13 July 2018

Construction & Engineering | Construction

Construction

Derailed By Project Reviews

Neutral (Maintained)

Stocks Covered:	11
Ratings (Buy/Neutral/Sell):	1 / 10 / 0
Last 12m Earnings Revision Trend:	Negative

Top Picks	Target Price
Sunway Construction (SCGB MK) – BUY	MYR 2.42

The construction landscape has seen drastic changes post-GE14. Mega-infrastructure projects such as the ECRL, MRT2, MRT3, LRT3, and HSR have been reviewed – and are subject to either cost-cutting measures, deferment or cancellation. Projects that have been spared thus far include the Pan Borneo Highway, PTMP and TRX. With fewer large-scale projects commencing in the near term and news flow likely to remain unexciting, we maintain our NEUTRAL stance on the sector.

The KLCON Index has fared poorly, falling 31% after the 14th general election (GE14). This comes amid a review of large-scale infrastructure projects that would either be subject to cost-cutting measures, deferment or cancellation. These reviews are part of the present government's plans to rein in fiscal spending in areas it views as unnecessary.

MRT2 and LRT3 to proceed at a reduced cost. Following a meeting with the CEP, project owner MRT Corp will study measures to reduce the cost of the MYR32bn MRT2 project. However, no specific targets in terms of the quantum or timeline for the cost cuts have been provided. We believe that measures that could be implemented include a reduction in the number of stations, a shorter rail alignment or a lower PDP fee.

The LRT3 project, on the other hand, was first introduced in 2014, at an initial cost of MYR9bn. Latest estimates by the Ministry of Finance (MoF) and Prasarana Malaysia, however, peg the project cost at MYR31.6bn. After a review conducted by the MoF, a reduced final cost of MYR16.6bn has been approved by the Government. A total of seven cost rationalisation measures have been identified by the Government – which in our view, could reduce the contract sums of LRT3 contractors.

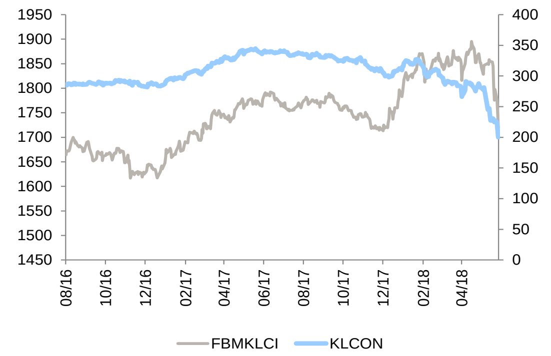
High-speed rail (HSR) can be revived. In a recent *The Straits Times* interview, Finance Minister Mr Lim Guan Eng stated that if the cost of the project can be brought down, the Government could consider reviving the project – subject to Singapore agreeing to any changes. This is a positive development, in our view.

Key events to lookout for. We will be looking closely at the mid-term review of the 11th Malaysia Plan and Budget 2019 scheduled for mid-October and November 2018 respectively for possible developments on infrastructure projects. Besides that, Prime Minister Tun Dr Mahathir Mohamad's trip to China and the expected conclusion of the Selangor water restructuring programme will be anticipated in August.

Maintain NEUTRAL. We foresee fewer mega projects commencing in the near term and less exciting news flow in the form of contract awards and project commencements. We prefer to adopt a wait-and-see approach, until there are clear indications of a return of large-scale public infrastructure projects, reforms on the public procurement system for project tenders, and an emphasis on local content – measures that could provide re-rating catalysts for the sector.

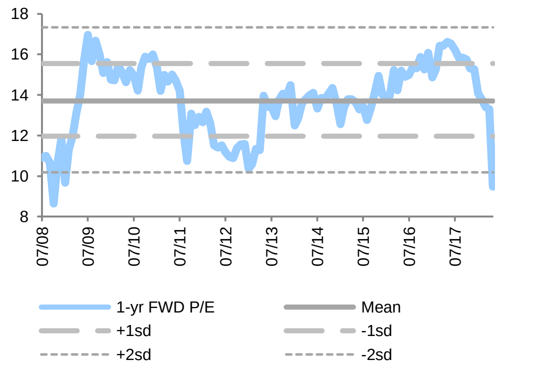
Our Top Pick is Sunway Construction (SCGB MK, BUY, TP: MYR2.42), due to its ability to win contracts from both its parent Sunway (SWB MK, BUY, TP: MYR1.82) and external parties.

Historical performance (KLCON & FBM KLCI)



Source: Bloomberg

10-year P/E band chart – KLCON



Company Name	Rating	Price	Target	% Upside (Downside)	P/E (x) Dec-18F	P/B (x) Dec-18F	Yield (%) Dec-18F
Sunway Construction	BUY	MYR1.80	MYR2.42	34.4	14.2	4.0	4.4
Gadang	NEUTRAL	MYR0.68	MYR0.82	20.5	4.4	0.6	4.6
Gamuda	NEUTRAL	MYR3.38	MYR3.45	2.2	10.1	1.0	3.6
George Kent Malaysia	NEUTRAL	MYR1.29	MYR1.66	28.5	5.7	1.3	6.2
Hock Seng Lee	NEUTRAL	MYR1.40	MYR1.50	7.1	12.9	1.0	1.2
IJM Corp	NEUTRAL	MYR1.81	MYR1.96	8.1	18.5	0.7	2.4
Kerjaya Prospek	NEUTRAL	MYR1.48	MYR1.73	17.1	12.2	1.9	2.5
Kimlun Corp	NEUTRAL	MYR1.31	MYR1.76	34.1	7.2	0.6	3.7
MGB	NEUTRAL	MYR0.96	MYR1.20	25.0	8.1	0.8	-
Pintaras	NEUTRAL	MYR2.56	MYR2.90	13.1	18.2	1.3	8.0
WCT	NEUTRAL	MYR0.83	MYR0.78	(6.3)	6.2	0.4	8.0

Source: Company data, RHB

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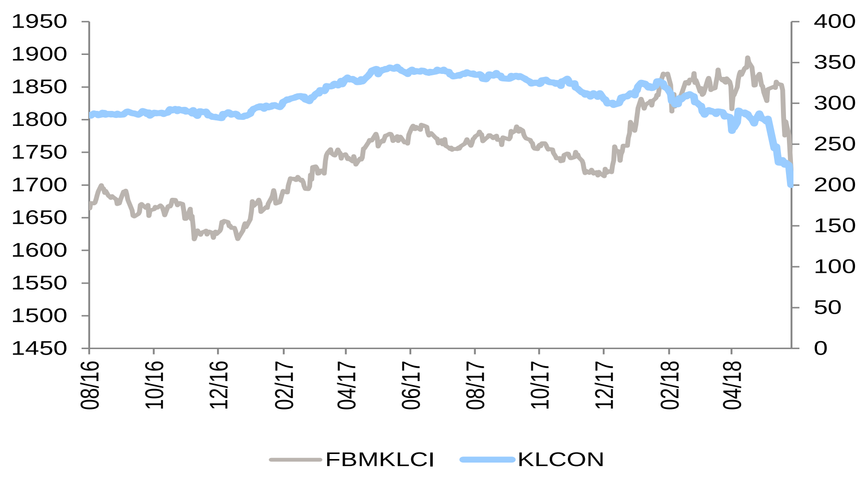
Derailed By Project Reviews

The sector has not fared well post GE14

The Kuala Lumpur Construction Index (KLCON) index has fallen 31% after GE14 – underperforming the FBM KLCI, which has fallen 8.4%. This comes amid a review of large-scale infrastructure projects that would either be subject to cost-cutting measures, deferment or cancellation. These reviews are part of the present government's plans to rein in fiscal spending in areas that it views as unnecessary.

While clearly negative on the sector in the near- to mid-term, the emphasis on fiscal prudence could ultimately have positive long-term implications, in our view. A sound government balance sheet could translate into an increased amount of infrastructure projects being introduced and sustained.

Figure 1: Comparative performance between the FBM KLCI and KLCON



Source: Bloomberg, RHB

Figure 2: Estimated project costs and completion rates (%) of selected projects

Project	Est. Cost (MYRbn)	Latest progress
ECRL	81	13%
MRT2	32	30%
MRT3	40	Cancelled
LRT3	16.6	10%
HSR	110	Deferred
Pan Borneo Sarawak	16	On-going, 15%
Pan Borneo Sabah	12.8	Tenders
Gemas-JB Double Tracking	9.4	Awarded
Penang Transport Masterplan (PTMP)	46*	Pending approval on LRT scheme and environmental impact assessment (EIA)
Tun Razak Exchange	6	80% (Phase 1)
JB–Singapore RTS	4	Preliminary approvals
Putrajaya Tram	3	Announced
Kuching LRT	11	Announced

**Inclusive of undersea tunnel*

Source: Project owners, media, RHB

ECRL suspended until further notice

The Government has instructed the engineering, procurement, construction and commissioning (EPCC) contractor, China Communications Construction (ECRL) SB, a subsidiary of China Communications Construction Company (CCCC, 1800 HK, BUY, TP: HKD11.70), to suspend works on the project effective 4 Jul. No duration for the suspension has been specified.

In our view, the suspension could be to facilitate negotiations to reduce the overall cost of the project cost, pegged by the MoF at MYR81bn. According to *The Star*, Tun Dr Mahathir Mohamad would be visiting China in August. We believe talks could be held and further details on the project could be revealed then. The press also reported that a MYR22bn compensation/penalty would be incurred for an outright cancellation of the project which is 13-15% complete.

Listed companies on Bursa Malaysia that would be affected from the suspension include HSS Engineers (HSS MK, NR) and Lafarge Malaysia (LMC MK, SELL, TP: MYR5.05), which secured contracts worth MYR82.5m and MYR270m from the project. The former has received a letter from CCCC dated 6 Jul on the suspension of its contract until further notice.

MRT2 will go ahead but at a reduced cost

Following a meeting between the Council of Eminent Persons (CEP) and Mass Rail Transit (MRT) Corp CEO Dato' Sri Shahril Mokhtar, MRT Corp has been tasked to study and implement cost-cutting measures for the MRT2 project. The project, estimated to cost MYR32bn for construction, is also referred to as the Sungai Buloh-Serdang-Putrajaya (SSP) Line, which comprises 37 stations and spans 52.2km, inclusive of 13.5km underground.

MRT Corp's MRT2 project director, Datuk Amiruddin Ma'aris, meanwhile, told the media that the project owner does not have a specific target in terms of the quantum of cost reduction. Meanwhile, he noted that the study could take some time as proper studies have to take place in order not to affect the project's safety and functionality.

According to our channel checks, we understand that various cost-cutting measures are currently being studied, such as a reduction in the number of stations, a reduction in the length of the rail alignment, or a reduction in the project delivery partner (PDP) fee. In our estimate, cancelling the construction of stations, which could reduce the project's cost by between MYR70-100m per station, is likely to be one of the measures implemented.

It remains, at this juncture, premature to accurately ascertain the impact on companies that have exposure to MRT2 contracts, due to a lack of clarity on the details of cost-cutting measures. Hence, we have not made any changes to companies under our coverage.

In our view, Gamuda (GAM MK, NEUTRAL, TP: MYR3.45) could be one of the companies most susceptible to a negative earnings revision. Having been appointed as the PDP for the MRT2, Gamuda, along with its JV partner, was contracted to earn a 6% fee of the overall project construction cost. The company does not rule out the possibility of this fee being reduced, which would have a negative impact on our earnings forecasts – every 1 ppt drop in the fee would reduce our FY18F-20F earnings by 2%.

Meanwhile, the overall project cost will likely be reduced as well. According to our sensitivity analysis, every 5% reduction in the overall project cost would reduce our FY18F-20F earnings by 1.4%. However, works are progressing as usual, in the absence of any official announcements.

Figure 3: List of contract awards – MRT2

No.	LOA Date	Contractor	Contract Amount (MYRm)
ADVANCED WORKS			
1	23-Nov-15	P.E.S.B. Engineering SB	10.36
2	23-Nov-15	Huls Transmission SB	7.55
3	2-Feb-16	Acre Works SB	77.79
4	2-Feb-16	Central Geo SB	1.98
5	25-Mar-16	Trans Resources Corporation SB	74.4
6	14-Mar-16	M.O. Jaya SB	8.92
7	29-Mar-16	WCT	133.4
8	15-Jul-16	S.N. Akmida Holdings SB	59.5
UNDERGROUND WORKS			
1	31-Mar-16	MMC Gamuda KVMRT (T) SB	15,470
GUIDEWAY (VIADUCT)			
1	31-Mar-16	Sunway Construction SB	1,200
2	4-Apr-16	Ahmad Zaki SB	1,400
3	19-May-16	IJM Construction SB	1,470
4	14-Nov-16	WCT	896.4
5	10-Mar-17	Trans Resources Corporation SB	858.1
6	10-Mar-17	Gadang Engineering (M) SB	952.0
7	15-Dec-16	Mudajaya Corporation	558.6
8	17-Nov-16	MTD Construction SB	678.7
9	10-Mar-17	Acre Works SB	N/A
10	19-May-16	Malaysian Resources Corporation	648.0
SYSTEMS			
1	19-May-16	Bombardier - Global Rail Consortium	458.02
2	5-May-16	Najcom - EVD Joint Venture	78.54
3	19-May-16	HAP Consortium	1,620
4	25-Aug-16	CCCC - George Kent JV	1,010
5	14-Jul-16	Colas Rail Consortium	693.03
6	1-Aug-16	Sapura - EVD Consortium	632
7	14-Sep-16	Indra Sistemas and Rasma Corporation Consortium	152.9
STATIONS			
1	15-Mar-17	Sunway Construction SB	212.3
2	21-Dec-16	S.N. Akmida Holdings SB	N/A
3	14-Jun-17	IJM Construction SB	342.1
4	19-Sep-17	WCT	199.5
5	12-Oct-17	Apex Communications SB	243.3
6	12-Oct-17	Ahmad Zaki SB	288.4
7	19-Sep-17	S.N. Akmida Holdings SB	219.7
8	12-Oct-17	Acre Works SB	137.9
9	15-Sep-17	Malaysian Resources Corporation	145.8
DESIGNATED SUPPLIERS			
1	25-Mar-16	SPC Industries SB	199.9
2	25-Mar-16	Acre Works SB	169.99
DESIGNATED CONTRACTORS			
1	19-Sep-17	Rani - MS Engineering SB	73.4
2	12-Oct-17	EITA Elevator (M) SB	69.8
3	12-Oct-17	Rani - MS Engineering SB	42.9
4	12-Oct-17	Global Rail Dom Industries (BMS 201) JV	39.8
DEPOTS			
1	12-Sep-17	Consortium KKM - TRC	348
2	5-May-16	TSR Bina SB	90
		Total	**32,000**

Source: MRT Corp, RHB

MRT3 circle line a no-go

The MYR40bn circle line, spanning 40km (80% underground) and comprising 26 stations had been conceived to connect both the MRT1 and MRT2 lines, as well as several other rail lines. The project was structured under an EPCC (with financing) model.

According to an article published by *The Edge Financial Weekly*, the EPCC role was close to being awarded to a consortium comprising MMC (MMC MK, BUY, TP: MYR2.70), Gamuda and George Kent (GKEN MK, NEUTRAL, TP: MYR1.66), with China Communications Construction (1800 HK, BUY, TP: HKD11.70) possibly being included in the mix as well. This was, however, brought to an abrupt stop when Tun Dr Mahathir Mohamad announced that the project would be scrapped.

While abiding by the Government's decision, MRT Corp CEO Dato' Sri Shahril Mokhtar hopes that the government will consider reviving the line once the fiscal situation improves, to upgrade the overall connectivity of the MRT system.

In our view, a reduced cost for the project could be on the cards, possibly at MYR20bn, ie 50% lower than the initial MYR40bn by reducing the underground portion. Another alternative, in our view, is the possibility of the project being broken down into stages and stretched over a longer period to ease the Government's financial burden.

Besides the abovementioned companies, HSS Engineers had in Apr 2013 secured a MYR290m contract for independent consulting works for the MRT3 project. This contract has since been terminated.

LRT3 to proceed at a final cost of MYR16.6bn

First mooted in 2014 with at an initial cost of MYR9bn, estimates by the MoF and Prasarana, pegged the latest projected cost for the project at MYR31.6bn. However, following a review on the project, a reduced final cost of MYR16.6bn has been approved by the Government. This final price tag includes costs related to construction, land acquisition, project management, consultancy fees, operational & overhead costs and interest.

The steps taken to rationalise the cost of the project include:

i. Reducing the order of 42 sets of 6-car trains to 22 sets of 3-car trains. Based on the feasibility study of the LRT3 project, the 22 sets of 3-car trains is more than sufficient to cope with the anticipated passenger demand until the year 2035 before additional 3-car trains need to be ordered.

   Companies that could be affected: CRRC Zhuzhou Locomotive Co Ltd, Siemens Ltd China and Tegap Dinamik SB;

ii. Reducing the construction size of the LRT train depot due to the significantly reduced number of LRT trains to be acquired.

   Companies that could be affected: WCT (WCTHG MK, NEUTRAL, TP: MYR0.78) – infrastructure component (almost complete); TRC Synergy (TRC MK, NR) – building component;

iii. Streamlining the size and design of the LRT stations based on Kelana Jaya LRT line standards instead of being benchmarked against the much larger MRT stations.

   Companies that could be affected: WCT (WCTHG MK, NEUTRAL, TP: MYR0.78), Mudajaya (MDJ MK, NR), Gabungan AQRS (AQRS MK, NR), Sunway Construction (SCGB MK, BUY, TP: MYR2.42) and IJM Corporation (IJM MK, NEUTRAL, TP: MYR1.96);

iv. Shelving the construction of five stations with very low projected passenger ridership until such a time the demand is deemed necessary for these stations to be built. These provisional stations are Lien Hoe, Temasya, SIRIM, Bukit Raja and Bandar Botanic.

   Companies that could be affected: WCT (Lien Hoe station), Gabungan AQRS (Temasya station), Apex Communications SB (Sirim station), Rahimkon SB (Bukit Raja station) and SN Akmida Holdings SB (Bandar Botanic station);

v. Cancelling an unnecessary 2km tunnel for the LRT together with an underground station at Persiaran Hishamuddin, Shah Alam.

   Companies that could be affected: IJM Corporation;

vi. Extending the timeline to complete the LRT3 project from 2020 to 2024 in order to further reduce construction cost which was inflated due to "acceleration costs", ie to speed up the project incurs additional costs.

Companies that could be affected: all with work package contracts (WPC), in the form of lower variation orders for accelerated works

vii. Restructuring from a PDP model to a "fixed price contract" with MRCB-GK JV. This will ensure that the price will be fixed and will not be subject to cost overruns. The details of this contract will be disclosed at a later stage.

Companies that could be affected: George Kent, Malaysian Resources Corp (MRCB) (MRC MK, Under Review)

Our checks with contractors indicate that contractors have indeed received instructions from the Government to suspend station works until further notice. However, station works would have only started at a later stage, ie 2019 onwards. We gather that works are currently at the piling stage, which will be followed by the construction of guideways.

While we are able to broadly identify contractors who could be affected by the cost-cutting measures, we make no changes to our forecasts, as we understand that the affected companies have yet to be formally notified on the changes or received revised contracts. At this point, the reductions in contract values (if any) have yet to be determined.

Figure 4: List of selected contract awards – LRT3

Date Awarded	Package	Company	Amount (MYRm)
9/10/2017	GS01	Mudajaya Corporation	1,160.0
5/10/2017	GS02	WCT Holdings	640.0
29/8/2017	GS03	WCT Holdings	840.0
5/10/2017	GS04	Gabungan AQRS	1,205.6
N/A	GS05	Apex Communications SB	N/A
N/A	GS06	Rahimkon SB	N/A
5/10/2017	GS07/08	Sunway Construction	2,308.7
N/A	GS09	Pembinaan Jaya Zira	N/A
N/A	GS10	SN Akmida Holdings SB	N/A
13/3/2018	UG	IJM Corporation	1,115.7
5/4/2017	TD1	WCT Holdings	185.9
5/9/2017	TD2	TRC Synergy	760.6
4/4/2017	PC2	Mudajaya Corporation	58.3
28/2/2018	ESC (E)	EITA	80.6
6/3/2018	ESC (W)	EITA	70.5
6/3/2018	LIF (E)	EITA	27.8
6/3/2018	LIF (W)	EITA	27.9
9/3/2018	NBE	Muhibbah Engineering (M)	57.6
2/8/2017	LRV	CRRC-Siemens-Tegap Dinamik JV	1,560.0
		Total	**10,099.1***

Source: Companies, RHB

**Tally of publicly announced contract sums*

HSR could be revived at a lower cost

Before GE14, the Government had appointed the PDPs for the HSR – MRCB & Gamuda for the northern portion and YTL Corp (YTL MK, NR) & TH Properties for the southern portion. However, following the change in federal government, the project was scrapped due to financial constraints. Since its cancellation, the government has adopted a softer stance towards the HSR project, stating that it will consider reviving the project a year or two from if the country's fiscal situation improves.

According to an article by *The Star*, a cheaper option being studied is to utilise KTM's double-track infrastructure but with lower travel speeds of 200kmph (versus the HSR's 320kmph) costing MYR20bn has been proposed to the Government.

In a recent interview by *The Straits Times Singapore*, Finance Minister Mr Lim Guan Eng stated that the project itself made sense, but not at an exorbitant cost. In addition, he noted that the Government has received proposals for the project at half the initial cost, which are being studied. He added that if the cost can be brought down, the Government could consider reviving the project, subject to Singapore agreeing on any changes.

Based on these recent developments, we believe there is a decent chance that the project could be revived, perhaps in 2019. This could be a positive catalyst for the sector.

Pan Borneo Highway, TRX, JB-SG RTS and Penang LRT to proceed

Meanwhile, high-impact projects such as the Pan Borneo Highway, Johor Bahru-Singapore Rapid Transit System (RTS) and Penang Light Rail Transit (LRT), are likely to proceed as planned according to the relevant authorities - Sabah Chief Minister, Datuk Seri Shafie Apdal, Minister of Transportation, Mr Anthony Loke and Penang Chief Minister, Mr Chow Kon Yeow. These projects are being emphasised in order to address the issues of rural connectivity and road congestion.

Figure 5: Selected project updates

Project	Current developments	Companies involved - awarded or express interest in participating
Pan Borneo Sarawak	No new developments, work is progressing on schedule.	HSL, Naim Holdings, Gamuda, Zecon, Kimlun, CMSB, Bina Puri, Mudajaya, TRC, KKB Engineering, WCT
Pan Borneo Sabah	The Government's manifesto promises to ensure the Pan Borneo Highway is built. Sabah Chief Minister, Datuk Seri Shafie Apdal has also mentioned that the project must go on. There has been positive developments indicating that the project is moving forward, such a MYR60.7m consulting job for the highway being awarded to UEM Edgenta on 1/6/2018.	Gabungan AQRS, WCT, Gadang, MMC, Suria Capital, Bina Puri
Gemas-JB Double Tracking	The project was awarded to a consortium consisting of China Railway Construction Corp, China Railway Engineering Corp and China Communication Construction Consortium Sdn Bhd. According to media reports, the consortium then sub-contracted the project to YTL Berhad. We believe that the project is under review.	YTL, Fajarbaru
Penang Transport Masterplan (PTMP)	Penang Chief Minister, Mr Chow Kon Yeow stated in a media interview that he is committed to proceed with the project. He hopes that by 2HCY18, the proposals would be tabled for approval and kick-start the first 3 components, the Light Rail Transit (LRT), the Penang Island Link highway and land reclamation sites by 2HCY19.	SRS Consortium (60% owned by Gamuda)
Tun Razak Exchange	According to TRX City CEO, Phase 1 comprises Exchange 106 and Menara Prudential, both open to tenants early next year is almost 80% complete. The second phase consisting of a public plaza, streetscapes and a 10-acre central park, will be completed in 2020. The final phase is the development of south-side parcels. The project recently saw a MYR2.8bn funding commitment by the government that would ensure all 3 phases are completed by 2024.	WCT, Gadang, IJM Corp
JB–Singapore RTS	Labelled as a high impact project by the Ministry of Transport to alleviate traffic congestion along the Johor Causeway, the project is likely to continue. A strategic partnership was supposed to be signed between Malaysia and Singapore on 30/6/2018 which will be postponed while a review takes place.	N/A
Putrajaya Tram	No new developments	N/A
Kuching LRT	No new developments	N/A

Source: Companies, RHB

Abolishment of toll roads deferred

In its manifesto, the Pakatan Harapa-led Government pledged to abolish highways tolls in stages and provide fair compensation to the affected companies. However, due to the current unfavourable financial situation, the Government has stated that it will only implement this pledge when its financial health recovers. We estimate that there are MYR55.7bn worth of bonds and *sukuk* outstanding. On the other hand, equity holders would also be seeking for compensation for forgone revenue for their remaining concession period – significantly adding on to the cost of abolishing toll roads.

Figure 6: Outstanding bonds issued by toll consessionaires

Toll roads	Owner	Concession Tenure (years)	O/S bond (MYRm)	Average Daily Traffic
Karak Highway East Coast Expressway Phase 1 (ECE1) KL-Seremban Expressway	MTD Capital group (100%)	38 28 23	2,790	N/A
Sungai Besi Highway (SBH)	IJM Corp (100%)	30	650	150,321
Maju Expressway (MEX)	Maju Holdings SB (100%)	33	1,300	112,242
Cheras - Kajang Highway	Taliworks (51%)	40	420	N/A
East Klang Valley Expressway (EKVE)	Ahmad Zaki SB (100%)	50	1,000	N/A
New North Klang Straits Bypass Expressway	Taliworks (50.3%)		200	N/A
Shah Alam Expressway (KESAS)	Gamuda (70%)	35	1,061	341,148
Duta-Ulu Kelang Expressway (DUKE) - Phase 1 & 2 Duke Phase 3	Ekovest (60%) Ekovest (100%)	34 53	2,480 3,640	N/A N/A
Kajang - Seremban Highway (LEKAS)	IJM Corp (50%)	33	1,136	65,524
Lebuhraya Damansara - Puchong (LDP)	Litrak Holdings (100%)		1,150	453,970
Maju Expressway (MEX)	Maju Expressway SB	33	400	N/A
Kajang Dispersal Link Expressway (Silk Highway)	Lingkaran-Lebuhraya Kajang SB (100%)	36	608	N/A
Lebuhraya Putrajaya - KLIA extension	Maju Holdings SB (100%)	33	1,450	NA
Eastern Dispersal Link (EDL)	MRCB Corp (100%)	34	1,044	N/A
North-South Expressway New Klang Valley Expressway Federal Highway Route 2 Seremban-Port Dickson Highway North South Expressway Central Link Malaysia-Singapore Second Link Butterworth-Kulim Expressway Penang Bridge	Projek Lebuhraya Usahasama Berhad (PLUS) (100%)		30,400	N/A 91,000
Lebuhraya Kemuning Shah-Alam (LKSA) Sungai Besi-Ule Kelang Elevated Expressway (SUKE)	Permodalan Nasional (100%)	40 55	415 510	N/A N/A
Smart Tunnel	Gamuda (50%)	40	325	30,685
Guthrie Coridor Expressway (GCE)	Permodalan Nasional (100%)		500	
Senai-Pasar Gudang Desaru Expressway (SPD)	Rancak Bistari SB (70%), YPJ Holdings (30%)	33	2,704	NA
Penchala Link Kerinchi Link Damansara Link	Gamuda (43.7%)	33 36 36	458	96,226 56,166
West Coast Expressway (WCE)	IJM Corp (40.6%)	50	1,112	NA
		Total	**55,753**	

Source: Bond Pricing Agency Malaysia (BPAM), RHB

Selangor water restructuring could be completed in August

According to a recent article by Bernama, Dr A. Xavier Jayakumar, Minister of Water, Land and Natural Resources assured the public that the longstanding Selangor water supply issue would be concluded in one month from July 2018, ie by August.

The consolidation of the state's water assets has lasted for more than 10 years. The main point of contention preventing the takeover of the final privately-owned water asset in the state – Syarikat Pengeluar Air Sungai Selangor SB (SPLASH) – was differing views on the valuation of the water treatment plant concessionaire.

In order for the state government to successfully acquire SPLASH, the equity owners of SPLASH, the state government (through Air Selangor) and Pengurusan Aset Air (PAAB, wholly-owned by MoF), which provide the funding, have to collectively agree on an acquisition price. Splash is 40% owned by Gamuda, 30% by Kumpulan Perangsang Selangor (KUPS MK, NR) and 30% by The Sweetwater Alliance SB (privately owned).

The most recent offer made to acquire SPLASH amounted to MYR250.6m, which represents a P/BV of 0.07x based on SPLASH's book value of MYR3.47bn as of end-2017. This offer was rejected by the vendors, as other state water assets such as Melaka, Negeri Sembilan, Johor, Perlis, Penang, Perak and Kelantan were transacted at a valuation of 1x P/BV.

We remain NEUTRAL on the sector

We foresee fewer mega projects commencing in the near-term and less exciting news flow in the form of contract awards and project commencements. We prefer to adopt a wait-and-see approach, until clear indications of a return of large-scale public infrastructure projects, reforms on the public procurement system for project tenders, and an emphasis on local content.

We believe these initiatives could present positive catalysts for the sector in terms of new job opportunities, as public-listed companies with the technical capabilities would have a better chance of securing projects in a fully-transparent open tender system.

We will be observing the mid-term review of the 11th Malaysia Plan and Budget 2019 scheduled for mid-October and November 2018 respectively. Besides that, Tun Dr Mahathir's trip to China and developments on the Selangor state water restructuring plans will be closely watched in August. A re-rating on the sector, in our view, could materialise if the Government increases its spending on public transport and infrastructure projects.

Valuations are currently lingering at trough levels. The KLCON is trading at 9.5x 12-month forward P/E, 2SD below its 10-year mean of 13.7x. However, we do not foresee a further de-rating to the sector, as short- to mid-term earnings should be cushioned by existing outstanding construction orderbooks. In our estimate, construction companies under our coverage maintain an average of 4.2x of the respective construction revenues for the prior financial year. A re-rating to the upside is equally as unlikely at this juncture, in our view, with less clarity on future job replenishment opportunities for the sector.

Our only BUY recommendation is Sunway Construction (SCGB MK, BUY, TP: MYR2.42). We remain optimistic on Sunway Construction's prospects in securing new jobs. This is due to its strong backing by parent Sunway (SWB MK, BUY, TP: MYR1.82) and external parties. The company has secured five new jobs in 2018 totalling MYR0.75bn, which is within our MYR2.2bn new orderbook estimate for FY18. Its total outstanding orderbook stands at MYR6.2bn, more than 3x its FY17 construction revenue.

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