

05 July 2019

Construction

S.O.S!

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UNDERWEIGHT



Year-to-date, listed companies clinched RM8.3b, of works in total – some 13% lower YoY. This fact was probably obscured by the excitement over the revival of the mega ECRL project. Positive as it may sound, this space, in our view, is overly crowded and competitive as there were 859 Grade 7 classified contractors that participated in the pre-qualification exercise all eyeing just 40% of the civil works portion which could be valued at c.RM18.0b based on a reduced overall project value of RM44bn.

KLCON is trading at 1-year Fwd. PER of 13.4x slightly above its 10-year average levels of 13.2x, after staging a strong rebound of 76% from its weakest level of 7.6x (-3.0SD to the 10-year average). That aside, the PER trading discount between KLCON to KLCI had also narrowed from -53% (at -3SD levels) to -22% (-0.5SD levels) which we believe to be fair due to the lack of fresh catalyst coupled with lethargic contract flows.

We opine that for its discount factor to narrow up its average levels of -15% the sector would require strong catalysts like the continuation of MRT3 and HSR or firm direction in the infrastructure development space by the government which should be more than just re-tendering of projects from LRT3, KVDT and ECRL, but also the revival of MRT3 and HSR. Hence, we maintain our UNDERWEIGHT recommendation on this sector which investors can take the opportunity to “Sell on Strength” (S.O.S.)!



The force remains strong. At our report cut-off date of 21-June-2019, the sector remained bullish as stocks under our coverage continued to register positive returns averaging 9.3% in the current quarter on top of a stellar 21.8%-return in the previous quarter. This was mainly driven by large cap contractors, in particular, WCT and GAMUDA, which have risen by >30%, QoQ. We are not surprised with the rally in the construction space year-to-date given the heavy post-election sell-down last year. Year-to-date, KLCON Index outperformed KLCI with a positive return of 41.6% compared to KLCI's year-to-date loss of 0.5% due to greater clarity, with far lessened risks of further reviews, on infrastructure project costs, including rail projects like MRT2 and LRT3, which are proceeding after renegotiations with the government.

Results review. For 1QCY19, we saw better performance from contractors, where out of 11 stocks that we cover, only 3 disappointed and 1 reported above expectations, compared to 4 disappointments in 4QCY18. The rest came in within expectations.

The 3 stocks that disappointed were SENDAI, MUHIBAH, and SUNCON where slower billings from its construction divisions were mainly to blame. As for IJM that came in above expectations, it was due to its plantation division reporting lower than expected losses, coupled with an impressive performance from its property division.

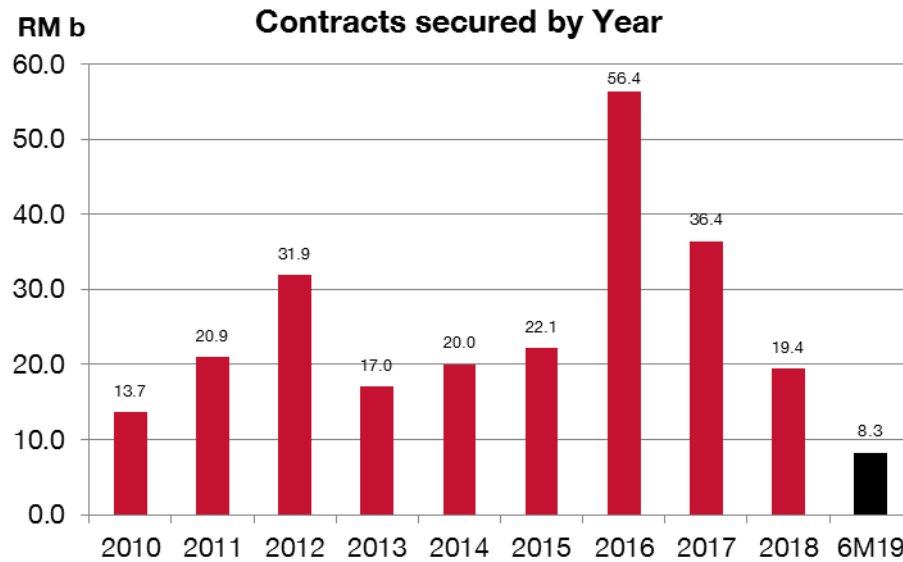
YoY, bulk of the contractors CNP were down by 0.5%-68.7%, and with MITRA slipping into losses, except for HSL, KERJAYA, and KIMLUN, which registered growth between 6.8%-26.2% driven by better billings progress backed by the growth in order-book size in recent years. (Note that GKENT and GAMUDA have odd financial year ends and the results review does not reflect its recent results.)

Boring contract flows. Year-to-date, listed companies clinched a total worth of RM8.3b, (-12.7% YoY) of works by our estimates. While the market is all hyped up over projects like ECRL for which total project cost was reduced to RM44.0b, we believe this particular space to be overly crowded and competitive as there are 859 Grade 7 classified contractors participating in the pre-qualification exercise - all competing for the 40% civil work portion of ECRL possibly valued at c.RM18.0b or less. Assuming 10% of the Grade 7 contractors are successful in clinching an award from ECRL, it would translate to an average contract size of RM225.0m for each player. Due to the stiff competition, we opine that the margins from ECRL would be less attractive for large-cap contractors to participate, but would be benefit smaller players that are hungry on order-book replenishment. As for 2HCY19, we believe that the contract flows could be slower than 1HCY19 if contract awards from KVDT and ECRL commences in 2020, bringing total awards to <RM16.0b for 2019. Nonetheless, with the highly anticipated Budget-20, we hope that the government will revive mega infrastructure projects like MRT3 and High-Speed-Rail.

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Penang Transport Master Plan (PTMP). While GAMUDA is positive on the potential prospects from PTMP, which could be valued at RM16.0b - RM8.0b in tunnel works and RM8.0b LRT - the Penang state government are looking at the funding option without including land sales. We opine that the project to be still in early stages and the construction duration is as at 8-years, carrying higher risk to profitability due to the fluctuation in raw material prices and labour costs. Hence, we remain less excited on the project for now until funding has been secured by the Penang state government.

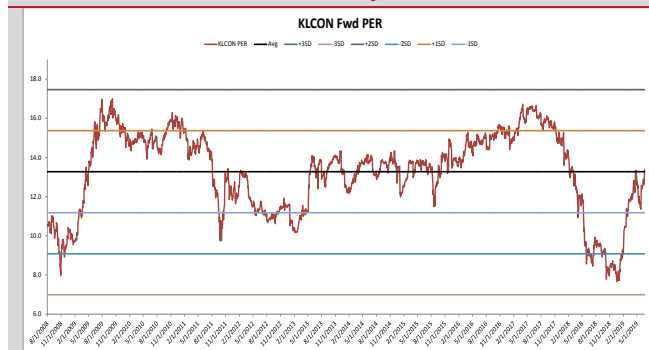
Contracts Secured by Year



Source: Kenanga Research

Opportunity to sell on strength. Currently, KLCON is trading at 1-year Fwd. PER of 13.4x slightly above its 10-year average levels of 13.2x, after staging a strong rebound of 76% from its weakest level of 7.6x (-3.0SD to the 10-year average). That aside, the PER trading discount between KLCON to KLCI had also narrowed from -53% (at -3SD levels) to -22% (-0.5SD levels) which we believe to be fair due to the lack of fresh catalyst coupled with lethargic contract flows. We opine that for its discount factor to narrow up its average levels of -15% the sector would require strong catalysts like the continuation of MRT3 and HSR or firm direction in the infrastructure development space by the government which should be more than just re-tendering of projects from LRT3, KVDT and ECRL. Recently, we upgraded GAMUDA from UP to MP with a higher TP of RM3.75 (from RM2.90) premised on the strong improvement in its property division, better than expected construction margins and strong drive to venture overseas i.e. Australia market. While we reiterate our UP call on SUNCON, we upgraded its TP to RM1.45 (from RM1.40) as we revised our order-book replenishment assumptions higher to RM1.8b, and we also ceased coverage on SENDAI. **However, we maintain our UNDERWEIGHT recommendation on this sector which investors can take the opportunity to “Sell on Strength” (S.O.S.).**

Chart 1: KL Construction’s 10-year Fwd-PER



Source: Kenanga Research

Chart 2: KLCON vs KLCI PER Discount Factor



Sector risks. Our major concerns for the sector remain unchanged, i.e. labour issue, high staff turnover, especially mid-management, sharp raw material costs like cement, which almost see a sharp rise in the average selling price for its oligopoly status (fortunately stopped by the government), which could hurt profitability as the growing demand for human capital in the sector lead to higher overheads for contractors, and unexpected margin compressions.

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APPENDIX

Contractor Share Prices Quarterly Performance

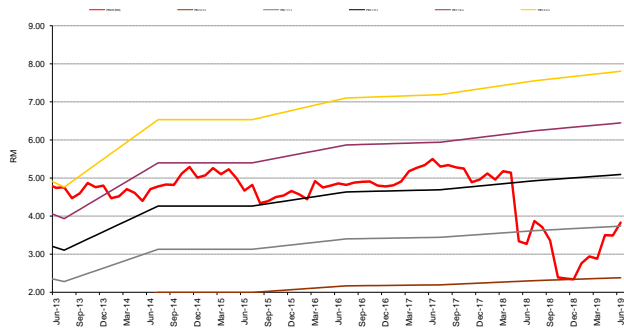
Contractors	Share Price Changes over 4QCY18 review period	Share Price Changes over 1QCY19 review period	Share Price Changes over 2QCY19 review period	Share Price Changes over 3QCY19 review period
IJM	1.1%	-13.1%	32.1%	14.8%
GAMUDA	1.2%	-30.9%	26.8%	32.5%
WCT	13.0%	-25.3%	20.6%	30.5%
SUNCON	-2.2%	-23.1%	30.0%	12.1%
GKENT	4.5%	-35.1%	25.1%	1.8%
Big cap average	3.6%	-25.5%	26.9%	18.3%
HSL	-1.4%	-2.2%	7.4%	-4.1%
MUHIBAH	-6.2%	0.0%	2.8%	-3.7%
MITRA	-18.6%	-31.6%	46.3%	-11.4%
KIMLUN	-8.8%	-12.1%	11.9%	13.1%
KERJAYA	-7.8%	-23.9%	14.8%	7.3%
Small-mid cap average	-8.6%	-14.0%	16.6%	0.2%
Overall Average	-2.5%	-19.7%	21.8%	9.3%

Source: Kenanga Research

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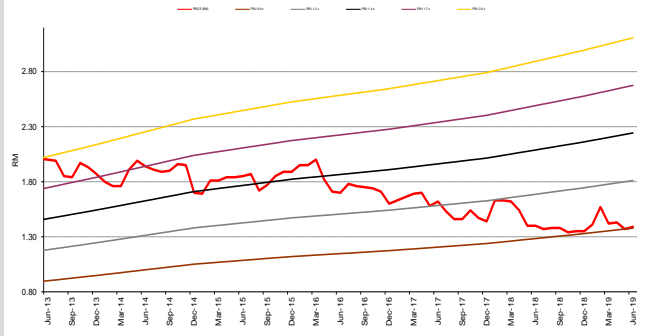
CONTRACTORS FWD PBV

Fwd PBV: GAMUDA

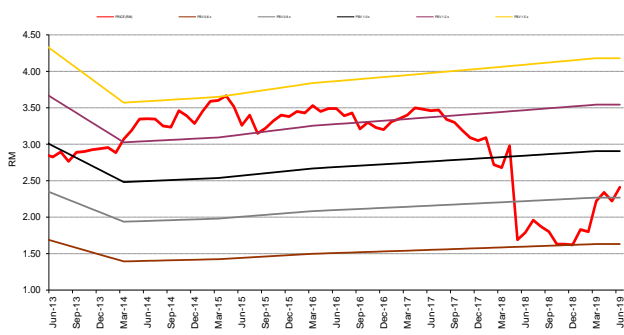


Source: Kenanga Research

Fwd PBV: HSL

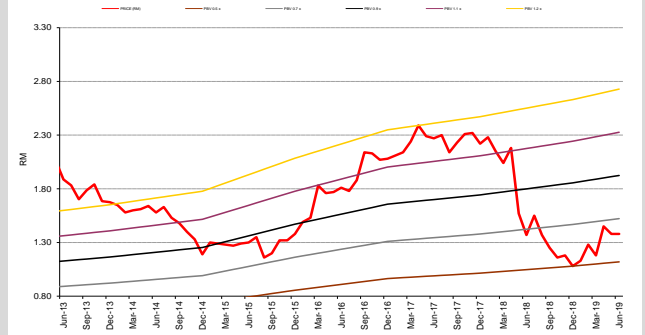


Fwd PBV: IJM

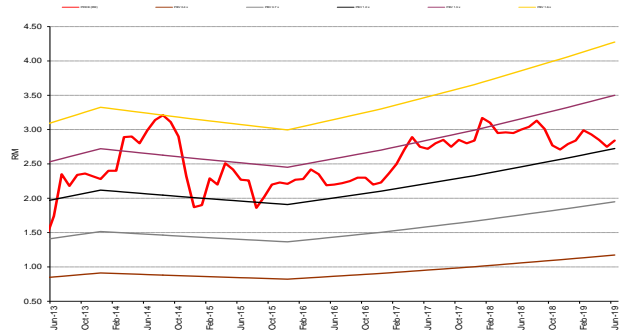


Source: Kenanga Research

Fwd PBV: KIMLUN

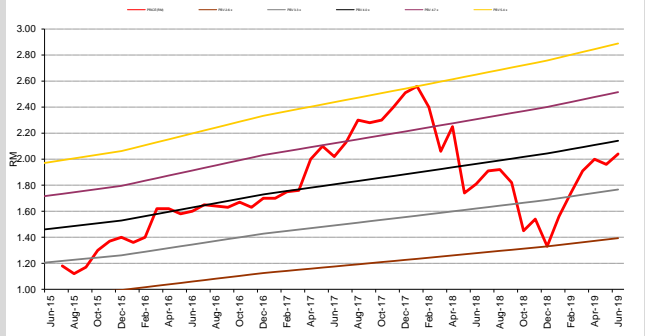


Fwd PBV: MUHIBAH

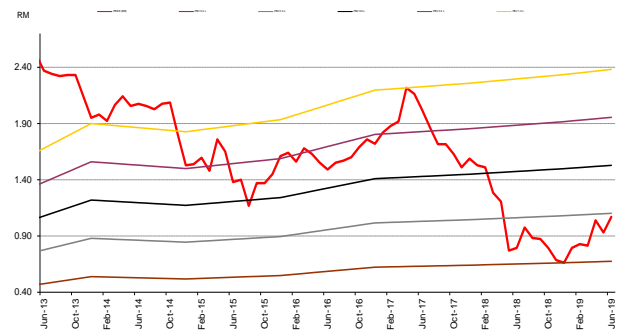


Source: Kenanga Research

Fwd PBV: SUNCON

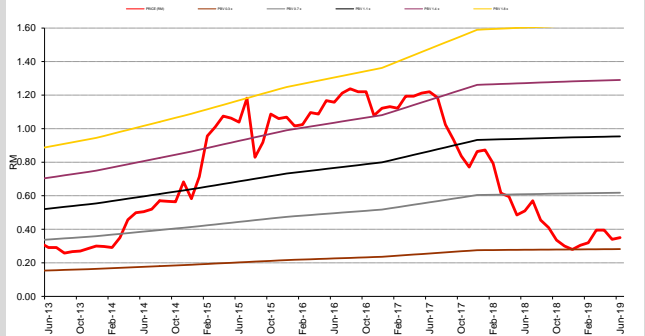


Fwd PBV: WCT

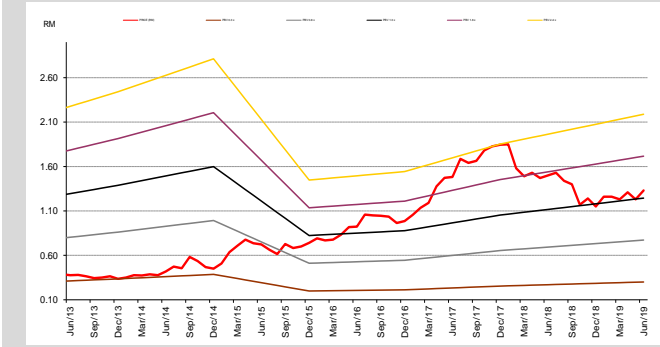


Source: Kenanga Research

Fwd PBV: MITRA

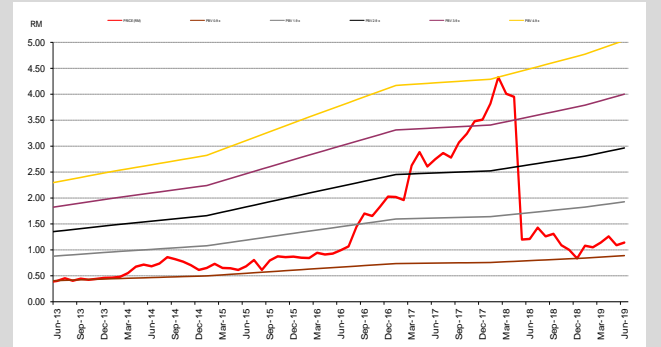


Fwd PBV: KERJAYA



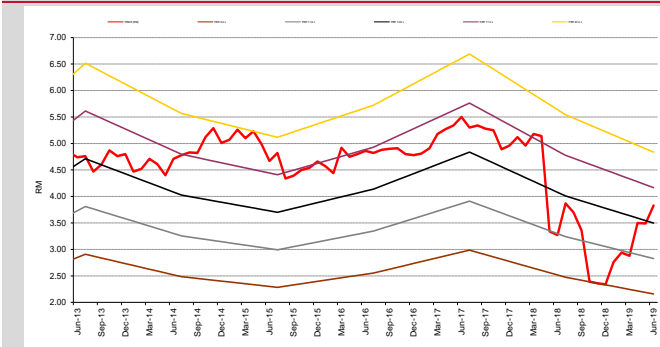
Source: Kenanga Research

Fwd PBV: GKENT



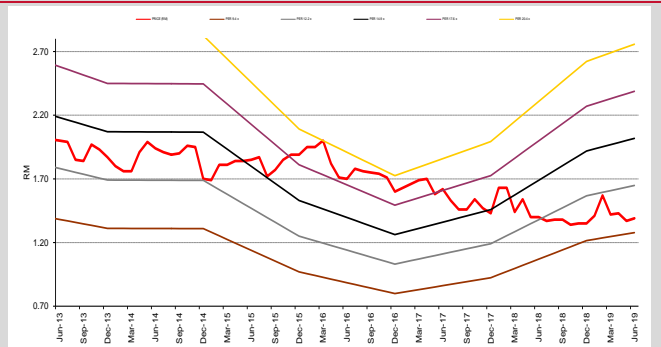
CONTRACTORS FWD PER

Fwd PER: GAMUDA

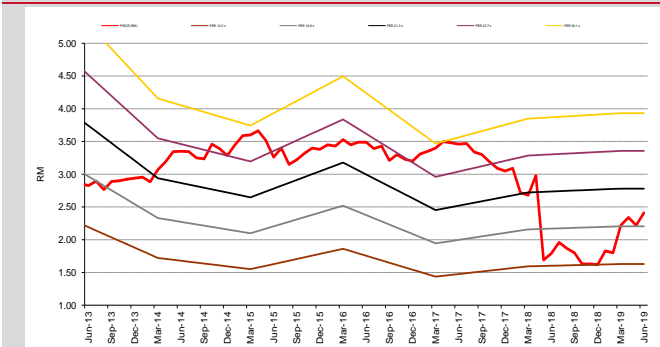


Source: Kenanga Research

Fwd PER: HSL

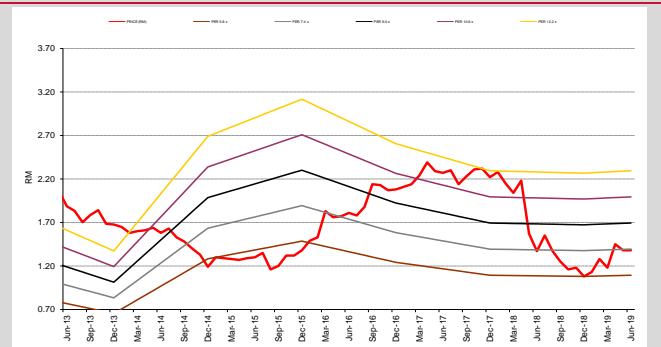


Fwd Core PER: IJM

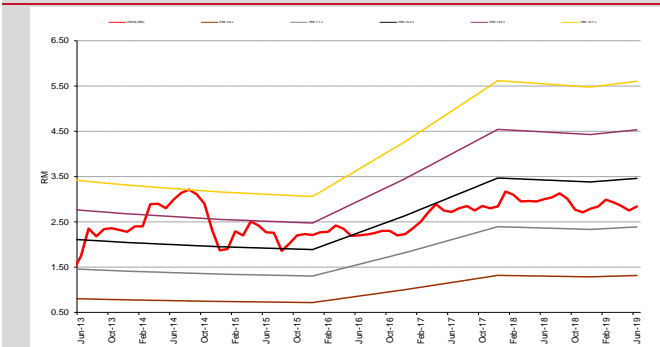


Source: Kenanga Research

Fwd Core PER: KIMLUN

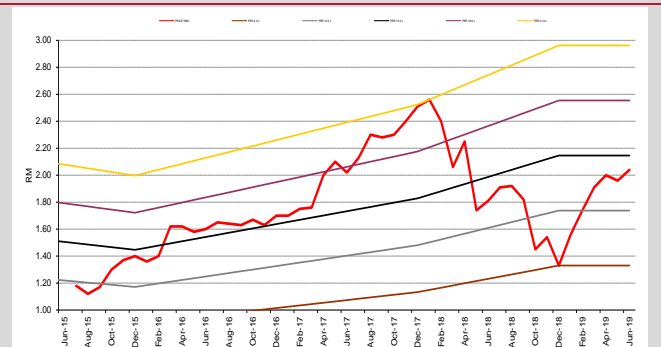


Fwd PER: MUHIBAH

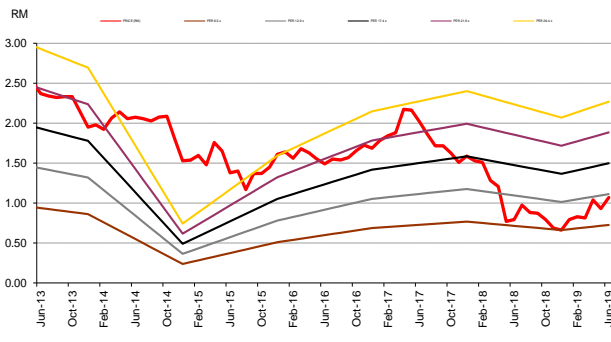


Source: Kenanga Research

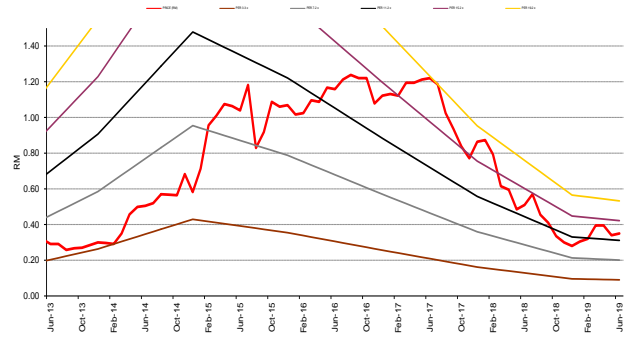
Fwd Core PER: SUNCON



Fwd PER: WCT

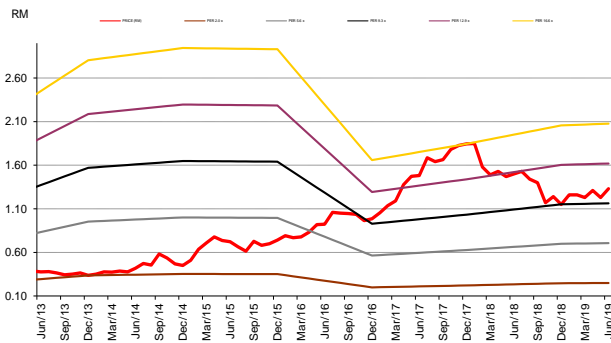


Fwd PER: MITRA

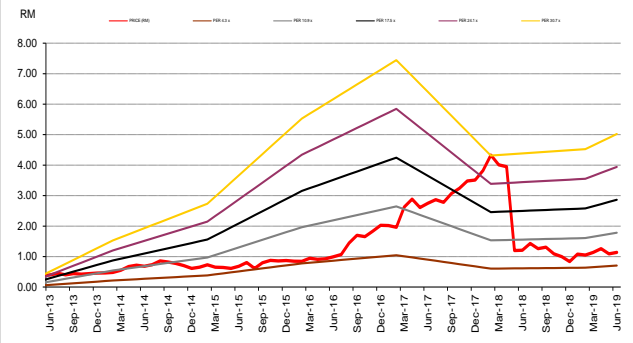


Source: Kenanga Research

Fwd PER: KERJAYA



Fwd PER: GKENT



Source: Kenanga Research

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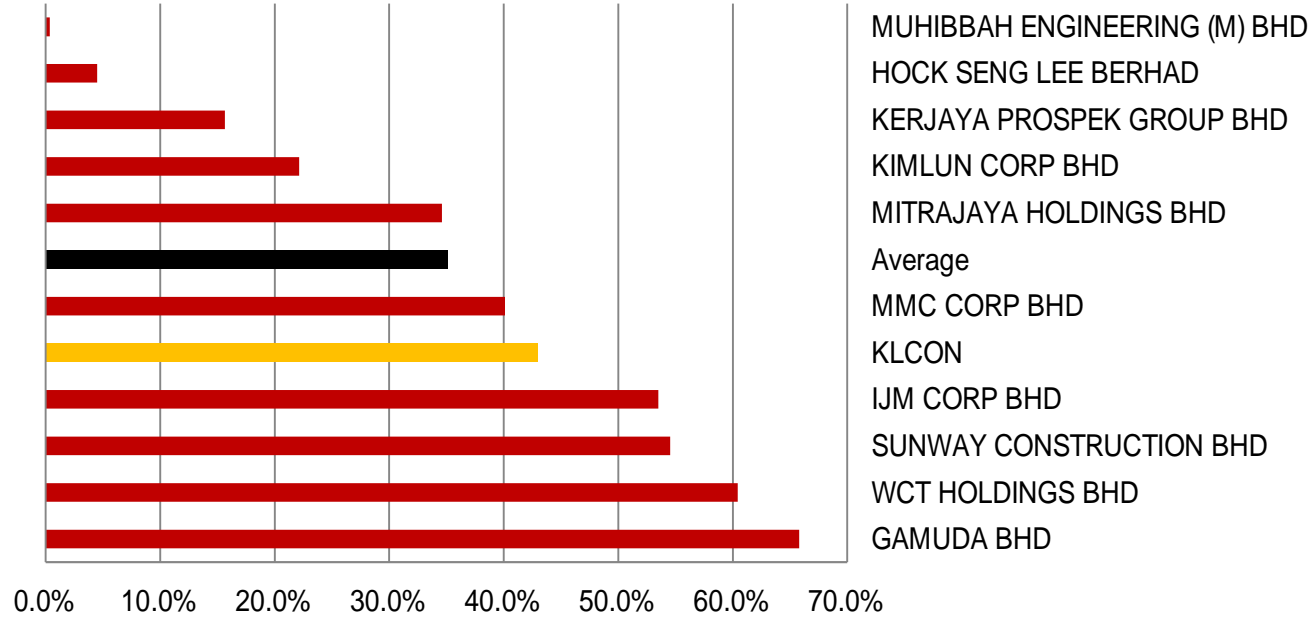
Valuation & Justification For Calls

NAME	Price (21/6/19) (RM)	Mkt Cap (RMm)	Target Price (RM)	Valuation Basis	Rating
GAMUDA	3.83	9,456.1	3.75	Sum-of-Parts (11.0x FY20E PER construction)	MP
GEORGE KENT	1.14	614.0	1.15	Sum-of-Parts (7.0x FY20E PER construction)	MP
HOCK SENG LEE	1.39	763.8	1.40	10.0x FY20E PER	MP
IJM CORP	2.41	8,745.9	1.80	Sum-of-Parts (9.0x FY20E PER construction)	UP
KERJAYA	1.33	1,639.7	1.20	Sum-of-Parts (10.0x FY20E PER construction)	UP
KIMLUN CORP	1.38	458.0	1.35	7.0x FY20E PER	MP
MITRAJAYA	0.350	311.4	0.200	Sum-of-Parts (6.0x FY20E PER construction)	UP
MUHIBBAH	2.84	1,369.0	3.20	Sum-of-Parts (7.0x FY20E PER construction)	OP
SUNCON	2.04	2,630.3	1.45	Sum-of-Parts (11.0x FY20E PER construction)	UP
WCT HOLDINGS	1.07	1,478.3	0.815	Sum-of-Parts (8.0x FY20E PER construction, ascribed 30% discount to its investment properties)	UP

Source: Kenanga Research

YTD Performance of Core Coverage

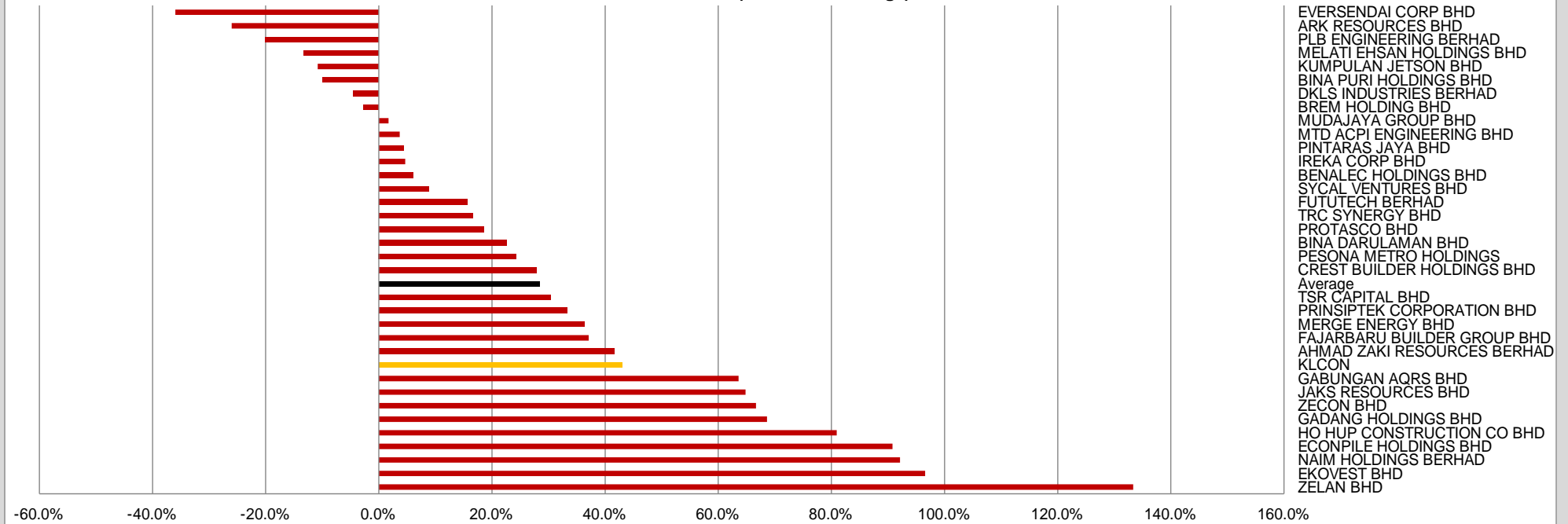
Share Price YTD Gain CY19 (Core Coverage)



Source: Company, Kenanga Research

YTD Performance of Non-Core Coverage

Share Price YTD Gain CY19 (Non-Core Coverage)



Source: Company, Kenanga Research

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Peer Comparison

Name	Last Price (21/6/19) (RM)	Market Cap (RM'm)	Shariah Compliant	Current FYE	Revenue Growth		Core Earnings Growth		PER (x) - Core Earnings			PBV (x)		ROE (%)	Net Div Yid (%)	Target Price (RM)	Rating
					1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.		
STOCKS UNDER COVERAGE																	
GAMUDA BHD	3.83	9,456.1	Y	07/2019	-20.8%	0.3%	-17.1%	-13.9%	11.6	13.9	16.2	1.2	1.2	8.7%	3.1%	3.75	MP
GEORGE KENT (MALAYSIA) BHD	1.14	614.0	Y	01/2020	14.4%	-0.3%	4.9%	33.1%	8.1	7.7	5.8	1.3	1.2	16.0%	4.3%	1.15	MP
HOCK SENG LEE BERHAD	1.39	763.8	Y	12/2019	18.7%	15.6%	31.6%	10.3%	14.2	10.8	9.8	1.0	0.9	8.8%	1.9%	1.40	MP
IJM CORP BHD	2.41	8,746.9	Y	03/2020	22.8%	2.0%	11.0%	2.2%	20.9	18.9	18.5	0.9	0.9	4.7%	2.1%	1.80	UP
KERJAYA PROSPEK GROUP BHD	1.33	1,639.7	Y	12/2019	28.3%	-4.4%	11.5%	1.9%	11.9	10.7	10.5	1.7	1.5	14.9%	2.2%	1.20	UP
KIMLUN CORP BHD	1.38	458.0	Y	12/2019	6.0%	-5.2%	-1.2%	2.5%	7.3	7.4	7.2	0.7	0.7	9.0%	3.1%	1.35	MP
MITRAJAYA HOLDINGS BHD	0.350	311.4	Y	12/2019	-4.7%	-7.3%	-40.7%	-11.7%	7.0	11.9	13.4	0.4	0.4	3.3%	4.3%	0.200	UP
MUHIBBAH ENGINEERING (M) BHD	2.84	1,369.0	Y	12/2019	-5.8%	3.8%	-2.5%	4.7%	8.4	8.7	8.3	1.2	1.1	13.4%	2.5%	3.20	OP
SUNWAY CONSTRUCTION GROUP BHD	2.04	2,630.3	Y	12/2019	-6.1%	27.1%	-12.2%	27.7%	18.9	21.5	16.9	4.4	4.0	19.4%	2.7%	1.45	UP
WCT HOLDINGS BHD	1.07	1,478.3	Y	12/2019	6.4%	14.1%	-13.8%	19.3%	11.8	13.7	11.4	0.5	0.5	3.4%	0.0%	0.815	UP
Simple Average					5.9%	4.6%	-2.9%	7.6%	12.0	12.5	11.8	1.3	1.2	10.2%	2.6%		
CONSENSUS ESTIMATES																	
AHMAD ZAKI RESOURCES BERHAD	0.425	254.2	Y	12/2019	N.A.	N.A.	N.A.	N.A.	17.3	N.A.	N.A.	0.5	N.A.	N.A.	N.A.	N.A.	SELL
BINA PURI HOLDINGS BHD	0.180	68.6	Y	06/2019	N.A.	N.A.	N.A.	N.A.	132.0	N.A.	N.A.	0.3	N.A.	N.A.	N.A.	N.A.	SELL
GABUNGAN AQRS BHD	1.42	700.4	Y	12/2019	25.8%	33.1%	26.2%	30.4%	11.4	9.1	0.0	1.4	1.4	15.8%	4.1%	1.75	BUY
GADANG HOLDINGS BHD	0.860	626.0	Y	05/2019	11.8%	15.6%	-33.1%	16.3%	6.5	9.7	0.0	0.8	N.A.	8.8%	2.7%	0.890	NEUTRAL
JAKS RESOURCES BHD	0.750	482.3	Y	12/2019	74.4%	-48.7%	655.6%	-21.2%	31.9	4.2	0.0	0.5	0.5	12.6%	0.0%	0.875	BUY
MUDAJAYA GROUP BHD	0.295	174.0	Y	12/2019	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	0.4	N.A.	N.A.	N.A.	N.A.	SELL
PINTARAS JAYA BHD	2.40	398.1	Y	06/2019	224.3%	-2.7%	135.7%	-6.5%	25.7	10.9	0.1	1.3	1.3	11.5%	7.5%	2.56	NEUTRAL
PESONA METRO HOLDINGS	0.230	159.8	Y	12/2019	12.1%	9.5%	130.2%	0.0%	19.4	8.4	0.0	1.0	N.A.	10.3%	4.3%	0.260	BUY
PROTASCO BHD	0.255	124.2	Y	12/2019	-1.4%	7.9%	365.8%	31.2%	N.A.	9.4	0.0	0.4	0.4	3.6%	5.5%	0.220	SELL
TRC SYNERGY BHD	0.630	302.7	Y	12/2019	15.8%	23.6%	70.8%	29.9%	14.5	8.5	0.0	0.7	0.7	8.5%	5.1%	0.750	BUY

Source: Bloomberg, Kenanga Research

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Stock Ratings are defined as follows:**Stock Recommendations**

OUTPERFORM : A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM : A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM : A particular stock's Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT : A particular sector's Expected Total Return is MORE than 10%
NEUTRAL : A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT : A particular sector's Expected Total Return is LESS than -5%

*****Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.**

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