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15 April 2019

Malaysia Infrastructure

IJM (IJM MK)
Rec BUY→O-PF
Market cap US\$2.0bn
Price RM2.10
Target RM2.55
(from RM2.46)
Up/downside +12%

SunCon (SCGB MK)
Rec BUY
Market cap US\$0.5bn
Price RM1.93
Target RM2.30
(from RM2.15)
Up/downside +19%

Gamuda (GAM MK)
Rec SELL
Market cap US\$1.9bn
Price RM3.19
Target RM2.75
(from RM2.65)
Up/downside -16%

Rail rejuvenation

ECRL resumption confirmation provides sector prospect lift

Tun Daim, the chief negotiator for the ECRL, brought cheer to the construction arena last Friday, announcing the line will resume for a cost of RM44bn, with the signing of a supplemental agreement with China Communications Construction Company, Ltd. On expectations of ECRL resumption previously in March, we upgraded the sector, and wrote positively on IJM, a major ECRL beneficiary (*Malaysia Construction (Back in play)*). But up 40% YTD we lower our IJM rating from BUY to O-PF. We raise our targets for Gamuda (SELL) and SunCon (BUY).

RN44bn cost within expectations although details pending

- The revised cost of RM44bn falls in-line with the figure previously alluded by Tun Daim (23 Mar). The government's total savings of RM21.5bn, from RM66bn previously, is close to the combined savings on LRT3 (RM15bn) and the MRT2 (RM8.8bn). The ensuing ECRL cost is brought to a more palatable RM60m per km from a heady RM98m per km previously. More detail on the ECRL is expected to be unveiled by Malaysia Rail Link (MRL) on Monday, where we look forward to the detail, among others, on the sources of savings, the detailed timeline and the potential awards.
- At present, conspicuously stripped out would be a 18km tunnel between Bentong and Gombak, previously (Figure 1 for new map), which we believe to be a major component of the savings by avoiding tunnelling through the hilly backbone of Malaysia. To achieve this, the route meanders south to include the state of Negeri Sembilan before making its way back up to Port Klang.
- The RM44bn contains a provisional sum for double tracking (figure 1), which we interpret to be the laying of a single track first on a double-track formation; this fits into the modus operandi of the new government of building what is first required.

Rejuvenation of sector with RM13bn in jobs assuming 30% local content

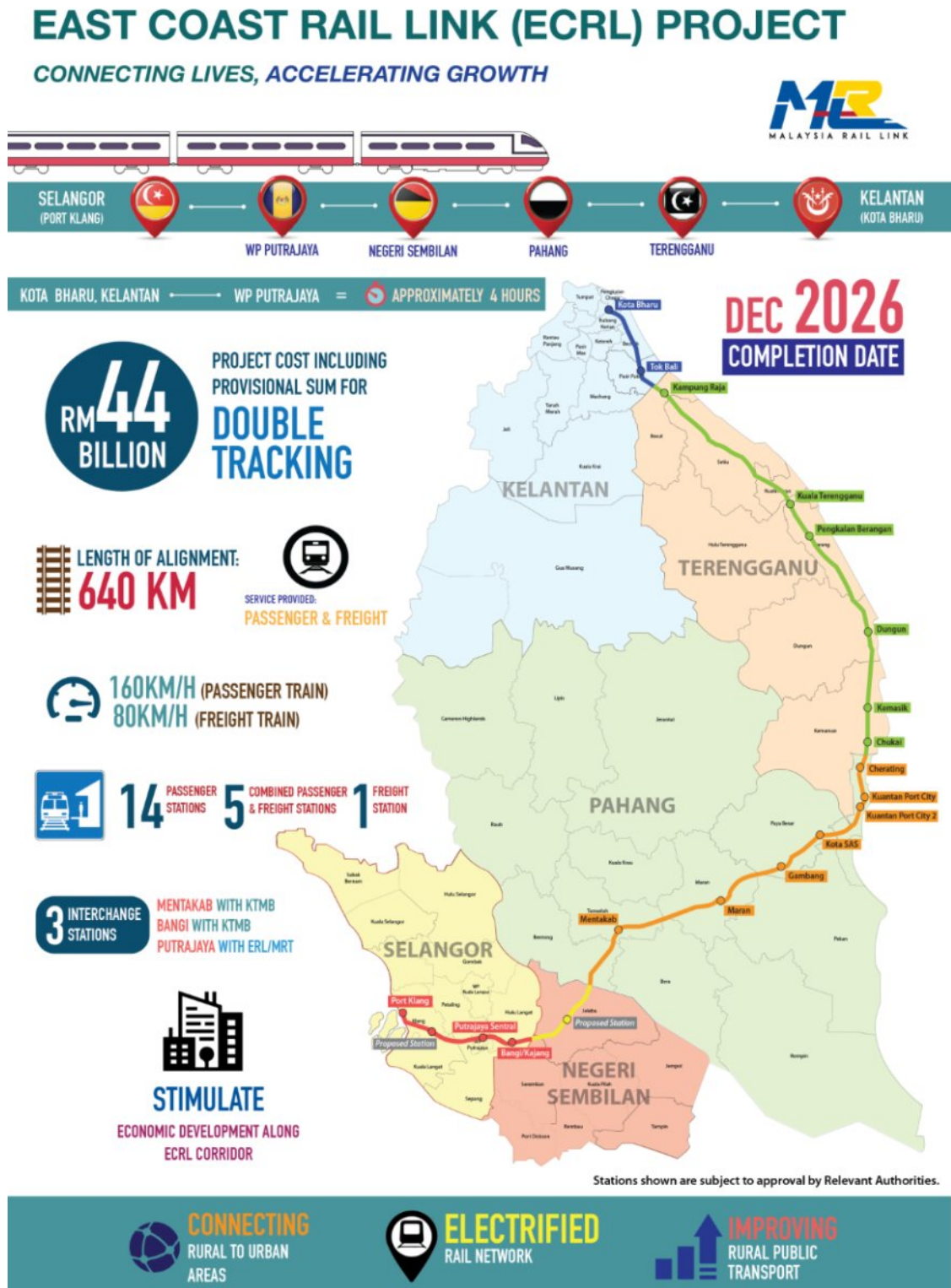
- The ECRL was last reported with 13% progress before suspension in July 2018. The timeline for ECRL completion is 2026, and we expect a few months before tenders following a redesign by consultants.
- While it was previously reported that up-to-50% of the content (the Star, 30 Jan) could be reserved for locals, we await more clarity from the press conference by Malaysian Rail Link on Monday. Assuming 30%-50% local content, this translates into RM13bn-RM22bn in job opportunities to revitalise the sector.
- Referencing the date since Tun Daim hinted the ECRL could be revived with savings of RM10bn, the KLCON Index has gained RM2.7bn in market cap, suggesting some pricing-in of expectations.
- Given the sizeable job wins and the need for a track record, we expect IJM/Gamuda/SunCon to benefit from additional job wins although we do not accord order book benefits pending the tender process (no official guidance by these companies for now on the ECRL). Each RM1bn increase in the order book is expected to increase earnings for FY20 by c.2%/2%/10%, assuming a four-year construction period.
- Inevitably, with a lowered price tag, there are margin questions since Malaysian firms may be participating only at sub-contractor level. Referencing CCCC, its Ebit margin averaged c.7% (past three years) so profitability may be lower for ECRL, we believe. Companies with strong track records will more likely merit selection under the ECRL.

Lower IJM from BUY to O-PF; raise GAM (SELL) & SunCon (BUY) target prices

- For IJM, we increase and construction and piling component to 0.5 std. above the 10-year mean PE of the KLCON Index (from average) to 14x on certainty with the ECRL. This takes its share price from RM2.46 to 2.55, commensurate with an O-PF rating (from BUY). Applying the same metric to Gamuda's construction segment results in a higher target price of RM2.75 (previously RM2.65). A re-rating of Gamuda will most likely be on MRT3, a HSR revival, clarity on the PTMP terms or a favourable disposal price for its tolled highways.
- With a better job outlook & LRT3 to gain revenue momentum, we raise our target price for SunCon from RM2.15 to RM2.30, by giving half the benefit to its net cash per share of 29 sen.

Figure 1

Revised ECRL alignment



Source: CLSA, Malaysian Rail Link

No shortage of construction opportunities given the RM44bn price tag

The construction cost for the ECRL is reduced to RM44 bn, which includes provision for a double track, and still should provide ample opportunities for job replenishment. Details on cost reduction would likely be made clearer with MRL press conference on 15 April 2019. In terms of opportunities for station works, the revised ECRL line will feature 14 passenger stations, 5 combined passenger and freight stations and 1 freight station. This compares to 23 stations in its original iteration (based on Phase 1). The ECRL will also feature 3 interchange stations.

Figure 2

Comparison of statistics on ECRL stations, before and after		
Number of stations (by type)	Original*	Revised ECRL
Passenger	12	14
Freight	2	1
Passenger and freight	9	5

Source: CLSA, East Coast Rail Link Environmental Impact Assessment Report 2017, Malaysia Rail Link. *Based on phase 1, which excludes phase 2 ie from ITT Gombak to Port Klang and from Wakaf Bharu to Pengkalan Kubor.

New alignment is 40km shorter, but crucially maintains port to port connectivity

New alignment sidesteps Gombak and Bentong station in favour of heading south to Negeri Sembilan. We see this as a necessary cost cut given that the tunnel of 18km would have been a chunky component of the cost. The total line is reduced by 40 km. Critically, port-to-port connection still intact, ie connecting Kuantan port to Port Klang. Also importantly, despite the re-route, we understand that travel time isn't much changed, with Kuala Lumpur to Kota Bharu (previously to adjacent Wakaf Bharu) at c.4 hours.

Redesign phase before awards

Given the finalisation of the value, we expect the project to proceed to redesign phase which may take a few months before tenders are called for evaluation. Actual construction work is likely to take place at a later stage. Retaining 94% of the total original line of 688km also presents no shortage of opportunities for building materials companies.

Contractors with strong track records expected

Given the smaller total project cost, we believe it would be in CCCC's interest to expedite the project for efficiency and reduce potential delays and disruptions. Therefore, this plays to the advantage of proven contractors. We see Gamuda, IJM and SunCon among potential beneficiaries. Each RM1 billion increase in order book is expected to increase earnings for FY20 by some 2%/2%/10% respectively, assuming 4 year construction.

Figure 1

Listed names associated with the ECRL project/expressed interest	
Company	Description
HSS Engineers (N-R)	Supervising consultancy services for ECRL and potential ECRL re-design work
Gabungan AQRS (N-R)	Has first right of refusal for construction in Kota SAS, where a station remains
IJM	Eyeing supply of piles, aside station construction work near Kuantan Port. Port connectivity would encourage more FDI into industrial park
Gamuda	Earlier was in negotiations with CCCC as potential subcontractor to ECRL; has working relationship with CCCC in MRT project
Econpile (N-R)	Potential piling beneficiary; has partnered CCCC in 2 other projects
Lafarge (N-R)	Previously had RM270 mn supply deal for ECRL
WZ Satu, Fajarbaru (N-R) WCT (N-R), SunCon	A selection of companies having previously expressed interest to bid

Source: CLSA, companies

Three divisions to benefit

IJM: triple benefit

We see IJM as the key beneficiary from the ECRL. Its industry division (majority piling) has seen its pre-tax profit erode to about RM70-80 mn a year recently on competition on smaller diameter piles given intense pricing in the property market, aside from rising costs in FY2018. The introduction of ECRL will help IJM, where it has built 1 (of 10) plant (200,000 tonnes capacity) in the proximity to Kuantan port; potentially larger diameter piles is envisaged to be needed for ECRL, providing better margin outlook. Piling would be required for areas where the foundation needs strengthening or in elevated segments and bridges.

Figure 3

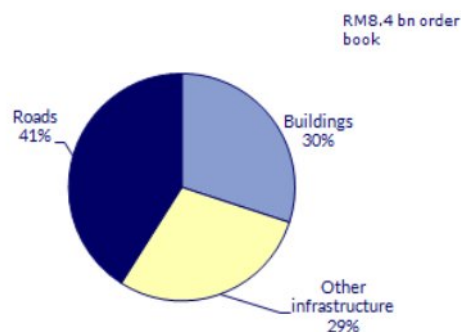
Industry division pre-tax profit (where piling typically represents more than 70% of revenues)



Source: CLSA, IJM

Figure 4

IJM breakdown of construction order book (Dec 2018)



Source: CLSA, IJM

Revised alignment retains two stations near IJM's Kuantan port

In the area of construction, the revised ECRL has retained a design of 2 stations in Kuantan Port City 1 and Kuantan Port City 2 which we think are opportunities for IJM given its presence there. Every RM1bn million of additional order book may translate to earnings of 2%, assuming 4 year construction.

Advent on ECRL should be positive for future FDI

If the ECRL negotiation, as reported, includes an element of future Chinese investment, this should bode well to IJM from the perspective of welcoming future investments into the national industrial park, and in turn benefitting port throughput on higher utilisation. The availability of port-to-port connectivity with the advent on the ECRL may also incentivise foreign companies to locate at the Malaysia-China Kuantan industrial park.

Target price increased to RM2.55 from RM2.46

With benefit of construction prospect clarity, we accord valuations to its construction and piling segment to 14x PE, being 0.5sd below long-term 10-year mean PE (previously average PE of 13x). All else equal, this results in a target price increase to RM2.55 from RM2.46. No changes in earnings as we await more guidance by MRL or company.

Figure 5

IJM valuation					
Malaysia (RM mn)	Basis	Revised	Previous	Remark	
Construction	14x sustainable profit	2,131	1,901	Increased to 14x sustainable profit from 13 previously	
Concrete products (industry)	14x sustainable profit	1,139	947	Increased to 14x sustainable profit from 13 previously	
Local highways	DCF	2,736	2,736		
IJM Land	10% haircut to RNAV	4,305	4,305		
IJM Plantations	56% ownership	470	470	18x 2018 net profit	
WCE Holdings	26% ownership	138	138	Market value	
Scomi Group	21% ownership	13	13	Market value	
Overseas concession assets		690	690		
Revised gross asset value (RGAV)		11,622	11,199		
Company level net cash/(debt)		(1,235)	(1,235)		
Revised net asset value (RNAV)		10,387	9,964		
No. of shares		3,636	3,636		
RNAV/share (RM)		2.86	2.74		
Discount		10%	10%		
Target price		2.55	2.46		

Source: CLSA, IJM

Previously interested in participating

Gamuda: rerating catalysts still brewing

Gamuda, being leading engineering solutions company in Malaysia, should stand in good stead for participation in the ECRL. Previously, it had ambitions to participate as one of the subcontractors to CCCC on one of the 8 packages under ECRL, although the discussions didn't bear fruit. Despite the removal of the long 18km tunnelling section, the original ECRL had an aggregate of c49km of total tunnelling work opportunities for the tunnelling expert. Every RM1bn of work from ECRL would likely increase earnings by c2%, assuming 4 year construction period.

Increase in target price to RM2.75 from RM2.65

Similar to IJM, the better outlook for construction prospects with the ECRL leads us to accord 0.5sd above 10-year KLCON index PE at 14x (from 13), resulting in a target price upgrade.

Rerating catalysts ahead though details are scant

Looking ahead, potential revival of the MRT3 would be a rerating catalyst, as would be the high-speed rail returning to the table; we understand the government is currently engaging consultants to study options to reduce cost project ahead of the April 2020 decision timeline (tender issued on 8 April). Meanwhile, details on PTMP would also allow us to bake in numbers into our projections. In the meantime, discussion for the tolled road sale is still ongoing, which we view to be somewhat an overhang.

Figure 6

Gamuda valuation revisions			
RM mn	Revised	Previous	
Malaysia	RNAV (RM mn)	RNAV (RM mn)	Basis
Construction	2,220	2,005	14x sustainable profit From previously 13x
Property division	2,672	2,672	10x sustainable profit
Highway concessions	2,535	2,535	Discount of 30%
SPLASH	1,020	1,020	
Water O&M contract	774	774	
OTHERS			
NPV of Vietnam projects, overseas concessions and net cash/(debt)	1,613	1,613	
SOTP	10,834	10,619	
Fully-diluted no. of shares (m)	2,994	2,994	
Fully-diluted RNAV/share (RM)	3.62	3.55	
Discount	25%	25%	
Fully-diluted TP at discount to RNAV (RM)	2.75	2.65	

Source: CLSA

SunCon could be more selective to prioritise piling, mechanical and engineering work

Well supported by internal jobs, SunCon is also actively looking for overseas ventures

We accord half the benefit to a sizeable net cash pile of 29 sen per share

SunCon (BUY) – stands in good stead for ECRL work, especially piling

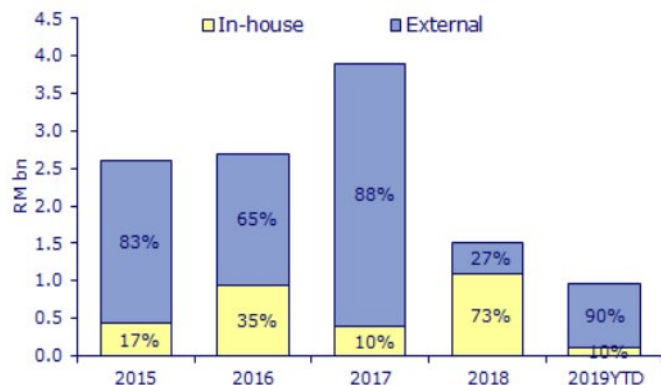
For SunCon, we understand that its RM1.5 bn guidance for job replenishment in 2019 may not have factored in any potential ECRL job wins. Even so, we believe that it is likely to be selective on job replenishment on the ECRL, such as in piling work, predicated on its already large outstanding order book of RM5.8 bn. Its piling arm is among the large firms in the local construction industry.

We believe that its current RM1.5 bn order book replenishment target may be fulfilled with a combination of local jobs (partly supported by internal jobs) as well as overseas work. It is eyeing rail-related work in India as well as potential building projects in Myanmar.

Given the prospect of jobs to add to its backlog and LRT3 review expect to complete soon and resume normal pace of revenue recognition, we are comfortable to accord half the benefit of its sizeable cash pile of 29 sen per share (average over past 3 years of 27 sen per share) to its share price. This results in a target price increase to RM2.30 from RM2.15 previously. While SunCon (16x PE for 19) trades as a premium to sector, this recognises it as among the few pure-play contractors with a net cash position. It also benefits from a sizeable helping of internal job flow by its parent, Sunway Berhad, which formed 25% of total jobs awards over the past 5 years.

Figure 7

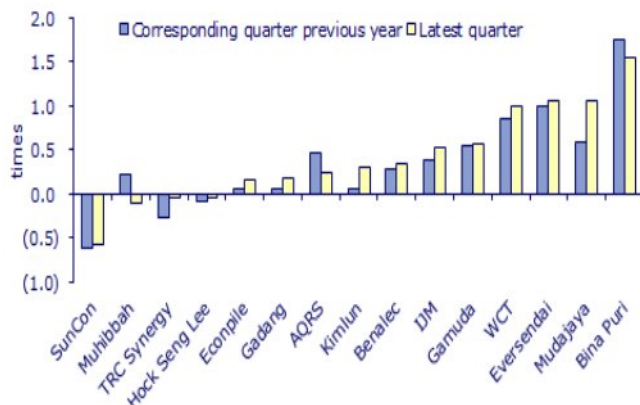
SunCon: order book wins by internal and external job split



Source: CLSA, SunCon

Figure 8

Gearing ratios and YoY change: SunCon has the distinction of superior balance sheet strength



Source: CLSA, SunCon

Figure 9

SunCon: valuation

PE method of valuation	Remarks	Revised (RM mil)	Previous (RM mil)
Earnings (20CL)	15.4x, i.e. PE multiple at 1 sd above sector mean of 13x	179.9	179.9
Multiple applied (x)		15.4	15.4
Total		2,770	2,770
Number of shares		1,293	1,293
Price per share (RM)		2.15	2.15
Net cash per share (RM)	50% benefit given to net cash	0.15	-
Target price (RM)		2.3	2.15

Source: CLSA, SunCon

Figure 10

Construction peer comp

	Price (RM)	Mkt cap (US\$m)	ADT (US\$m)	PE (x)	EPS Growth (%)	PB (x)	ROE (%)	Yield (%)	EV/EBITDA (x)		
				CY19	CY20	CY19	CY20	CY19	CY20	CY19	CY20
KLCI-listed peers											
IJM MK	2.3	2,002	1.65	15.7	14.3	2.2	20.3	0.8	0.8	5.2	5.5
GAM MK	3.2	1,915	4.18	14.2	12.2	(1.5)	12.0	1.4	1.3	7.9	8.1
SCGB MK Equity	1.9	607	0.47	18.3	13.9	(3.5)	17.6	3.9	3.5	25.0	26.7
EVSD MK Equity	0.5	92	0.82	6.0	6.2	5.1	(3.6)	-	-	6.5	5.7
HSL MK Equity	1.4	193	0.02	12.0	10.8	29.3	12.3	1.0	0.9	8.3	8.7
KICB MK Equity	1.2	96	0.03	6.3	6.1	(17.5)	13.9	0.5	0.5	9.0	8.2
MUHI MK Equity	2.9	348	0.45	8.4	8.2	20.1	10.1	1.1	1.0	13.3	12.3
GKEN MK Equity	1.1	148	1.94	8.7	8.1	61.7	(13.5)	1.1	1.1	13.4	13.3
TRC MK Equity	0.6	75	0.77	9.2	8.0	(31.3)	56.8	0.7	-	7.7	8.4
WCTHG MK Equity	0.8	280	0.45	10.6	9.8	(25.5)	2.6	0.4	0.4	3.6	3.9
GADG MK Equity	0.6	105	0.47	19.8	6.3	(51.1)	(6.7)	-	-	6.0	6.6
AQRS MK Equity	1.3	154	1.60	9.0	7.7	76.8	19.7	1.5	-	16.0	18.6

Source: CLSA, Bloomberg

Valuation details - Gamuda Bhd GAM MK

We value Gamuda's construction division based on 16x sustainable earnings (similar to industry average), while applying 14x sustainable earnings for its local property projects. We use DCF to value its Vietnam property development project, expressway and water supply operation and maintenance concessions. Its water supply concession assets are valued based on a 1x book value. Recognising that there could be some uncertainty on the timing of SPLASH sale and with property projects still at nascent stages, our RM6.25 target price for Gamuda is based on a 10% discount to our estimated fully-diluted RNAV/share.

Investment risks - Gamuda Bhd GAM MK

Execution risk on its construction projects could lead to cost overruns whilst slow recovery of the Vietnam economy will dampen demand for its property launches in Hanoi and Ho Chi Minh City, which makes up over 40% of its new property launches. We are concerned on the EPS dilution from the potential more than 20% increase in share base from the warrant and ESOS exercise which we expect will cause the PE ratio of the company to seem steep.

Valuation details - IJM Corp Bhd IJM MK

Our valuation for IJM reflects PE-based valuations for its construction and industrial divisions and an RNAV-based valuation for its property segment with an 8.8% WACC and DCF for its concessionaire stakes, with a discount of 20%.

Investment risks - IJM Corp Bhd IJM MK

With near record high order book, the key risk is execution of the project to ensure profitability and completion according to schedule. Slower property demand due to weaker consumer sentiment has affected IJM's property sales and risk would be a sustained slowdown or further margin pressure. Rising labour costs could put pressure on construction profit margins. Regulatory risk related to toll-road and port concessions are not uncommon.

Valuation details - Sunway Construction Group Bhd SCGB MK

We value SunCon using the price-earnings multiple approach. Its target price is derived from 15.4x 20CL earnings which is at 1sd above 10-year mean PE for the KLCON index; we accord an above sector average PE given its flow of internal jobs and strong balance sheet.

Investment risks - Sunway Construction Group Bhd SCGB MK

The investment risks for SunCon mainly stem from construction risk. Specific risk to our estimates would be lower-than-expected margins (below 5-8%) or amount of projects secured falls below our expectation, either due to inability to secure projects or caused by delay on project roll-out. The increase in steel prices beyond anticipated will also creep into margins as SunCon hedges steel needs for a future six-month period. On the pre-cast segment, risks to our earnings will be timing of recovery of the margins currently in doldrums due to competition. SunCon is also susceptible to risk facing the construction industry in general, which includes the risk of disputes and ensuing lengthy negotiations which is not uncommon, not to mention the fluctuations in raw materials and availability of labour.

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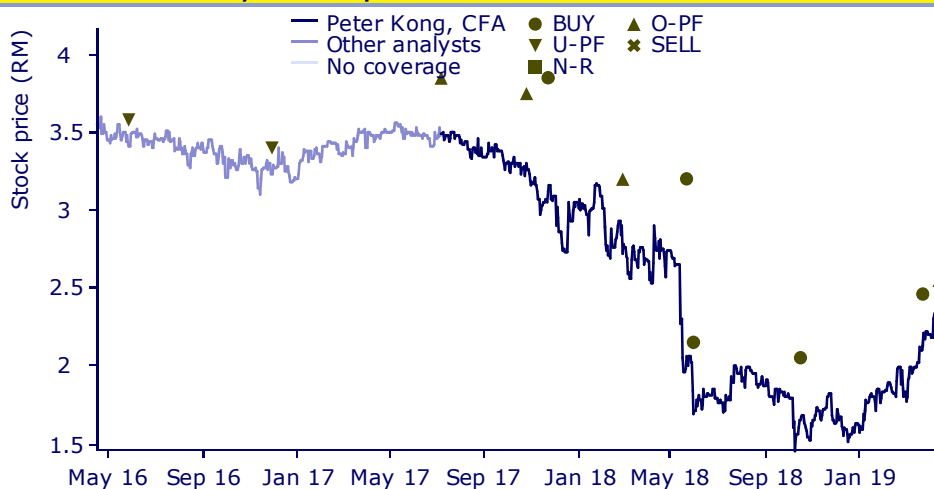
AQRS (N-R)
Benalec (N-R)
Bina Puri (N-R)
CCCC (1800 HK - HK\$8.19 - BUY)
Econpile (N-R)
Eversendai (N-R)
Fajarbaru (N-R)
GADG MK (N-R)
Gamuda (GAM MK - RM3.19 - SELL)
Hock Seng Lee (N-R)
IJM (IJM MK - RM2.27 - O-PF)
IJM Land (N-R)
IJM Plantations (N-R)
KICB MK (N-R)
Kimlun (N-R)
Lafarge (N-R)
Mudajaya (N-R)
Muhibbah (N-R)
Scomi (N-R)
Splash (N-R)
SunCon (SCGB MK - RM1.93 - BUY)
Sunway (N-R)
TCR Synergy (N-R)
WCE (N-R)
WCT (N-R)
WZ Satu (N-R)

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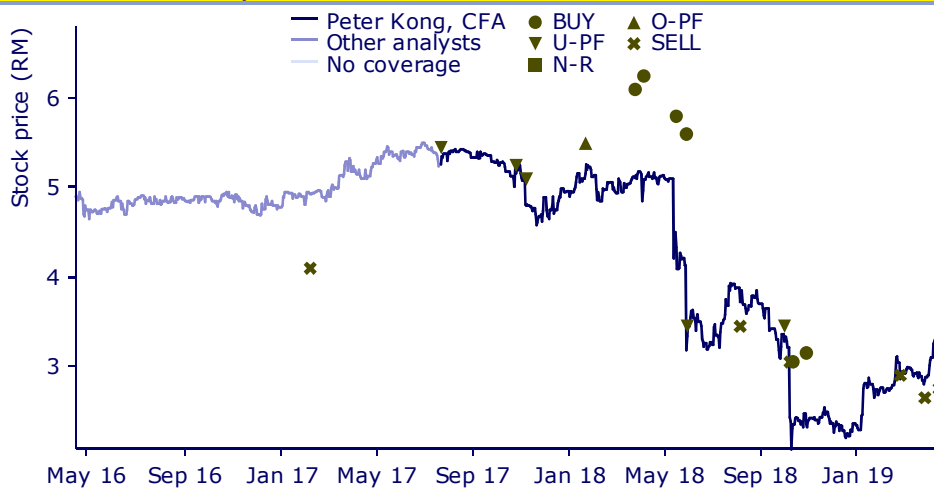
Recommendation history of IJM Corp Bhd IJM MK



Date	Rec	Target	Date	Rec	Target
LATEST	O-PF	2.55	23 Nov 2017	BUY	3.85
25 Mar 2019	BUY	2.46	26 Oct 2017	O-PF	3.75
17 Oct 2018	BUY	2.05	07 Jul 2017	O-PF	3.85
31 May 2018	BUY	2.15	29 Nov 2016	U-PF	3.40
22 May 2018	BUY	3.20	27 May 2016	U-PF	3.58
28 Feb 2018	O-PF	3.20			

Source: CLSA

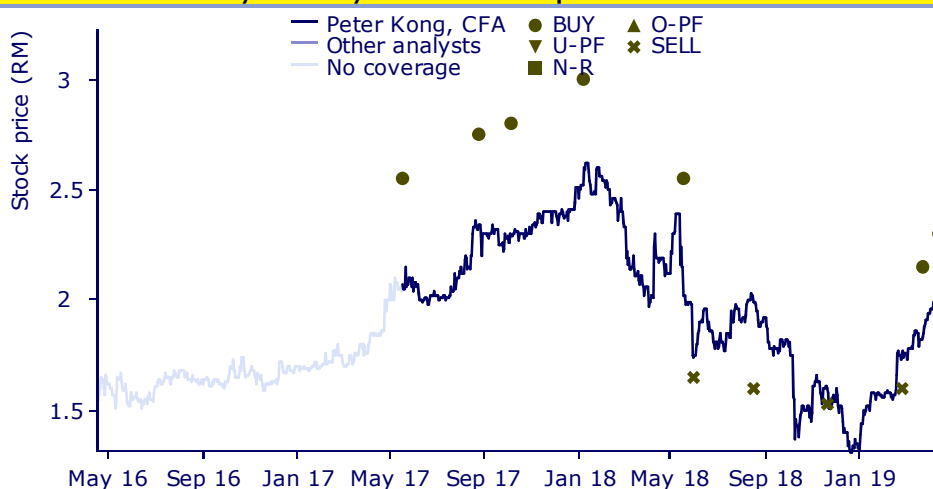
Recommendation history of Gamuda Bhd GAM MK



Date	Rec	Target	Date	Rec	Target
LATEST	SELL	2.75	30 May 2018	BUY	5.60
28 Mar 2019	SELL	2.65	17 May 2018	BUY	5.80
25 Feb 2019	SELL	2.90	06 Apr 2018	BUY	6.25
29 Oct 2018	BUY	3.15	26 Mar 2018	BUY	6.10
12 Oct 2018	BUY	3.05	22 Jan 2018	O-PF	5.50
08 Oct 2018	SELL	3.05	08 Nov 2017	U-PF	5.10
01 Oct 2018	U-PF	3.45	26 Oct 2017	U-PF	5.25
06 Aug 2018	SELL	3.45	23 Jul 2017	U-PF	5.45
31 May 2018	U-PF	3.45	07 Feb 2017	SELL	4.10

Source: CLSA

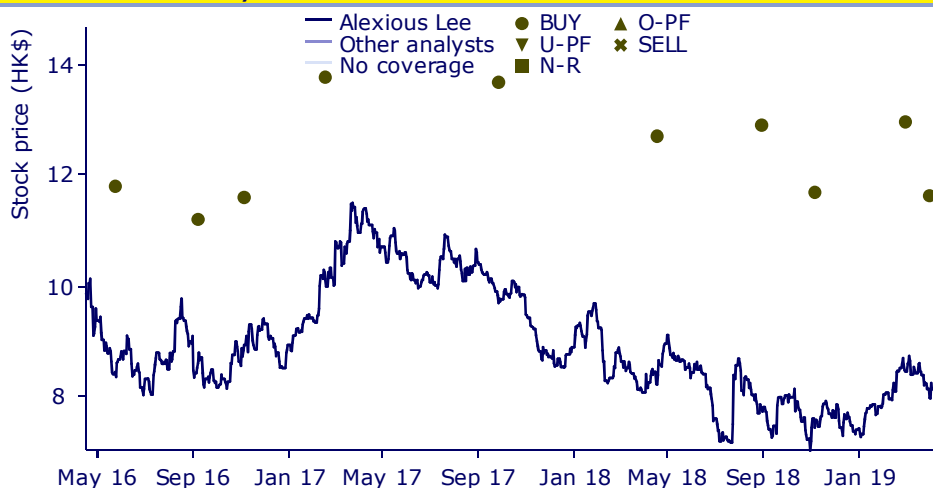
Recommendation history of Sunway Construction Group Bhd SCGB MK



Date	Rec	Target	Date	Rec	Target
LATEST	BUY	2.30	18 May 2018	BUY	2.55
25 Mar 2019	BUY	2.15	08 Jan 2018	BUY	3.00
26 Feb 2019	SELL	1.60	06 Oct 2017	BUY	2.80
21 Nov 2018	SELL	1.53	25 Aug 2017	BUY	2.75
17 Aug 2018	SELL	1.60	18 May 2017	BUY	2.55
31 May 2018	SELL	1.65			

Source: CLSA

Recommendation history of China Communications Construction Co Ltd 1800 HK



Date	Rec	Target	Date	Rec	Target
01 Apr 2019	BUY	11.63	26 Sep 2017	BUY	13.69
01 Mar 2019	BUY	12.97	16 Feb 2017	BUY	13.78
05 Nov 2018	BUY	11.69	04 Nov 2016	BUY	11.60
29 Aug 2018	BUY	12.91	06 Sep 2016	BUY	11.20
17 Apr 2018	BUY	12.71	23 May 2016	BUY	11.80

Source: CLSA

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