

Construction sector still at the top of the heap

BY BILLY TOH

As the second half of the year approaches, most investors on Bursa Malaysia are probably heaving a sigh of relief as the benchmark FBM KLCI has gained 8.2% year to date while the FTSE Bursa Malaysia Small Cap Index has surged 17.1%. This is after two to three years of lacklustre performance.

The good news for those who stuck to the construction and infrastructure theme is that the Bursa Malaysia Construction Index has gained 18.5% year to date.

Chris Eng, head of research with Etiqa Insurance & Takaful, opines that the construction sector is still the top pick. "We remain positive about the construction sector. Revenue and earnings contribution from ongoing jobs will kick in this year," he says.

Eng's comments are reflective of most of the narrative of investment strategies in Malaysia.

Affin Hwang Investment Bank Bhd, in a June 5 report titled "Malaysia strategy", says the earnings of construction and infrastructure players are expected to improve in the subsequent quarters as progress billings accelerate on existing projects, new contracts are secured and property sales pick up.

According to the research house, the construction and infrastructure's headline net profit jumped 98.6% year on year mainly due to one-off gains or the absence of one-off losses at IJM Corp Bhd, WCT Holdings Bhd and Gabungan AQR5 Bhd.

"The better operating profit of most of the construction companies covered by us also contributed to the good results. The record-high order books of most companies and acceleration in progress billings spurred year-on-year earnings

growth. Most construction companies also saw better profit margins due to rising revenue while cost pressure was contained," it says.

Besides expecting higher earnings for construction players this year, CIMB Equity Research also highlights in its June 1 strategy report that these companies will benefit from newsflow and new jobs at major infrastructure projects, such as the RM28 billion MRT2.

JP Morgan Asia Pacific Equity Research, too, is optimistic that the construction sector will outperform the benchmark index. Its analyst Mak Hoy Kit says in his report that more than RM241 billion of rail-related investments will help drive the construction sector's growth. He also notes that with a more stable and higher oil price, there is more fiscal flexibility for the government.

Another foreign research house, Nomura, shares the sentiment because construction players showed improved margins in their first-quarter results. While the research house is "underweight" on Malaysian equities, it is positive about tourism and transport-related names and commodity plays in Asia ex-Japan.

"We expect pure-play construction companies to continue to outperform stocks that have diversified into property. Thus, Sunway Construction Group Bhd remains our top pick in the Malaysian construction space," says Nomura analyst Tushar Mohata in his June 5 report.

On the progress of the KL-Singapore high-speed rail, CIMB Equity Research says tenders for its asset company, AssetsCo, will be called in the fourth quarter of this year.

As the pre-tender phase of AssetsCo kicks off, MyHSR and Singapore's Land Transport Authority (LTA) will jointly conduct an industry briefing in Singapore on

Update of major infrastructure contracts

PROJECT	EST AMOUNT (RM BIL)	POTENTIAL WINNERS
MRT2 and 3	60	Gamuda, MMC, IJM, Sunway, various
Gemas-JB double tracking	8	Gamuda, IJM, WCT
LRT3	10	MRCB-George Kent and other local contractors
Pan-Borneo Highway	27	CMS, Naim, HSL and other peninsular players
East Coast Rail Link	55	China Communication Construction Company
Penang Integrated Transport	27	Gamuda, IJM likely to have subcon role
KL-Singapore high-speed rail	60	Gamuda, YTL, various
Jalan Tun Razak traffic dispersal	0.9	Various
BRT KL to Klang	4	Various
Bandar Malaysia	64	Various
Tun Razak Exchange	16	Various
DUKE3 (Setawangsa-Pantal Expressway)	3.6	Ekovest

July 5. The AssetsCo that is appointed will be responsible for supplying, making available and maintaining the HSR trains and associated systems, such as track, power, signalling and telecommunications, and will function as a network operator.

According to MyHSR, the governments of Japan, South Korea and China are strongly lobbying for a major role in the HSR project.

"We see each of these governments forming consortiums ahead of the tender. We gather that having a local partner in a consortium is not required, although this will be decided upon by MyHSR and LTA later. For now, it appears that a local partner in AssetsCo may have little role to play as most local companies or contractors have limited experience in HSR assets

and operations," says CIMB Equity Research's Sharizan Rosely in a June 21 report.

The research house is optimistic of an improvement in the progress of the KL-Singapore HSR project in the second half of the year but believes it is too early to name the winners of the project. Within its coverage, Gamuda Bhd remains the top pick for the rail theme while Muhibbah Engineering (M) Bhd is its preferred small and mid cap.

Backed by consistent spending

DBS Group Research analyst Chong Tjen-San writes in his report that Malaysia's construction sector is backed by consistent spending. According to him, construction spending as a percentage of gross domestic product has been trend-

ing upwards and stood at 4.9% last year. He adds that while the percentage is relatively low, the multiplier effect on the economy is huge.

The research house believes that transport-related infrastructure, such as mass rapid transit (MRT), light rail transit (LRT), the Pan-Borneo Highway, East Coast Railway Link and eventually the HSR, will be of utmost importance to the economy and will see negligible risk of delays or cuts in spending.

MIDF is upbeat about the construction sector but cautious about stock valuations.

Despite the research house's bullish view of the construction sector, its analyst, Fadhli Dzulkifly, tells The Edge that the sector would not be able to maintain its current dizzying 23.5 times price-earnings ratio (PER). He says this should normalise to 17.5 times PER or about 1.1 times book value, thus becoming more appealing to value hunters.

He says while MIDF likes the sector, he favours construction companies with strong core competences and a diversified non-commodity revenue stream. "Despite a change in our recommendation due to share price movements, we see bright prospects for Muhibbah Engineering, Malaysian Resources Corp Bhd and Gabungan AQR5 due to their forte in construction backed by a revenue stream from airport concessions, facility management and state-specific property developments."

According to Fadhli, the long list of potential infrastructure projects under the National Development Plan reiterates the government's commitment to boost rural and urban connectivity. He says the NDP will be the "cavalry" that consolidates and integrates the sector. ■