Risk of order-book reductions seen for construction sector

We favour contractors that have been securing projects on an open-tender basis, which is the transparent process favoured by the new government.

Construction sector

Maintain neutral: In the mid-term review of the 11th Malaysia Plan 2016 to 2020 (11MP), the government has cut the development expenditure ceiling to RM220 billion from RM260 billion to consolidate its fiscal position. The annual construction sector average growth rate is expected to moderate to 4.3% in 2018 to 2020 from 7.1% in 2016 to 2017 due to the slow property market and re-prioritising of major infrastructure projects. We reiterate our "neutral" call on the construction sector with IJM Corp Bhd, Sunway Construction Group Bhd (SunCon) and HSS Engineers Bhd as our top "buys".

The ongoing major infrastructure projects under 11MP will continue to be implemented, but costs will be rationalised for some of the projects. This will sustain the construction activities of contractors undertaking works for the Pan Borneo Highway, Klang Valley mass rail transit Line 2, light rail transit Line 3, Gemas-Johor Baru Double Tracking and four expressways in the Klang Valley. It is also positive to note that the cut in the development expenditure budget under the 11MP was moderate with an average of RM44 billion per annum (pa) balance to be spent in 2018 to 2020, compared with the average of RM43.5 billion pa expended in 2016 to 2017.

The new government's shift to prioritise inclusiveness in development will see higher allocation of development expenditure to less developed states and expanding public services and utilities. Improvement in water and wastewater services, electricity supply and flood mitigation, and the building of schools, hospitals and roads will be emphasised. IJM Corp and SunCon have been building private hospitals and will likely benefit under the open-tender system to award new government hospital contracts. Other potential beneficiaries are Ekovest Bhd and Malaysian Resources Corp Bhd for flood mitigation projects, and HSS, Taliworks Corp Bhd, Salcon Bhd and Gamuda Bhd for water and wastewater projects.

The government plans to build 200,000 affordable homes in 2018 to 2020, to be spearheaded by the National Affordable Housing Council. The public transport modal share remains low at 21% in 2017 and the 40% target by 2020 may not be achievable. The major public transport project mentioned in the mid-term review that is yet to be implemented is the RM4 billion Singapore-Johor Baru Rapid Transit System. Potential contractor beneficiaries of rail projects include Gamuda, YTL Corp Bhd and IJM Corp.

We reiterate our "neutral" call as we remain cautious on the sector due to the risk of order-book reductions with cost cuts for infrastructure projects. We favour contractors that have been securing projects on an open-tender basis, which is the transparent process favoured by the new government. Our top "buys" are IJM Corp (large-cap), SunCon (mid-cap) and HSS (small-cap). The key upside risk is an acceleration in public infrastructure spending, and the key downside risk is further cuts in spending. — *Affin Hwang Capital Research, Oct 19*