



AmResearch

Sector report

19 May 2015

CONSTRUCTION

Bottom-up opportunities from 11MP

OVERWEIGHT

(Maintained)

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Rationale for report: Sector update

Investment Highlights

- **11MP – What to expect?** Under Budget 2015 – the final year of the outgoing 10th Malaysia Plan (10MP) – overall development expenditure was c.19% higher YoY at RM50bil (including c.RM2bil for contingencies). Total development expenditure allocated at the start of the 10MP was ~RM230bil. For the upcoming 11MP, we believe the new allocation has to be balanced against the government's fiscal objectives – i.e. 2015 fiscal deficit target of 3% and a balanced budget by 2020 – amid a weaker MYR and lower oil revenues.
- **Impetus will likely come from the reaffirmation of key projects highlighted during Budget 2015:** Our channel checks indicate that while it is unlikely for any major new infrastructure jobs to be announced under 11MP, sentiments for Malaysian contractors will still be lifted by the reaffirmation of several catalytic projects announced under Budget 2015 last October. Key cornerstone projects to look out for include:-
 - (1) **MRT2 (RM23bil):** The second Klang Valley MRT line (56km) will link Sg.Buloh and Selayang. While there was a delay (due to plans to incorporate a station in Bandar Malaysia), we still expect major work packages to be dished out from mid-2016 onwards. This implies that tenders should be called by 4Q15. The Project Delivery Partner (PDP) role has been awarded to the **MMC Corp-Gamuda JV** (which undertook the same role for MRT1). This puts the JV in a strong position to secure the tunneling contract. Likewise, we also believe that **Econpile** is in a strong position to win upcoming piling works given its track record for MRT1, while **Kimlun Corp** may supply tunnel lining segment and segmental box girders for MRT2.
 - (2) **Klang Valley LRT 3 (RM9bil):** Along with MRT2, we believe the LRT 3 line (Bandar Utama-Shah Alam-Klang) will be among several key public transportation projects that will gain prominence under the 11MP. Earlier press report suggests that six shortlisted candidates – (i) an **MMC-Gamuda JV**; (ii) a tie-up between **Malaysian Resources Corp (MRCB)** and **George Kent**; (iii) **UEM Group**; (iv) **Naza TTDI-CSDR Zhushou JV**; (v) **Sunway**; and (vi) **WCT-Alloy MTD Group** – are in the running for the PDP role.
 - (3) **West Coast Expressway (RM5bil):** Appointed as the engineering, procurement and construction (EPC) contractor in January, **IJM** could still be in the running for the balance RM2.2bil worth of jobs after securing the first portion worth ~RM2.8bil. Equally, IJM may expand its current record RM7bil orderbook further via the Kuantan Port expansion project (RM3bil; Phase 1: ~RM1.8bil), after it had won a RM1.2bil contract to build a new deep water terminal at Kuantan Port. Notably, IJM owns a 60% stake in the Kuantan Port concession, as well as pockets of industrial land near the port.
 - (4) **Pan Borneo Highway (RM27bil):** The RM27bil highway – involving 1,663km of roads (Sarawak: 936km; Sabah: 727km) – was officially kicked-off late March. It is supposed to be a fast-track project that involves private sector participation. The stretch in Sarawak – costing ~RM15bil – will be toll-free and was reportedly awarded to Lebuhraya Borneo Utara. Works on the Sarawak portion is expected to be completed by 2023. Construction will begin with the 40km Tg.Datu-Sematan (by end-2018) and 740km Sematan-Miri (by 1Q 2023) stretches. While the exact funding structure is not immediately known, we reckon that Sarawak-based contractor **Hock Seng Lee** could be a key beneficiary as it has:- (i) a strong balance sheet that would enable the group to take on payment-in-kind jobs (e.g. land swap); and (ii) a niche in marine-engineering works, which comes in handy given the state's hilly terrain.
 - (5) **Other notable projects** include the balance of works for the Langat 2 project and urban highways included in Budget 2015 (i.e. the RM5.3bil Sg.Besi-Ulu Kelang Expressway [SUKE], and RM4.2bil Damansara-Shah Alam Expressway). The status and timing for these projects remain unclear, although the Federal government recently reiterated its desire to proceed with Langat 2 despite the Selangor water impasse. Also, a proposed **RM30bil East Coast Rail Line** (620km from Tumpat to Kuantan Port) is on the cards. Feasibility studies for the latter were completed in 4Q14 but there has been no further updates since.
- **Penang Transport Master Plan (PTMP):** Beyond the scope of the 11MP, we highlight the Penang Transport Master Plan (PTMP) as another major infrastructure project to look out for in the coming months. Costing RM27bil (including over RM6bil that had already been awarded to the Zenith-BUCG for the Penang undersea tunnel and road bypass project), six parties have been shortlisted for the PDP role. They are **Gamuda, IJM, WCT, Prasarana, Singapore-based CGC Group Pte Ltd**, and two **Hong Kong** investors. The winning bidder could seal the contract by June with construction works commencing by 2016.

OTHER KEY POINTS

- (1) Given the continuity of projects under the Economic Transformation Program (ETP) and the upcoming 11MP, our economics team is expecting construction GDP growth to remain robust at 11% for 2015F and 13% for 2016, vs. 11.6% for 2014.

To be sure, 1Q15 construction GDP growth remained solid at 9.7% YoY as Malaysia's GDP expanded 5.6% YoY. We believe the strong construction performance can be attributable to good progress being made with several cornerstone infrastructure projects, including the MRT 1 line where civil works are now substantially completed.

- (2) From our channel checks, there will likely be a greater shift towards private sector participation – which first gained prominence during the outgoing 10MP – in funding future infrastructure projects under the 11MP, given the Federal government's fiscal priorities.

The private sector-led projects could take many forms, including an outright private funding or other partnerships with the government (e.g. Public Finance Initiative [PFI], Public-Private Partnership [PPP], Built-Operate-Transfer (BOT) or Built-Lease-Transfer [BLT]).

The move towards more private sector participation is also seen as a pre-emptive move by the Malaysian government ahead of the changes to International Public Sector Accounting Standards (IPSAS) which is supposed to have come into force this year.

The policy changes in how the Malaysian government records its books, could have greater implications on higher debt levels and greater scrutiny on off-balance sheet debt items. However, by extension this would somewhat curtail the government's ability to fund future infrastructure projects.

- (3) The risk of a liquidity pullback from emerging markets in the event of a tightening US interest rate cycle could put pressure on domestic borrowing costs for infrastructure projects, and in turn, lower the NPVs.
- (4) The evolving political situation is another concern. The Selangor government's decision to not grant approval for the proposed Kinrara-Damansara (KIDEX) last February is a case in point. In addition, the Selangor water restructuring exercise has yet to reach a resolution.

To be sure, apart from the West Coast Expressway (WCE), there has been no tangible progress on five other highways worth ~RM20bil which is supposed to come on-stream over the next one to two years.

- (5) There is now greater regulatory scrutiny on the targeted returns of new highway concessions. Additional to this is the possible accounting changes on amortisation policies, which accentuate any losses for new concessions in the initial years.
- (6) A few mega development projects (e.g. Tun Razak Exchange, KL 118, Bandar Malaysia and KWASA Damansara) could provide more building opportunities for Malaysian contractors over the next few years. However, progress is still at the initial stages.

- (8) Along with Baram Dam, we envisage the potential roll-out of the Baleh Dam could kickstart a new wave of construction opportunities within Sarawak's SCORE, as power demand from energy-intensive industries increase. In January, it was reported that Sarawak Energy Bhd (SEB) could commence the construction of the 1,285MW Baleh dam by next year (completion: 2024) after receiving approval for the dam's Social and Environmental Impact Assessment (SEIA) report from the authorities.

Concurrently, we see Sarawak Cable as a key beneficiary of more transmission line-related projects, as SEB is conducting land acquisition for the construction of a proposed 500kV/275kv substation in Tada, Kanowit. The substation will interconnect the Baleh dam with SEB's 500kV backbone grid via a 500kV double-circuit transmission line.

- (9) The continuation of projects under the 11MP will provide renewed orderbook momentum for domestic suppliers of building material. However, we continue to maintain a NEUTRAL outlook on the building material sector due to localised challenges faced by both the cement and steel players.
- (10) Specifically, cement players continue to face pricing pressure due to new incoming capacity over the next two years. As for steel, the industry is still beset with cheap Chinese imports amid a muted international steel price outlook.
- (11) Furthermore, the net impact on building material will be lagged and not evident in the near-term. As such, Ann Joo Resources is our only BUY within the building materials sector (NEUTRAL weighting), and that is mainly from a valuation standpoint (i.e. the stock is trading at 2015F trough P/B value of 0.5x).

EXHIBIT 1: KEY INFRASTRUCTURE PROJETS TO LOOK OUT FOR DURING THE 11MP PERIOD (2016-2020)

Projects	Value (RM bil)	Expected date of award	Major beneficiaries	Owner
Klang Valley MRT Line 2 ¹ (Sg.Buloh-Serdang-Putrajaya)	23.0	major contracts: mid-2016 onwards	Tunnelling: MMC-Gamuda JV SBG/tunnel lining: Kim Lun Piling: Econpile	MRT Corp
Klang Valley LRT Line 3	9.0	PDP: July 2015 Work packages: end-2015 onwards	PDP: seven bidders Six pre-qualified earlier - MMC-Gamuda JV - MRCB-George Kent JV - UEM - Naza TTDI-CSR Zhuzhou JV - Sunway - WCT-Alloy MTD JV	Prasarana
West Coast Expressway - balance of works ² Banting - Taiping (276km; another 40km to be built later)	2.2	Second Phase: 2H15	IJM	West Coast Expressway Sdn Bhd: (50 + 10 year concession) K Euro: 80% IJM : 20%
Kuantan Port Expansion - balance of works ³	1.8	Phase 1 bal: ~RM0.6bil - 2H15 Phase 2: RM1.8bil - 2016/2017	IJM	Kuantan Port Concession IJM: 60% Guangxi Beibu: 40%
Pan Borneo Highway	27.0	Sarawak stretch: RM15bil awards by 2H15 Sabah stretch: ~RM12bil - n/a	Sarawak stretch: local contractors/HSL	
Penang Transport Master Plan	20.7	PDP: June 2015 Major work packages: 2016 onwards	Six shortlisted for PDP: - Gamuda - IJM - WCT - Prasarana - CGC Group - Two Hong Kong investors	30-year concession: Zenith-BUCG JV Other components: n/a
East Coast Rail Line (620km: Tumpat-Kuantan Port - cutting across KL)	30.0	n/a feasibility studies targeted for completion in 4Q14	n/a	n/a
Sg.Besi-Ulu Kelang Expressway (SUKE) - 59km (Sg.Besi-Duta-Ulu-Kelang Expressway [DUKE])	5.3	n/a	n/a	Prolintas
Damansara-Shah Alam Expressway (DASH) - 47km Puncak Perdana, Shah Alam - Penchala interchange	4.2	n/a	n/a	Prolintas

Notes: ¹ PDP contract already awarded to MMC-Gamuda JV in October 2014

² IJM-K Euro JV appointed EPC & contractor for packages 3, 4, 5, & 8 (RM2.8bil) in Dec 2014.

³ Kuantan Port Expansion: IJM was awarded the RM1.2bil contract to build a new deepwater terminal in February 2014.

Excluding breakwater contract (4.7km) awarded to Inai Kiara, part of a RM1bil federal funding for the Kuantan Port expansion.

⁴ Concession for Sarawak stretch reportedly awarded to Lebuhraya Borneo Utara (LBU)

⁵ RM6.3bil undersea tunnel & 3 road bypass projects already awarded to Zenith-BUCG JV in 2013.

⁶ 50-year concession signed in February 2013.

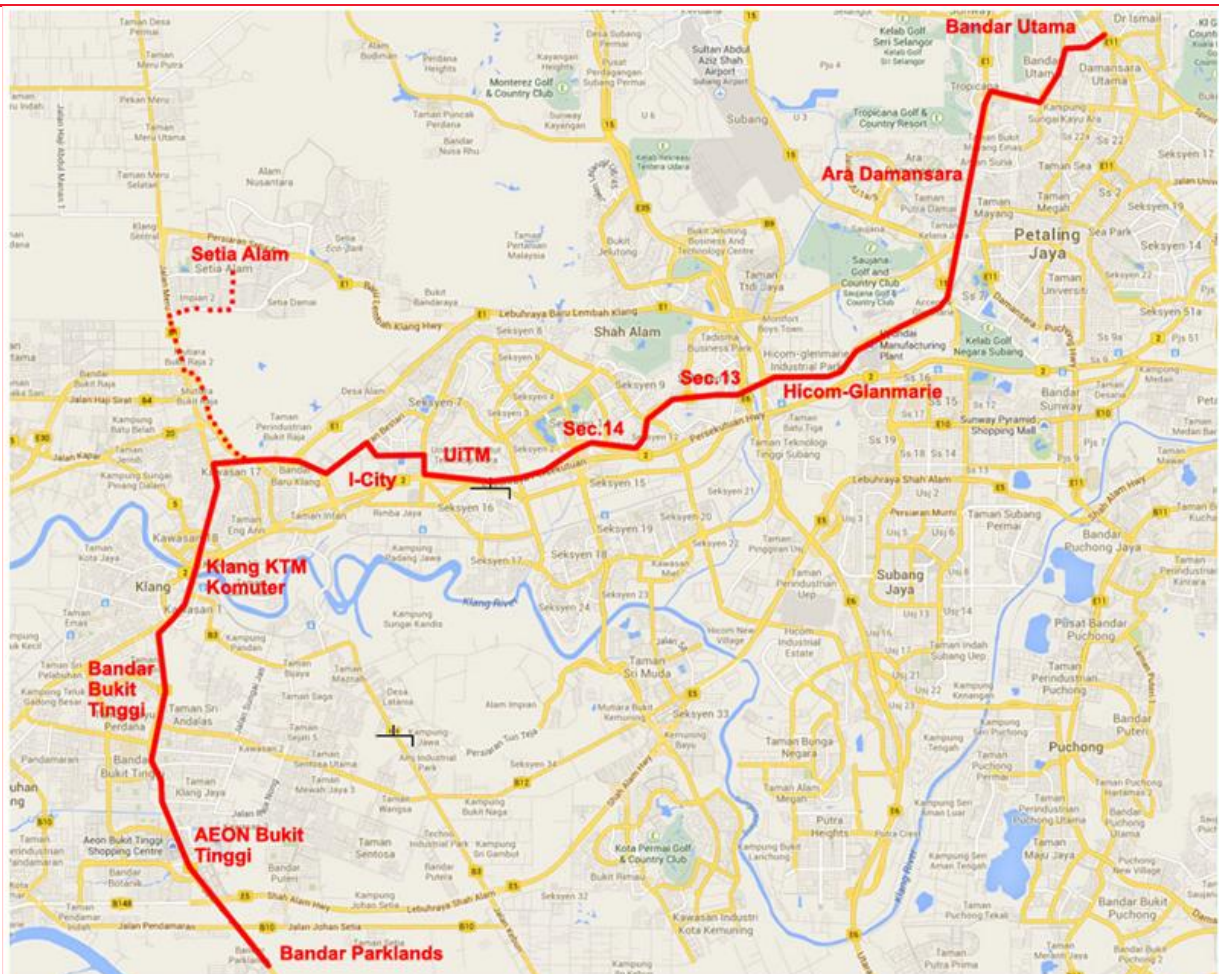
Source: Various, AmResearch

EXHIBIT 2: PROPOSED MRT2 ROUTE



Source: Kinibiz, AmResearch

EXHIBIT 3: PROPOSED LRT 3 ROUTE



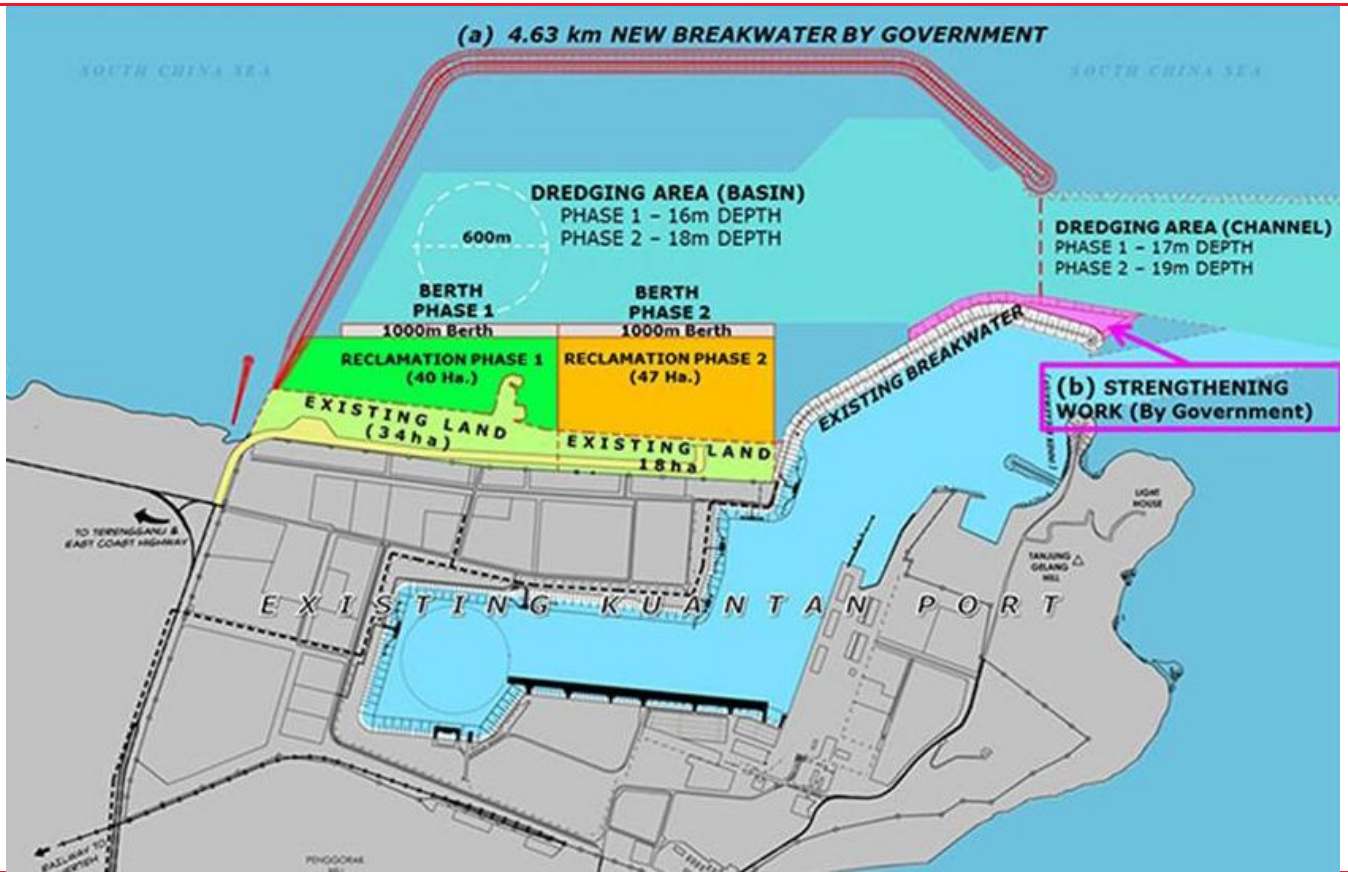
Source: Kinibiz, AmResearch

EXHIBIT 4: WEST COAST EXPRESSWAY (WCE) ALIGNMENT



Source: WCE, AmResearch

EXHIBIT 5: PROPOSED KUANTAN PORT EXPANSION



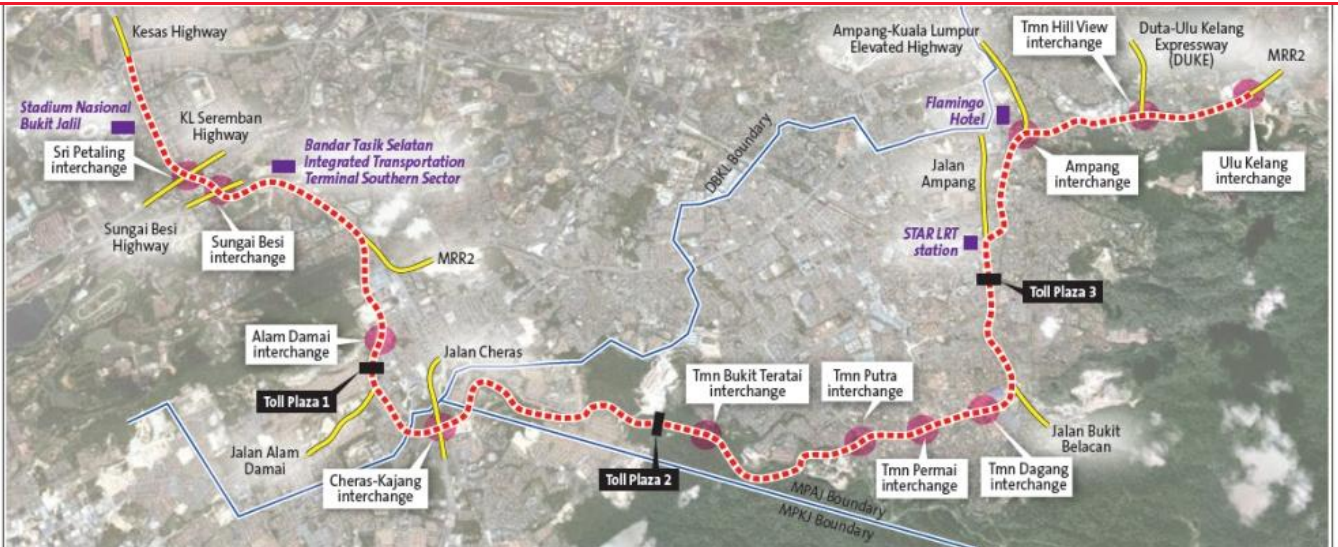
Source: Kuantan Port Consortium, AmResearch

EXHIBIT 6: PAN BORNEO HIGHWAY



Source: freemalaysiatoday.com, AmResearch

EXHIBIT 7: PROPOSED SUNGAI BESI-ULU KELANG ELEVATED EXPRESSWAY (SUE) ALIGNMENT



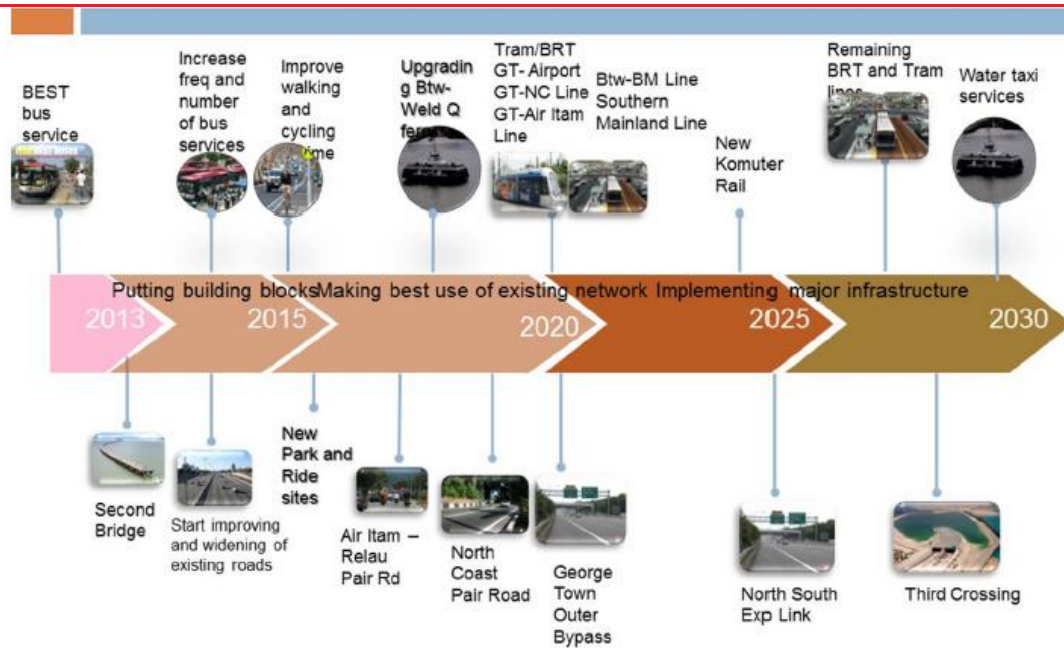
Source: internet, AmResearch

EXHIBIT 8: PROPOSED DAMANSARA-SHAH ALAM EXPRESSWAY (DASH) ALIGNMENT



Source: internet, AmResearch

EXHIBIT 9: TIMELINE FOR PENANG TRANSPORT MASTER PLAN



Source: Penang government, AmResearch

EXHIBIT 10 : CONSTRUCTION SECTOR VALUATION MATRIX

	Last Price (RM)	Core EPS (FD) (sen)			PE Ratio			Market Cap (RM mil)	Div. Yield (%) FY15F	Net Gearing (%) FY15F	Fair Value (RM)	Recommendation
		FY15F	FY16F	FY17F	FY15F	FY16F	FY17F					
Construction stocks												
IJM Corporation Bhd	7.19	40.8	46.9	55.1	17.6	15.3	13.0	12,820.7	2.1	45.3	8.15	BUY
WCT Holdings Bhd	1.82	11.8	12.9	14.5	15.5	14.1	12.6	1,956.4	2.2	56.1	1.80	HOLD
Gamuda Bhd	5.21	30.9	34.1	34.5	16.9	15.3	15.1	12,365.2	2.9	40.6	5.80	BUY
Sarawak Cable Bhd	1.27	18.1	19.1	19.3	7.0	6.6	6.6	402.7	2.0	143.0	1.70	BUY
Benalec Holdings Bhd	0.75	5.9	6.2	11.3	12.6	12.0	6.6	595.4	3.4	20.8	1.25	BUY
KKB Engineering Bhd	1.86	13.7	15.3	21.2	13.5	12.1	8.8	479.5	3.8	nm	2.05	BUY
Hock Seng Lee Bhd	1.86	16.0	17.8	18.6	11.6	10.5	10.0	1,022.1	1.7	nm	2.30	BUY
Econpile Holdings Bhd	1.11	9.3	11.2	11.3	11.9	9.9	9.8	594.0	1.8	nm	1.40	BUY
Kimlun Corp Bhd	1.33	12.9	13.6	14.2	10.3	9.8	9.4	400.0	3.8	23.3	1.38	HOLD
Stocks with construction exposure												
Sunway Bhd	3.55	33.1	32.1	33.2	10.7	11.1	10.7	6,207.7	9.2	43.9	3.74	BUY
Malaysian Resources Corp. Bhd	1.33	5.8	8.1	8.5	22.9	16.5	15.7	2,376.2	1.5	131.3	2.30	BUY
Building materials												
Ann Joo Resources Bhd	1.03	10.9	12.6	14.8	9.5	8.1	7.0	515.6	2.9	107.6	1.56	BUY
Lion Industries Corporation Bhd	0.42	0.1	1.0	1.8	289.8	44.0	23.3	300.3	0.0	11.6	0.55	HOLD
Press Metal Bhd	2.98	23.7	32.6	37.5	12.6	9.1	8.0	3,869.2	5.4	91.4	3.20	HOLD
Lafarge Malaysia Bhd	9.69	39.4	40.4	45.4	24.6	24.0	21.3	8,233.5	3.7	nm	8.90	HOLD

Source: AmResearch

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