

16 December 2016

Busy Years Ahead For Contractors

All eyes on infrastructure spending

Although the allocation for gross development expenditure in Budget 2017 only increased by 2.2% YoY to MYR46bn, we believe public sector projects remain one of the Government's main focus – in particular, transportation-related infrastructure. Meanwhile, most mega projects would be funded off-balance sheets via special purpose vehicles (SPVs) or on a build-operate-transfer (BOT) basis. This is as the long list of projects that were announced and slated for implementation in the coming year are likely not part of the development expenditure.

Figure 1: Major projects mentioned in Budget 2017

Projects	Value (MYRm)	Potential beneficiaries
Road / Highways		
Accelerating the implementation of the Pan-Borneo Highway	28,900	Large- to mid-sized contractors
New and upgrading of village roads (616km)	1,200	Small- and mid-sized contractors
Maintenance of state roads	4,600	Protasco, CMS and others
Upgrade of estate roads	20	Small and mid-sized contractors
Two overhead motorcycle ramps at the Federal Highway	29	Mid-sized contractors
Rail projects		
New East Coast Rail Line project	55,000	Large-sized contractors
Restoring the East Coast Railway Line	100	Mid-sized contractors
Public Amenities		
Football Academy Phase II in Gambang, Pahang	50	Mid-sized contractors
Upgrading sports facilities	122	Mid-sized contractors
To build and upgrade new hospitals and clinics	na	Mid-sized contractors
Reconstruct primary and secondary schools (120 unit) and upgrade science laboratories (1,800 units)	570	Small and mid-sized contractors
Construction of 227 primary and secondary schools	478	Small and mid-sized contractors
Infrastructure and socio economic development for the five economic corridors	2,100	Large to mid-sized contractors
Upgrading and building of local amenities	800	Small-sized contractors (G1 and G2)
97,000 street lights and 3,000 LED lights will be installed at crossroads	na	Small-sized contractors
Water and electricity		
Clean water supply (include upgrading of FELDA water supply system)	732	Water pipe manufacturers
Grants and loan to improve water supply and capacity	665	Water pipe manufacturers
Water supply fund	500	Water pipe manufacturers
Water treatment projects in 42 Orang Asli villages	222	Mid-sized contractors
69 flood mitigation plans	495	Small and mid-sized contractors
Electricity supply	460	Power equipment and cable makers
MySuria Programme	45	Solar panels supplier
Affordable housing		
Government vacant land for 1Malaysia Public Housing Programme (PR1MA) (30,000 units)	na	Mid-sized contractors
People-friendly homes (PMR) (5,000 units)	200	Small and mid-sized contractors
Under 1Malaysia Civil Servants' Housing Programme (PPA1M) (30,000 units)	na	Mid-sized contractors
MyBeautiful New Home	200	Small contractors
People's Housing Programme (PPR)	134	Small and mid-sized contractors
Second-generation house infrastructure developments for FELCRA and RISDA	200	Small and mid-sized contractors
To build houses in urban areas for rental to eligible youths (10,000 units)	na	Small and mid-sized contractors
New houses and repairs for dilapidated rural houses (17,000 units)	350	Small contractors
Maintenance of flat housing	300	Small contractors

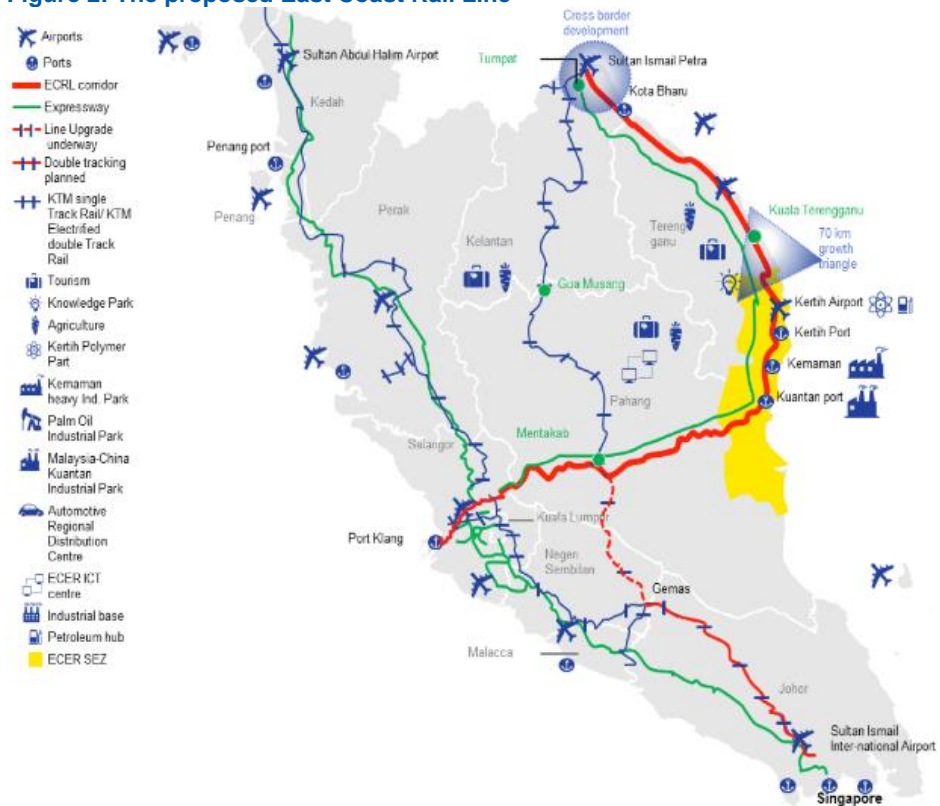
Source: 2017 Budget, RHB

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ECRL is the new kid on the block

Key projects that struck us as relatively new in Budget 2017 included the proposed new ECRL project connecting the Klang Valley and the East Coast. The 600km rail project is estimated to cost MYR55bn. The Treasury’s secretary-general Tan Sri Dr Mohd Irwan Serigar Abdullah was quoted by *Business Times* on 31 Oct as confirming the engineering, procurement, construction and commissioning (EPC) contract would be awarded to China Communication Construction Company Ltd (CCCC), while the financing agreement would be with Export-Import Bank of China (EXIM). Meanwhile, we only expect the project to hit the ground at end-2018 or early 2019.

Figure 2: The proposed East Coast Rail Line



Source: Land Public Transport Commission

More contract awards in the near future?

Aside from the remaining packages for MRT2 and Pan Borneo highway (Sarawak), there are still a few more projects in the pipeline scheduled to be awarded in the coming months through 1H17. All eyes are on the LRT3 and Pan Borneo highway (Sabah).

Additionally, we understand that there are a few more work packages from the West Coast Expressway (WCE), the Refinery and Petrochemical Integrated Development (RAPID) project, and long awaited sub-contracting works for the Gemas-Johor Bahru EDT project. There are also several mega projects in the early stages of construction and planning, such as the TRX and BCC projects.

Awards for these projects can be expected in the coming months, and possibly extend to the next few years given that some of the mega development projects may take decades to be fully implemented.

What is left beyond 2018?

Some may raise concerns over the availability of new jobs from 2018. We believe that there remain many public and private projects in the pipeline, such as the HSR project between Kuala Lumpur and Singapore, and works related to the PTMP.

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Meanwhile, *Bangkok Post* quoted Thailand Transport Minister Arkhom Termpittayapaisith as saying that he is preparing to sit for talks with Malaysia to discuss an ambitious initiative to build a new HSR system linking Bangkok and Kuala Lumpur, which would complete the 1,400km journey in six hours.

The PTMP may enter into the contract award stage, whilst MRT3 may be in the planning stage by 2018, in our view. We may also finally see a revival of the property market by then, with more new launches, as well as the Bandar Malaysia development gradually taking off.

Figure 3: Key logistic infrastructure initiatives in Malaysia

No	Project	MYRm	4Q16	1Q17	2Q17	3Q17	4Q17	2018	2019	2020	> 2020
1	KVMRT 1	23,000									
2	KVMRT 2	28,000									
3	KVMRT 3	36,000									
4	KVLRT 3	9,000									
5	BRT Kuala Lumpur - Klang	1,500									
6	BRT Kota Kinabalu	1,000									
7	HSR Kuala Lumpur - Singapore	60,000									
8	Gemas-JB electrified double tracking project	7,130									
9	Pan Borneo Highway (Sarawak)	16,100									
10	Pan Borneo Highway (Sabah)	12,800									
11	Sg Besi-Ulu Kelang Expressway (SUKE)	5,300									
12	Damansara-Shah Alam Highway (DASH)	4,200									
13	Central Spine Road	6,600									
14	Penang Transport Master Plan (PTMP)	46,000									
15	New East Coast Rail Line	55,000									

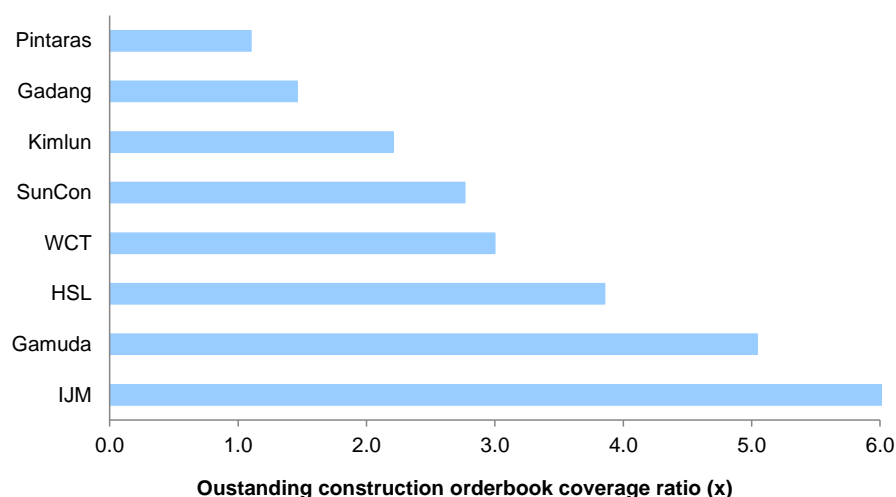
Estimated construction period

Source: RHB

Earnings uptick in 2017?

After relatively robust contract flows this year, we expect a meaningful pick-up in the earnings of local contractors going into 2017, as project implementation and hence, billings pick up steam. That said, we believe the results for some of the contractors may still disappoint in 4Q16 due to lower job recognition – since older projects secured in previous years are coming to the tail-end of their billing cycles. In the meantime, new projects secured earlier this year are still at the site planning stage, with little work commissioned to date.

Figure 4: Construction companies' outstanding orderbook coverage ratios (x)



Source: Company Data, RHB

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Note that two large-cap construction companies, namely Gamuda (GAM MK, BUY, TP: MYR5.55) and IJM Corp (IJM MK, BUY, TP: MYR3.81) have the highest outstanding orderbook coverage ratios for the construction division, at 5x and 6.1x respectively. These may limit their ability to take on other bigger jobs, which may in turn, open doors for mid- and small-cap contractors to capitalise on the slew of contracts set to be awarded in the coming months, in our view.

Reiterate OVERWEIGHT stance for the construction sector

We maintain our OVERWEIGHT stance on the construction sector. Overall, the healthy orderbook – driven by public sector infrastructure projects – would keep local contractors busy in the medium term, in our view.

Key risks for the sector include new job awards falling short of our estimates, and higher input costs, which may translate into poor margins. Although certain projects may face funding challenges, we note that most public projects have already secured financing via special purpose vehicles (SPVs).

Gamuda is our Top Pick for the sector (large-cap). We like the company's prominent role in Malaysia's infrastructure development. Aside from a record orderbook of MYR9bn, Gamuda is eyeing other projects and a role in the next phase of rail-related infrastructure development.

Separately, Gadang (GADG MK, BUY, TP MYR1.40) is our preferred pick for smaller cap construction stock as we see a good opportunity to accumulate after the recent sell-down, since the stock is also currently trading at a forward P/E of less than 7x vs the peer average (which is in the low teens). Apart from strong medium-term earnings visibility, it has also laid its foundation for the longer term.

Figure 5: Construction sector's valuations

	FYE	Price (MYR/s)	Target (MYR/s)	Mkt Cap (MYRm)	P/E (x)		EPS Growth (%)		P/BV(x)	P/CF(x)	ROE (%)	DY (%)	Rec
					FY17F	FY18F	FY17F	FY18F					
IJM^	Mar	3.34	3.81	11,973	15.6	15.0	30.9	4.3	1.2	14.0	8.0	2.6	Buy
Gamuda	Jul	4.90	5.55	11,853	17.0	14.6	11.2	16.5	1.6	80.3	9.8	2.4	Buy
Suncon	Dec	1.68	1.86	2,172	14.5	12.8	12.2	13.4	3.4	11.1	25.5	2.4	Buy
HSL	Dec	1.65	2.48	909	9.9	9.5	41.5	3.5	1.1	16.9	12.2	1.5	Buy
Kimlun	Dec	2.19	2.39	680	8.8	8.4	5.3	4.6	1.2	7.1	14.2	2.9	Buy
Gadang^	May	0.94	1.40	608	6.1	5.7	3.3	6.0	0.9	8.4	15.4	3.2	Buy
WCT	Dec	1.79	1.81	2,149	14.8	12.9	45.3	15.1	0.8	31.2	5.4	3.4	Neutral
Pintaras	Jun	3.60	3.50	589	14.7	11.8	+>100.0	25.0	1.7	11.6	11.9	5.3	Neutral
Sector Avg					15.0	13.6	21.7	10.3					

^ FY17-18 valuations refer to those of FY18-19

Note: Data is as of 14 Dec 2016

Source: RHB

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