Risk of order book reductions seen with infrastructure job cuts

Construction sector

Maintain neutral: The outlook for the construction sector remains challenging as the federal government is reviewing ongoing infrastructure projects to reduce costs by 20%-33%. Projects that could be affected include the Klang Valley mass rapid transit Line 2 (MRT2) and light rail transit Line 3 (LRT3), Pan Borneo Highway (PBH) and Gemas-Johor Baru Electrified Double Tracking (EDT). There are opportunities in state government projects in Penang and Sarawak. Top "buys" are IJM Corp Bhd, Sunway Construction Group Bhd (SunCon) and HSS Engineers Bhd.

We gather that the MRT2 project could see a 25% reduction in cost to RM24 billion from an initial estimate of RM32 billion. The MMC Gamuda joint venture (JV) will be the most affected as it is the main contractor for the underground section and the project delivery partner (PDP) for the above-ground section of the MRT2. Other listed contractors that could be affected due to ongoing work on above-ground packages secured include Ahmad Zaki Resources Bhd, Gadang Holdings Bhd, George Kent (M) Bhd, IJM Corp, Malaysian Resources Corp Bhd (MRCB), MTD ACPI Engineering Bhd, Mudajaya Group Bhd, SunCon, TRC Synergy Bhd, TSR Capital Bhd and WCT Holdings Bhd. Since the cost reductions will come from the reduction in the scope of work, we believe only the contract values will be reduced while profit margins should be preserved.

We gather that the LRT3 construction cost could be slashed to RM9 billion to RM10 billion from an initial estimate of RM15 billion to RM16 billion. The MRCB-George Kent JV will be most affected as the PDP for the project. We maintain our forecasts for MRCB as we believe we were conservative in our contract value assumption at RM9 billion for the LRT3 despite the previous escalation in cost. Other contractors affected include Gabungan AQRS Bhd, IJM Corp, SunCon and WCT.

The Penang and Sarawak state governments are looking to improve road and public transport infrastructure in their respective states. The Sarawak state government plans to complete the upgrading of the Coastal Highway and trunk roads at an estimated cost of RM11 billion. Project pre-qualification bids have been called. Potential Sarawak beneficiaries are Cahya Mata Sarawak and Hock Seng Lee. The Penang Transport Master Plan is pending approval by federal government authorities to be implemented and public feedback collection is ongoing. The Pan Island Link 1 (PIL1) highway and George Town-Bayan Lepas Airport LRT is estimated to cost RM16 billion. The Gamuda-led SRS Consortium is the PDP for the project.

We reiterate our "neutral" call on the construction sector as we remain cautious on the sector due to the risk of order-book reductions with potential cost cuts for infrastructure projects. However, we believe the concerns are reflected in current share prices. Our top "buys" are IJM (large-cap), SunCon (mid-cap) and HSS (small-cap). The key upside risk is an acceleration in public infrastructure spending and the key downside risk is further cuts in spending. — *Affin Hwang Capital Research, Oct 4*

Construction peer comparison

COMPANY NAME	RATING	SHARE PR (RM)	TP (RM)	MKT CAP (RM MIL)	YEAR END	CORE PER (X)		CORE EPS GROWTH (%)		EV/ EBITDA (X)	P/BV (X)	ROE (%)	DIV YIELD (%)	RNAV/ SHARE	SH PR DIS-COUNT TO RNAV
						CY18E	CY19E	CY18E	CY19E	CY18E	CY18E	CY18E	CY18E		
IJM Corp	Buy	1.79	2.45	6.5	Mar	14.1	12.5	10.4	12.5	10.2	0.6	4.3	4.4	2.82	37
Gamuda	Hold	3.33	3.46	8.2	July	12.4	13.1	2.1	(5.7)	12.5	1.1	9.9	3.6	4.36	24
MRCB	Buy	0.70	0.88	3.1	Dec	14.1	9.4	8.1	48.8	15.5	0.6	9.7	2.5	1.56	55
WCT	Hold	0.89	0.92	1.2	Dec	7.8	7.5	20.7	4.0	14.8	0.4	4.8	3.4	1.70	48
Sunway Construction	Buy	1.81	2.45	2.3	Dec	14.5	12.5	19.0	16.1	8.1	3.7	25.8	3.9	2.72	33
Gabungan AQRS	Buy	1.03	1.60	0.5	Dec	9.1	6.0	58.5	52.2	5.2	1.2	17.5	2.9	2.12	51
WZ Satu	Hold	0.31	0.30	0.2	Aug	39.3	9.5	(66.0)	>100	10.6	0.5	0.9	6.6	0.50	39
Pintaras	Hold	2.43	2.41	0.4	June	19.0	11.1	(10.5)	58.5	6.3	1.3	6.7	8.2	NA	NA
HSS Engineers	Buy	0.94	1.18	0.5	Dec	19.9	18.4	1.6	8.5	11.5	1.6	7.9	2.5	NA	NA
Average				**22.9**		**12.2**	**11.0**	**8.2**	**11.7**	**11.7**	**1.2**	**6.4**	**4.2**		**38**

Note: Pricing as of close on Oct 3, 2018

Sources: Bloomberg, Affin Hwang forecasts

D&O earnings likely to grow with bullish automotive LED prospects

D&O Green Technologies Bhd (Oct 4, 95 sen)

Initiate coverage with outperform and a target price of RM1.03: We started looking into D&O Green Technologies Bhd (D&O) in the late of 2015, when the company was in the midst of turning around after suffering three years of consecutive losses. The company made a timely and bold move of getting into the automotive light-emitting diode (LED) business at that time, when the application of LEDs was still at an early stage. Today, the group has successfully established a strong footprint in the global automotive LED market, ranking No 4 worldwide. We believe the bullish prospects on the extensive use of automotive LED is likely to bring in stronger earnings growth for the group over the next few years. Given that the share price has performed admirably in recent weeks, we are more inclined toward suggesting an accumulation on weakness though the emergence of a new significant shareholder may also serve to bolster confidence and drive prices even higher.

D&O is principally involved in research and development, design and manufacturing of LEDs for automobiles, general lighting and televisions. The automotive LED segment makes up more than 95% of D&O's sales.

The group has allocated RM40 million for a new manufacturing facility next to the existing plant in Melaka. Renovation work at the new factory building started two months ago and will be carried out in three phases over a six-year period till 2023. Under Phase One of the renovation plan, the new office building is expected to be completed by the second quarter of financial year 2019 (2QFY19) at a cost of RM29 million. Completion of the new office building will free up space in the existing plant for production capacity expansion, which could potentially double the current production capacity.

In contrast to the general lighting and television LED market, there is an ultra-high standard for the automotive LED segment as prospective suppliers will need to spend few years to go through pre-qualifying tests before being nominated for inclusion into the supply chain for module makers. Stringent requirements are necessary as any defects could pose damage to the automakers' reputations and/or image. Under its "Dominant" brand name, it possesses the AEC-Q101 certification, a world class automotive quality standard.

We expect 15%-23% earnings growth for FY18-FY20. This comes as a result of the gradual exit from the LED market for general lighting and television in 2014, while also channelling its resources into the automotive LED market segment, which is more stable and has higher margins. Since then, the company has seen a successful turnaround with the revenue loss from the non-auto segment taken over by rapidly improving automotive LED sales. Core earnings also grew from a paltry RM700,000 to FY17's RM13.9 million. We expect earnings growth of 15%-23% with a consistent gross margin of 27% over the next two years. As it takes at least one to two years to be a pre-qualified auto LED supplier, we see earnings visibility over the next few years. — *PublicInvest Research, Oct 4*

D&O Green Technologies Bhd

FYE DEC (RM MIL)	2016A	2017A	2018F	2019F	2020F	CAGR (%)
Revenue	430.1	463.3	549.5	664.3	759.6	12.0
Gross profit	32.0	47.9	57.9	73.0	87.3	22.2
Pre-tax profit	29.7	45.8	55.8	70.6	84.9	23.4
Core net profit	11.2	13.9	39.7	52.0	62.5	41.0
EPS (sen)	0.7	0.9	2.6	3.4	4.1	41.0
PER (x)	132.0	106.4	37.2	28.5	23.7	
DPS (sen)	0.0	0.5	0.5	0.5	0.5	
Dividend yield (%)	0.0	0.5	0.5	0.5	0.5	

Sources: Company, PublicInvest Research estimates

CPO seen to trade within RM2,100 to RM2,400 per tonne in October

Agribusiness sector

Maintain neutral: Findings from a survey of 21 plantation areas by the CIMB Futures team reveal that Malaysian crude palm oil (CPO) output likely grew 15% month-on-month (m-o-m) to 1.858 million tonnes in September 2018. Palm oil exports likely rose around 50% m-o-m, based on export statistics released by SGS, ITS and Amspec Malaysia. Overall, we estimate Malaysian palm oil inventory likely rose 0.4% m-o-m to 2.49 million tonnes as at the end of September. The official figures will likely be released on Oct 10.

The projected 15% m-o-m rise in CPO output for September is higher than the historical September average mom increase of 2% over the past 10 years. We attribute the higher-than-historical-average m-o-m rise in output to the lower base effect as August 2018's production of 1.6 million tonnes is the lowest monthly output in August since 2010, which planters attributed to a shift in cropping patterns. Our survey revealed that estates in Sarawak posted the highest m-o-m production increases, followed by those in Sabah. Peninsular Malaysia estates posted the smallest m-o-m rises in production.

We estimate that Malaysian palm oil exports grew around 50% m-o-m last September, based on estimates from cargo surveyor ITS (51.6% m-o-m), SGS (54.6% m-o-m) and Amspec Malaysia (49.2%) as traders may have deferred purchases on expectations of the zero export tax effective Sept 1.

To recap, palm oil exports fell 26% year-on-year (y-o-y) in August 2018 to 1.1 million tonnes, the lowest monthly palm oil exports in August since 2010.

The flattish palm stockpile for September and rising crude oil prices are supportive of CPO prices in the near term.

Average CPO price fell 0.3% m-o-m to RM2,178 per tonne in September 2018 due to concerns over strong palm oil supplies in Indonesia. However, this was partially offset by expectation of stronger biodiesel demand in view of the rising crude oil prices and Indonesia's proposal to raise biodiesel usage effective Sept 1, 2018.

The flattish palm stockpile for September and rising crude oil prices are supportive of CPO prices in the near term. We project CPO prices to trade within the RM2,100 to RM2,400 per tonne range in October. Key upside/downside risks include higher/lower CPO prices. Our top regional picks are Genting Plantations, Wilmar and First Resources. — *CGSCIMB Research, Oct 3*