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WCT Holdings WCTE.KL WCTHG MK

EQUITY: ENGINEERING & CONSTRUCTION

Low margins in 3Q14; scaling back plans

Quick Note

Global Markets Research

25 November 2014

Rating Remains	**Reduce**
Target price Remains	MYR 1.90
Closing price 24 November 2014	MYR 1.91

Analyst briefing takeaways: lower targets going forward

- We expect consensus to continue to cut earnings for FY14-15F, with **margin pressure** from **property development** (ie, 1Medini Residences phase 1) and **construction** (55% of orderbook is low-margin building jobs) to continue for the next few quarters.
- Management has lowered its **full-year property sales target by almost half** and is now aiming for ~MYR620mn for FY14F (new launches: MYR1.85bn).
- Management is now guiding that it may possibly **look to create a REIT in 2015, with just three assets** – the BBT Shopping Mall (Klang), Paradigm Mall (Kelana Jaya) and Gateway@KLIA2. We had earlier expected management to go for a REIT after it had completed two other Paradigm Malls, in JB and OUG, but as per the company they are looking to reduce balance sheet strain earlier. Total asset size will be ~MYR 2bn+, and would be subject to shareholder approval (eg, from EPF and MAHB, who own stakes in the Paradigm Mall and Gateway@KLIA2 respectively).

Positives: Construction orderbook momentum looks better

Amongst the positives, we find that orderbook replenishment momentum looks much better now, with MYR1bn worth of new projects in YTD 2014, and a strong tender pipeline (see Fig 4). We remain bearish on Qatar jobs as we feel that margins tend to be lower due to re-negotiations with the project owners.

About the results: Margins disappoint across all segments

WCT reported an adjusted net income of MYR26mn for 3Q14, down 37% y-y and 25% q-q. Cumulative net income for 9M14 of MYR100mn (-32% y-y) is in line with ours (83%), but much lower than the consensus (60%) full-year estimate.

We think that there are still downside risks to the Street's FY15F EPS due to: **1)** lower construction margins; **2)** property unbilled sales (which will be the driver of near-term earnings) of only ~MYR 589mn in 1H14, which implies only ~one year worth of earnings at current recognition rates; **3)** slower property sales; and **4)** potential dilution from warrants and higher borrowing costs from the recently issued MYR600mn of sukuk (bonds).

Fig. 1: WCT: 9M14 results snapshot

MYR mn	9M14	Nomura FY14F	9M as % of NMR FY14F	Consensus FY14F	9M as % of Cons FY14F
Revenue	1,340	1,878	71%	1,800	74%
Adj EBITDA	173	255	68%	294	59%
Reported NPATAMI	100	121	83%	164	61%
Adj NPATAMI	100	121	83%	164	61%

Source: Company data, Bloomberg, Nomura estimates

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Divisional highlights - All segments weak, slowdown in property billings, margins falling

Construction

- The outstanding external construction orderbook as at end of 9M14 was MYR2.28bn, implying visibility of ~2 years. YTD order wins stand at MYR994mn.
- While the revenues were marginally up y-y in 9M14, operating profit was down by double digits due to margin compression of 5ppt y-y.

Property development

- Management lowered its full-year sales target to almost half and is now aiming for MYR617mn (MYR1.2bn earlier). This is in line with lower target launches of MYR1.85bn (MYR2.4bn earlier).
- Cumulative sales at MYR497mn for 9M14 (81% of new FY target), out of which MYR380mn is in SPA sales, and the rest are bookings / options.
- BBT2 High rise and Laman Greenville are still seeing strong sales. Take-ups in the Azure Residences Tower 1 is 46%.
- The project deferred was Medini (A-60 Medini @ MYR 500mn GDV). Unbilled sales were at MYR589mn. OUG Land will now be launched in mid 2015.

Property investment

- Premiere hotel occupancy rate was at 61%, same as 2Q14. Average footfall at Gateway mall @KLIA2 rose to 110,000 per day from 97,000 per day.
- Earnings are likely to get a MYR10mn boost once MAHB (MAHB MK, Reduce) extends its concession agreement for KLIA2 with the government, which would also imply a higher useful life for the Gateway mall, in our view.

Fig. 2: WCT: 3Q14 earnings review

MYR mn	3Q14	3Q13	% chg y-y	2Q14	% chg q-q	9M14	9M13	% chg y-y	FY14F	9M % of FY14F
Turnover	**471**	**419**	***13%***	**401**	***17%***	**1,340**	**1,392**	***(4%)***	**1,878**	**71%**
Construction	362	269	*34%*	260	*39%*	949	935	*1%*	1,236	77%
Property Development	95	135	*(30%)*	124	*(24%)*	346	410	*(15%)*	584	59%
Property Investment & Management	14	14	*(2%)*	17	*(18%)*	44	47	*(6%)*	58	76%
Operating profit	**43**	**74**	***(42%)***	**56**	***(24%)***	**166**	**231**	***(28%)***	**249**	**67%**
Construction	23	33	*(29%)*	27	*(13%)*	87	128	*(32%)*	101	86%
Property Development	13	35	*(64%)*	23	*(46%)*	60	82	*(27%)*	117	51%
Property Investment & Management	7	6	*16%*	6	*15%*	20	22	*(9%)*	31	64%
Share of profit in associates / JCE	4	3	*26%*	4	*2%*	13	11	*13%*	24	54%
Adjusted Pretax profit	**32**	**60**	***(46%)***	**45**	***(29%)***	**135**	**195**	***(31%)***	**176**	**76%**
Reported NPAT	26	41	*(37%)*	34	*(25%)*	100	141	*(29%)*	121	83%
Adj. NPAT (ex forex, revaluation)	**26**	**41**	***(37%)***	**34**	***(25%)***	**100**	**147**	***(32%)***	**121**	**83%**
Operating margins (%)	**9%**	**18%**	***-9 ppt***	**14%**	***-5 ppt***	**12%**	**17%**	***-4 ppt***	**13%**	
Construction	6%	12%	***-6 ppt***	10%	***-4 ppt***	9%	14%	***-5 ppt***	8%	
Property Development	13%	26%	***-13 ppt***	19%	***-6 ppt***	17%	20%	***-3 ppt***	20%	
Property Investment & Management	51%	43%	***8 ppt***	36%	***14 ppt***	45%	46%	***-1 ppt***	53%	
Basic Earnings per share (cent)										
Reported basic EPS (cent)	2.37	3.78	*(37%)*	3.14	*(25%)*	9.19	13.23	*(31%)*	11.53	
Normalised basic EPS (cent)	2.37	3.78	*(37%)*	3.14	*(25%)*	9.19	13.82	*(34%)*	11.53	

Source: Company data, Nomura estimates

Fig. 3: WCT: Current orderbook

Gulf States	MYR mn
Government Administrative Office, Qatar	395
New Doha Int'l Airport, Qatar (15%)	2
	397
Malaysia - Civil Engg and Infra	
PLUS Widening	175
Tun Razak Exchange	101
RAPID	342
Others	2
	620
Malaysia - Building	
MyTown Shopping Centre	652
KK Medical Centre	101
Putrajaya Commercial Office	287
Ministry of international Trade (MITI)	180
UITM	36
Others	8
	1,264
External orderbook	**2,281**
Outstanding external orderbook	2,281
Orderbook burn rate (FY13)	1,168
IMPLIED CONSTRUCTION EARNINGS VISIBILITY (years)	**2.0**

Source: Company data, Nomura research

Fig. 4: WCT: Potential projects and tenderbook

Major Potential projects	
Tenders Submitted	**Value (MYR mn)**
Local Projects	2,021
Overseas Projects	2,040
Total	4,061
Tenders under preparation	
Local Projects	1,760
Overseas Projects	1,300
Total	3,060

Construction Contracts Targets 2015

MALAYSIA
- Petronas RAPID Pengerang Civil Works
- Tun Razak Exchange (TRX)
- Warisan Merdeka
- Kwasa Damansara Land Civil Works (PDP)
- LRT 3
- Mass Rapid Transit 2
- KK Water Supply Scheme
- KL - JB High Speed Rail
- Southern Double Track
- Hydro Electric Dam in Sarawak
- Hydro Electric Dam in Sabah

MIDDLE EAST
- Qatar Roads and Expressways
- Qatar Earthworks and Infrastructure works
- Government Office Buildings in Qatar

Source: Company data, Nomura research

Fig. 5: Property target launches in 2014

Project	GDV (MYR mn)
BBT2 - Shop + serviced apartment	394
Laman Greenville @ Klang South	542
Skyz Jelutong	160
The Azure Residences, Kelana Jaya	490
Brio Residence, Johor	241
One Medini Garden Villa	23
Total	**1,850**

Source: Company data

Fig. 6: Shopping malls and hotel occupancy

Paradigm Mall	
Retail space leased	97%
Avg footfalls per day	
Weekday	36,000
Weekend	60,000
Gateway Mall @KLIA2	
Retail space leased	80%
Avg footfalls per day	110,000
Premiere Hotel, Klang	
Occupany	61%
Avg Room rate per day	MYR 260
Room to F&B Revenue	58 : 42

Source: Company data

Appendix A-1

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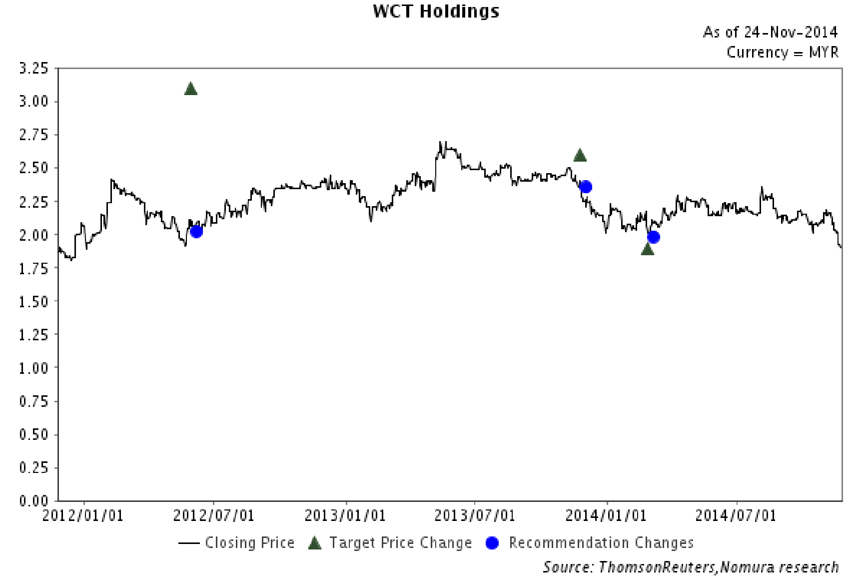
Issuer	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
WCT Holdings	WCTHG MK	MYR 1.91	24-Nov-2014	Reduce	N/A	

WCT Holdings (WCTHG MK) **MYR 1.91 (24-Nov-2014)** Reduce (Sector rating: N/A)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
27-Feb-14	Reduce		2.03
27-Feb-14		1.90	2.03
25-Nov-13	Neutral		2.40
25-Nov-13		2.60	2.40
30-May-12	Buy		2.07
30-May-12		3.10	2.07

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We value WCT using a sum-of-the-parts (SOTP) methodology derived from 1) Construction segment valued at 8.5x PE CY14F 2) NAV of property segment at a 13.4% discount rate; 3) the NAV of investments in malls and hotels at 11% discount rate; 4) NAV of India expressways at 9.2% discount rate; and 5) NAV of KLIA2 IC at 9.4% discount rate. Our SOTP calculation implies a valuation of MYR2.0bn for WCT's businesses. To this we add cash from warrants (~MYR700mn) to arrive at our price target of MYR1.90/share.The benchmark index for this stock is MSCI Malaysia.

Risks that may impede the achievement of the target price Key upside risks to our view stems from 1) New project awards larger than our estimates: We currently build in MYR600mn of total new projects in FY14F/15F/16F each. In case WCT is able to secure projects exceeding our assumed value (like the Kwasa Damansara land civil works, with both having EPF as a major shareholder), there might be upside risk to the stock. 2) Higher-than-expected margins for construction and property development: We have cut our margin assumptions on cost and labour pressures in Malaysia and the Middle East. However, if these were to reverse, it could pose an upside risk. 3) Higher-than-expected property sales 4) Arbitration wins (e.g. the Meydan Racecourse arbitration).

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