12 June 2023

Construction & Engineering | Construction

Construction

Overweight (from Neutral)

Slowly Escaping The Storm; U/G To OVERWEIGHT

Stocks Covered	11
Rating (Buy/Neutral/Sell):	8 / 2 / 1
Last 12m Earnings Revision Trend:	Negative

- **U/G to OVERWEIGHT from Neutral; Top Picks: Gamuda, Sunway Construction (SunCon), and Kerjaya Prospek (KPG).** We upgrade our sector call premised mainly on our upgrade for Gamuda (36.5% weightage of the KL Construction Index) to BUY from Neutral – viewing it as a strategic hedge for any downside risks stemming from the domestic construction sector. Additionally, we take note of dissipating headwinds in the form of a more manageable building material cost environment and reasonable supply of labour to support construction progress.
- **The value of construction work done in 1Q23** reached MYR32.2bn (+9.2% YoY). During this same period, the construction sector's economic output grew 7.4% YoY, marking the fourth consecutive quarter of YoY growth. While the Mass Rapid Transit 3 (MRT3) contract rollout could likely take a longer time – sometime in late 4Q23 or early 1Q24 – contractors may fill in the temporary void of local infrastructure jobs by focusing on industrial ones. Prospects for industrial properties remain resilient in light of foreign investments, eg data centre providers from Singapore relocating to Malaysia.
- **1Q23 underperformance was a temporary blip, in our view.** Out of the 10 companies that reported results, one came in line, one exceeded expectations, and eight fell below estimates. Most contractors had projects that were still at their initial stages. Hence, progress billings have yet to pick up. We believe the adequate supply of labour should result in higher revenue recognitions for projects while building materials cost pressures dissipate as projects without cost escalation clauses – secured before the Russia-Ukraine conflict – approach their tail-end.
- **Near- to medium-term pocket of opportunities** may also arise from the rollout of other infrastructure projects, particularly the remaining phases of the Pan Borneo Highway (PBH) Sabah and Sarawak, and the Bayan Lepas Light Rail Transit (BLLRT). These projects have received positive updates by the Government. Prime Minister Dato' Seri Anwar Ibrahim has urged for the adoption of a fast-track approach for PBH and allocated funds for the BLLRT, which was previously supposed to be state government funded.
- **Top Picks.** We introduce Gamuda as a new Top Pick in addition to KPG and SunCon. Overall, we believe it can weather any downside risks pertaining to local big ticket infrastructure jobs. The reason: Gamuda has a sizeable presence overseas (>70% of orderbook comes from overseas). Meanwhile, KPG has a framework arrangement with Samsung C&T that enables it to be exposed to more private sophisticated jobs (backed by its net cash pile). We also favour SunCon for its diverse tenderbook comprising internal jobs plus data centres and factories, under which the Song Hau 2 Power Plant project in Vietnam (pending financial close) could boost the orderbook by c.MYR6bn.
- **Key downside risks** to our sector call are longer-than-expected delays in contract rollouts and larger-than-expected cost reductions for MRT3.

Company Name	Rating	Target (MYR)	% Upside (Downside)	P/E (x) Dec-23F	P/B (x) Dec-23F	ROAE (%) Dec-23F	Yield (%) Dec-23F
Advancecon	Neutral	0.26	(13.4)	71.9	0.8	1.1	0.3
Econpile Holdings	Sell	0.14	(24.8)	31.3	0.6	2.0	0.7
Gabungan AQRS	Buy	0.40	43.0	3.6	0.2	6.7	2.4
Gamuda	Buy	4.95	16.5	14.1	1.1	7.8	8.0
IJM Corp	Neutral	1.59	(0.9)	19.1	0.6	2.8	3.6
Kerjaya Prospek	Buy	1.55	41.0	9.8	1.1	11.1	4.1
KKB Engineering	Buy	1.80	32.0	15.5	1.0	6.3	3.2
Malaysian Resources Corp	Buy	0.40	34.2	19.4	0.3	1.5	1.5
MGB	Buy	0.93	34.5	12.1	0.7	6.3	1.7
Pintaras Jaya	Buy	1.94	14.6	44.2	0.7	1.6	1.2
Sunway Construction	Buy	2.05	24.7	13.8	2.7	19.9	4.3

Source: Company data, RHB

Top Picks

Top Picks	Target Price
Gamuda (GAM MK) – BUY	MYR4.95
Kerjaya Prospek (KPG MK) – BUY	MYR1.55
Sunway Construction (SCGB MK) – BUY	MYR2.05

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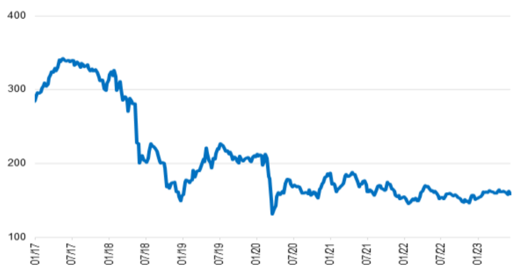
KL Construction Index's performance



Source: Bloomberg

1Q23 Results At a Glance

Overall, the construction sector delivered 1Q23 results that were below expectations. Out of the 10 companies that reported results, one came in line, one exceeded expectations, and eight fell below estimates. The companies that underperformed expectations are: i) SunCon, ii) Malaysian Resources Corp (MRCB), iii) KPG, iv) Gabungan AQRS (AQRS), v) Pintaras Jaya, vi) Econpile Holdings, vii) KKB Engineering (KKB), and viii) Advancecon. Meanwhile, the quarterly performance of IJM Corp met expectations while MGB's results exceeded projections. Note: Of the aforementioned firms, only Pintaras Jaya was upgraded to BUY from Neutral – reflecting the dissipating headwinds for its Malaysia operations while most of its profitability was underpinned by construction demand in Singapore.

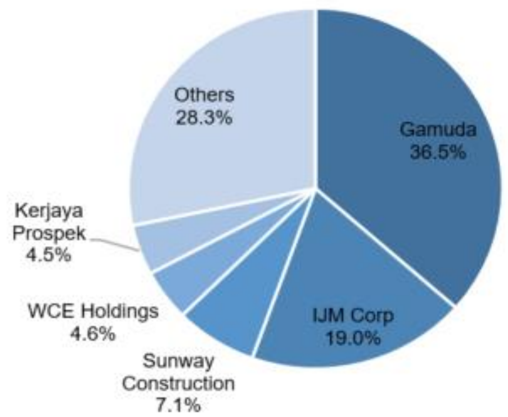
We deem the sector's 1Q23 underperformance to be a temporary blip, as most projects in hand are still at their initial stages. Therefore, progress billings remained slow during this period. However, we believe that work done will pick up in subsequent quarters owing to the relatively adequate supply of labour.

Figure 1: Quarterly performance vs estimates (RHB universe)

Stocks	Results review (released for the Mar-23 quarter)	Remarks	Results period	FYE
MGB	Above	1Q23 core profit of MYR12m (+82% YoY) exceeded our and Street's FY23 estimates at 40% and 38%. The positive deviation was due to better-than-expected cost management.	1Q23	December
IJM Corp	Within	IJM's FY23 (Mar) core earnings of MYR277m (+71% YoY) met our estimates – accounting for 96% of our full year projections. It generated a core profit of MYR50.5m (-21% YoY) during 4QFY23. The PBT for the construction segment dropped 20% YoY due to lower construction activities, as some major projects were completed during the previous financial year, whilst new projects secured are presently in their initial stages of progress.	4QFY23	March
SunCon	Below	SunCon's 1Q23 core profit of MYR25.9m (-27% YoY) was below estimates, at 16% and 17% of our and Street's full-year projections. In terms of PBT, the construction segment reported a 22% YoY decline in 1Q23 as some major projects are still in their early stages	1Q23	December
Pintaras Jaya	Below	Pintaras Jaya's 9MFY23 (Jun) core net loss of MYR1m was below our and Street's full-year earnings projections of MYR5m and MYR14m. However, it marked its first quarterly core profit of MYR0.9m in 1QFY23 after two quarters of core losses.	3QFY23	June
AQRS	Below	AQRS' 1Q23 core profit of MYR6.7m (-15% YoY) missed estimates – accounting for 17% of our and Street's CY23 projections. Its construction segment saw a 75% YoY jump in core PBT for 1Q23 – translating into a higher core PBT margin of 7.5% (1Q22: 5.7%). This was mainly contributed by the Light Rail Transit 3 or LRT3, E'Island Lake Haven, and Pusat Pentadbiran Sultan Alam Shah projects.	1QFY23	June (18 months)
KPG	Below	KPG's 1Q23 core profit of MYR29.3m (+2.4% YoY) was below estimates at 20% of our and Street's full-year projections. The construction segment recorded PAT of MYR29.3m (+3.8% YoY) in 1Q23, backed by higher progress billings from increased construction activities.	1Q23	December
Advancecon	Below	Advancecon recorded a 1Q23 core net loss of MYR4m vs our full-year earnings estimates of MYR2m – mainly due to ongoing losses from the quarry segment. The group recorded a 7% YoY jump in revenue in 1Q23 amid better progress of construction jobs, which led to a >10% PBT growth for the construction arm in the quarter.	1Q23	December
KKB	Below	KKB's 1Q23 core profit of MYR3.4m (+53% YoY) is below estimates at only 12% of our and Street's full-year projections. Despite recording revenue of MYR60.5m (-35% YoY) in 1Q23 (1Q22: MYR93.4m), its PBT for the same quarter was >50% YoY higher.	1Q23	December
MRCB	Below	MRCB's 1Q23 core profit of MYR8.5m (-40% YoY) missed expectations at 14% and 16% of our and Street's full-year estimates. Its construction wing saw a 72% YoY drop in 1Q23 EBIT due to the completion of key projects in late 2022, eg Damansara-Shah Alam Elevated Expressway or DASH Package CB2.	1Q23	December
Econpile	Below	Econpile's 9MFY23 (Jun) core net loss of MYR4.9m (9MFY22: -MYR27.4m) missed our and Street's full-year earnings estimates of MYR2m and MYR7m. In 3QFY23, ECON recorded a core loss of MYR0.5m, as residual cost pressures from private property projects secured in FY20-21 are receding as they approach their tail-end.	3QFY23	June

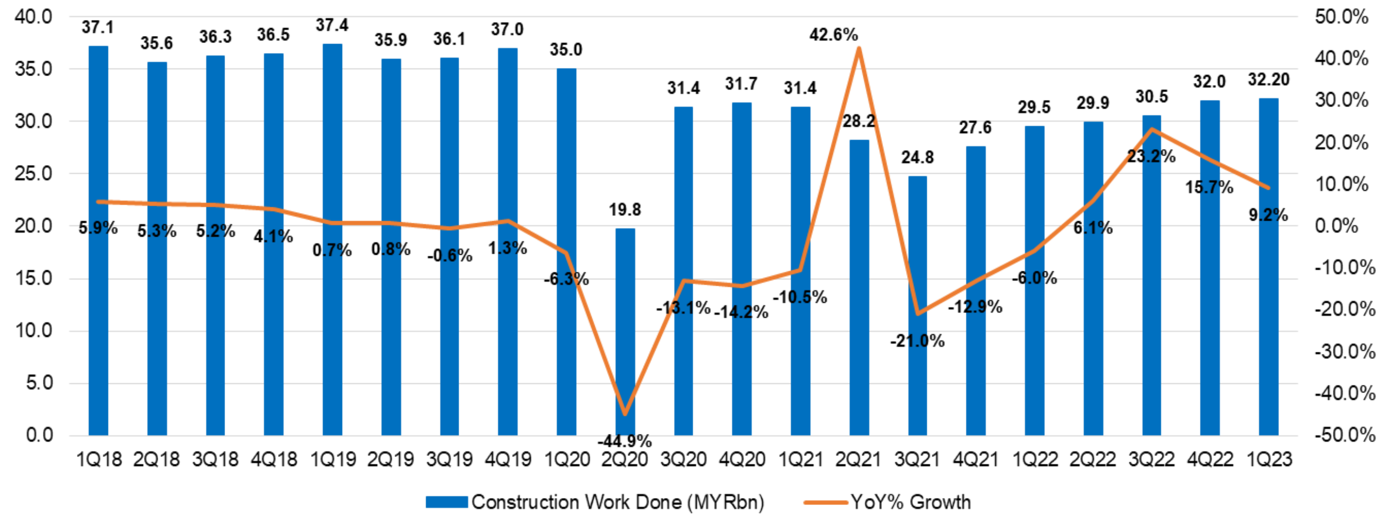
Source: Company data, RHB

Figure 2: KL Construction Index weightage breakdown (%)



Source: Bloomberg

Figure 3: Quarterly construction work done (MYRbn)



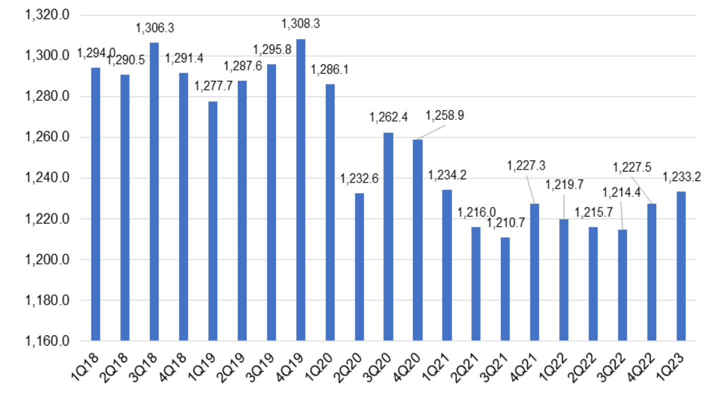
Source: Department of Statistics Malaysia (DOSM)

The total value of construction work done in 1Q23 exhibited a 9.2% YoY expansion to reach MYR32.2bn (1Q22: MYR29.5bn). In the same vein, the total value of construction work done during this time period also increased on a QoQ basis, growing 1% QoQ, which marked the sixth consecutive quarter of sequential rises. In terms of construction subsectors – excluding special trade activities that have smaller values when compared to other subs-sector) – the value of construction work done under the civil engineering segment recorded the largest YoY growth of 17.2% in 1Q23 to reach MYR12.1bn, ie the highest value of work done in eight quarters. We think this is attributable to the gradual improvement in working conditions – particularly from the labour front – as our channel checks indicate that contractors have been seeing better movement in terms of arrival of foreign workers post the approval stage. Construction work done for non-residential buildings saw the second-largest YoY growth in 1Q23 of 9.6% to reach MYR9.8bn – the highest since 1Q19. This is in line with the anticipated growth of the industrial buildings sub-sector. Conversely, the value of construction work done for residential buildings saw a 2.2% YoY drop in 4Q22 after a 17.8% YoY growth in 3Q22.

Labour supply developments. Operating conditions were further facilitated by reasonable labour supply, with contractors such as SunCon not pursuing the additional 300 foreign workers quota – it believes its newly received 394 workers are sufficient. KPG, on the other hand already has 4,000 workers, but expects another 1,000 to come in during the next few months – enabling the group to operate optimally in its view. Overall contractors under our coverage are of the view that labour shortage issues are no longer a major pain point for their respective operations.

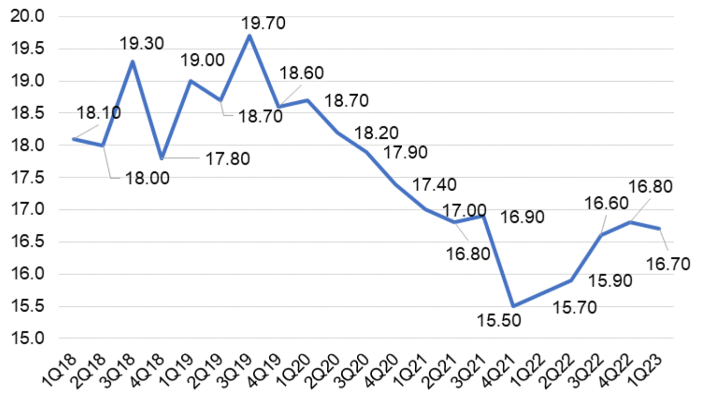
Productivity wise, total hours worked under the construction industry reached the highest point in 13 quarters during 1Q23 at 834m hours. Likewise, labour productivity per hour worked grew by 6% YoY to MYR16.70 per hour during this quarter vs 1Q22's MYR15.70 per hour. Such productivity levels are in line with the number of filled jobs in the construction sector, which increased to 1,233.2k in 1Q23 vs 1Q22's 1,219.7k – indicating that the gradual arrival of workers into the country is filling up sector vacancies.

Figure 4: Jobs filled in the construction sector ('000)



Source: DOSM

Figure 5: Labour productivity in the construction sector – value added per hour (in MYR)

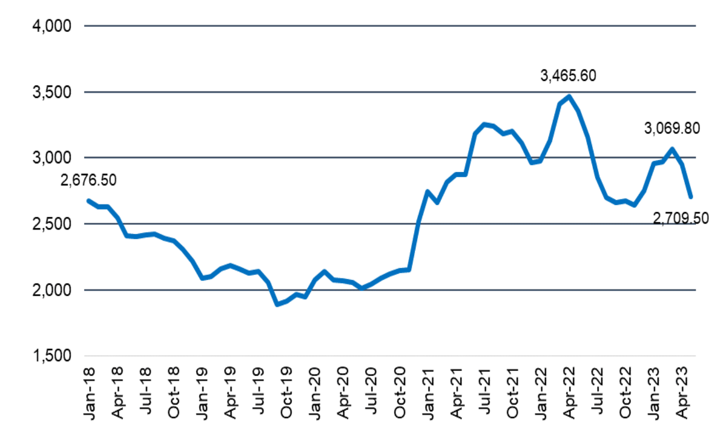


Source: DOSM

Some signs of easing pressures from the building material cost front. The price of bulk cement incurred by contractors such as SunCon witnessed some signs of easing. The average price of steel bars saw a 19% YoY drop to MYR2,709.50 per tonne in May – marking a 12th consecutive month of YoY declines. Moreover, the YoY pace at which steel prices were declining have been gradually picking up from January to May. Meanwhile, the average prices of bulk cement reached a 5-month low of MYR369 per tonne in May vs the historical peak of MYR388.7 per tonne in January. On further scrutiny, the rate of YoY% increases for bulk cement prices have softened – only increasing by 9.7% YoY in May vs 41.3% YoY in January. Even during 1Q23, the rate of increase has already slowed to a tune of 26% YoY in March.

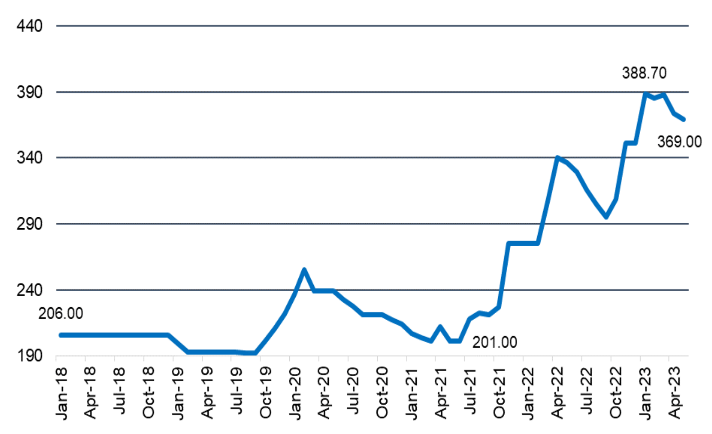
As a result, we witnessed some expansion in GPMs for a number of contractors in 1Q23 vs 1Q22. Notable contractors that experienced this: Econpile, IJM Corp, KKB, Advancecon, and MGB. This tallies with contractors citing receding pressures from building materials costs as projects – especially ones with no cost escalation clauses secured prior to the start of the Russia-Ukraine conflict – are reaching their tail-ends while new projects have factored in the current material prices trends, which are less volatile than before. As such, the risk of continuing margins compressions is somewhat manageable.

Figure 6: Steel bar prices (MYR per tonne)



Source: Sunway Construction (SunCon)

Figure 7: Bulk cement prices (MYR per tonne)

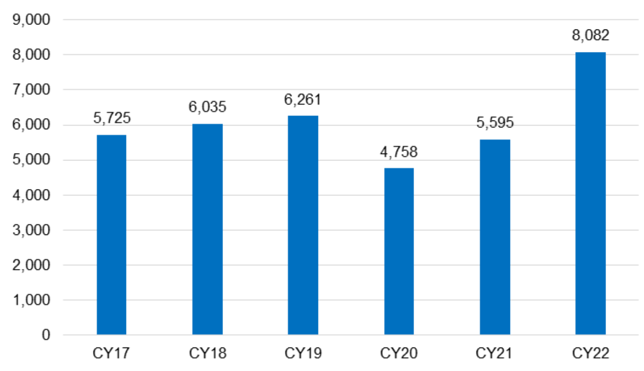


Source: SunCon

Industrial properties in Malaysia to present pocket of opportunities for contractors. The industrial property segment remains resilient post the pandemic with active industrial property transactions in 2022. Malaysia saw MYR21.2bn worth of industrial properties – ie factories, warehouses, and manufacturing facilities – transacted last year vs 2021's MYR17bn. This represented a 25% YoY growth. Likewise, the number of transactions for industrial properties in Malaysia grew by 44% YoY to reach 8,082 transactions in 2022 (2021: 5,595 transactions). In fact, this is the highest number of transactions within a span of six years, ie 2017-2022.

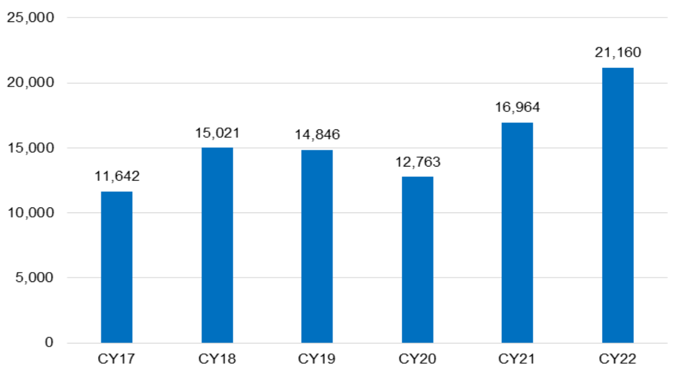
Overall, China's reopening could lead to an increase in foreign direct investments or FDIs – particularly for the manufacturing sector. This is further facilitated by the fact that this country is one of the East Asian nation's export partners. Malaysia's strategic location as a gateway to ASEAN is also a factor. Such growth in industrial properties represents an opportunity for contractors to tap into – acting as a temporary fill-up in the current gap from public infrastructure jobs.

Figure 8: Number of transactions in the industrial property segment in Malaysia



Source: National Property Information Centre (NAPIC)

Figure 9: Value of transactions in the industrial property segment in Malaysia (MYRm)



Source: NAPIC

Data centre operators are still seen to be actively expanding in Malaysia. Based on our recent *Telecommunications: The Rise of Data Centres in ASEAN* thematic report, Malaysia is seeing a raft of new/emerging data centre investments – over 800MW of capacity is projected to come on stream in phases over the next five years. Lower land and energy costs are seen as the key draws.

Singapore's decision in early 2022 to calibrate new data centre builds has also been a blessing in disguise, with the likes of Equinix, AirTrunk, Yondr Group, and GDS Holdings locating their maiden facilities in Johor. More importantly, the setting up of cloud regions by Microsoft and Amazon Web Services or AWS are major coups, with significant upsides for the domestic data centre industry and even contractors. In fact, there were already three announcements of foreign data centre providers establishing facilities here within 1H23 – Princeton Digital, AirTrunk, and NEXTDC.

Figure 10: Announcement details of foreign data centre providers relocating to Malaysia in 1H23

Data centre provider	Announcement	Estimated Capacity	Investment	Location
AirTrunk	Jan 2023	150MW+	Not disclosed	Johor Bahru
Princeton Digital	May 2023	150MW	MYR2bn	Sedenak Technology Park, Johor
NEXTDC	Jun 2023	65MW	MYR3bn	Petaling Jaya, Selangor

Source: Various media

We have seen Yondr Group awarding a MYR1.7bn job to SunCon for its data centre in Sedenak Technology Park in Johor. Meanwhile local data centre firms such as AIMS have seen contracts awarded to local contractors. For instance, AIMS Data Centre awarded Gamuda subsidiary Gamuda Engineering with a MYR170m job to construct a data centre in Cyberjaya in February – according to the Construction Industry Development Board's (CIDB) data base – with an estimated completion target by end 2023. While no exact details were mentioned in CIDB's database, we believe the data centre could be the AIMS Cyberjaya Block 2 with a capacity of 8MW, under which Gamuda will be utilising its "Next-Gen Digital Industrialised Building System (IBS)" solution via Industrial Revolution 4.0 technology. Recall: SunCon's more than MYR20bn tenderbook consists of data centre jobs in Cyberjaya and possibly Johor – putting the company in a sweet spot to ride on the country's data centre boom.

Figure 11: AIMS' first data centre in Cyberjaya

Source: DC Byte

MRT3 – slowly but surely. A possible positive development regarding MRT3 for contractors, is that the Government could tweak non-construction cost components (without affecting the MYR34bn construction cost element) – such as project management, land acquisition, and other costs – to achieve the MYR5bn reduction in overall costs from the initial MYR50bn (Figure 12). Alternatively, the Government may slightly adjust downwards all cost components to achieve the 10% reduction in overall costs. The condition allowing any participating contractor to be eligible for the MRT3 systems package on top of being awarded with one of the three main civil work packages may enable contractors to cast a wider net on opportunities from the project.

Figure 12: MRT3 estimated cost breakdown – assuming the lowest bidders based on The Edge's article – prior to any cost review by the Government

Work packages	Value (MYRbn)
Breakdown of construction component into five packages:	**34.3**
CMC301 – MRCB (lowest bidder)	2.9
CMC302- Syarikat Pembenaan Yeoh Tiong Lay (lowest bidder)	10.8
CMC303 – MMC Gamuda (lowest bidder)	13.3
Project management consultancy (PMC) package awarded to HSS Engineers	1.0
Systems package	6.3*
Land acquisition	**8.4**
Project management	**5.6**
Others	**1.9**
Total	**50.2**

*Note: *Amount left of after taking into account the PMC and civil construction costs (based on lowest bidders)*
Source: RHB, Malaysia Parliamentary reply in Aug 2022, Land Public Transport Act 2010, Land Public Transport Agency, Various media

BLLRT – likely sooner than later. The Government's plan to allocate additional funds to expedite the rollout of BLLRT is a positive for the sector. Discussions are still underway in relation to the location of the LRT depot, and it has been mutually decided that the chosen location will be an existing site on Penang Island – rather than on the reclaimed Silicon Island (Island A) of the Penang South Island. In fact, the Government has decided to extend the BLLRT's route to Tanjung Bungah vs the original plan from Penang International Airport to Komtar, potentially resulting in a higher project value – we estimate this could be MYR11-12bn compared to the initially estimated MYR9-10bn.

Gamuda to be involved in BLLRT as a project delivery partner (PDP). Based on a master agreement executed in Jul 2020 between Gamuda – via its subsidiary SRS Consortium – and the Penang State Government, the consortium will assume the role of PDP for BLLRT with a fee of 5-7.5%. Gamuda's involvement in BLLRT is clear, pending the finalised details of the project by the Government. The longer alignment of this train network may also entail higher PDP fees for Gamuda while potentially having more packages to be awarded for participating contractors.

The Penang State Government has received eight submissions from local and international consortiums for the BLLRT under the pre-qualification process held between 3Q22 and 4Q22. SunCon is one of the contractors under our coverage that participated in said pre-qualification exercise.

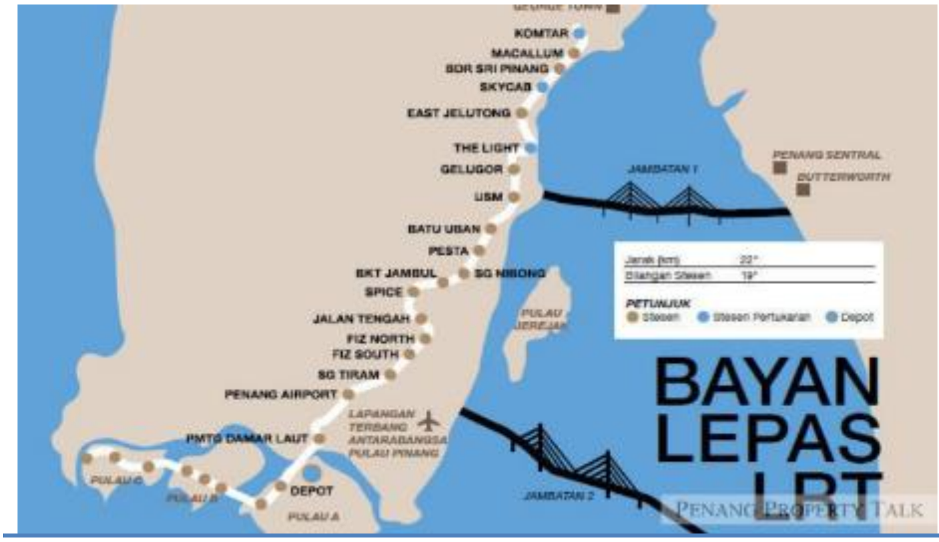
In the longer run, the possible earlier commencement of the BLLRT by end of 2023, within a 5-year timeframe, could result in other transit lines under the Penang Transport Master Plan being rolled out after that – providing more job replenishment opportunities for contractors.

Figure 13: Proposed transit lines in Penang

Proposed transit lines in Penang	Length (km)	Number of stations
Bayan Lepas LRT	29	27
Ayer Itam Line (Komtar-Paya Terubong)	13	13
Tanjung Tokong (Komtar-Tanjung Tokong)	7	8
Georgetown-Butterworth	18	8
Raja Uda-Bukit Mertajam	28	21
Permatang Tinggi-Batu Kawan	14	15

Source: Penang Infrastructure Corporation, New Straits Times

Figure 14: BLLRT initial alignment plans before the scale-down of Penang South Islands



Source: Penang Property Talk

Upcoming phases of PBH Sabah and Sarawak. There has been news flow about the Government adopting a fast-track approach for the PBH projects in Sabah and Sarawak. Such aspirations are further supported by the Government's allocation of MYR20bn for both states to continue and expedite the implementation of PBH Sarawak and Sabah, as well as the Sabah-Sarawak Link Road (SSLR) under Budget 2023. With the MYR16bn Phase 1 of the PBH Sarawak project reaching the tail-end of completion, construction work is set to start for Phase 2 (also known as the Northern Coastal Highway) (Figure 18), linking Limbang and Lawas via Brunei.

SSLR. In addition to Phase 2 of PBH Sarawak, there are plans to accelerate the construction of the SSLR (more than 300km) under which Phase 1 (77km from Simpang Gelugus to Long Lopeng) is currently underway with a contract value of MYR1.1bn. This was awarded to Samling Resources as the main contractor. Kimlun Corp (KICB MK, NR) was awarded with a MYR780m subcontract by Samling Resources in Nov 2021 for the main works of construction and maintenance of SSLR Phase 1 (Lawas to Long Lopeng Junction). Phase 1 has reached 13.6% completion as at Apr 2023, with expected completion by Jan 2026.

SSLR Phase 2 is expected to begin construction in 4Q23, with the Government currently carrying out the process of management and price evaluation for the remaining phases of the project. Phase 2 of the PBH Sarawak and the SSLR projects will reportedly cost the Government a combined MYR12bn.

Figure 15: Work packages under SSLR Phase 2

Package	Details
1	61km stretch between Mulu and Long Seridan
2	101km stretch from Long Seridan to Nanga Medamit
3	63km section between Long Lopeng and Long Komap
4	97km section from Rumah Aling to Long Merarap

Source: Dayak Daily

PBH Sabah. For Phase 1 of PBH Sabah, another 20 packages (mostly in Sabah's east coast) out of the total 35 are expected to commence by the end of 2023. A potential beneficiary of the upcoming phases or work packages of PBH Sabah is AQRS. Via its JV with Sabah Economic Development Corp (SEDCO) under an entity called SEDCO Precast, the group has the ability to supply precast components for PBH Sabah, given it is the largest precast concrete manufacturing facility in the state. We estimate the packages to supply precast components for PBH Sabah will be in excess of MYR200m. Overall, such developments should boil down to potential job replenishments among contractors in the coming years, in addition to other big ticket infrastructure projects such as MRT3.

Figure 16: Key highlights of Phase 1 of PBH Sabah and Sarawak

Details	Phase 1 of PBH Sarawak	Phase 1 of PBH Sabah
Number of work packages	11	35
Cost	MYR16.1bn	MYR12.9bn
Length	786km	706km
Start and end point	Telok Milano-Miri	Sindumin-Tawau
Completion progress as at early Jan 2023	c.91%	c.73%

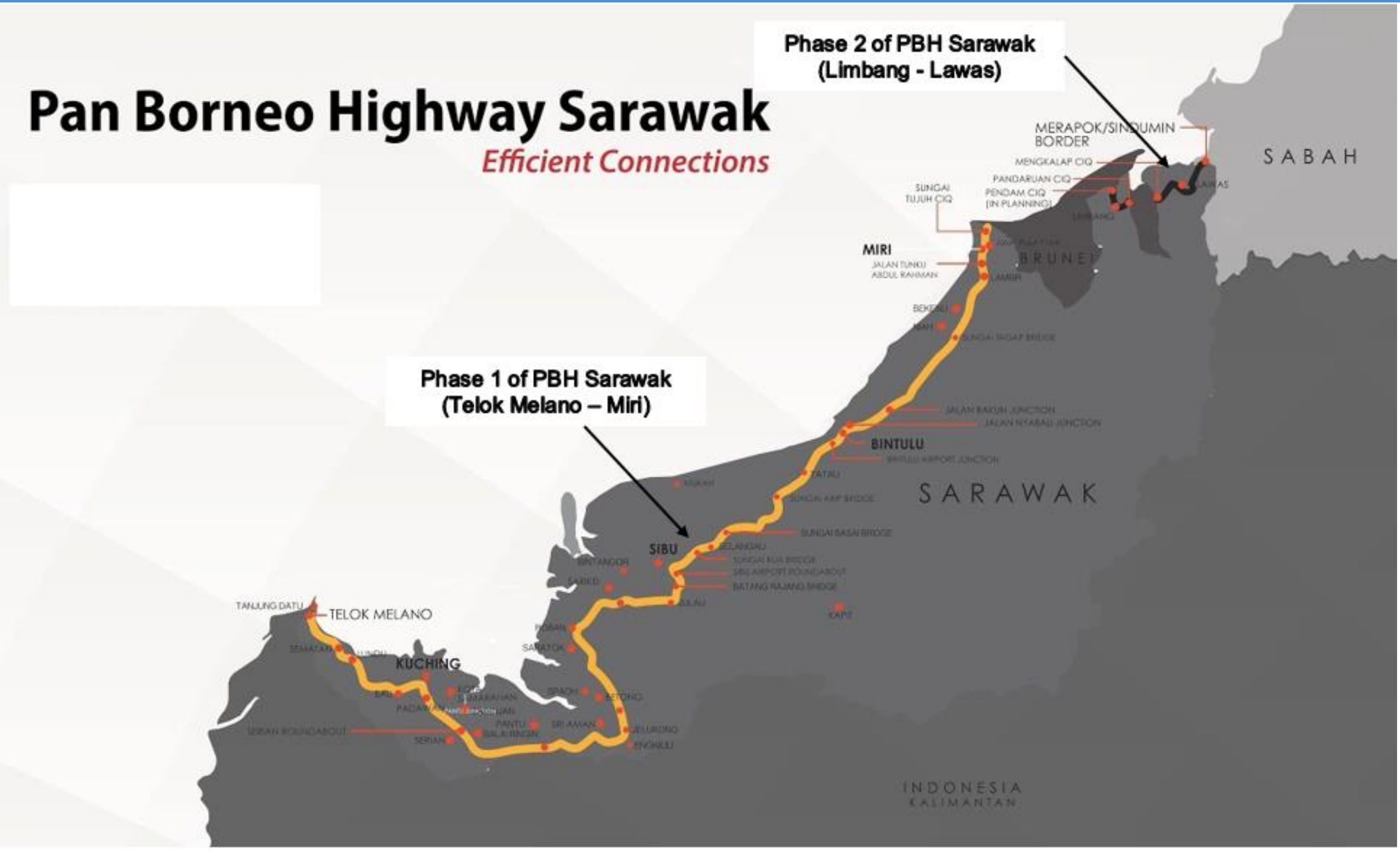
Source: Various media

Figure 17: List of contractors involved in PBH Sarawak Phase 1 (not exhaustive)

Contractors	Work package	Value (MYRm)
Kimlun via JV with Zecon (30% Kimlun, 30% Zecon)	WPC03: Serian roundabout to Pantu Junction	1,460
Gamuda via JV with Naim Holdings (30% Gamuda, 70% Naim)	WPC04: Pantu Junction to Batu Skrang	1,567
TRC Synergy (through its subsidiary Trans Resources Corp) via JV with Endaya Construction and Pembinaan Kuantiti SB (30% Trans Resources Corp, 70% other JV partners)	WPC05: Batang Skrang to Sungai Awik Bridge	1,310
Cahya Mata Sarawak (through its subsidiary PPES Works via a JV with Bina Puri (70% PPES Works, 30% Bina Puri)	WPC06: Sungai Awik Bridge to Bintangor Junction	1,360
Hock Seng Lee via JV with Dhaya Maju Infrastructure (Asia) SB (70% Hock Seng Lee, 30% Dhaya Maju Infrastructure (Asia))	WPC07: Bintangor Junction to Julau Junction and Sibu Airport to Sungai Kua Bridge (including Batang Rajang Bridge)	1,700
Mudajaya via JV with Musyati SB (30% Mudajaya, 70% Musyati)	WPC08: Sungai Kua Bridge to Sungai Arip Bridge	1,326
KKB via JV with WCT (70% KKB Engineering, 30% WCT)	WPC09: Sungai Arip Bridge to Bintulu Airport Junction	1,289

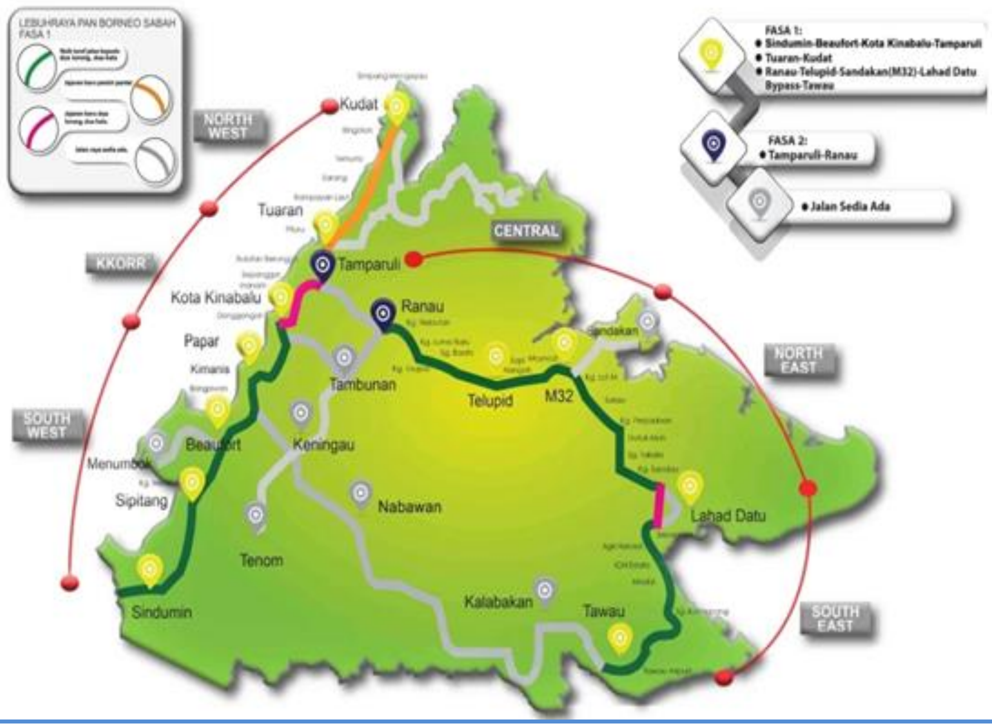
Source: Bursa Malaysia announcements

Figure 18: PBH Sarawak



Source: Lebuh Raya Borneo Utara

Figure 19: PBH Sabah



Source: Ministry of Works

Kuching Urban Transportation System (KUTS) to provide additional opportunities in Sarawak. The Kuching Autonomous Rapid Transit (ART) is a component under Phase 1 of the Kuching Urban Transportation System (KUTS) project (estimated at MYR6bn), fully financed by the Sarawak State Government. Phase 1 of KUTS involves a c.70km route comprising three lines and 31 stations. Thus far, privately owned Hock Seng Lee clinched a contract for the advanced works related to the Rembus depot for the Blue Line of the Kuching ART in Kota Samarahan (worth MYR64.3m) in Nov 2022, and is slated for operations in 4Q25. This coincides with the Stage 1 opening of the Kuching ART passenger service for the Blue Line. Aside from this, two system packages for the Kuching ART were awarded in Jul and Nov 2022.

The tender for the full construction and completion of the Rembus Depot and associated works for the KUTS project were called in late May, with a submission deadline by 12 Jul. Kimlun Corp is a contractor that has clearly expressed its interest to participate in the Kuching ART project since the Environmental Impact Assessment report highlighted that Line 1 of Kuching ART would be 67% elevated, while Line 2 is to be 96% elevated – presenting opportunities for the group to supply precast components such as segmental box girders. Apart from Kimlun Corp, we do not discount KKB's participation in this project – particularly for fabrication-related works backed by Sarawak Economic Development Corporation's (SEDC) 10.7% shareholding in KKB. Sarawak Metro, which is the project owner of Kuching ART, is a wholly owned subsidiary of SEDC.

Figure 20: Contracts awarded so far under the Kuching ART project

Work packages	Job scope	Appointed contractor	Value (MYRm)
System Package 1	Supply of the rolling stock, which is the hydrogen-powered ART vehicles; depot equipment, and maintenance vehicles; signalling and control systems; and automatic platform gate.	JV between EPR (Kuching SB, Global Rail, and Mobilus.	1,425
System Package 2	Supply of telecommunication, supervisory control, and data acquisition, automatic fare collection; computerised maintenance management system, operation control centre, and information technology system.	JV between DOM industries (M) and China Railway Electric Engineering Group Malaysia	448
Advanced works for Rembus Depot	Construction and completion of the advanced works for Rembus depot	Hock Seng Lee	64

Source: Various media

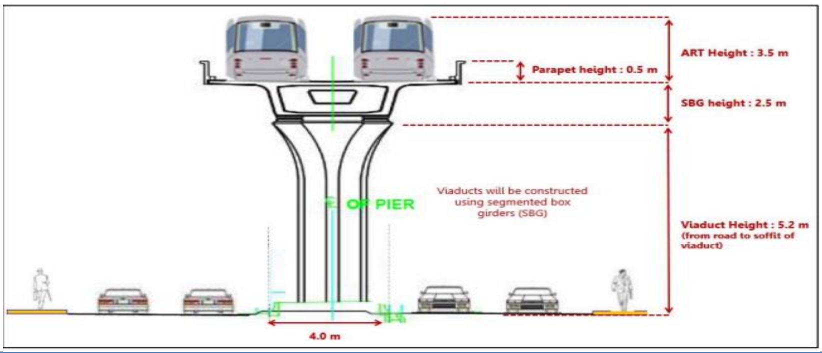
Figure 21: Prototype hydrogen-powered ART vehicle in Zhuzhou, China

Source: Sarawak Metro

Figure 22: Artist illustration of the Rembus depot

Source: Sarawak Metro

Figure 23: Cross-section of Kuching ART's elevated section



Source: Kuching ART Environmental Impact Assessment report, Sarawak Metro

Figure 24: Lines under Kuching ART (Blue, Red, and Green Lines)

Source: Sarawak Metro

Figure 25: Details of the three lines under Kuching ART

Line	Remarks	Length
Blue Line	Rembus to Hikmah Exchange	27.6km
Red Line	Kuching Sentral to Pending	12.3km
Green Line	Pending to Damai Central, Santubong	30km

Source: Various Media

Kuala Lumpur-Singapore High Speed Railway (HSR). For the HSR project, five companies were invited by the Government for the request for information (RFI) exercise in March – MMC Corp, MRCB, WCT, Berjaya Group, and YTL Group. Despite the absence of dominant contractors like Gamuda and IJM Corp in the RFI, we do not discount the possibility of the invited parties – particularly MRCB – to form a consortium with a contractor like Gamuda to participate in the HSR. Note: In 2018, Gamuda and MRCB – via a 50:50 JV – secured a contract that commissioned the JV company as the PDP for the northern section of the HSR before it was cancelled. The contract also required the JV firm to submit a MYR5m commitment bond and corporate guarantees issued by both MRCB and Gamuda to MyHSR Corp within 14 days from the awarding of the contract.

Figure 26: Contracts previously awarded under HSR prior to cancellation in 2021

Consortiums	Section	Remarks
MRCB and Gamuda	PDP for northern portion	Bandar Malaysia station to the contract boundary, which is the first standard viaduct pier on the Melaka station's south side.
TH Properties and Syarikat Pembenaan Yeoh Tiong Lay	PDP for southern portion	First standard viaduct pier on the south side of the Melaka station to the international boundary between Malaysia and Singapore.

Source: Various Media

Johor Bahru LRT (JB LRT). In March, the Government cited that it is considering proposals for the construction of an LRT line in Johor Bahru. Prior to this, Nylex Malaysia (NYL MK, NR) proposed in Dec 2022 to enter into discussions with CRRC Changchun Railway Vehicles from China for the construction of an LRT system in Johor Bahru. This would be connected with the Rapid Transit Link or RTS being constructed between Johor Bahru and Singapore. Planned as an integrated property development that is categorised as transit-oriented development, the project is subject to an ongoing feasibility study and the grant of a concession award by the Johor State Government, according to the report.

The potential onset of the JB LRT could give rise to job replenishment opportunities for contractors involved in previous LRT projects, namely LRT3. These are AQRS (which has an ongoing property development project in Johor Bahru called The Peak), SunCon, and MRCB.

East Coast Rail Link (ECRL). From 2017 until 1Q23, the civil contracts awarded under ECRL has reached MYR11.2bn. This exceeds the MYR10.7bn (40% of total civil work projects) targeted for local contractors. Construction work for the entire 665km ECRL line from Kota Bharu (Kelantan) to Port Klang (Selangor) is 40.8% completed as of Apr 2023. It is expected to be completed by the end of 2026 and begin operations in Jan 2027. Looking ahead, Prime Minister Dato' Seri Anwar Ibrahim intends to increase local contractors' participation for the ECRL project – particularly within the remaining southern sections in Selangor.

Figure 27: Contracts awarded under the ECRL (not exhaustive)

Contractor	Job scope	Date	Value (MYRm)
Advancecon	Subcontractor for the construction and completion of subgrade earthwork of section five of ECRL.	Apr 2023	11.5
Tanco Holdings	Construction and commissioning contract for ECRL awarded by China Communications Construction ECRL.	Mar 2023	43.4
HSS Engineers	Contract to provide additional supervising consultancy services for section 9 of the East Coast Rail Link (ECRL) from Serendah to Port Klang, Selangor (53.5km).	Jan 2022	16.6
Tanco Holdings	Construction and completion of substructure for Section 2 of the rail link, which borders Kelantan and Terengganu, and the construction and completion of structures for eight bridges in Besut and Setiu, Terengganu. The subcontracts were awarded by Sri Medan Holding.	Jan 2022	41.5
Nestcon	Subcontracts on the infrastructure work for Package S1-1 and Package S1-2 stretches in Kota Bharu, Kelantan. The subcontracts were awarded by China Communications Construction ECRL.	Jan 2022	90.4
Advancecon	Subcontractor for the proposed construction and completion of ground treatment work of Section 4 of ECRL.	Oct 2021	17.0
IJM Corp	Construction of substructure works and partial superstructure works for the Sungai Pahang bridge, as well as T-Beam fabrication and installation of this bridge and other bridges in Section 6 of the rail link.	Aug 2021	258.0
Gabungan AQRS	To undertake drainage works for the ECRL project in Pahang.	Jun 2020	37.0
HSS Engineers	Provide supervising consultancy services for infrastructure works for ECRL.	Dec 2017	82.5

Source: Various media

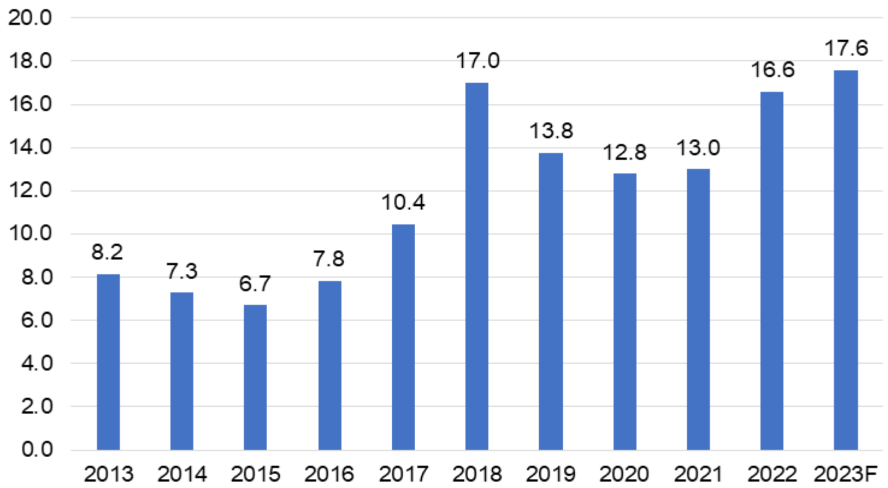
Figure 28: Progress of respective ECRL sections

Sections	Completion progress
Terengganu	55.0%
Kelantan	51.9%
Pahang	43.0%

Note: Completion as at Mar to Apr 2023
Source: Various Media

Development expenditure (DE) allocation to transport subsector is seeing an upwards trend. To encapsulate the job flow prospects for the local construction sector, it is worthwhile to observe the absolute value of Malaysia's DE allocation for the transport subsector. Although the percentage of total DE allocated to this subsector is on an overall downtrend to 18.1% for 2023F from 30.3% in 2018, the absolute value allocated to it is seen to be steadily increasing from MYR12.8bn in 2020 to an estimated MYR17.6bn in 2023. A major rerating catalyst would be if the Government decides to revise the total MYR400bn allocated for 12th Malaysia Plan (2021-2025) during its mid-term review in September/October. Up until now, c.MYR232.8m worth of DE has been allocated since 2021.

Figure 29: Absolute value of Malaysia's development expenditure allocation for the transport subsector

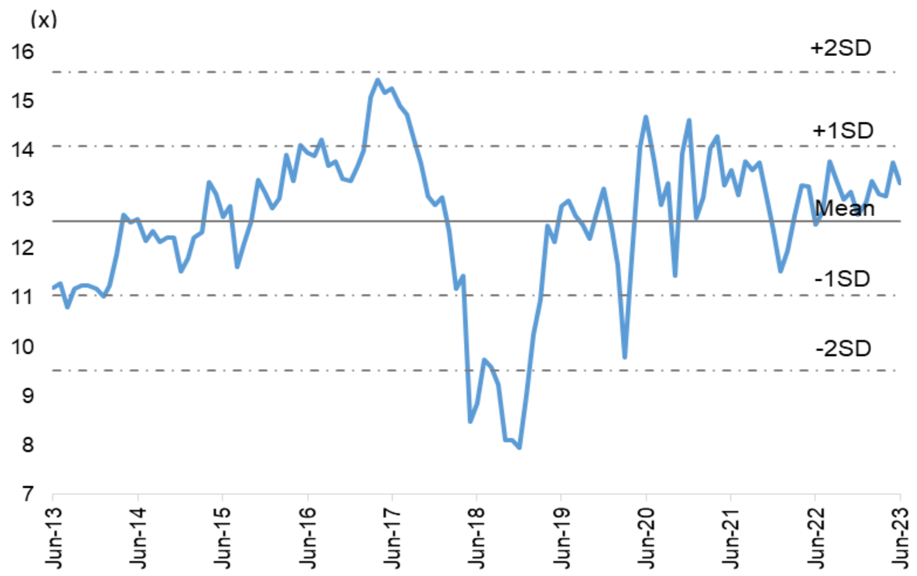


Source: Ministry of Finance

Valuations. The KL Construction Index is trading at a 13.3x P/E, c.+0.5SD from its 10-year mean of 12.6x. The index was trading at 15.6x in mid-2017 during the construction upcycle. We think that the rise in valuations during that period was likely attributable to the broad rally from most counters under the index instead of being pushed by just a few heavyweights.

Now, the rise in KL Construction Index's valuation is mostly underpinned by heavyweights like Gamuda (constituting a 36.5% weightage of the index) backed by its overseas job prospects. Job flows are yet to pick up from the infrastructure sector but, having received strong indications from the Government (eg the BLLRT), we view current valuations of the index as undemanding. Hence, it is an attractive level to enter.

Figure 30: KL Construction Index's 10-year P/E band



Source: Bloomberg

All in, we upgrade the sector to OVERWEIGHT from Neutral. With these points in mind, we advocate investors to be selective on counters with certain niches to weather any downside risks, ie unexpected labour shortage, slow rollout of public infrastructure projects in Malaysia, and prolonged period of building material costs. Contractors that suit these criteria are Gamuda, SunCon, and KPG.

We favour Gamuda as a strategic hedge towards any uncertainties from the local infrastructure due to its sizeable presence in overseas markets – particularly Australia (more than 70% of the outstanding orderbook) – combined with the group's potential to clinch the MRT3 systems package (in addition to the tunnelling civil works package). KPG and SunCon both continue to strengthen their presences in the industrial building jobs space. The former formed a partnership with Samsung C&T to secure more of such jobs, ie factories and warehouses. The group's net cash pile of more than MYR200m should enable KPG to easily gear up for large jobs in the future if required to.

On the other hand, SunCon's more than MYR20bn tenderbook comprises some data centre projects – reducing its reliance on internal jobs from its parent, which contributes 30-40% of its construction orderbook.

Downside risks for the sector: Slower-than-expected project rollouts and larger-than-expected cost reductions for MRT3.

Figure 31: Construction projects already/expected in the pipeline (not comprehensive, updated as of June)

Projects	Estimated job value (MYRbn)	Latest updates
LRT3	16.6*	83% progress as at end of 1Q23 with expected completion in 2024. Progress billings have significantly improved and are expected to increase in 2023.
Johor Bahru-Singapore RTS Link	3.7 (Malaysia's portion)	Progress stood at 36% completion as at Apr 2023. The project is expected to commence operations by end-2026. Of the 4km length, 2.7km are in Malaysia and 1.3km in Singapore. The RTS link will transit from the underground Woodlands North Station to the above-ground Bukit Chagar station via a 25m high bridge across the Straits of Johor.
Sabah-Sarawak Link Road	MYR1.1bn (for first phase)	The SSLR phase 1 has reached 13.6% completion as at Apr 2023 with expected completion by Jan 2026.
Pan Borneo Sarawak Highway	16.2 (first phase)	Phase 1 of Sarawak Pan Borneo Highway project is 91% complete as at Jan 2023. The entire phase 1 is expected to be completed by the end of this year except for package 11 (Lambir and Beluru) which is expected to be completed in 2024 following a change in the scope of the project.
Pan Borneo Sabah Highway	12.9 (for first phase)	The Sabah Pan Borneo Highway project is 73% complete as of Jan 2023. The project is expected to be fully completed by end of 2025.
West Coast Expressway	5.9 (excluding land acquisition)	Completion progress is 84% as at Jan 2023. Four out of 11 sections of the expressway have been completed. In the second half of 2023, four more sections will be opened, with the remaining in 2024.
Central Spine Road	7.3	Expected to be completed in 2026. The project's total cost is MYR7.3bn and involves six packages with an over 200km stretch, starting from Kuala Krai, Kelantan to Simpang Pelangai, Negeri Sembilan.
East Coast Rail Link	50.3^	Line-wide progress stood at 40.8% as at Mar 2023 with target completion to be in Dec 2026.
KVMRT3	34.3^	Government will be carrying out cost study to reduce overall cost from MYR50bn to under MYR45bn.

*Note: *Project value reduced post revision*
Note 2: ^Civil works
Source: Various media, Company data, RHB

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