that exceeded MYR1bn and awarded to IJM Corp in 2018 was, in our view, due to spillover of the LRT3 project, initially scheduled to be awarded in 2017. The value of this contract could be brought down, in our view, due to ongoing cost-cutting measures being studied for the LRT3 project. In our estimate, there was only one other infrastructure project awarded – road works in Johor Bahru to Kimlun. This sums up the poor job visibility from the public sector currently faced by contractors.

Sorting companies by new contracts secured in 2018, IJM Corp sits firmly at the top spot, with over MYR1.6bn in contracts secured to date. However, as previously stated, this figure could be brought down once cost-cutting measures are finalised for the LRT3 project. Rounding up the top four in our list are Sunway Construction, WCT, and Kerjaya, which have benefitted primarily from private sector projects where sentiment is better.

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Figure 4: Construction contract wins for RHB Universe

Company	Date	Project	Amount (MYRm)
Gadang	20/8/2018	TRX infrastructure	86.1
Hock Seng Lee	14/8/2018	Petronas MRSM Bintulu	101.2
IJM Corp	13/3/2018	LRT3 underground	1,115.7
IJM Corp	5/9/2018	Affin Bank HQ @ TRX	505.0
Kerjaya Prospek	12/4/2018	BBCC building works	357.3
Kerjaya Prospek	5/6/2018	STP2 Bridge	138.6
Kimlun	20/6/2018	Gerbang Nusajaya	53.5
Kimlun	6/6/2018	JB Road Project	144.1
MGB	27/6/2018	Alam Perdana Ijok	175.2
Sunway Construction	26/2/2018	Sunway GEOLake	223.0
Sunway Construction	27/2/2018	Sunway Carnival Shopping Mall	286.0
Sunway Construction	14/5/2018	Sunway Medical Centre Penang	180.0
Sunway Construction	23/5/2018	BBCC piling	46.3
Sunway Construction	23/5/2018	TNB Bangsar	23.2
Sunway Construction	16/8/2018	Other in house & piling	40.6
WCT	12/7/2018	TRX Lifestyle Quarters	555.0
Total			4,030.8

Source: Company data, RHB

Figure 5: Companies sorted by contract wins in 2018

Company	Contracts secured in 2018	Management forecast (current FY)	Our forecast
IJM Corp	1620.7*	1,500-2,000	1,500.0
Sunway Construction	799.1	1,500.0	1,500.0
WCT	555.0	2,000.0	500.0
Kerjaya Prospek	495.9	1,000.0	1,000.0
Kimlun	197.6	600-800	300.0
MGB	175.2	800-1,000	800.0
Hock Seng Lee	101.2	na	400.0
Gadang	86.1	300-500	200.0
Pintaras Jaya	30	150	200.0
Gamuda	-	na	nil
George Kent	-	na	50.0
MRCB	-	na	nil

Note: *MYR1.12bn was secured in the company's previous financial year (FY18)

Source: Company data, RHB

MRT2 and Pan Borneo Highway (Sarawak) progressing well; LRT3 stalled

Ongoing large-scale (>MYR10bn) projects such as MRT2, LRT3 and Pan Borneo Highway (Sarawak) are currently being reviewed by the government. This could lead to a reduction in project cost which would in turn result in a lowering of the value of contracts held by companies under our coverage. At this juncture, however, the quantum of decrease remains uncertain, and timelines for the reviews have yet to be determined, except for Pan Borneo Highway (Sarawak), which is scheduled to complete its review in Sep 2018, according to the Ministry of Works.

Based on our channel checks with contractors, as well as an analysis of quarterly reports, we gather that the progress for MRT2 and Pan Borneo Highway (Sarawak) have seen few disruptions despite being under review, as costs are scrutinised. Quite the opposite, progress for the LRT3 project has stalled. We believe it is pending significant changes to the project scope. For LRT3, the project delivery partner (PDP) model would likely be scrapped in favour of the Engineering, Procurement, Construction and Commissioning (EPCC) model, along with significant design changes. Further delaying works, in our view, could be management changes at Prasarana Malaysia, the project owner.

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Figure 6: Estimated project costs and completion rates (%) of selected projects

Project	Est. Cost (MYRbn)	Latest progress	Listed companies involved
MRT2	32	30%	MMC-Gamuda (PDP & Tunneling), WCT, Suncon, AZRB, TRC, IJM, Gadang, Mudajaya, MRCB, Gkent, Kimlun, Eita, Metronic, Muhibah, TSR
LRT3	16.6	5%	George Kent-MRCB, Mudajaya, WCT, Suncon, Gabungan AQRS, Econpile, IJM, TRC, Eita, Muhibah
Pan Borneo Highway (Sarawak)	16	30%	HSL, Naim Holdings, Gamuda, Zecon, Kimlun, CMSB, Bina Puri, Mudajaya, TRC, KKB Engineering, WCT
Gemas-JB Double Tracking	9.4	Commencing	YTL, Fajarbaru, Econpile
Tun Razak Exchange	6	85% (Phase 1)	Gadang, WCT, IJM Corp

Source: Project owners, media, Company data, RHB

Gaining a bit more clarity on deferred/cancelled projects

Following a signing ceremony between ministers from Malaysia and Singapore, the MYR110bn Kuala Lumpur-Singapore high-speed rail (HSR) project has been officially deferred by two years. Construction is now expected to commence in May-2020 (from 2018) and operations beginning 2031 (extended five years from 2026). Between now and May 2020, the Malaysian Government will continue to review the project in order to reduce costs.

The latest development provides clarity in terms of the status and timeline for the project, which is positive, in our view. Based on the revised timeline, tenders could be called as soon as mid-2019. Meanwhile, the longer construction period of 10 years (from seven years) would mean that the project cost is spread over a longer duration, easing the Government's annual financial commitment to the project. It is likely that the project would be cheaper than its initial MYR110bn estimate, with the adoption of the EPCC model – instead of a PDP model – likely being one of the cost-cutting measures incorporated.

For the MYR81bn East Coast Rail Link (ECRL) project, Prime Minister Tun Dr Mahathir Mohamad provided an update to the media following his trip to China in Aug 2018. He stated that the Government is currently studying the possibility of deferring or selecting a new contractor to undertake the project. This is, however, subject to negotiations with the existing China-based contractor on matters such as compensation concluding favourably.

Figure 7: Status of upcoming projects

Project	Est. Cost (MYRbn)	Latest progress
ECRL	81	Deferred (13% complete)
MRT3	40	Cancelled
HSR	110	Deferred
Pan Borneo Highway (Sabah)	12.8	Awards deferred
Penang Transport Masterplan (PTMP)	46*	Pending approval on LRT scheme and environmental impact assessment (EIA)
JB-Singapore RTS	4	Approved in-principal
Putrajaya Tram	3	Announced, no updates
Kuching LRT	11	Announced, no updates

Note: *Inclusive of the undersea tunnel

Source: Project owners, media, company data, RHB

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We recommend investors to follow the flow of contracts in stock selection

We prefer contractors which have not disappointed in terms of securing new contracts in 2018. Companies that meet this criteria are Sunway Construction and Kerjaya, which are our Top Buys. In 2018, the two company have respectively secured new contracts amounting to MYR799m and MYR496m, receiving a steady flow of awards from external private developers and in-house units. Both companies appear to have weathered the drought in new jobs caused by the deferment of large-scale public projects.

Looking ahead, we continue to favour companies that have significant exposure to private sector projects. Upcoming developments that could provide job flows, in our view, include Pavilion Damansara, Menara Dayabumi redevelopment, TRX, TNB Bangsar and other residential developments within the Klang Valley. From the public sector, projects that have received the Government's blessing such as Gemas-JB double tracking, the PTMP and the JB-Singapore RTS could be worth watching.

We also like MRCB for its efforts in monetising assets, ie the sale of the Eastern Dispersal Link (EDL) and a stake in Bukit Jalil Sentral. We also believe that the stock has been unfairly punished, with few reasons to justify the steep -33% YTD decline.

Figure 8: Selected project updates

Project	Current developments	Companies involved - awarded or express interest in participating
Penang Transport Masterplan (PTMP)	Penang Chief Minister, Mr Chow Kon Yeow hopes that proposals would be tabled to the cabinet for approval by 2H18 for the first three components – the Light Rail Transit (LRT), the Penang Island Link (PIL) highway and land reclamation sites. Earlier this week, a JV between Vizione (VZH MK, NR) and Vertice (VERT MK) won a MYR815m contract from Consortium Zenith Construction for an approved packaged under the PTMP. We believe further approvals and awards could spark some interest in the construction sector.	Penang based contractors: SRS Consortium (60% owned by Gamuda), Vertice, Vizione, Kerjaya Prospek (has jobs in Penang), Ewein
JB-Singapore RTS	Labelled as a high impact project by the Ministry of Transport to alleviate traffic congestion along the Johor Causeway has received reaffirmation to continue. An approval in-principle has been granted, pending a working paper to be presented to the cabinet in September 2018, according to the Ministry of Transport.	Johor based contractors: Kimlun, YTL

Source: Company data, RHB

Maintain NEUTRAL

We remain NEUTRAL on the broader sector amid setbacks in the rollout of new projects, and a possible reduction of outstanding orderbook amid cost-cutting measures. We believe that most of the negative news have been reflected in share prices, with stocks declining 20-30% after the general elections, capping downside risk. Upside risk, meanwhile, is also limited in our view, due to a lack of clarity of future projects.

Sector valuations – as represented by the Kuala Lumpur Construction Index (KLCON) – remain at depressed levels – 9.2x 12-month forward P/E, around -2SD from its 10-year mean of 13.7x forward P/E.

In the near-term, we recommend investors adopt a trading approach based on news flow such as contract awards and project updates. For the mid to long term, we prefer to wait for more clarity and firm details regarding the status of mega projects. We believe that the upcoming Budget 2019 in November could shed more light on prospects for the sector in 2019. At this juncture, however, we do place a high possibility of ground-breaking development with regards to the government infrastructure development budget for 2019, considering the prudent stance observed by the Government.

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Buy: Share price may exceed 10% over the next 12 months

Trading Buy: Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain

Neutral: Share price may fall within the range of +/- 10% over the next 12 months

Take Profit: Target price has been attained. Look to accumulate at lower levels

Sell: Share price may fall by more than 10% over the next 12 months

Not Rated: Stock is not within regular research coverage

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