

HLIB Research

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NEUTRAL (Maintain)

KLCON (203.7 pts)

Stock Rating

Stock	Rating	Price	Target
GAMUDA	HOLD	3.38	3.58
IJM	BUY	1.81	2.23
WCT	HOLD	0.83	0.78
MRCB	HOLD	0.74	0.63
SUNCON	BUY	1.80	2.37
KIMLUN	HOLD	1.31	1.66
HSL	HOLD	1.40	1.38
MITRA	HOLD	0.48	0.53
GKENT	HOLD	1.29	1.17
PESONA	HOLD	0.28	0.28
PROTASCO	SELL	0.47	0.47

Construction

Scaling down LRT3

The Cabinet has approved the continuation the LRT3 at a final cost of RM16.63b. Construction of the project will be restructured from a PDP model to a 'fixed price contract' and timeline is extended from 2020 to 2024. We maintain our construction project cost assumption at RM12bn. Apart from the PDP (MRCB-GKent) listed contractors that are exposed to the LRT3 are Suncon, WCT, IJM, AQRS, Mudajaya and TRC. Due to extension of construction timeline, we cut GKent FY19-21 earnings by 26-37%. For MRCB, we cut FY18-20 earnings by 8-10%. Maintain TP and recommendation for all affected counters pending for more clarification on the exact work scope impact.

NEWSBREAK

The Cabinet at its meeting on 11 July 2018 has approved the continuation of the LRT3 project at a final cost of RM16.63b. This cost will include all project costs, including but not limited to Work Package Contracts, land acquisition, project management, consultancy fees, operational and overhead costs, as well as interest during construction. In addition, the construction of the project will be restructured from a PDP model to a 'fixed price contract' model.

Key steps taken to reduce the cost of the project include: (i) reducing the order of 42 sets of 6-car trains to 22 sets of 3-car trains; (ii) reducing the construction size of the LRT train depot; (iii) streamlining the size and design of the LRT stations based on Kelana Jaya LRT line standards; (iv) shelving the construction of 5 stations which are Lien Hoe, Temasya, SIRIM, Bukit Raja and Bandar Botanic; (v) cancelling the 2km tunnel together with an underground station at Persiaran Hishamuddin, Shah Alam and (vi) extending the timeline to complete the LRT3 project from 2020 to 2024.

HLIB's VIEW

Within expectations. News of downsizing LRT3 is not a surprise to us as we mentioned before that downsizing and hence, reducing cost is the most plausible option. Besides, less compensation is required in scaling down of the project compared to scrapping the project altogether.

Fixed price contract model. The project has been restructured from the PDP model to a 'fixed price contract'. We understand that details of the new model are still under discussion and will be disclosed at a later stage. We maintain our construction project cost assumption at RM12bn pending for more details. However, MRCB-GKent JV will be negatively affected by the extension of construction timeline as their earnings from the project will be recognised over longer period.

Impact to listed work contractors. Apart from the PDP, listed contractors that are impacted by this news are Suncon (RM2.3b Package GS07-08), WCT (3 work packages amounted to RM1.67b), IJM (RM1.1b underground package), Gabungan AQRS (RM1.2b Package GS04), Mudajaya (RM1.2b Package GS01) and TRC (RM761m Package TD2).

Earnings and valuation. Due to extension of construction timeline from 2020 to 2024, we cut GKent FY19-21 earnings by 26.1%, 34.3% and 37.4% respectively. For MRCB, we cut FY18-20 earnings by 7.9%, 10.1% and 9.2% respectively. Nonetheless, we maintain our earnings forecast and TP for Suncon, WCT and IJM pending for more details on the work packages affected. We maintain our bear case scenario TP for both GKent and MRCB (which we have previously removed the PDP portion from their respective SOP valuation) given heightened uncertainty and pending for more clarification on the project.

Figure #1 GKent SOP valuation

SOP Component	Amount (RM m)	Multiple (x)	Valuation (RM m)	Per Share
Engineering - NPV of profits		12%	110	0.20
LRT3 PDP - NPV of profits		12%	17	0.03
Metering - 10x P/E	23	10	232	0.41
Net cash	373	0.8	298	0.53
SOP Value			657	1.17

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Figure #2 MRCB SOP valuation

Sum of Parts	RM m	PE (x) / WACC	Value to MRCB	FD Per Share
Construction - FY18 earnings	39	10	387	0.07
LRT3 PDP fees - annual average	3	10	32	0.01
Property development - NPV of profits		10%	2,391	0.43
Property investment - cap rate		7%	720	0.13
Eastern Dispersal Link - asset value		10%	1,135	0.20
Stake in MRCB-Quill REIT at RM1.48 TP	1,500	28%	418	0.07
Firm value			5,084	0.90
Sale of Bkt Jalil development to EPF			960	0.17
Cash proceeds from Warrants A			1,328	0.24
Cash proceeds from Warrants B			548	0.10
Less: Net debt			(2,879)	(0.51)
Equity value			5,041	0.90
Discount applied		30%	(1,512)	(0.27)
Target price			3,529	0.63

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Figure #3 LRT3 work packages award

Date	Contract	(RM/m)	Awarded To	Awarded By
22-Mar-18	Noise barriers for LRT3	33	Muhibbah Engineering	Prasarana
13-Mar-18	Underground package for LRT3	1,116	IJM Corporation	Prasarana
9-Mar-18	Noise barriers for LRT3	58	Muhibbah Engineering	Prasarana
6-Mar-18	106 escalators and 95 lifts for LRT3	126	EITA Resources	Prasarana
28-Feb-18	114 units of escalators for LRT3	81	EITA Resources	Prasarana
30-Jan-18	Bored piling works (Zone 2&3) for LRT3	39	Ikhtmas Jaya	Mudajaya Group
16-Nov-17	Bored piling for LRT3 (Package GS04)	209	Econpile Holdings	Gabungan AQRS
9-Oct-17	LRT3 (Package GS01)	1,160	Mudajaya Group	Prasarana
5-Oct-17	LRT3 (Package GS04)	1,206	Gabungan AQRS	Prasarana
5-Oct-17	LRT3 (Package GS02) Merchant Square to Suria Damansara	640	WCT Holdings	Prasarana
5-Oct-17	LRT3 (Package GS07-08) Kawasan 17 to Sri Andalas	2,309	Sunway Construction	Prasarana
5-Sep-17	LRT3 (Package TD2)	761	TRC Synergy	Prasarana
29-Aug-17	LRT3 (Package GS03) Suria Damansara to Temasya Glenmarie	840	WCT Holdings	Prasarana
5-Apr-17	Johan Setia depot (Phase 1) LRT3	186	WCT Holdings	Prasarana

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BUY	Expected absolute return of +10% or more over the next 12 months.
HOLD	Expected absolute return of -10% to +15% over the next 12 months.
SELL	Expected absolute return of -10% or less over the next 12 months.
UNDER REVIEW	Rating on the stock is temporarily under review which may or may not result to a change from the previous rating.
NOT RATED	Stock is not or no longer within regular coverage.

Sector rating definitions

OVERWEIGHT	Sector expected to outperform the market over the next 12 months.
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UNDERWEIGHT	Sector expected to underperform the market over the next 12 months.